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# RBI maintains status quo

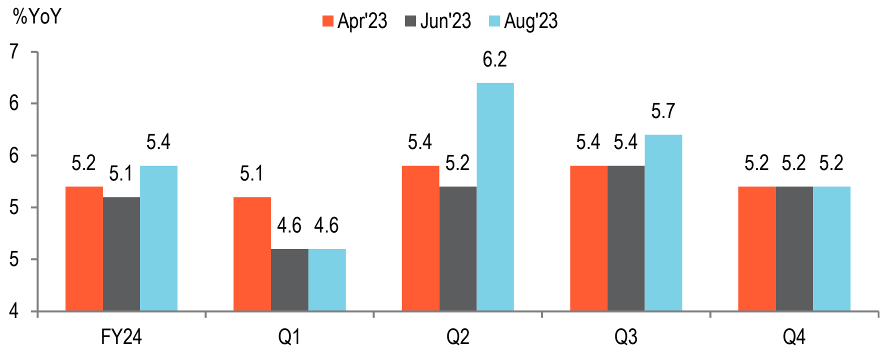
In a unanimous decision, MPC members have decided to keep the policy rates on hold, with this, repo rate remains unchanged at 6.5%, SDF at 6.25% and MSF and bank rate at 6.75%. With a vote of 5-1, RBI has also planned to continue with stance of "withdrawal of accommodation". Governor noted that given the uncertainty in inflation outlook, RBI remains prepared to act accordingly 'if situation warrants'. He insisted that MPC remains focused and committed on ensuring that inflation aligns with the target level, while supporting growth. *Today's statement had a hawkish tilt with inflation projection revised upwards and we therefore expect no rate cut in FY24.* The earliest possibly of rate cut has now shifted to Q1'FY25, with likelihood of a possible rate hike also on the table.

**Status quo:** In line with our expectation, RBI for the 3rd time in a row has decided to keep repo rates unchanged at 6.5%. With this announcement, the SDF rate continues at 6.25% and MSF and Bank rate at 6.75%. It was noted that going ahead, higher kharif sowing, buoyant service sector and growing consumer optimism will support household consumption. Furthermore, business optimism, healthy corporate balance sheet and pick up in government capex will play an important role in renewal of capex cycle. RBI noted the external headwinds from slowing global demand, coupled with volatility in financial market evolving geopolitical conditions across the globe continue to pose risk to overall outlook.

**Inflation projections revised upwards:** For FY24, *RBI has revised its projection upwards by 30bps to 5.4% from 5.1% in Jun'23. This is largely on account of sharp rise in the forecasts of Q2FY24 revised up 6.2% from 5.2% earlier, higher projection for Q3 (5.7% versus 5.4%). Estimates for Q4 have been retained at 5.2%. Notably, inflation for Q1FY25 has been projected at 5.2%* with risk evenly balanced. The upside pressure on the headline inflation trajectory in the near term is on the back of spike in the vegetable inflation in the near term. Though some moderation is expected with arrivals of fresh goods. These forecasts are based on the assumption of normal monsoon. RBI emphaised that it will remain vigilant on any shocks on account of supply disruptions due to adverse weather conditions. It will remain proactive and ensure the impact of any such shocks on price level will not persist. RBI also noted of risk emanating from El Nino, higher global food prices due to global uncertainties and uneven distribution of South-West Monsoon. Against this, MPC will closely track the evolving inflation scenario and bring the inflation to the target and anchor inflation expectations.

However, given surplus liquidity in the system is on the rise, the RBI has announced the introduction of an incremental CRR increase of 10%. This will be on incremental deposits over May 19th when the withdrawal/exchange of the Rs 2000 note was announced. This will impound liquidity and hence in a way act as a tightening measure. Therefore, a hawkish tinge is added to the policy.

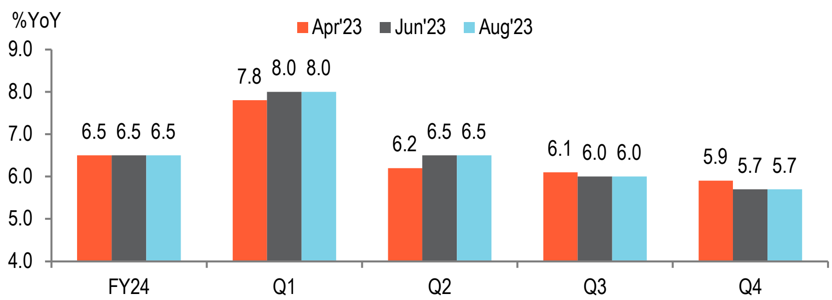
**Figure 1: Headline CPI forecast hiked to FY24**




Source: RBI, Bank of Baroda Research

**GDP growth unchanged:** RBI retained its GDP forecast for FY24 at 6.5%, unchanged from Jun'23 projections as aggregate demand conditions continue to remain buoyant. Risks continue to be broadly balanced with Q1FY25 GDP growth projected at 6.6%. The overall economic activity remains positive. On supply side, sowing activity has picked up pace even as spatial and temporal distribution of rainfall continues to remain uneven. Some of the high frequency indicators such as for urban demand including air passenger traffic, passenger vehicle sales and for rural demand, factors such as tractor and fertilizer sales have been reflecting sustained growth. Additionally, improvement in agriculture credit, and higher sales volume for FMCG goods will aid in recovery of rural demand. On the back of the pick-up in government capex, revival in private capex and growing business optimism, investment activity is expected to show improvement. Downside risk have been reflected through weaker exports, contraction in non-oil-non-gold imports, given the slow external demand. However, RBI remains confident that India is much better equipped to withstand any external demand headwind compared to its global counterparts.

**Figure 2: RBI growth projections**




Source: RBI, Bank of Baroda Research

**Impact**

- The incremental change of NDTL between 19 May 2023 and 28 Jul 2023 is around Rs 10 lakh crore. Considering 10% of the amount, which is around Rs 1 lakh crore, which is required to be maintained as incremental CRR. If the same is invested in SDF with a yield of 6.25%, then Rs 520 crore turns out to be the opportunity cost for banks.

- We expect GDP growth at 6.3% from the previous projection of 6-6.5% for FY24. We remain watchful as we closely track any possible risk from El Nino and uneven distribution of rainfall. Moreover, weak external demand, uncertainty over global central bank rate action along with tight global financial conditions, remain a key risks to our growth forecast.

- We expect inflation at 5.5% in FY24 from a previous expectation of 5-5.5%. RBI's inflation forecast of 5.4% is a tad lower than our estimate despite revising its projection upwards. Lower acreage of pulses might have some impact on inflation too going ahead, in addition to the vegetable spike likely in the near term. However, inflation is expected to moderate in Q3 and Q4 which will offer some respite.

- With the objective to strengthen consumer protection and offer more transparency, RBI has announced reset of interest rate of EMIs based on floating interest rate. This will offer the option to switch to fixed rate or foreclosure and provide clarity to borrowers to change or reset the tenor and EMIs. We don't think there will much shift to a fixed regime as interest rates are expected to come down though in FY25 and not FY24.

- There has been a review of the regulatory structure for IDFs such as enabling borrowings from ECBs amongst others. This will help to enhance flow of funds to the infra sector which is necessary to accelerate growth in the economy.

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