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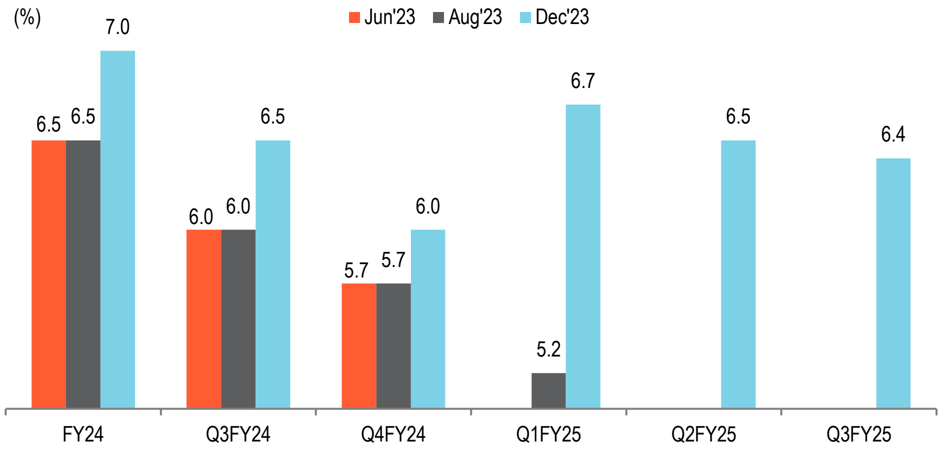
RBI maintains status quo

MPC members for the 5th consecutive time kept policy rates on hold, by keeping repo rate unchanged at 6.5%, SDF at 6.25% and MSF and bank rate at 6.75%. RBI also left its stance of "withdrawal of accommodation" unchanged with the vote of 5-1. Central bank reiterated its focus on bringing inflation down to 4% mark on a durable basis and vowed to maintain liquidity conditions in the system in alignment with its policy stance. GDP growth forecasts for FY24 were revised upward with RBI now expecting growth to clock 7%, supported by domestic consumption, manufacturing sector and investment. For first three quarters of FY25, RBI expects slight moderation in average growth to 6.5%. Inflation forecasts were retained and projections for first the quarters of FY25 shows that RBI expects inflation to hit 4% mark only briefly in Q2FY25. We foresee no change in stance in the next policy statement and no rate cut before Q2FY25.

Balanced hold: In line with our expectation, RBI decided to remain on hold, and unanimously decided to keep the repo rate unchanged at 6.5%. Subsequently, SDF rate remains at 6.25% and MSF and Bank rate at 6.75%. Providing a dovish tint to the policy, Governor in his statement added that policy makers must remain "*mindful of the risk of overtightening*". This was balanced by adding that policymakers should also be mindful of "*risk of being carried away by a few months of good data or by the fact that CPI inflation has come within the target range*". The central bank has also reaffirmed that its target is to bring inflation below 4%, and therefore continued to retain its stance at "withdrawal of accommodation".

GDP growth hiked: RBI has upwardly revised its GDP growth forecast for FY24 to 7%, with Q3 growth projected at 6.5% (6% as per Aug'23 forecasts) and Q4 at 6% (5.7% earlier). Growth is then expected to rebound in Q1FY25 (6.7%), before easing again in Q2 (6.5%) and Q3 (6.4%). The upward revisions to overall FY24 number and Q3 and Q4 figures is account of resilience seen in high frequency data so far. The central bank has highlighted that manufacturing sector gathered momentum in Q3 (eight core and PMI) as price pressures declined. Service industry is also holding ground (e-way bills, toll collections, port cargo traffic, rail freight volume, diesel consumption, GST collections and PMI). On the demand side, urban demand is steady (air passenger traffic, PV sales, household credit) and rural demand is showing signs of recovery (sales figures of FMCG companies). Push from festive demand is also a positive. Investment demand is driven by public sector spending and progressive trends are emerging from improvement in fixed assets and capacity utilization of private manufacturing companies. However, we still believe that RBI estimates are slightly more on the optimistic side. Key downside risks are emerging from Rabi sowing, owing to impact of El Nino and thus possible faltering of agriculture growth in the coming quarters. This may the hurt rural demand. In addition to this, waning base effect will also no longer provide support to growth figures, and we thus maintain our growth forecast of 6.6-6.7% for FY24.

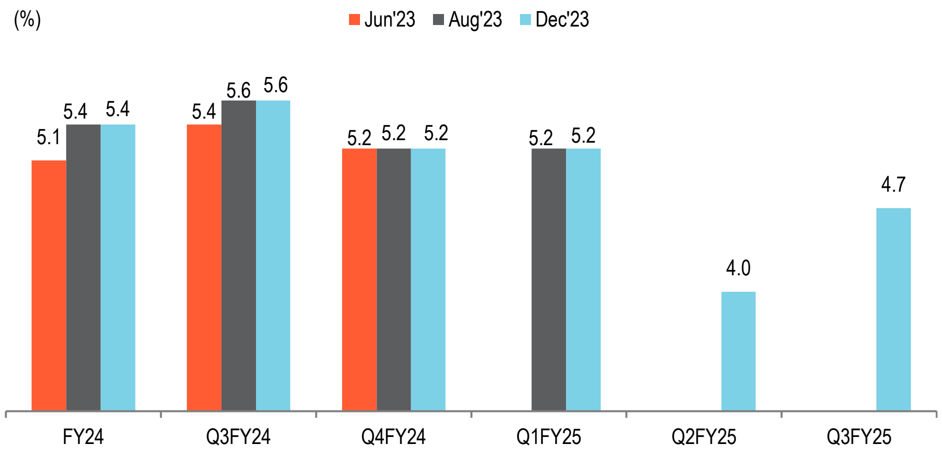
Figure 1: RBI growth projections revised upwards



Source: RBI, Bank of Baroda Research

Inflation projections maintained: For FY24, RBI has retained its projection at 5.4% as it expects uncertainty in food prices to remain in the coming months. Even the latest high frequency data shows that upside pressures persists in case of prices of onions, potato, some varieties of pulses, and *atta*. Other risks highlighted by the central bank include, monitoring the progress of Rabi sowing (especially wheat, spices and pulses) and rising global sugar prices. Some comfort to inflation can be expected from subdued global commodity prices, and imported edible oil prices. Although crude oil prices seem to be on a downward trajectory currently, volatility in prices is also a potential concern. As result, projection for Q3FY24 was kept unchanged at 5.6% for Q4 at 5.2%. Even at the start of FY25, inflation is expected to remain above 4% mark at 5.2% and is anticipated to come down to 4% only in Q2, before rising again in Q3 to 4.7%.

Figure 2: Headline CPI forecast for FY24 retained



Source: RBI, Bank of Baroda Research

Impact

- As RBI's policy statement was broadly in line with market expectations, 10Y yield is currently trading flat at 7.24%. Dovish tone of the policy (mention of risk of overtightening) was balanced by reaffirming the central banks view that few months of good data should not imply shift in stance and that RBI continues to target bringing inflation down to 4% on a durable basis. We do not shift in stance even in the next policy statement and probability of any rate cut is ruled out before Q2FY25.

- On the liquidity front, RBI noted that deficits in Oct-Nov'23 promoted heavy use of MSF and SDF facilities by banks. Deficit in liquidity was driven by higher demand for currency during the festive season; RBI operations and government cash balances. Therefore the need for conducting OMO sales did not arise. Going forward, as government spending picks up pace, pressures on liquidity is expected to ease and RBI has again reiterated that it will manage liquidity in line with policy stance.

- We believe that RBI's upward revision to GDP projection for FY24 (7%) is slightly more on the optimistic side and we maintain that growth will most likely fall in the 6.6-6.7% bracket. Signs of weakness in global economy (US, Europe, Japan), uncertainty in the timing of Fed rate cuts, and impact of El Nino on our Rabi sowing remain key risks to our growth forecast. Faltering agriculture growth can in turn have an impact on rural demand and corporate profits. We thus remain cautious and await more information on Rabi sowing to gauge the impact on GDP.

- We continue to maintain our view that inflation will swing between 5-5.5% in FY24, broadly in line with RBI's 5.4% inflation forecast. As pointed out by the central bank, we also believe that upside pressures can emerge from volatility in food prices and international crude oil prices. Weaker than expected Rabi sowing can push prices of Wheat, pulses and spices higher. Global sugar and rice prices are already a cause of concern. However, efficient supply chain management by the government and subdued global commodity prices can help provide some cushion.

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