Our Views

Surprise move by MPC: Pause, not a Pivot

Since May of last year, the central bank has increased the repo rate by 250 basis points to drive down inflation. However, recognizing the uncertainty caused by the worldwide banking crisis and the associated contagion risks, the Monetary Policy Committee (MPC) unanimously decided to keep the repo rate unchanged at 6.5%. MPC kept its 'withdrawal of accommodation' stance, emphasising its preparedness to take action if necessary.

The panel cautioned that inflation concerns aren't fully resolved yet, and it plans to proceed with prudence going forward. February retail inflation rate was 6.44%, down from January's 6.52%, but stayed above the central bank's comfort level of 6.00%.

In my view, increased global uncertainty, a stable currency in 2023, and the incomplete transmission of previous aggressive rate hikes likely prompted the MPC to take a brief pause in the rate hiking cycle.

By maintaining its accommodation stance and leaving the door open to further rate hikes, the MPC has clearly indicated that the war on inflation is far from over. Rather, the RBI prefers to wait and see how the situation develops in the face of global banking instability, OPEC production cuts, and geopolitical tensions.

High interest rates are seen by many as a critical factor in dampening demand, which is causing policymakers to worry about slowing consumption and lacklustre private investment. The RBI's pause will shift the growth-inflation trade-off in the central bank's favour.

Intriguingly, RBI has not attributed the pause to fears of slowing economic growth. Despite the Central Bank's concerns about global instability, bank failures, and contagion risks, it remains bullish on domestic growth. The Indian government's economic growth forecast for FY24 has been raised by the Central Bank of India from 6.4% to 6.5%. The RBI's forecast for GDP growth in FY24, while lower than the 7% seen in FY23, is still higher than the market consensus.

As of late, the economy has shown signs of moderation with evident slowdown in business performance. In light of the current political climate, the Central Bank is unlikely to implement any significant policy changes. At the moment, the effective interest rate is close to 1.4%. Interestingly, India is one of the select nations with a real interest rate greater than 1% in the positive.

We are reasonably safe from the expanding global risks thanks to the robust financial positions of our corporations and banks. There's no denying that the global economic slowdown will hurt India's economy. Our ability to export manufactured goods is being directly affected by the worldwide decline in demand. There has been a decline in the trade deficit as a result of slower imports. The service sector has been thriving despite a downturn in merchandise exports. Our external sector is robust in the face of global turmoil thanks to our CAD, which is projected to drop below 2% in FY24, and our healthy forex reserves. The Indian rupee would rise in value as a result. The dollar could face downward pressure in the months ahead because of the possibility that the US Federal Reserve will slow or even halt its rate hikes. Due to developments in the global economy, the Reserve Bank of India (RBI) now has breathing room to take stock.

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Inflation is currently the Central Bank's top priority. Recent CPI inflation has exceeded the RBI's upper band of 6%, but this is expected to decline in the near future. Although it is expected that CPI inflation will moderate in FY24, it is still expected to remain above the Central Bank's target of 4%. The fact that year-over-year core CPI inflation has been above 6% for the past calendar year is also significant. According to the data, core inflation will be persistent and average over 5.5% in FY24. The Reserve Bank of India (RBI) would be extra cautious about inflationary risks posed by a further rise in global crude oil prices and food prices in the event of weather-related disruptions.

Due to inflation's unpredictability, RBI has left the door open to possible future rate hikes. With inflation likely to stay above the RBI's 4% target in 2023, a rate cut is unlikely. Future response from the Central Bank will be fluid and data driven.

Sunil Sanghai
Founder & CEO
NovaaOne Capital Pvt. Ltd

Sreyans Manu Rai
Senior Associate
NovaaOne Capital Pvt. Ltd.