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RBI FIFTH BI-MONTHLY POLICY REPORT FY 23 - 24

8th December, 2023

Status Quo Maintained

Unanimous Vote to Keep Repo Rate Steady at 6.5%

During its meeting spanning from December 6 to December 8, 2023, **the Monetary Policy Committee (MPC) unanimously opted to maintain the Policy Repo Rate within the Liquidity Adjustment Facility (LAF) at the existing 6.50%.**

The primary objective behind this decision is to ensure the continued control of inflation all while sustaining economic growth. The Consumer Price Index (CPI) headline inflation showed a moderation to 4.9% in October from the previous 7.4% in July, across all CPI components, including Fuel, Food, and Core (CPI inflation excl. food and fuel). **The Standing Deposit Facility (SDF) Rate remains stable at 6.25%, and both the Marginal Standing Facility (MSF) Rate and Bank Rate remaining unchanged at 6.75%.**

In a **5:1 majority decision, the MPC has chosen to gradually reduce accommodation**, a move aimed at progressively aligning inflation with the established target while supporting economic expansion.

Addressing India's economic outlook, the RBI has **revised its GDP growth projection for FY24 to 7.0%**, up from the initial estimate of 6.5%. Additionally, the GDP growth forecast for Q1FY24 has increased to 6.7%, and new projections have been introduced for Q2 and Q3 FY25. On the inflation front, the RBI maintains its forecast for FY 2024 at 5.4%, with fresh estimates introduced for Q2 and Q3 FY24.

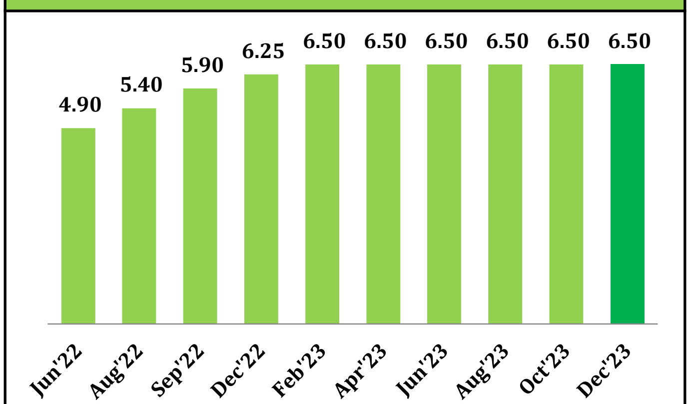
RBI's GDP GROWTH OUTLOOK

Period	Projection	Earlier
FY24	**7.0%**	**6.5%**
Q3 FY24	6.5%	6.0%
Q4 FY24	6.0%	5.7%
Q1 FY25	6.7%	6.6%
Q2 FY25	6.5%	-
Q3 FY25	6.4%	-

RBI's CPI INFLATION OUTLOOK

Period	Projection	Earlier
FY24	**5.4%**	**5.4%**
Q3 FY24	5.6%	5.6%
Q4 FY24	5.2%	5.2%
Q1 FY25	5.2%	5.2%
Q2 FY25	4.0%	-
Q3 FY25	4.7%	-

RBI REPO RATES (%)



MARKET's REACTION*

Nifty50	**20,969.40** ▲68.25	▲0.33%
Nifty Bank	**47,262.00** ▲420.60	▲0.90%

*DATA as on 3:30 PM – 8th December, 2023

Key Highlights:

- **Fragile Global Economy:** The global economy remains in a delicate state, marked by a slowdown in world trade due to rising global protectionism. Efforts to restore supply chains have been hindered by challenges such as high debt, geopolitical tensions, and adverse weather conditions. Inflationary pressures in advanced economies are easing, leading to expectations of an early end to the monetary tightening cycle and boosting market confidence. Sovereign Bond Yields are softening, reflecting the current lack of expectations for additional rate hikes. The strength of US Dollar has also declined.
- **Buoyant Economic Activity in Domestic Economy:** In the second quarter of FY24, India's economic performance was robust, registering a substantial GDP growth of 7.6%. This impressive expansion was fueled by strong domestic demand, increased investment, and heightened government consumption. The manufacturing sector showcased resilience, benefiting from lower input costs and a surge in demand. November witnessed noteworthy GST collections, reaching Rs. 1.68 lakh Crore. Household consumption experienced a notable upswing, driven by both urban and improving rural demand, further accentuated by heightened festival-related spending. Investment activity, especially in public sector capital expenditure, played a pivotal role in fostering growth, as evidenced by increased steel consumption, elevated cement production, and a rise in imports of capital goods. Manufacturing capacity utilization remained above average, and private manufacturing companies observed robust growth in investments related to fixed assets.
- **CPI Inflation:** The CPI inflation saw a dip of 2 percentage points to 4.9% in October 2023, driven by lower vegetable prices and fuel deflation. The RBI foresees a potential uptick in headline inflation in November–December due to uncertainties in food prices and unfavorable base effects. Monitoring factors like Kharif crop arrival, Rabi sowing progress, and El Niño conditions is essential for predicting food price inflation.
- **Liquidity Conditions:** Having an excess of funds in the system poses challenges for both prices and the stability of the financial system. In response to the economic impact of COVID-19, the Reserve Bank of India, akin to other central banks worldwide, injected additional liquidity. Effectively, the RBI reduced its balance sheet from 28.6% to 23.3% of GDP during the COVID-19 period, implementing measures such as ICRR in the preceding policy meeting. After a 4.5-year gap since May 2019, system liquidity turned into a deficit in September 2023, persisting through October and November. Banks turned to the Marginal Standing Facility (MSF), and the utilization of the Standing Deposit Facility (SDF) was also high. Autonomous factors tightened system liquidity more than expected in the October policy statement. However, with increased government spending and a more balanced distribution of liquidity, pressures have eased, aligning with the prevailing monetary policy stance. Looking ahead, government spending is anticipated to further alleviate liquidity conditions.
- **Market Conditions:** The long-term Government Securities (G-sec) yields have decreased, indicating a robust demand from financial institutions and a decline in global bond yields.
- **External Sector:** In October 2023, India witnessed a resurgence in both merchandise exports and imports, with services exports maintaining strength in Q2FY24. Recognized as the primary recipient of remittances, the net balance from services and remittances is anticipated by the RBI to contribute significantly to offsetting the current account deficit. The RBI observed a positive shift in FPI in FY24, recording net inflows amounting to US$ 24.9 billion by December 6. However, Net FDI moderated to US$ 10.4 billion in the period of April-October 2023. Despite this, net inflows from external commercial borrowings (ECBs) and non-resident deposit accounts surpassed the figures from the previous year.

Additional Measures

The Reserve Bank of India (RBI) has announced several additional measures aimed at strengthening the country's financial and regulatory framework. These measures include:

- **Review of Forex Derivative Transactions:**

  In response to market developments and feedback from participants, the RBI has refined and consolidated the regulatory framework for Forex derivative transactions. This strategic move is expected to streamline and strengthen the Forex derivatives market by improving operational efficiency and accessibility for users.

- **Connected Lending Framework:**

  Recognizing the need for a comprehensive approach, the RBI has introduced a unified regulatory framework for connected lending applicable to all regulated entities. This initiative aims to fortify the pricing and management of credit by regulated entities, ensuring a more cohesive and robust lending environment.

- **Regulation for Web-Aggregation of Loan Products:**

  Acknowledging concerns related to web-aggregation of loan products and its potential impact on consumer interests, the RBI has instituted a regulatory framework within the digital lending ecosystem. The objective is to instill greater customer-centricity and transparency in digital lending practices.

- **Establishment of Fintech Repository:**

  To stay abreast of developments in the rapidly evolving Fintech sector, the RBI is proposing the establishment of a Fintech Repository. Operationalized by the Reserve Bank Innovation Hub, this repository, slated for April 2024 or earlier, will encourage voluntary contributions of relevant information from FinTech companies, fostering a more informed regulatory environment.

- **Enhancement of UPI Transaction Limit:**

  In a bid to facilitate higher-value transactions for essential services, the RBI proposes an increase in the UPI transaction limit from ₹1 lakh to ₹5 lakh per transaction for payments to hospitals and educational institutions. This adjustment aims to accommodate larger financial transactions for healthcare and education purposes.

- **e-Mandates for Recurring Transactions:**

  To expedite the adoption of e-mandates, the RBI is considering an increase in the limit for an additional factor of authentication (AFA) from ₹15,000 to ₹1 lakh per transaction. This adjustment specifically targets recurring payments for mutual fund subscriptions, insurance premium subscriptions, and credit card repayments, fostering greater ease and convenience for consumers.

- **Establishment of Cloud Facility:**

  Recognizing the growing volume of data managed by banks and financial entities, the RBI is actively working on establishing a cloud facility for the financial sector in India. Envisioned to enhance data security, integrity, and privacy, this cloud facility will also provide better scalability and business continuity. The phased rollout over the medium term aims to ensure a calibrated and effective implementation.

The Way Ahead:

Looking ahead, the Reserve Bank of India anticipates a positive trajectory for the Indian economy. Private consumption is expected to receive support from a gradual improvement in rural demand, a robust manufacturing sector, and continued strength in services.

Healthy balance sheets of banks and corporates, high capacity utilization, business optimism, and government emphasis on infrastructure spending are likely to drive private sector capital expenditure. The drag from external demand is expected to ease with a turnaround in merchandise and services exports. Despite these positive factors, the RBI acknowledges risks from geopolitical turmoil, financial market volatility, and growing geo-economic fragmentations. **Keeping these developments in mind, the real GDP growth for the next fiscal year is projected at 6.7% for Q1, 6.5% for Q2, and 6.4% for Q3.**

On the inflation front, uncertainties in food prices may significantly influence the inflation outlook. High-frequency indicators point to a potential increase in key vegetable prices, posing a near-term risk to CPI inflation. Ongoing monitoring of *Rabi* sowing progress and concerns about elevated global sugar prices are noted. **While global commodity prices have softened, CPI inflation for 2023-24 is projected at 5.4%, with Q3 at 5.6% and Q4 at 5.2%. For Q1:2024-25, inflation is estimated at 5.2%, Q2 at 4.0%, and Q3 at 4.7%, with risks considered evenly balanced.**

Despite progress, achieving the 4.0% CPI target requires continued efforts, given the volatility in headline inflation due to frequent and intense supply-side shocks. Monetary policy is emphasized to remain actively disinflationary while supporting growth. The RBI underscores the importance of clear and consistent communication to anchor economic agents' expectations, acknowledging the need for careful consideration of every action to ensure overall macroeconomic and financial stability.

Chart 1: Quarterly Projection of Real GDP Growth (y-o-y)

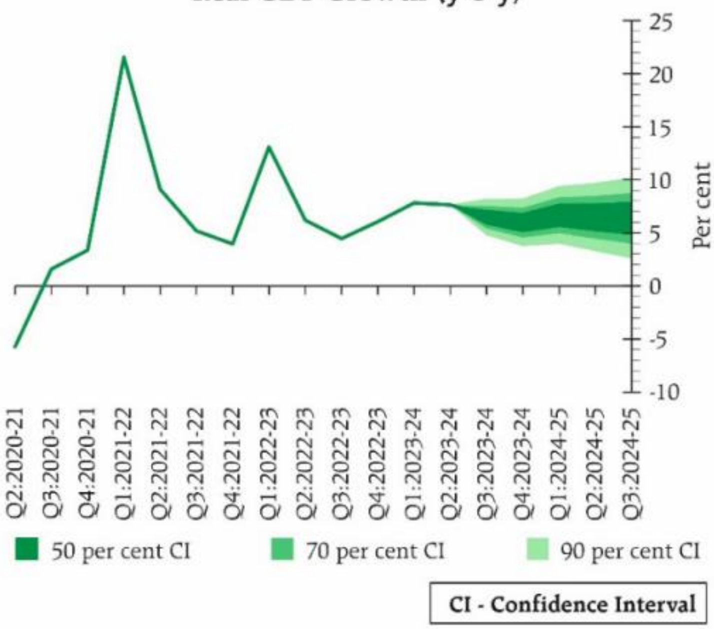
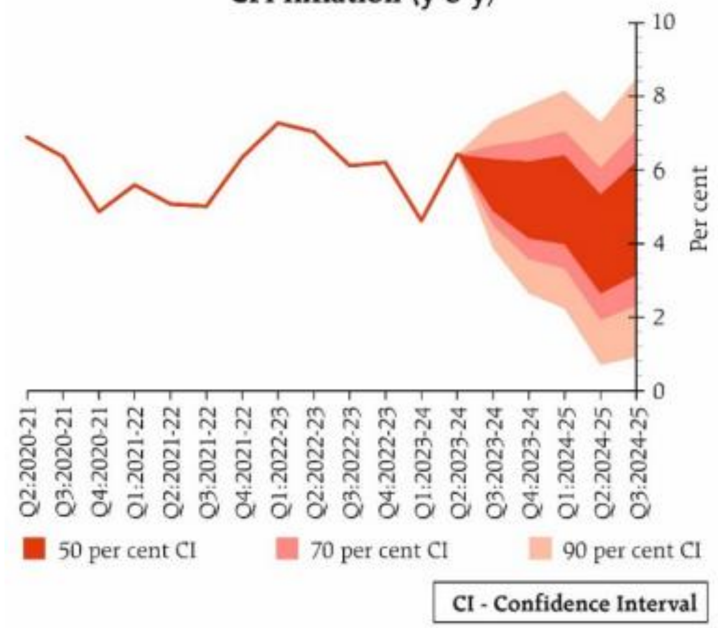


Chart 2: Quarterly Projection of CPI Inflation (y-o-y)



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