3 Jun 2024

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Economist

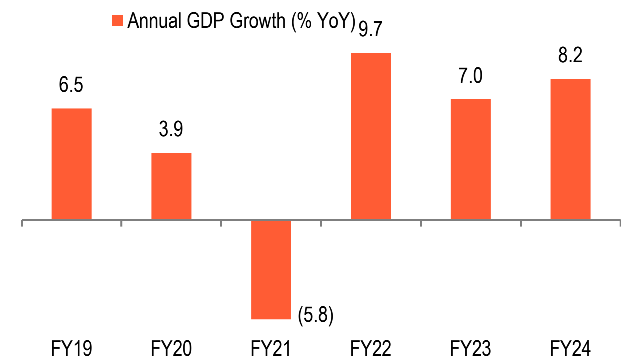
RBI to hold rates

In the upcoming credit policy meet of RBI, which is scheduled on 5-7 Jun 2024, we expect MPC to maintain status quo. No change in stance is also expected, as RBI will keep liquidity tight to keep short-term rate higher and support INR. Liquidity deficit may ease as elections come to an end government spending will see a pick up in the coming months. Further, upward revision to RBI's GDP forecast for FY25 can be expected. CPI forecasts may not change as of now.

What has changed since the last policy?: Since the last policy, RBI will be evaluating performance of economic activity, trends in inflation, arrival of monsoon, movement of domestic high frequency indicators and international oil prices, and global developments.

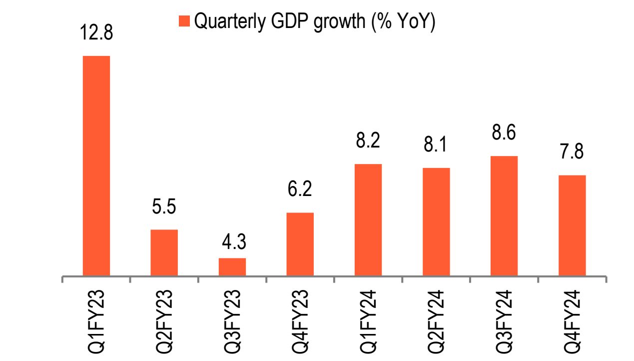
Domestic growth scenario: Latest data released by Mospi shows that economic activity continues to remain resilient with annual GDP growth for FY24 revised upward from 7.6% as per second advanced estimates to 8.2% as per provisional estimates. This is also higher than 7% growth registered in FY23. The correction was driven by upward revision to growth estimates for manufacturing, agriculture, finance/real estate/professional services, and public admin and defence. In Q4FY24 however, slight moderation was noted as GDP growth eased to 7.8% from upwardly revised 8.6% in Q3 (8.4% earlier). Sectors contributing to the drag were mining, manufacturing, utilities, construction, and trade & hotels. On the other hand, agriculture, finance/real estate/professional services, and public admin and defence performed well.

Figure 1: Annual GDP Growth



Source: CEIC, Bank of Baroda Research

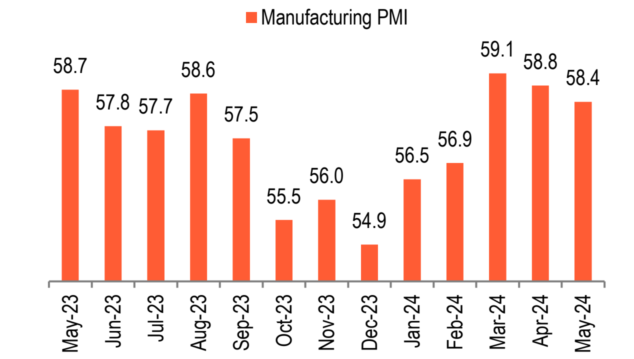
Figure 2: Quarterly GDP Growth



Source: CEIC, Bank of Baroda Research

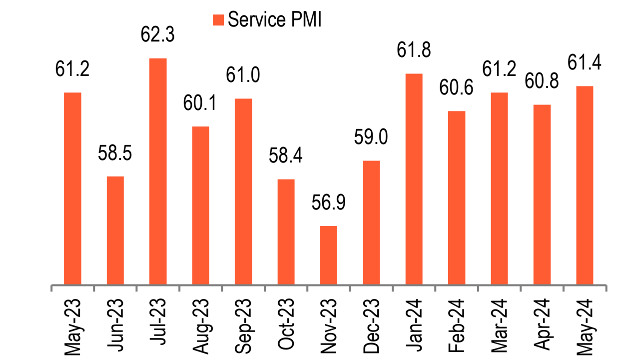
High-frequency indicators: In Q1FY25 so far (Apr/May'24), economic activity is signalling mixed trends. While some of the indicators such as, manufacturing PMI and vehicle registration are showing slight moderation, other indicators such as services PMI, air passenger traffic, GST collections, are indicative of continued momentum. Centre's overall tax collections (both direct and indirect) have also been robust. Net revenue collections has seen double digit growth in Apr'24 (16.4%), following decline noted in Apr'23 (-13.9%). As economic activity remains broadly resilient, RBI will remain in wait and watch mode. We believe that RBI may revise its GDP projections upward in the upcoming policy meet.

Figure 3: Manufacturing PMI close to last year's level



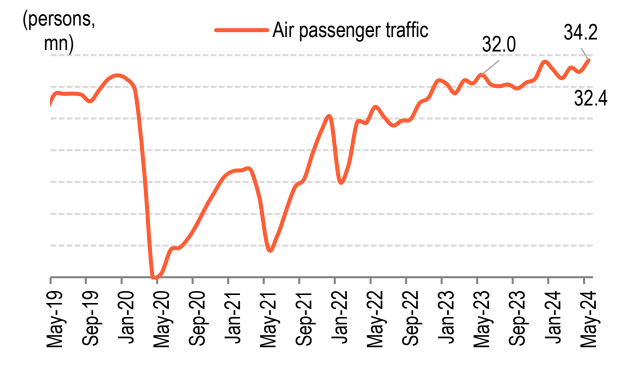
Source: Markit, Bank of Baroda Research

Figure 4: Services PMI higher than last year



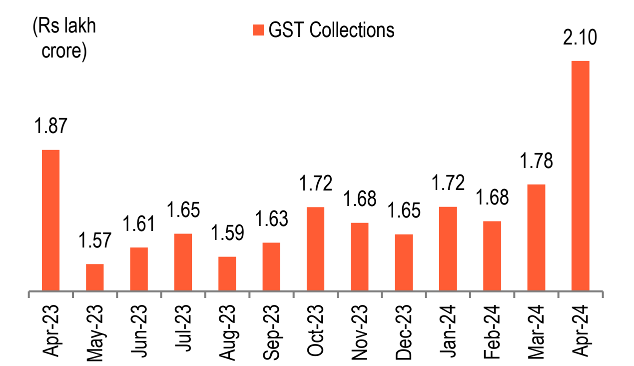
Source: Markit, Bank of Baroda Research

Figure 5: Air passenger traffic higher than last year



Source: CEIC, Bank of Baroda Research

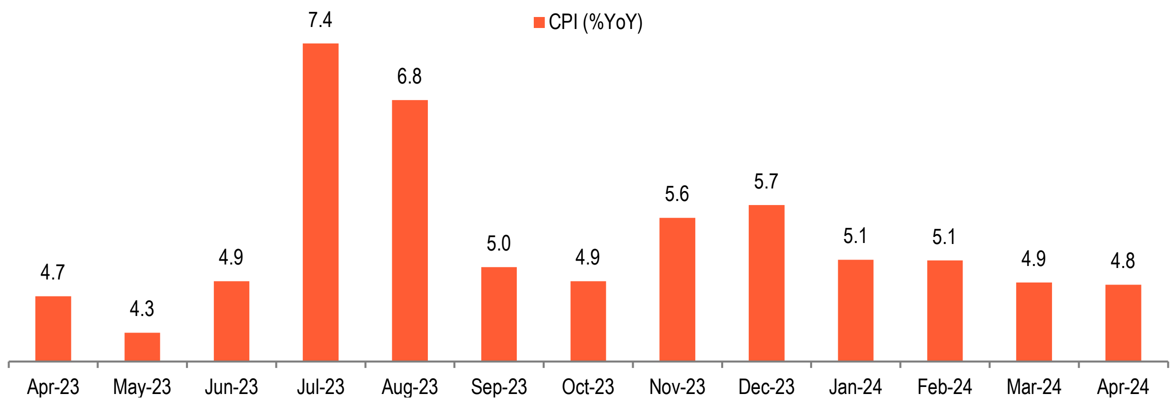
Figure 6: GST collections at record high



Source: CEIC, Bank of Baroda Research

Domestic inflation scenario: Latest CPI print for Apr'24 shows that inflation remains broadly sticky at 4.8% versus 4.9% in Mar'24. As per RBI's Apr'24 policy statement, the central bank expects inflation to average at 4.9% in Q1 and the come down to 3.8% in Q2. However, this is based on assumption of a normal monsoon. In view of prevailing heat wave conditions in most parts of the country, inflation in May'24 is also expected to remain broadly unchanged from previous months. On the positive front, vegetable prices are beginning to show some moderation and IMD has recently declared onset of monsoon in Kerala and has even predicted above normal rainfall for this year. On the other hand, key upside risks persist owing build-up in oil prices (+9.6% YoY in May'24 versus +6.8% in Apr'24) and other commodity prices such as aluminium, copper and gold. Our study shows that US$10/bbl increase in oil prices, leads to 40-60bps increase in CPI. It is to be seen if RBI will revises its current inflation forecast of 4.5% for FY25.

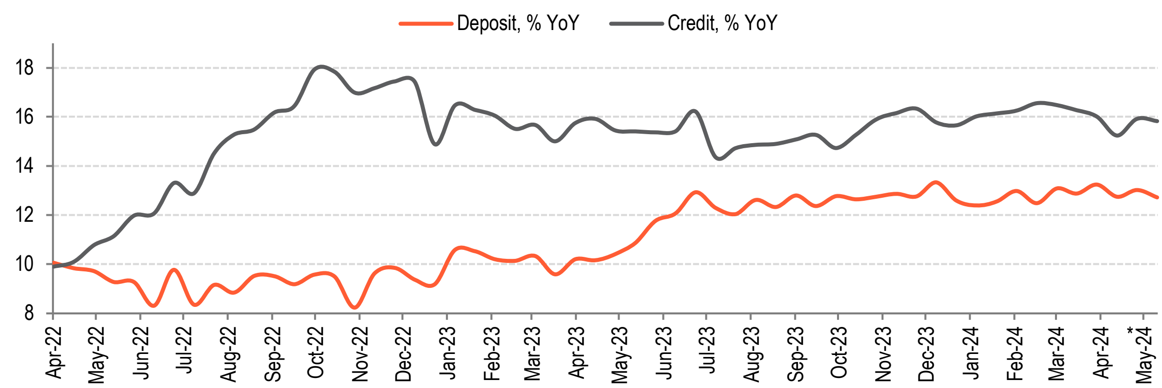
Fig 7: CPI still sticky



Source: CEIC, Bank of Baroda Research

Banking sector growth: Bank credit (excluding the impact of HDFC merger) continues to maintain a healthy pace of growth at 15.8% as of 17 May'24, compared with 15.4% as of 19 May'23. At the start of Q1FY25 (Apr'24), credit to services sector (19.2% versus 21.3% in Apr'23) and industry (6.9% versus 7.2%) noted slight moderation, but still remain relatively healthy. Credit growth in personal loan segment also registered some easing, but still remains in double digit (17.4% versus 19.4%). On the other hand, deposit growth has witnessed much sharper improvement as it rose by 12.7% as of 17 May'24, compared with 10.9% increase as of 19 May'23. Increase in deposit rates by banks has helped.

Fig 8: Credit and Deposit growth



Source: RBI, Bank of Baroda Research| * Data as of 17 May 2024

Transmission of rates: In measuring how transmission of interest rates as of Apr'24 across different spectrum have fared, the change is taken from Apr'22 just before RBI embarked on the journey of rate hikes, to control inflation. The transmission of interest rates is better for PSBs relative to PVBs.

In case of PSBs, the transmission on fresh term deposits has seen an increase of 240bps. On the lending side, transmission still remains as WALR has risen by 208bps. For PVBs the increase on fresh deposits is lower at 218bps and that on loans is at 160bps. In FY24, fresh term deposit rates rose by 15bps in case of PSBs and by 8bps in case of PVBs. In FY24, weighted average lending rates rose by only 1bps in case of PSBs and by 21bps in case of PVBs.

Table 1. Fresh term deposit and lending rates

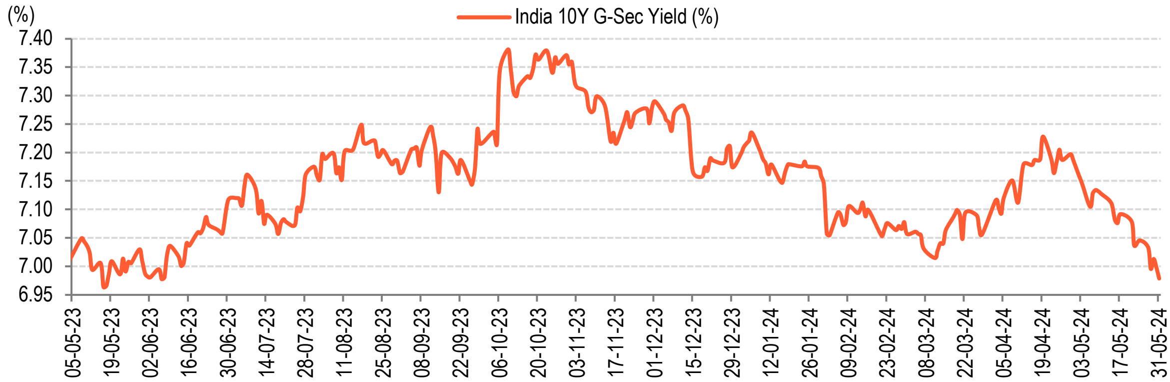
Transmission of rates	Apr'22	Apr'23	Apr'24
WADTDR: PSBs	4.32	6.68	6.72
WADTDR: PVBs	4.39	6.48	6.57
WALR: PSBs	6.77	8.49	8.85
WALR: PVBs	8.53	9.68	10.13

Source: RBI, Bank of Baroda Research

System liquidity: On an average, liquidity has remained in deficit in the month of May'24 (till 30 May) at Rs 1.42 lakh crore, compared with a surplus of Rs 20,240 crore in Apr'24. A part of reason for pressure on liquidity is limited government spending during the period of general election. We expect RBI to maintain tight liquidity in the coming months as well, to maintain pressure on short-term yields, which may in turn support INR. Thus we expect RBI to keep its stance—"withdrawal of accommodation"—unchanged in the Jun'24 policy.

Softening sovereign yields: Since the last policy, yields on 10Y G-sec have fallen by ~14bps and are currently trading around the 6.98% mark, compared with 7.09% before the Apr'24 policy. Bond buyback announced by the central government, limited borrowing in weekly auctions, and improved prospects of normal monsoon in the country, have supported domestic yields so far.

Fig 9: India 10Y G-Sec Yield



Source: Bloomberg, Bank of Baroda Research

Global developments: Macro data for US economy still shows resilience in domestic activity. Consumer confidence is up, jobless claims remain range bound, and industrial production is showing signs of revival and survey results of manufacturing and service sector companies is also hinting at steady domestic demand. Further, inflation remains sticky. In view of this, uncertainty around Fed cutting rates remains with CME FedWatch tool showing 47% probability of rate cut in Sep'24/Nov'24 and 40% in Dec'24.

Where do our forecasts stand?: Looking at the factors mentioned above, we believe that growth fundamentals still remain strong. Key uncertainty remains around the spatial distribution of rainfall during the monsoon season and impact of severe heat wave on food prices. Rise in international oil and other commodity prices remains an additional concern.

1. We expect GDP growth to moderate to ~7.3-7.4% in FY25. Our slightly higher than RBI's 7% growth forecast is based on premises of recovery in consumption and private investment.

2. We expect headline CPI to settle at ~4.5-5% in FY25, with risks tilted to the upside. Ongoing heat conditions in the country and trajectory and timing of monsoon rains in major crop growing states will be critical. Further, considering retail inflation has remained sticky so far, we await RBI's decision to revise its current forecasts (4.5% for FY25).

3. On the external sector side, INR has depreciated further by 0.2% since the last policy, as US$ has strengthen further (DXY is up by 0.4% during the same period). INR is currently hovering around 83.5/$ mark. As US economy is continuing to show signs of strength in certain sectors, chances of Fed cutting rates aggressively this year have dwindled. This has supported dollar strength. Further, increase in oil prices may also impact our CAD, which is further putting strain on INR. We expect it to trade in the range of 83-83.50/$ in the next fortnight.

4. Under these conditions, we expect RBI to maintain status quo on rates and stance. We do not expect any significant announcement on liquidity front either. We also do not expect any change in stance of "withdrawal of accommodation" by RBI.

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