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RBI maintains status quo

RBI's policy came out on expected lines with both stance and rates being kept on hold. Growth and inflation estimates have also been retained at the same level and 6.5% and 5.4% respectively, for FY24, from its Aug'23 policy projections. This policy again reiterated the 4% target band as inflation and highlighted on being vigilant towards the same. It has stressed the need to carefully monitor recurring incidence of overlapping price shocks and persistence and generalization of the same. In that context, spillover from global food and energy shock cannot be ruled out.

Governor's statement also signaled some tightening liquidity conditions going forward and highlighted that liquidity distribution in the banking system has remained skewed.

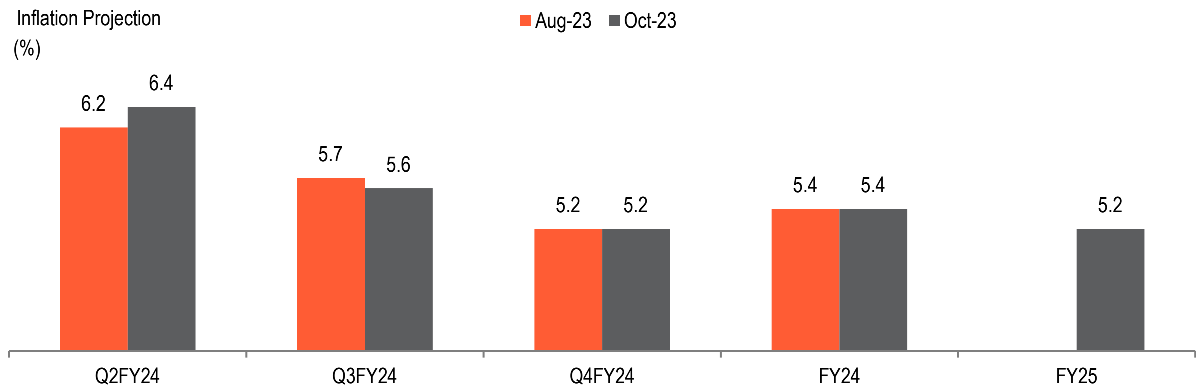
The 10Y yield inched up to 7.34% compared to its yesterday's close of 7.22%, as RBI has kept the option of OMO sales open.

Overall we retain our forecast of 5.5% for CPI in FY24, with some upside risk of ~0.15-0.25% from the ongoing festive demand, World Cup event and volatility in oil prices. Real GDP growth in FY24, is also retained at 6.3%, with current high frequency indicators holding up in a pretty balanced manner. We expect no rate action in FY24, as of now.

Status quo: In line with our expectation, RBI has decided to keep repo rate unchanged at 6.5%. Even 5 out of 6 MPC members have kept the stance of monetary policy unchanged at 'withdrawal of accommodation'. Growth and inflation projections have been retained at the same level as last policy.

Inflation projections retained: *RBI has kept headline CPI projection for FY24 unchanged at 5.4%. However, the quarterly trajectory have been slightly revised. Q2 projection has been revised upward by 20bps to 6.4% from 6.2% earlier, Q3 projections on the other hand have been revised downward by 10bps to 5.6% from 5.7% estimated in Aug'23, Q4 projection has been retained at 5.2%. For FY25, CPI is expected to moderate to 5.2%.* The policy has reiterated that 4% is the target band for inflation and MPC will be vigilant towards achieving the same. The upside risks that have been highlighted are lower sowing putting price pressure on pulses, oilseeds. Apart from this lower reservoir level might be a deterrent on Rabi sowing going forward. Even the spillover from global food and energy price shock cannot be ruled out entirely.

Figure 1: Headline CPI forecast for some quarters altered, FY retained at 5.4%



Source: RBI, Bank of Baroda Research

GDP growth unchanged: RBI retained its GDP forecast for FY24 at 6.5%, unchanged from Aug'23 projections. Even all the quarterly forecasts have been retained at the same level, with Q2 at 6.5%, Q3 at 6.0%, Q4 at 5.7% and Q1FY25 at 6.6%. The policy remained bullish on growth re-emphasizing the resilience of Indian economy amidst uncertain global environment. It clearly signaled tightening global financial conditions, rising geopolitical tensions, deteriorating external environment as key downside risks to growth. On the other hand, stable urban and rural demand as well as healthier government capex and bank's balance sheet would support recovery going forward.

Liquidity conditions: The policy document stated that liquidity conditions have moderated due to the combined impact of incremental CRR (I-CRR), and advance tax outflows related payment for Sep quarter. Apart from this, it is highlighted that distribution of liquidity in the banking system has remained skewed and this was reflected in the movement of operating target of monetary policy-the WACR. It has been reiterated in the Governor's statement that 'it is desirable for banks to explore lending opportunities in the inter-bank call market rather than passively parking funds in the SDF at relatively less attractive rates.'

Apart from this, it has been pointed out that generally with higher currency demand due to festive demand, liquidity pressure widens. Further, RBI has signaled that the option of OMO sales contingent on the evolving liquidity conditions have been kept open. Currently liquidity is in deficit of Rs 34, 061 crore compared to Sep'23 level of average deficit of Rs 17,799 crore.

Impact on 10Y yield: India's 10Y yield rose to 7.34% compared to yesterday's close of 7.22%, this increase of more than 10bps, tantamount to RBI's option of keeping OMO sales open.

Important Regulatory Developments:

- RBI has decided to strengthen and harmonise the extant regulatory framework governing project finance, which face issues particularly with regard to having lengthier gestation periods. The Prudential Framework for Income Recognition, Asset Classification and Provisioning pertaining to advances for Project Under Implementation is going to expedite the process in near term.
- In an effort to harmonise the credit concentration norms among NBFCs, RBI has permitted NBFCs in the Middle and Base Layers as well to offset their exposures with eligible credit risk transfer instruments which were earlier permitted for Upper Layer only.
- In an effort to promote digitization at the grass root level, the Payments Infrastructure Development Fund (PIDF-scheme) has been proposed to be extended till 31 Dec 2025. Also, it is proposed to include beneficiaries of PM Vishwakarma Scheme in all centres under the PIDF Scheme.
- For ensuring efficient and fair resolution of customer complaints by enabling an apex level review, a master direction on Internal Ombudsman mechanism in Regulated Entities will be brought out.

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