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RBI MAINTAINS STATUS QUO THOUGH DIVERGENCE BECOMING PRONOUNCED: LIQUIDITY MANAGEMENT CRUCIAL: WE FACTOR IN THE FIRST RATE CUT IN OCTOBER 2024

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Along predicted lines, RBI MPC kept repo rate at 6.50% (eighth-time in a row), though the decision saw increased dissent. RBI also decided to remain focused on withdrawal of accommodation Constructive dissent, as they say, is the bedrock of healthy deliberations amidst staying tuned to long term objectives and hence one should not read between the lines much. **Interestingly, 32 of the 48 decisions of the MPC on the repo rate have been unanimous with respect to the direction of policy rate change while there was disagreement on 16 decisions. The disagreement with the 'majority view' was not limited to external MPC members; even internal members had differences on the size as well as direction of policy rate changes, negating views in literature that only external members help avoid "groupthink".**

RBI retained its inflation projection for FY25 at 4.5% with Q1 at 4.9%, Q2 at 3.8%, Q3 at 4.6%, and Q4 at 4.5%. The outlook for inflation will largely be shaped by food inflation trajectory. Further, volatility in crude oil prices and financial markets along with firming up of non-energy commodity prices may pose upside risks to inflation. RBI enhanced its Real GDP growth projection for FY25 by 20 bps to 7.2% (Q1: 7.3%, Q2: 7.2%, Q3: 7.3%, and Q4: 7.2%) with risks evenly balanced. The expectation of normal monsoon augurs well for agriculture and rural demand while sustained momentum in manufacturing and services activity may enable a revival in private consumption. However, the bright outlook may be clouded with geopolitical tensions, volatility in international commodity prices, and geoeconomic fragmentation.

In a clear sign of decoupling of RBI from US Fed that was a given earlier, the RBI governor has clearly stated that though the RBI considers the impact of the US/ or other advanced countries' policy change, the rate decision will be majorly influenced by domestic growth and inflation outlook. This sets the ball for a possible divergence between individual paths and timing of rate cuts even as ECB to Bank of Canada to Swiss SNB and Swedish Riksbank have already pivoted to rate cuts. **In fact, past experience shows synchronized rate actions result in more volatility.** The Governor has vociferously cautioned about the persisting gap between credit and deposit growth rates and suggested banks to re-strategise their business plans.

Meanwhile, liquidity has turned into surplus in Jun'24 after remaining in deficit during 20 Apr-31 May'24. However, the Government is moving towards JIT mechanism of fund transfer whereby Government cash balances has moved to RBI E-Kuber and hence system liquidity in future may become agnostic to Government spending. **Thus liquidity management will continue to remain one of the most critical issues during this fiscal and RBI may have to innovate on liquidity augmentation tools going forward.**

One of the most important announcements in today's policy deliberations for banks concerns enhancing the Bulk Deposit limits to ₹3 crore and above from earlier 'Single Rupee term deposits of ₹2 crore and above' brought forth in 2019. This move reflects the changing landscape of liquidity, as also deposit centricity for banks from savers on two aspects; substitution and competition. The flexibility offered to major banks as also SFBs (already offered a glide path by the regulator to convert into Universal Banking avatars) to decide the optimal bounds of pricing will imbibe a better visibility on ALM front. **Colloquially, this could also hint at either bank lending rates remaining higher for longer (than earlier anticipated) or the NIM of banks to retract once a benign rate cycle begins.** Further, export and import regulations are proposed to be rationalized under FEMA to promote ease of doing business as cross border trade transactions are rapidly undergoing change.

Rising incidences of frauds has been a matter of concern. Accordingly, RBI decided to form a committee that will explore the possibility of creating Digital Payments Intelligence Platform which will harness advanced technologies to mitigate payment fraud risks. Furthermore, the third edition of our global hackathon, "Harbinger 2024 – Innovation for Transformation" will be launched with two overarching themes viz., 'Zero Financial Frauds' . On the payment side RBI has extended facility of standing instruction on per-paid instruments such as FASTag and UPI Lite. The idea is to provide an auto-replenishment facility to the customer and avoid repetitive transactions.

In all the June monetary policy was mixed bag as it happened in the midst of political transition. While the direction of policy is more or less decided, RBI has adopted more cautious stance to observe new government moves. **Overall, RBI will continue the hold the rates in coming policy as well and will revisit the stance in H2 of FY25. We expect first cut in October 2024.**

REPO RATE KEPT AT 6.5%

- As widely expected, MPC decided to keep repo rate at 6.50% (eighth-time in a row), though not unanimously. Two of the members voted to reduce the policy repo rate by 25 bps. RBI also decided to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns to the target, while supporting growth. The same two members voted for a change in stance to neutral.
- RBI retained its inflation projection for FY25 at 4.5% with Q1 at 4.9%, Q2 at 3.8%, Q3 at 4.6%, and Q4 at 4.5%. The outlook for inflation will largely be shaped by food inflation trajectory. Further, volatility in crude oil prices and financial markets along with firming up of non-energy commodity prices may pose upside risks to inflation.
- RBI enhanced its Real GDP growth projection for FY25 by 20 bps to 7.2% (Q1: 7.3%, Q2: 7.2%, Q3: 7.3%, and Q4: 7.2%) with risks evenly balanced. The expectation of normal monsoon augurs well for agriculture and rural demand while sustained momentum in manufacturing and services activity may enable a revival in private consumption. However, the bright outlook may be clouded with geopolitical tensions, volatility in international commodity prices, and geoeconomic fragmentation.

DIVERGENCE IN VOTING PATTERN: PRELUDE TO CHANGE IN RATE AND STANCE

- Voting records of individual members on the policy rate has exhibited diversity. Thirty-two of the 48 decisions of the MPC on the repo rate have been unanimous with respect to the direction of policy rate change while there was disagreement on 16 decisions. The disagreement with the 'majority view' was not limited to external MPC members; even internal members had differences on the size as well as direction of policy rate changes. This is in contrast with the view in the literature that only external members help avoid "groupthink" (Sibert, 2006).
- Here one interesting aspect that need to analyse is that the increasing or sustained diversity in voting pattern led to change in interest rate decisions or not. Past examples during Dec'16-Aug-17 indicate that change in voting pattern ultimately leads to change in interest rate decision. In the current situation, where in the last two policies only one member dissented, now two of the members dissented and this may ultimately lead to change in rate/stance going forward.

POLICY HINTED AT DECOUPLING FROM US FED

- Often the central banks across the world follow the US Fed monetary decision. When the Fed raises rates, it leads to capital outflows from the rest of the world, thereby prompting them to raise rates either to prevent capital outflows by managing interest rate differential or prevent exchange rate depreciation and keep domestic inflation under control.

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	Q1 FY25	Q2 FY25	Q3 FY25	Q4 FY25	FY25
Jun'24	4.9	3.8	4.6	4.5	4.5
Apr'24	4.9	3.8	4.6	4.5	4.5
Feb'24	5.0	4.0	4.6	4.7	4.5
Dec'23	5.2	4.0	4.7	-	-
Real GDP Growth (%)	**Q1 FY25**	**Q2 FY25**	**Q3 FY25**	**Q4 FY25**	**FY25**
Jun'24	7.3	7.2	7.3	7.2	7.2
Apr'24	7.1	6.9	7.0	7.0	7.0
Feb'24	7.2	6.8	7.0	6.9	7.0
Dec'23	6.7	6.5	6.4	-	-

Source: RBI, SBI Research

- Likewise, RBI is considered to follow the Fed interest rate decision. However, the RBI governor has clearly stated that though the RBI considers the impact of the US/ or other advanced countries' policy change, however their rate decision is majorly influenced by domestic growth and inflation outlook.
- The current statement of the RBI governor clearly indicates that the RBIs path may differ from the Fed and it may cut the rates before the Fed if the domestic conditions warrants it. The first rate cut by RBI might be in Q3 FY25, though the rate cut cycle is likely to be shallow.

LIQUIDITY TURNED TO SURPLUS MODE

- Liquidity has turned into surplus in Jun'24 after remaining in deficit during 20 Apr-31 May'24. Accordingly, liquidity deficit post Apr'24 policy, as given by Net LAF position, has reduced to Rs 0.73 lakh crore.
- Meanwhile, Government surplus cash balances have declined to Rs 1.1 lakh crore in Jun'24 so far compared to Rs 3.0 lakh crore in May'24. Core/durable liquidity surplus has thus moderated improved to Rs 1.51 lakh crore.
- **However, the Government is moving towards JIT mechanism of fund transfer whereby Government cash balances has moved to RBI E-Kuber and hence system liquidity may become agnostic to Government spending. Thus liquidity management will continue to remain one of the most critical issues during this fiscal and RBI may have to innovate on liquidity augmentation tools.**

- The governor has also cautioned about the persisting gap between credit and deposit growth rates (incremental C/D ratio hovering around 100) and suggested banks to re-strategise their business plans.
- RBI has adopted a preventive approach to balance the risks emanating from exuberance shown by select REs to fan the expansionary yet lop-sided credit cycle, cautioning strongly to proactively manage risk limits, appetites and exposures granularly, maintaining a prudent balance between assets and liabilities even as liquidity is impacted by mechanisms like JIT.

DEVELOPMENT AND REGULATORY MEASURES

- **Review of limit of Bulk Deposits for SCBs (excluding RRBs), SFBs and Local Area Banks:** One of the most important announcements in today's policy deliberations for banks concerns enhancing the Bulk Deposit limits to ₹3 crore and above from earlier 'Single Rupee term deposits of ₹2 crore and above' brought forth in 2019.
- This move reflects the changing landscape of liquidity, as also deposit centricity for banks from savers on two aspects; substitution and competition. While the glut in raising deposits from retail book has forced many a banks to increasingly opt for wholesale deposits, the savers themselves are split for alternate, competing channels of investments with diminishing opportunity cost. The flexibility offered to major banks as also SFBs (already offered a glide path by the regulator to convert into Universal Banking avatars) to decide the optimal bounds of pricing, co-terminus with risks, to attract sticky deposits from non-conventional sources to support quest for growth while imbibing better visibility on ALM front.
- **Colloquially, this could also hint at either bank lending rates remaining higher for longer (than earlier anticipated) or the NIM of banks to retract once a benign rate cycle begins.**
- **Rationalisation of Export and Import regulations under Foreign Exchange Management Act (FEMA), 1999:** Currently Master Direction – Export of Goods and Services (Updated as on November 22, 2022) and Master Direction – Import of Goods and Services (Updated as on November 21, 2022) are guiding the ADs in respect of exports and import payments. With changing dynamics of trade which includes rising digital trades, use of technology in trade, formation of FTAs and regional trading blocs which require a review of existing guidelines.

Average Liquidity Position (Rs lakh crore)				
	Average in FY24	5-Apr-24	Post policy average	6-Jun-24
Repo Outstanding	0.63	0.04	1.44	0.54
Reverse Repo Total	0.29	0.06	0.09	0.44
SDF	0.82	1.62	0.81	0.73
MSF	0.46	0.03	0.06	0.06
Net LAF (-absorption)	0.06	-1.48	0.73	-0.45
Government Cash Balance (net LAF-core liquidity)	2.37	1.06	2.52	1.18
Core Liquidity (-Surplus) system liquidity adjusted with GOI Balances	-2.33	-2.36	-1.73	-1.51

Card/Internet Frauds Has Increased Substantially								
	No. of Frauds				Amount Involved (Rs crore)			
	FY22	FY23	FY24	CAGR	FY22	FY23	FY24	CAGR
Advances	3,782	4,090	4,133	4.5	43,272	24,685	11,772	-47.8
Share %	41.8	30.2	11.5	-	95.4	94.5	84.5	-
Card/Internet	3,596	6,699	29,082	184.4	155	277	1,457	206.6
Share %	39.8	49.4	80.6	-	0.3	1.1	10.4	-
Others	1,668	2,775	2,860	30.9	1,931	1,165	701	-39.7
Share %	18.4	20.5	7.9	-	4.3	4.5	5.0	-
Total	9,046	13,564	36,075	99.7	45,358	26,127	13,930	-44.6

Source: RBI, SBI Research

- **Setting up a Digital Payments Intelligence Platform:** Due to growing number of digital frauds, RBI has announced to setup a committee, Chairman: Shri A.P. Hota, former MD & CEO, NPCI, on 'Digital Payments Intelligence platform', to examine various aspects of setting up a digital public infrastructure for Digital Payments Intelligence Platform. The Committee is expected to give its recommendations within two months.
- The share of card/internet frauds in volume has increased to 80.6% in FY24 from 39.8% in FY22. While in value terms, the share has increased to 10.4% in FY24 from 0.3% in FY22.
- **E-mandates framework extended to FASTag, UPI Lite payments:** As the adoption of e-mandates for recurring payment transactions has been increasing. So, RBI has proposed to include payments, such as replenishment of balances in FASTag, NCMC, etc. which are recurring in nature but without any fixed periodicity, into the e-mandate framework. These categories of payments are made as and when needed and therefore their replenishment is not time specific or amount specific.
- **Under the e-mandate framework, it is proposed to introduce an automatic replenishment facility for such payments. The automatic replenishment will be triggered when the balance in FASTag or NCMC or UPI Lite falls below a threshold amount set by the customer. This will enhance convenience in making travel / mobility related payments and reduce customer complaints.**

- **RBI Hackathon HARBINGER 2024 – Innovation for Transformation**: With view of foster innovation in financial services RBI will open the third edition of our global hackathon, “Harbinger 2024 –Innovation for Transformation” with two overarching themes viz., ‘Zero Financial Frauds’ and ‘Being Divyang Friendly. While the former is clearly guided by the rising cases of frauds and latter a financial inclusion initiative. The measure is expected to reduce operational risks in banks.

GLOBAL OUTLOOK

- Global growth is sustaining its momentum in 2024 and is likely to remain resilient, supported by rebound in global trade. Improving world trade prospects could support external demand in emerging markets like India and China.
- Inflation is easing in many geographies with central banks in Switzerland, Sweden, Canada and Euro Area have begun their rate easing cycle during 2024. On the other hand, market expectations of rate cut by the US Fed have moderated.
- It is expected that by the last quarter of 2024, most of the central banks will converge to monetary policy easing.

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