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RBI Policy View

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Change in stance with continuous focus on inflation

The MPC policy meeting today kept the policy rates on hold with a majority decision of 5-1 with Dr. Nagesh Kumar voting to reduce the policy repo rate by 25 basis points. The MPC unanimously decided to change the monetary stance to “Neutral” and being unambiguously focused on a durable alignment of inflation with the target, while supporting growth.

As stated in the RBI Governor’s statement, the change in stance gives MPC greater flexibility and optionality to act in sync with the evolving conditions. The MPC retained its forecast for GDP at 7.20% and CPI inflation at 4.50% for FY 2025 with minor tweaks in the quarterly expectations. While outlining the rationale for its decision, the MPC statement stated that the resilient domestic growth outlook provides headroom for monetary policy to focus on the goal of attaining a durable alignment of inflation with the target. The MPC statement reiterated that enduring price stability strengthens the foundations of a sustained period of high growth. The statement highlighted that with better prospects of both kharif and rabi crops and ample buffer stocks of foodgrains, there was greater confidence on the disinflation path later in the financial year and thus keeping in view the prevailing and expected inflation-growth dynamics, which are well balanced, the MPC decided to change the monetary policy stance.

The MPC statement mentioned that the risks stem from uncertainties relating to heightened global geo-political risks, financial market volatility, adverse weather events and the recent uptick in global food and metal prices. The RBI governor's statement emphasised that the inflation-growth balance have created congenial conditions for a change in monetary policy stance to neutral though risks remain and there was a need to closely monitor the evolving conditions for further confirmation of the disinflationary impulses. The governor’s statement also highlighted the fact that INR continued to be the least volatile among peer EME currencies and this was so even during the high volatility episode of the unwinding of yen carry trade in early August 2024. The lower volatility of the INR reflects India’s strong macroeconomic fundamentals and improved external sector outlook. The governor’s statement also highlighted the success of the Flexible Inflation Targeting (FIT) framework, which has completed 8yrs and stated that over the years, the framework has matured across various interest rate cycles and monetary policy stances and the prevailing well balanced growth-inflation dynamics was a testimony to the success of the FIT framework.

The RBI’s monetary policy report estimates GDP growth for FY26 at 7.10% and the CPI inflation at 4.10%.

On financial system stability, RBI voiced concerns regarding some likelihood of stress buildup in a few unsecured loan segments like loans for consumption purposes, micro finance loans and credit card outstandings. The RBI governor’s statement highlighted that some NBFCs were aggressively pursuing growth without building up sustainable business practices and risk management frameworks, and an imprudent ‘growth at any cost’ approach would be counterproductive. It advised that it was important that NBFCs, including MFIs and HFCs, follow sustainable business goals; a ‘compliance first’ culture; a strong risk management framework; a strict adherence to fair practices code; and a sincere approach to customer grievances.

The undertone of the policy was relatively balanced compared to previous couple of policies, which were more cautious, though it reiterated the continuous emphasis on achieving durable disinflation which can help in achieving long term sustainable growth.

Market Reaction

The bond markets, going into the policy, were expecting a status quo on the policy rates but were divided on change in the monetary stance. Thus the change in the monetary stance was welcomed by the markets and the benchmark 10yr bond yield touched an intraday low of 6.73%, before profit booking took place and the 10yr benchmark ended the day at 6.77%. The current geopolitical situation and the recalibration of expected rate cuts in US following continuous strong economic data had led domestic yields higher over the course of last one week and the 10yr bond yield had touched a high of 6.85% at the beginning of this week.

Our View: Rate cuts in Q3/4 FY2025

We think today’s policy was a continuation of the calibrated approach adopted by RBI over the past one year with emphasis on sustained and durable disinflation along with strengthening of the underlying macroeconomic variables.

FTSE Russel Index has included India’s FAR securities in its index beginning Sept 2025 and thus currently the FAR securities are included in three Emerging Market Indices. This is a long term positive and leads to favourable demand supply dynamics.

Going ahead, we believe that yields will continue to drift lower on the back of steady and low inflation, growth slowdown, which we believe can undershoot RBI’s projections and continuation of the monetary easing cycle across the world and investors can use any uptick in yields to increase their fixed income allocation.

Investors with medium to long term investment horizon can look at funds having duration of 6-7yrs with predominant sovereign holdings as they offer a better risk-reward currently. Investors having an investment horizon of 6-12 months can consider Money Market Funds as yields are attractive in the 1yr segment of the curve. We expect the benchmark 10yr bond yield to gradually drift lower towards 6.50% by Q4 FY2025.