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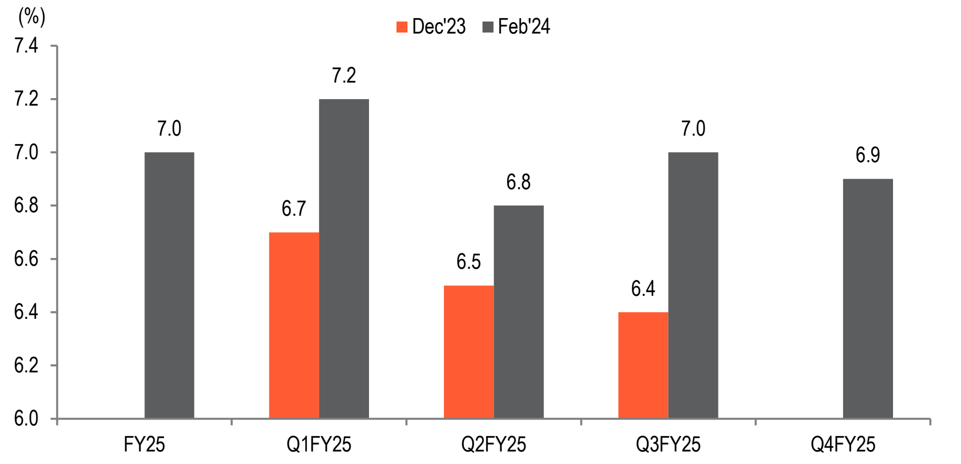
RBI remains on hold

MPC members for the 6th 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. However these decisions were not unanimous, and were passed with the vote of 5-1. Central bank highlighted that interest rate transmissions are still not complete and inflation is yet to be brought down to targeted level on a durable basis. Hence, RBI's stance should be viewed in this context, and "mix of instruments" will be used by the Central Bank to manage the liquidity situation. RBI expects GDP growth to remain at solid 7% in FY25, supported by government capex, domestic consumption and corporate profits. Inflation is projected to come down to 4.5% in FY25 from 5.4% in FY24, due to satisfactory Rabi sowing, dip in vegetable prices and expectation of a normal monsoon in FY25. We foresee no change in RBI's position before Aug'24. However, in case inflation surprises on the downside, then a tweak may be expected in Jun'24 policy.

No change in policy: In line with our expectation, RBI decided to remain on hold, thus keeping the repo rate unchanged at 6.5%. Subsequently, SDF rate remains at 6.25% and MSF and Bank rate at 6.75%. Stance was also retained at "withdrawal of accommodation". However, both decisions were not unanimous and were passed with 5-1 vote. Amongst MPC members, Prof Jayanth R. Varma voted for 25bps cut in policy rate and change in stance to "neutral". Governor Das highlighted that RBI's stance "should be seen in the context of incomplete transmission and inflation ruling above the target of 4% and our efforts to bring it back to the target on a durable basis". We thus expect earliest possible change in RBI's position only in Jun'24, that too if inflation falls significantly below RBI's expectations. If inflation follows RBI's trajectory then no change in position can be expected before Aug'24.

GDP growth: Following 7.3% growth in FY24 (as per NSO's advanced estimates), RBI expects 7% growth in FY25. Quarterly projections have also been revised upward, with growth in Q1 now estimated at 7.2% (versus 6.7% in Dec'23 policy), Q2 at 6.8% (6.5% earlier), Q3 at 7% (6.4% earlier) and Q4 at 6.9%. Robust growth in FY25 predicted on the back of: resilience shown in services activity, continued profitability of the manufacturing sector, likelihood of increased consumption demand, steady Rabi sowing, and government retaining focus on capital expenditure. Downside risks may emerge from escalation of geopolitical tensions and volatility in international financial markets. We believe RBI's FY25 growth projection to be slightly more optimistic and retain our estimates at 6.75-6.8%.

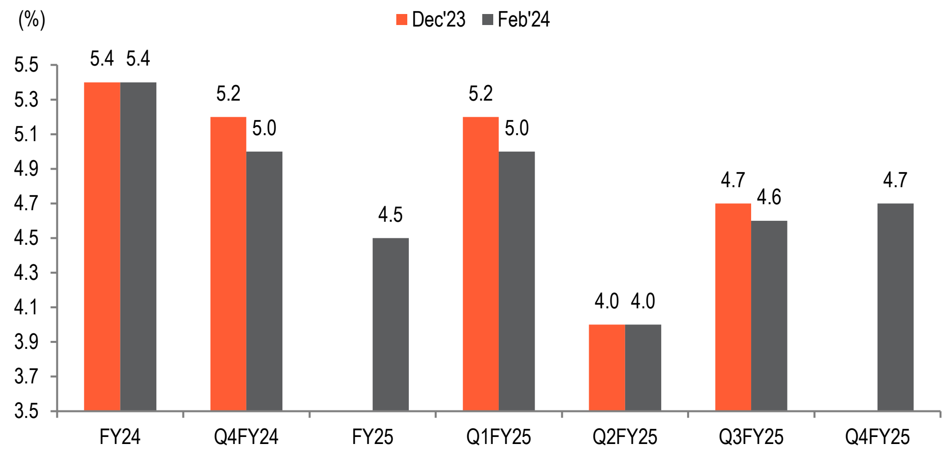
Figure 1: RBI's FY25 growth projections revised upwards



Source: RBI, Bank of Baroda Research

Inflation projections lowered: For FY24, RBI has retained its projection at 5.4%, however it has lowered Q4FY24 estimate from 5.2% (Dec'23 policy) to 5%. For FY25, the Central Bank expects inflation to come in at 4.5%, with Q1 at 5% (5.2% as per Dec'23 policy), Q2 at 4% (unchanged from Dec'23), Q3 at 4.6% (4.7% earlier) and Q4 at 4.7%. The downward revisions have been made as RBI remains confident that Rabi sowing has been satisfactory this season, and vegetable prices are also on a downward trajectory now. Further, these numbers are also based on the assumption of normal monsoon in FY25. Upside risks to these forecasts may emerge on account of volatility in international commodity price and in particular oil prices. Ongoing geopolitical tensions may impact supply chains, which could in turn have impact on global commodity prices.

Figure 2: Headline CPI expected to be closer to RBI's target in FY25



Source: RBI, Bank of Baroda Research

Impact

- As RBI's policy statement was broadly in line with market expectations, 10Y yield is currently trading at 7.08%. Governor again reiterated that the Central Bank is focused on bringing inflation back to 4% level on a durable basis and any change in stance should be looked at from the point of view of inflation and "incomplete transmission" of rates.

- On the liquidity front, RBI noted that "adjusted for government cash balances, potential liquidity in the banking system is still in surplus". Further, Governor clarified that liquidity conditions are "being driven by exogenous factors" and RBI's stance should not be linked with this. To "correct" liquidity conditions, RBI will continue with its "market operations". For instance, with government spending again picking up pace, RBI conducted VRRR auctions between Feb 2-7 to absorb surplus liquidity. Going forward, RBI will "deploy an appropriate mix of instruments to modulate both frictional and durable liquidity".

- We believe that RBI's upward revision to GDP projection for FY25 (7%) is slightly more on the optimistic side and we maintain that growth will most likely fall in the 6.75-6.8% bracket. We remain cautious on account of domestic agriculture growth and possible impact of geo-political tensions hampering global supply chains. In addition, expected slowdown in global economy, due to increased chances of 'soft landing' of the US economy, continued weakness in Eurozone and China's economy, along with uncertainty in the timing of Fed rate cuts, may also hurt external demand. We await more information on monsoon forecasts for this year to gauge the impact on GDP.

- We expect inflation to swing between 4.5-4.75% in FY25, broadly in line with RBI's 4.5% inflation forecast. As pointed out by the central bank, we also believe that upside pressures can emerge from volatility in global commodity prices, in particular international crude oil prices. Any deviation from normal monsoon can also have an impact on domestic food prices.

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