

# India Special Coverage:

## RBI lays the groundwork for a potential December rate cut

### Key takeaways

- ◆ The Reserve Bank of India (RBI) kept the benchmark policy rate unchanged at 6.5% at the 9 October monetary policy meeting. More importantly, the Monetary Policy Committee (MPC) unanimously chose to change the policy stance from “withdrawal of monetary accommodation” to “neutral”, which signals a dovish pivot from the central bank.
- ◆ Governor Shaktikanta Das highlighted that while rural demand and private investments were picking up, the RBI was monitoring the recent decline in PMIs and tax collections. He also emphasised that the hard-won progress to curb inflation must be protected, which indicates that the RBI is unlikely to deliver large rate cuts in the near future.
- ◆ The RBI’s decision is in line with our expectations. We expect the current rate cut cycle to be a shallow one, with cumulative 0.5% rate cuts till Q1 2025. We remain bullish on Indian equities and Indian local currency bonds, while USD/INR is expected to be largely range-bound till end-2024. The INR will benefit from a higher carry relative to most other developed and emerging market countries.



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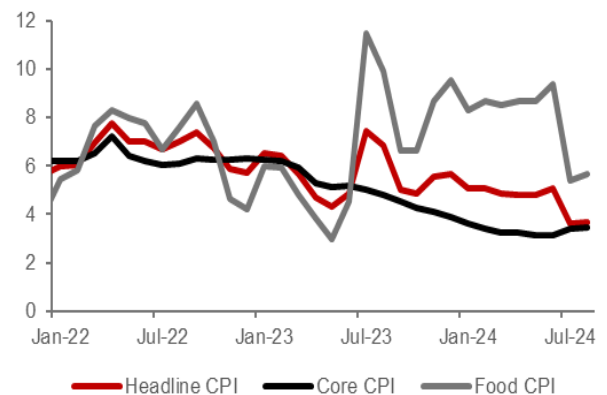


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### What happened?

- The RBI’s Monetary Policy Committee (MPC) kept the benchmark rate unchanged at 6.5% for the 10<sup>th</sup> consecutive meeting. More importantly, the MPC shifted the monetary policy stance from “withdrawal of monetary accommodation” to “neutral”, opening the door for a potential rate cut in December. This is also the first meeting since the appointment of three new external members.
- Governor Shaktikanta Das acknowledged that while domestic economic activity was holding steady, the RBI was monitoring the recent decline in manufacturing and service PMIs as well as the slower pace of Goods & Service Tax (GST) collection. He also pointed to the pickup in rural demand and private investments as key positives.
- The RBI released its revised growth and inflation forecasts. While the FY25 (Apr 24 – Mar 25) growth rate was unchanged at 7.2%, the RBI lowered its Q2 FY25 forecast but expected faster growth in Q3 and Q4 FY25.

### Easing food inflation opens room for the RBI to cut rates in December



Source: Bloomberg HSBC Global Private Banking and Wealth as of 9 October 2024. Past performance is not a reliable indicator of future performance.

- Unsurprisingly, Governor Das expected inflation in September to bounce higher due to the base effect. However, he mentioned that the RBI expected food inflation, which has been persistently sticky, to moderate in the coming months. The RBI kept the FY25 inflation forecast unchanged at 4.5% but forecasted the FY26 inflation to edge lower to 4.1%. He mentioned that it has taken a lot of work to bring inflation under control and that the RBI doesn't want it to spike again. We interpret this as a signal that the current easing cycle is likely to be a shallow one.
- While the RBI believes that the Indian financial system is in good health, it highlighted that it was closely monitoring the rise in unsecured lending by shadow lenders and non-banking financial companies. Governor Das advised such lenders to improve their risk management or risk facing action from the RBI.
- We take comfort from RBI's proactive monitoring of the financial landscape which should reduce the risk of significant vulnerabilities in the financial system.

## Investment implications

- The revised growth and inflation forecasts, as well as the comments by Governor Das in the press conference, indicate that the RBI remains comfortable with India's growth trajectory while keeping a vigilant eye on nascent signs of slowdown. The RBI re-emphasised the importance of credibly managing inflation while keeping external and domestic risks in view.
- The pivot in monetary policy stance to "neutral" is a clear signal that the RBI is preparing to cut interest rates, and we expect it to deliver a 0.25% rate cut in December and another 0.25% cut in Q1 2025, bringing the policy rate to 6.0%.
- The 10-year Indian government bond yields fell sharply shortly after the announcement of change in monetary policy stance, before yields clawed modestly higher. The clear pivot in RBI's policy stance is supportive of our bullish stance on INR local currency government bonds. The shift in the RBI policy, combined with disciplined supply and strong demand from international investors, leads us to expect Indian bonds yields to decline further.
- We view the recent pullback in Indian equities as an opportunity to add exposure. Despite the elevated valuations, Indian equities continue to be supported by double-digit earnings growth expectations, high ROEs and strong domestic investor flows. We remain bullish on Indian equities over the next 3-6 months. Within the market, we prefer large-cap stocks over the mid-and small-cap stocks. From a sector perspective, we retain our preference for financials, consumer discretionary and industrials.
- We expect USD/INR to be largely range-bound over the next 3 months. Despite the impending rate cuts, INR will benefit from a higher carry relative to most other developed and emerging market countries. While the escalation of geopolitical risks in the Middle East could lead to higher oil prices and drag INR, we take comfort from RBI's large FX reserves which crossed USD700bn recently. Additionally, we expect ongoing purchases of INR bonds by international investors due to index inclusion as a supportive technical tailwind for the INR.

### Latest projections by RBI's MPC

	CPI Projection		Growth Projection	
	Aug 24	Aug 24	Oct 24	Aug 24
Q2 (Jul – Sep 24)	4.1%	4.4%	7.0%	7.2%
Q3 (Oct – Dec 24)	4.8%	4.7%	7.4%	7.3%
Q4 (Jan – Mar 25)	4.2%	4.3%	7.4%	7.2%
<b>FY 2025</b>	<b>4.5%</b>	<b>4.5%</b>	<b>7.2%</b>	<b>7.2%</b>
<b>FY 2026</b>	<b>4.1%</b>		<b>7.1%</b>	

Source: RBI, HSBC Global Private Banking and Wealth as of 9 October 2024.

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