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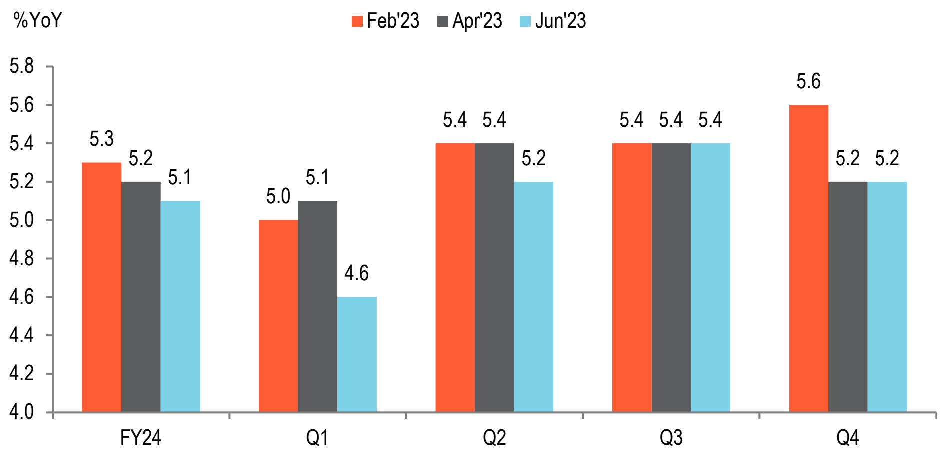
# RBI remains on hold

*MPC members today again unanimously decided to keep the policy rates unchanged, with this, repo rate remains unchanged at 6.5%, SDF at 6.25% and MSF and bank rate at 6.75%. RBI also maintained its stance of "withdrawal of accommodation" with the vote of 5-1. Governor Das insisted that as inflation is expected to remain above RBI's comfort level in FY24, thus the central bank will remain data dependent for future course of action. Also, following the demonetization of INR 2000 note, liquidity is expected to remain in surplus for some time and thus change in stance was not warranted. Today's statement was in a way hawkish at the margin and we no longer foresee rate cut in Q3FY24. The earliest possibly of cut has now shifted to Feb'24.*

**Possible Hawkish tilt:** 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%. The Governor in his statement emphasized that "that headline inflation still remains above the target and being within the tolerance band is not enough. Our goal is to achieve the target of 4.0%, going forward". This signals that RBI is still uncomfortable with above 5% inflation in FY24. Also, the bank expects inflation to peak in Q3FY24, thus making the possibility of the rate cut in Q3 highly unlikely. We now expect a cut in Q4. The stance was also left unchanged with a vote of 5-1, sighting that liquidity still remains in surplus and demonetization of INR2000 notes will further add to this. Thus, RBI is focused on "withdrawal of accommodation".

**Inflation projections lowered:** For the current fiscal year (FY24), RBI has further lowered its projection to 5.1% from 5.2% in Apr'23. This is largely on account of sharp downward revision to Q1FY24 forecast (4.6% versus 5.1% in Apr'23), and slight change to Q2 projection (5.2% versus 5.4%). Estimates for Q3 and Q4 have been left unchanged. Statistical base will be at play in Q1 and Q2, due to which these revisions have taken place. However, looking at RBI's current trajectory for CPI, inflation will go on gradually increasing till Q3 (peak), before slowing down in Q4. These forecasts assume normal monsoon. However, upside risks to these forecasts also exists. Spatial and temporal distribution of rainfall will be critical in deciding the trajectory of food inflation. Further, international commodity prices (sugar, rice, crude oil) and domestic prices of milk also pose threat to headline CPI. In addition, as investment activity is expected to pick up, that might create demand side pressure on prices. As a result, RBI has reiterated its commitment to bring inflation down to 4% on a durable basis.

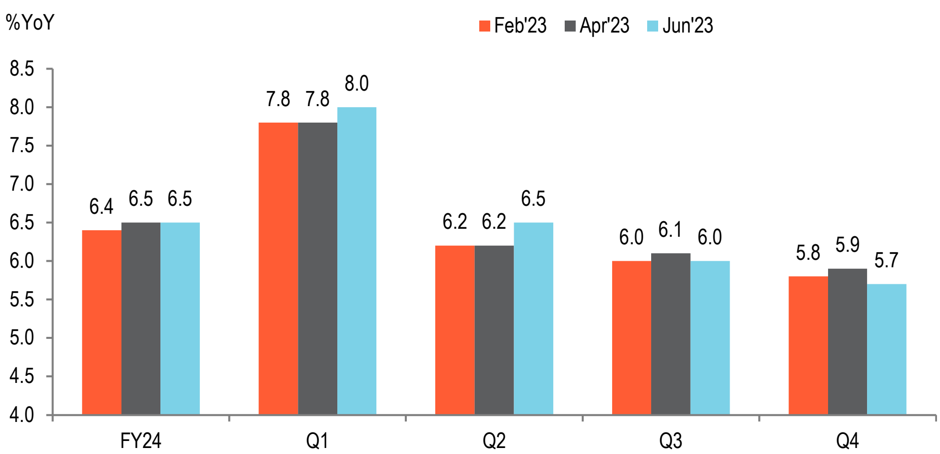
**Figure 1: Headline CPI forecast lowered further for FY24**




Source: RBI, Bank of Baroda Research

**GDP growth unrevised:** RBI continues to remain bullish on growth by maintaining its GDP forecast for FY24 at 6.5%, unchanged from Apr'23 projection. It has revised its estimates upward for Q1 (8% versus 7.8%) and Q2 (6.5% versus 6.2%), and downward for Q3 (6% versus 6.1%) and Q4 (5.7% versus 5.9%). This trajectory also supports our view that RBI is unlikely to cut rates until Q3FY23 and the window for rate cut opens only in Q4, when growth begins to slow down. RBI expects economy to do well as domestic activity continues to remain resilient so far (PV/2-wheeler sales, credit card outstanding, air passenger traffic growth). Pick up in government capex, RBI's survey results showing "higher investment intentions", and "healthy balance sheets of banks and corporates", will also aid higher growth. Downside risks highlighted by the bank include: below normal monsoon, weaker than anticipated global demand, global financial sector volatilities and prolonged geopolitical tensions.

**Figure 2: RBI growth projections**




Source: RBI, Bank of Baroda Research

**Impact**

- Despite RBI maintaining status quo, 10Y G-sec yields have inched up marginally by ~3bps but reverted subsequently. Slightly more hawkish than expected statement from the Governor and emphasis on achieving the target of 4% inflation has pushed our rate cut call from Q3FY24 to Q4FY24 (Feb'24). This implies rates will have to remain elevated for longer than earlier anticipated. No change in stance was in line with expectations as liquidity remains in surplus.

- We expect liquidity to also get support from government's recent decision to demonetize INR 2000 notes. This is move is expected to increase liquidity at least on temporary basis. Our estimates show that depending upon percentage of INR 2000 notes deposited in the bank (25%/50%/75%), liquidity may go up by Rs 0.9-2.7 lakh crore. This will help keep movement in 10Y bond yields range bound, and we expect yields to trade between 6.05-7.05% in the near term.

- We continue to maintain our view that GDP growth projection of 6.5% is on the higher side of the range projected by us at 6-6.5%. Weakness in global demand, tight global financial conditions, uncertain trajectory of Fed rate action, and possibility of below normal monsoon remain key risks to our growth forecast. Further, if core inflation remains sticky then it may impact private consumption. We thus remain cautious and await more information on monsoon forecasts to gauge the impact on GDP.

- We expect inflation to swing between 5-5.5% in FY24. RBI's inflation forecast of 5.1% is lower than our base case projection of 5.25%. In the worst case scenario, if monsoon disappoints/adverse climate conditions persist, international commodity prices inch up, inflation may touch 5.5%. However, in such a scenario, we expect government to intervene to smoothen the supply of essential food items and avoid any major spike in prices.

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