Monetary Policy Review

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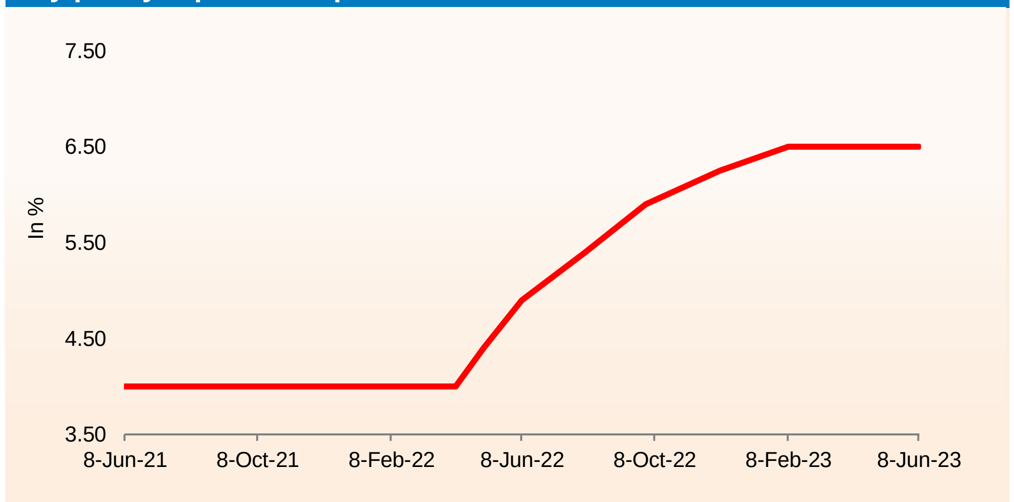
Summary - Stance and Rationale

- The Monetary Policy Committee (MPC) in its second bi-monthly monetary policy review of FY24 kept key policy repo rate unchanged at 6.50% with immediate effect for the second time. The standing deposit facility (SDF) rate also remains unchanged at 6.25%. All six members unanimously voted to keep the policy repo rate unchanged. The MPC also remained focused on withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth. Five out of six members voted in favour of the same.
- The MPC noted that CPI headline inflation moderated into the tolerance band in Mar-Apr 2023, as the central bank expected, reflecting the combined impact of monetary tightening and supply-side initiatives. The domestic economic activity is performing well. Consumer confidence is rising, and businesses are upbeat about the future. The MPC's cumulative rate raise of 250 bps is expected to keep inflationary pressures in check in the coming months. Inflation would need to be in line with the aim, thus monetary policy would need to be carefully managed.

Key policy repo rate kept on hold at 6.50%

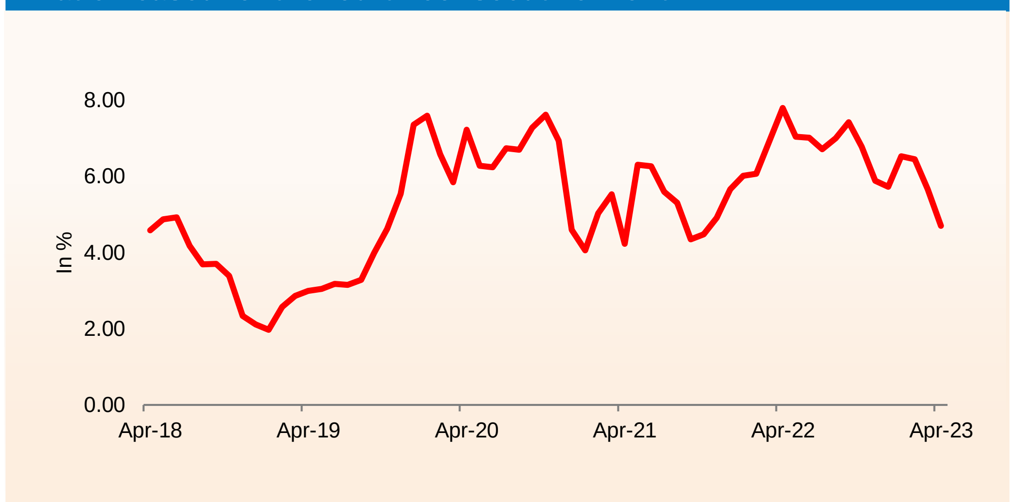


Source: Refinitiv

Inflation Outlook

- The direction of headline inflation in the future is probably going to be influenced by changes in food prices. For kharif crops, the India Meteorological Department's (IMD) prediction of a typical south-west monsoon seems encouraging; however, it would be necessary to closely observe the monsoon's regional and temporal distribution in order to evaluate the possibilities for agricultural production. Although crude oil prices have decreased, the future remains unclear.
- The industrial, services, and infrastructure firms surveyed by the Reserve Bank anticipate a hardening of input costs and output prices, according to the early findings of the surveys. The availability of the full poll data will shed more light on the situation.
- Taking into account these factors and assuming a normal monsoon, CPI inflation is projected at 5.1% for FY24, with Q1 at 4.6%, Q2 at 5.2%, Q3 at 5.4% and Q4 at 5.2%.

Inflation eased for the fourth consecutive month

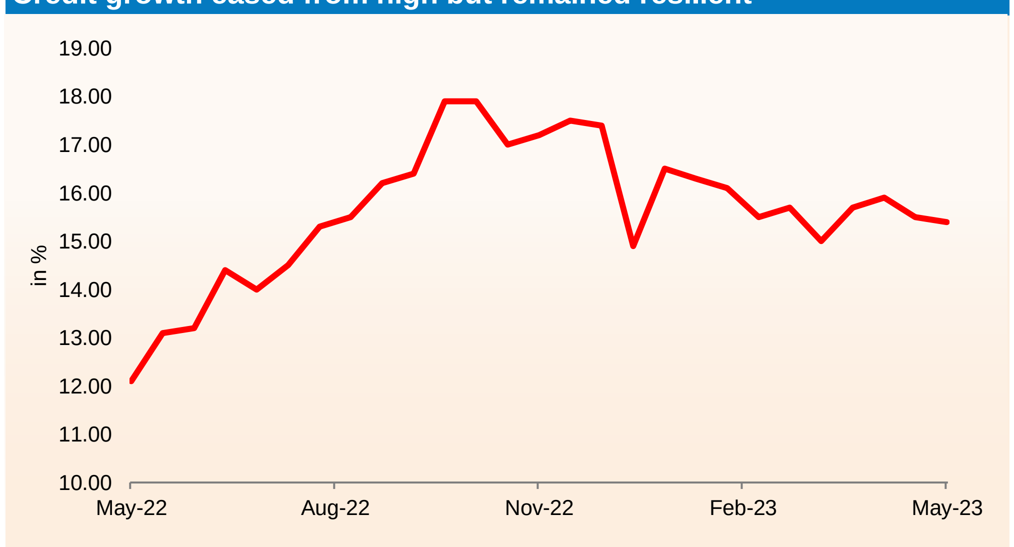


Source: Refinitiv

MPC outlook on Growth and Economy

- Private spending and general economic activity should be supported in the present year by the increased rabi crop production in 2022–2023, the anticipated typical monsoon, and the ongoing buoyancy in services.
- The government's emphasis on capital spending, commodity price stability, and healthy credit growth are all likely to foster investment activity. External demand weakness, geoeconomic fragmentation, and persistent geopolitical tensions, on the other hand, pose risks to the outlook.
- Taking all these factors into consideration, real GDP growth for FY24 is projected at 6.5% with Q1 at 8.0%, Q2 at 6.5%, Q3 at 6.0%, and Q4 at 5.7%, with risks evenly balanced.

Credit growth eased from high but remained resilient



Source: Refinitiv

Market Reactions

- Indian equity markets fell after the MPC kept key policy repo rate unchanged but said the war against inflation was far from done, indicating a policy tightrope walk. Key benchmark indices S&P BSE Sensex and Nifty 50 fell 0.49% and 0.47%, respectively.
- Bond yields rose after the MPC maintained its status quo as expected but said inflation will stay above target in the current financial year. Yield on the 10-year benchmark paper (7.26% GS 2032) rose 4 bps to 7.02% as compared to the previous close of 6.98%.

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