HSBC Mutual Fund

RBI Monetary Policy Update

October 9, 2024

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After FOMC, MPC pads up for the power play

The MPC changed the much-awaited monetary policy stance to neutral, paving the way for commencement of a rate easing cycle in India. The MPC noted that currently the macroeconomic parameters of inflation and growth are well balanced, headline inflation is on a downward trajectory and food inflation pressures are expected to see some easing later in the financial year. Domestic growth continues to remain resilient, but downside risks from geopolitical tensions and financial market volatility will remain a key monitorable. With risks of global slowdown having escalated and with the Fed commencing its rate easing cycle by 50 bps, we continue to believe that the RBI is unlikely to remain immune from rate actions by global Central Banks, thereby implying that the possibility of rate easing by 75-100 bps in India has meaningfully increased.

MPC Announcement:

The Monetary Policy Committee (MPC) came out with their bi-monthly policy statement on October 09, 2024. Some of the key announcements are as follows:

- The MPC decided by a majority of 5 out of 6 members to keep the policy Repo Rate unchanged at 6.50%. Dr. Nagesh Kumar voted to reduce the policy repo rate by 25 basis points
- Consequently, the standing deposit facility (SDF) rate remains unchanged at 6.25% and the marginal standing facility (MSF) rate and Bank Rate at 6.75%
- The MPC also decided unanimously to change the stance to 'neutral' and to remain unambiguously focused on a durable alignment of inflation with the target, while supporting growth. The growth and inflation estimates have been revised as per the below mentioned table:

	Growth		Inflation	
Period	Aug 2024 forecast	Oct 2024 forecast	Aug 2024 forecast	Oct 2024 forecast
Q2 FY2025	7.20%	7.00%	4.40%	4.10%
Q3 FY2025	7.30%	7.40%	4.70%	4.80%
Q4 FY2025	7.20%	7.40%	4.30%	4.20%
FY2025	7.20%	7.20%	4.50%	4.50%
Q1 FY2026	7.20%	7.30%	4.40%	4.30%

Source - RBI

The growth forecast for FY2025 has been maintained at 7.20%. While the inflation forecast for Q2 FY2025 has been reduced (in line with market expectations) by 30bps, the estimate for full year has broadly been kept unchanged at 4.50%.

The outcome of the MPC meeting on policy rates was in line with market expectations with MPC maintaining status quo on rates. With three new members of the MPC, market was looking forward to see how the voting pattern would emerge – Dr. Nagesh Kumar voted to reduce the policy repo rate by 25 basis points. Market was broadly divided on the stance change and the MPC decided to change the stance to neutral unanimously. The Governor mentioned that RBI will continue to remain nimble and flexible on liquidity, to ensure that money market interest rates evolve in an orderly manner.

Another major development that unfolded overnight was the inclusion of Indian Government Bonds in FTSE Emerging Markets Government Bond Index (EMGBI). The inclusion will be done in a phased manner on a monthly basis over a six-month period starting September 2025. India bonds would represent 9.35% of the index and the FAR eligible securities (including 14-year and 30-year securities) issued before 29-Jul-2024, will be added to the index*. As per a few market reports, the index tracks an AUM of around USD 45-50 billion, resulting in index related flows of around USD 4-5 bn into India.

Market Outlook:

Basis the current market environment, we continue to have a positive outlook on interest rates, based on various favorable factors:

- Global markets turning positive, with various Central Banks commencing easing of policy rates, including the recent 50 bps cut by FOMC
- Reduced Fiscal deficit number of 4.9%, which looks imminently achievable
- Strong index related inflows by FPIs (~ USD 18 bn since JP Morgan index inclusion announcement till end Sep 2024)
- Relatively low volatility of India's bond and currency markets versus other asset classes and peers
- Continuous build-up of FX reserves by RBI, taking the total FX reserves to almost USD 705 bn (as of Sep 27, 2024)
- Favorable G-Sec supply demand dynamics, with possible incremental G-Sec purchase by Banks to increase HQLA assets once the final LCR revision circular is released
- Benign core inflation along with expectations of a better than normal monsoon resulting in RBI revising their Q2 FY2025 inflation estimates
- With the stance change to neutral, liquidity can be expected to be in surplus mode over the coming few quarters

Our Take:

The MPC meeting today set the stage for commencement of a rate easing cycle in India. We assign a higher probability to a first rate cut in December, rather than in February. The December rate cut would be subject to easing in food inflation over the coming months as well as recent uptick in global commodity prices remaining under check. Over the course of the next year, we may expect the MPC to be able to cut rates by 75-100 bps. While Government bond yields have rallied by about 25-30 bps over past few months, we believe there is further space for yields to still move lower and resultantly, we maintain our positive outlook on interest rates and a long duration bias across our portfolios. Additionally, 3-5 year corporate bonds have relatively underperformed through this recent move and with AAA spreads over Government securities looking favourable, we believe this segment should perform well especially in a scenario of positive banking system liquidity.

Abbreviations:

FOMC: Federal Open Market Committee. MPC: Monetary Policy Committee. IGB: Indian Government Bond

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Source - RBI, HSBC Mutual Fund, Data as on 9 Oct 2024. *FOMC Russell

Note: Views provided above are based on information in public domain and subject to change. Investors are requested to consult their financial advisor for any investment decisions.

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