

Fig 1. Our CPI projections aligned with MPC, yet risks remain

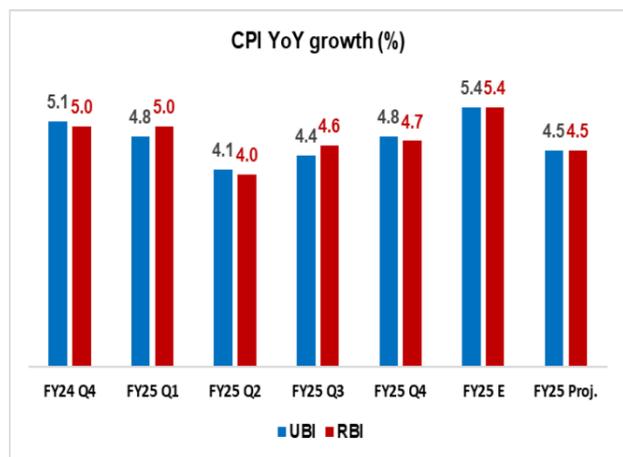
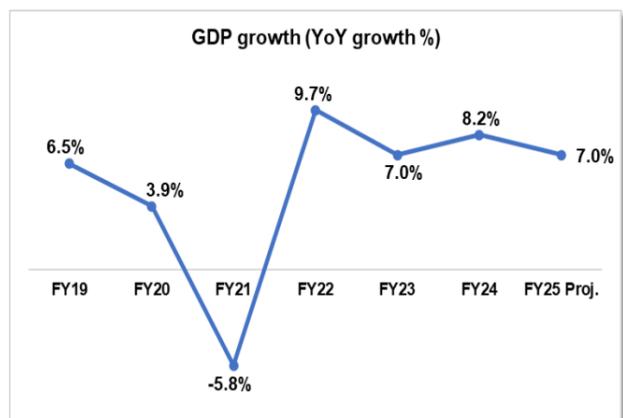


Fig 2. India's GDP growth remains robust



Source: CEIC

We expect status quo decision from RBI MPC in June

The upcoming June MPC review is likely to be a non-event, with RBI likely to opt to maintain status quo in both rates and stance. Growth indicators are holding up with Q4 FY24 GDP growth clocking 7.8%. The full year FY24 GDP growth printed a strong 8.2% y/y, way higher than the second advance estimate of 7.6%. Meanwhile, CPI inflation is back in 4% handle, food inflation remains closer to 8% and is a cause of concern even as record low core inflation at close to 3% is a source of comfort to MPC. Hence the flexible inflation targeting MPC may choose to wait and watch if the softening in inflation towards the 4% target (as expected by Q2 FY25) is durable. Additionally, MPC will be mindful of the recent trends in crude oil prices coupled with volatility in food prices which may sustain on heatwave concerns during April-June. Overall, we expect the MPC to stay data dependent and maintain the policy stance of “withdrawal of accommodation” in the 5-7 June meeting outcome.

Going forward in FY25 too, we see the GDP growth to hold up well at around 7% and GVA growth at 6.8%. The resilient growth provides space to MPC for delaying rate cuts while elevated food inflation needs close watch. So, the MPC is likely to stay vigilant and south-west monsoon would be in focus.

RBI likely to continue with fine-tuning operations to manage liquidity

The RBI in its Annual Report for 2023-24 has reiterated that tightened liquidity operations during 2023-24 are in sync with the monetary policy stance. Although liquidity in the banking system was in deep deficit zone beginning May'24, it is currently showing marginal surplus on forex flows and reversal of currency leakage post festive season. Hefty dividend of Rs.2.1 trn has likely led to a spike in GOI balances held with RBI to -Rs.5 trn, yet liquidity impact is contingent on timing of spending of the balance. Further, foreign flows on account of inclusion of Indian G-secs in the JPMorgan index would also ease liquidity situation.

Overall, the RBI has been agile and forthright in administering a judicious mix of instruments to regulate liquidity, ensuring systematic evolvement of money market rates while maintaining financial stability. Going forward, RBI is unlikely to announce any major liquidity measures but may continue to conduct variable rate repo (VRR) and VRRRs auctions to support liquidity given G-secs buybacks have not been successful.

Uncertainty looms over timing of US Fed's rate cut decision

The US Fed has been indicating in recent meetings that interest rates need to remain restrictive for a longer period. Globally, US inflation numbers are turning sticky showing resistance to move towards the 2% target. The US Fed is likely to keep their benchmark rate on hold in the 5.25%-5.50% range for some more time. As indicated by the latest CME Fedwatch, markets are pricing in a 55% probability that the rate cuts would commence from Sep'24. A delay by the US Fed in reducing rates is likely to weigh on the RBI's decision on starting its own policy rate easing cycle, in our view, even as some MPC members do not agree with this narrative. Apart from the global central bank actions, the RBI is likely to stay vigilant amid the fluidity of global narratives and also keep a close eye on crude oil prices.

In FY25, we expect the MPC to cut rates later than sooner

The RBI MPC is likely to maintain status quo in the upcoming June monetary policy while remaining cautious on inflation outlook. The policy commentary is likely to acknowledge the recent stability in the headline inflation and the favourable monsoon forecast by the IMD. However, the approach is likely to be balanced with a cautious tone on the fallout on food prices from extreme weather events, and risks of higher oil prices on geopolitical tensions. Food inflation risks remain as heat wave conditions could result in upward pressure on perishable items such as vegetables. Further higher volatility in commodity prices remains a cause of concern.

In our view, with strong growth dynamics, moderating inflation and RBI concerns about financial stability, policy easing may be implemented later rather than sooner. With inflation expected at 4.5% in FY25, the real rate of 200 bps is likely to open a small window for rate cut(s). Consequently, we expect the repo rate to be cut by 50 bps to 6% in FY25. For ensuring a sustainable credit cycle which has started after a decade, the RBI may continue to stay vigilant on buildup of credit excesses if any and defer shift of policy / liquidity stance. *On balance, we expect a shallow 50 bps rate cut cycle in H2-FY25 likely starting from October with rate cuts later than sooner.*

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