

SPECIAL UPDATE

Monetary Policy

April 05, 2024

Monetary Measures

- Monetary Policy Committee (MPC) decided with a majority of 5 out of 6 members to keep the policy repo rate unchanged at 6.50%.
- Consequently, the Standing Deposit Facility (SDF) remains unchanged at 6.25%. The Marginal Standing Facility (MSF) rate and the Bank Rate remains at 6.75%.
- The MPC also decided by a majority of 5 out of 6 members to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns to the target, while supporting growth.

Analysis & Outlook

- **Inflation:** Headline inflation softened to 5.1% during January-February 2024, from 5.7% in December. After correcting in January, food inflation edged up to 7.8% in February primarily driven by vegetables, eggs, meat and fish. CPI core (CPI excluding food and fuel) disinflation took it down to 3.4% in February. Going ahead, food price uncertainties would continue to weigh on the inflation outlook. An expected record rabi wheat production in 2023-24, however, will help contain cereal prices. Early indications of a normal monsoon also augur well for the kharif season. On the other hand, the increasing incidence of climate shocks remains a key upside risk to food prices. Low reservoir levels, especially in the southern states and outlook of above normal temperatures during April-June, also pose concern. The recent firming up of international crude oil prices warrants close monitoring. Geo-political tensions and volatility in financial markets also pose risks to the inflation outlook. Taking into account these factors and assuming a normal monsoon, CPI inflation for 2024-25 is projected at 4.5% with Q1 at 4.9% ; Q2 at 3.8% ; Q3 at 4.6 % ; and Q4 at 4.5%. The risks are evenly balanced.
- **Growth:** The global economy exhibits resilience and is likely to maintain its steady growth in 2024. The domestic economy is experiencing strong momentum. As per the second advance estimates (SAE), real gross domestic product (GDP) expanded at 7.6% in 2023-24 on the back of buoyant domestic demand. Real GDP increased by 8.4 % in Q3, with strong investment activity and a lower drag from net external demand. On the supply side, gross value added recorded a growth of 6.9% in 2023-24, driven by manufacturing and construction activity. Looking ahead, an expected normal south-west monsoon should support agricultural activity. Manufacturing is expected to maintain its momentum on the back of sustained profitability. Services activity is likely to grow above the pre-pandemic trend. Private consumption should gain steam with further pick-up in rural activity and steady urban demand. A rise in discretionary spending expected by urban households, as per the Reserve Bank's consumer survey, and improving income levels augur well for the strengthening of private consumption. The prospects of fixed investment remain bright with business optimism, healthy corporate and bank balance sheets, robust government capital expenditure and signs of upturn in the private capex cycle. Headwinds from geopolitical tensions, volatility in international financial markets, geoeconomic fragmentation, rising Red Sea disruptions, and extreme weather events, however, pose risks to the outlook. Taking all these factors into consideration, real GDP growth for 2024-25 is projected at 7.0% with Q1 at 7.1%; Q2 at 6.9 %; Q3 at 7.0 %; and Q4 at 7.0 %. The risks are evenly balanced.

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- **Liquidity:** Liquidity conditions eased during February and March in the wake of increased government spending, the Reserve Bank's market operations and the return-leg of a USD-INR sell buy swap auction. In particular, the liquidity situation improved in March with system liquidity turning intermittently surplus in the first half of the month. Anticipating the seasonal tightening of liquidity at end-March, the Reserve Bank injected liquidity through variable rate repo (VRR) operations – both main and fine-tuning operations. Consequently, the average borrowings under the MSF window moderated. Liquidity conditions have again turned surplus from March 30, necessitating VRRR auctions from April 2. Looking ahead, the Reserve Bank will remain nimble and flexible in its liquidity management.
- The benchmark 10-year paper and yields across the curve moved up by 1-2 bps from yesterday's close at the time of writing.

Position of Funds

Duration funds:

- The absolute yield levels are attractive from a medium to long-term investment horizon. Therefore, it represents a good opportunity for investors to invest in fixed income duration funds with a medium to long-term horizon.
- However geopolitical risks, global inflation trajectory, extreme weather conditions, volatile crude oil and food prices remain key risks. Markets are expected to remain volatile in the near term.

Money market funds:

- The yields at the shorter end of the curve will move in tandem with the liquidity in the system. The short-end rates are expected to be anchored around the repo rate.

MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS, READ ALL SCHEME RELATED DOCUMENTS CAREFULLY.

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