RBI not to follow Fed; domestic dynamics to determine rate cuts

POSITIVE PICTURE. Better liquidity position may provide a cushion to the central bank

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The Reserve Bank of India is unlikely to immediately follow US Fed in cutting the repo rate as its actions are primarily determined by domestic growth-inflation conditions and outlook.

The US Fed slashed its benchmark lending rate by 50 basis points to 4.75 per cent-5 per cent on Wednesday, its first reduction in more than four years, as it gained greater confidence that inflation is moving sustainably towards the 2 per cent target, and judged that the risks to achieving its employment and inflation goals are roughly in balance.

In his June 7th bi-monthly monetary policy review, RBI Governor Shaktikanta Das noted that there is a view that in matters of monetary policy, the Reserve Bank is guided by the principle of 'follow the Fed'. "I would like to unambiguously state that while we do keep a watch on whether clouds are building up or clearing out in the distant horizon, we play the game according to the local weather and pitch conditions."

RBI ACTION

"In other words, while we do consider the impact of monetary policy in advanced economies on Indian markets, our actions are primarily determined by domestic growth-inflation conditions and the outlook," Das said.

INDEPENDENT VIEW

Referring to the 50 bps cut in the Fed Funds rate as rather brave, Soumya Kanti Ghosh, Group Chief Economic Adviser, State Bank of India, observed that RBI may disassociate from the interest rate developments in the US and may take independent view on the domestic rates based on evolving conditions.

Domestic conditions are paramount and with robust growth higher than potential output, a case for pause exists, he said, adding that this is further supported by the fact that the impact of a weak dollar on international commodity prices and its pass through on Indian economy may evolve in coming days.

Additionally, the better liquidity position may provide the cushion to the central bank to ensure that the financial system can support the festival demand for credit. "As such, we don't anticipate any rate action by RBI in calendar 2024.

"An early 2025 rate cut (February) looks the best bet as of now.

"We still believe that liquidity challenges will remain for the banking sector with Government cash balances progressively moving out of the banking system with a move towards just-in-time mechanism," Ghosh said.

EMERGING MARKETS

Madhavi Arora, Chief Economist, Emkay Global Financial Services Ltd, said the RBI still has room to prioritise domestic dynamics.

The outsized cut by the US Fed has given Emerging Market Economies in Asia room to proceed with their own easing cycles, with the Bank of Indonesia delivering a 25 bps cut earlier in the day, she said.