24th October 2024

Post the surprise shift in the monetary policy stance to "neutral" by the RBI Governor in October 7-9 meeting, the MPC minutes were eagerly awaited to assess the rationale for policy decision. Yet, RBI Governor, with his assertive comments in a Bloomberg forum last week, that "rate cuts at this juncture are very risky, very premature" led the bond markets to pare back expectations of a rate cut in December, thereby taking the sheen off MPC minutes.

The key underlying view across MPC members (except dissenter Dr. Kumar) appears to be that growth momentum remains resilient. While food led CPI inflation hump may be seen till Oct'24, easing of inflation pressures towards 4% target is likely by end-FY25, unless shocks persist. On balance, greater confidence on inflation outlook led the MPC to shift the stance to neutral from withdrawal of accommodation **yet significant inflation risks remain**, with arduous battle on inflation far from won.

We maintain our view of start of a shallow 50 bps rate cut cycle from Feb'25. (Please see "India MPC: Stance shifts to neutral; "unambiguous" inflation focus stays").

Key themes in MPC minutes:

1. **Monetary policy tightening has paid off; greater confidence on inflation outlook**

While most members acknowledged that CPI inflation is likely to spike from sub-4% target levels in July/Aug'24 to sharply higher levels in Sep/Oct'24 led by food price pressures, the impact is likely to fade by Q4-FY25. In fact, the RBI Governor highlighted, *"the outlook for headline inflation towards the later part of the year and early next year points to further alignment with the 4 per cent target."* More importantly, he believes that the confidence on inflation outlook is not just led by food sub-segment on improved kharif and rabi season prospect, but also by core inflation, on easing input cost pressures and slackening output gap in manufacturing.

The RBI members firmly believe that the transmission of the 250bps rate hike cycle since May'22 has been the key driver of easing inflation pressures. Hence, there was a unanimous vote for change in stance as *"this would provide greater flexibility and optionality to monetary policy to act in accordance with the evolving outlook"*.

2. **Most members see growth dynamics as resilient except for the dissenter**

There is a divide somewhat between government nominees and RBI members on growth outlook. As is the case with respect to divide between RBI and economists. While the latter have been slightly pessimistic on growth prospects with the slowdown in high frequency indicators signalling that the Q2 FY25 GDP growth number is tracking closer to 6.5% (vs 7% projection for the MPC). As was the case in the monthly Bulletin, while the RBI members acknowledged the slowdown in Q2 on the back of unusually heavy rains in Aug/Sep'24 and *Pitru Paksha*, they expect it to be temporary with government spending, rural demand pickup and festive sales likely to drive strong growth in H2 FY25. Meanwhile, the dissenter Dr Kumar pointed out to weakness in growth numbers with another member Saugata Bhattacharya discussing about slip in near term growth indicators.

A key point to note is that the Dr Patra also flagged the output gap in manufacturing sector which can drive downward pressure on core inflation. While in recent commentary the RBI Governor has indicated that potential growth for the Indian economy is close to 7.5% versus 7.2% forecast for FY25, a clear acknowledgement of output gap in a specific sector shows some growth concern even as recovery is anticipated in H2 FY25.

3. **Focus stays on domestic macros; do not follow the Fed**

While this was a common assertion across RBI members and some government nominees, Dr Ranjan asserted that "post the Fed rate cut in mid-September, the world is divided - while 10 countries have followed the Fed, another 11 countries have taken a pause, while one has hiked its policy rate." The central banks implementing policy pivot are the ones facing growth slowdown or implemented very restrictive policy or started hiking very early in 2021 and India does not fall in any of the categories.

We have always believed that with the RBI led MPC hiking rates by almost 50% vis-a-vis the Fed in the last policy cycle, the rush to cut rates in response to the Fed is likely to be low. In fact, post the steep 50bps Fed rate cut, the chances of a repeat of similar quantum have reduced sharply as macro data has been relatively holding up well in the US economy.

4. **Significant inflation risks and their impact cannot be underestimated**

In the policy statement, Governor Das asserted that the "inflation horse has been brought to the stable and has to be kept on a leash with doors closed so that it does not bolt again". While he did not repeat the reference to inflation "horse" in the minutes, he did note the significant risks to outlook in the short term from a combination of global and domestic factors which warrant constant vigil. In fact, Dr Ranjan enlisted all event risks to watch out for in the short term - *"US elections, geopolitical risks and Chinese fiscal stimulus and its impact on global commodity prices"...along with "weather events"*.

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Key Statements by members

Member	Key Statements of members (paraphrased unless in italics)
RBI Governor Das	*"India's growth story remains intact"*… with *"The balance between inflation and growth is well-poised. Despite the near-term uptick in inflation, the outlook for headline inflation towards the later part of the year and early next year points to further alignment with the 4% target." "…uncertainties on the horizon – ranging from heightened geo-political tensions and volatile commodity prices to risks of adverse weather in food inflation." "At this stage of the economic cycle, having come so far, we cannot risk another bout of inflation."*
Dr Patra	*"…the path of inflation is reconfiguring towards the target in the baseline forecast, by my metric of four quarters ahead inflation. This trajectory will likely encounter a hump in the near months as the projections indicate, but this is largely due to an adverse base and one-off shocks". "Economic activity remains resilient in spite of the disinflationary monetary policy stance, supported by domestic drivers." "…a gradual wait-and-assess approach to removing policy restraint in terms of the policy rate remains appropriate as long as inflation is not lastingly close to its target."*
Dr Rajiv Ranjan	There is ample evidence now to say that monetary policy actions since May 2022 have worked well. *"…beyond the near-term hump, inflation projections during the latter part of the financial year give us comfort with food inflation likely to benefit from strong kharif sowing, adequate buffer stocks and likely good soil moisture conditions for rabi sowing." "While being focussed on its task of containing inflation, monetary policy has also ensured that growth remains on a steady path. Both the major drivers of growth, consumption and investment, having more than 90% share in GDP in Q1:2024-25, continue to grow at a good pace." "…while remaining largely immune to the Fed policy pivots. Post the Fed rate cut in mid-September, the world is divided - while 10 countries have followed the Fed, another 11 countries have taken a pause, while one has hiked its policy rate." "…there is now greater confidence on inflation aligning with the target unless disrupted significantly by weather events and worsening of geo-political risks." "But change in stance in no way implies dropping the guard on inflation." "Between now and December, we will have greater clarity on some of the uncertainties – US elections, geopolitical risks and Chinese fiscal stimulus and its impact on global commodity prices."*
Dr Nagesh Kumar	He was the lone dissenter, voting for a 25bps cut in the repo rate. *"The emerging trends in the Indian economy suggest a slowdown of the economic growth from 8.2% in 2023-24 to 6.7% in 2024-25:Q1." "...the Indian industry is clearly suffering from demand deficits in both domestic and external markets. Demand deficits may be the reason private investment has not picked up momentum." "Given that inflationary expectations have been successfully anchored, and industrial demand in both domestic as well as export markets is flagging, a rate cut could help to revive demand and help boost private investment."*
Saugata Bhattacharya	*"In the near term, however, some high frequency economic indicators (both hard data and surveys) suggest a loss of momentum, but still do not seem to show a material slowdown". "Inflation, on the other hand, appears to be more stable now. Persistent high food inflation might gradually trend down, given the relatively good distribution of above average rains and higher acreage sown." "Excluding vegetables, CPI inflation has remained below 4% for the past 8 months." "The arduous battle against inflation is far from won, but we are more confident of eventual success in bringing CPI inflation durably closer to the target." "Yet, risks on commodities inflation seem to be building up." "The multi-dimensional implications of a repo rate cut at this time and in the future needs careful evaluation. One of these might be a further and excessive easing of financial conditions; these conditions, to an extent, have already in the recent past resulted in a de facto easing of restrictive policy."*
Prof. Ram Singh	He was of the view that *"fundamental growth drivers and the mainstay of aggregate demand – consumption and investment demand – are gaining momentum." "Further, momentum in private consumption looks sustainable on the back of improved agricultural outlook and rural demand. Sustained buoyancy in services is also expected to support urban demand." "Food inflation is an important source of uncertainty, which has increased in August from the preceding month." "Adverse weather events, however, remain un-insurable risks to food inflation."*

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