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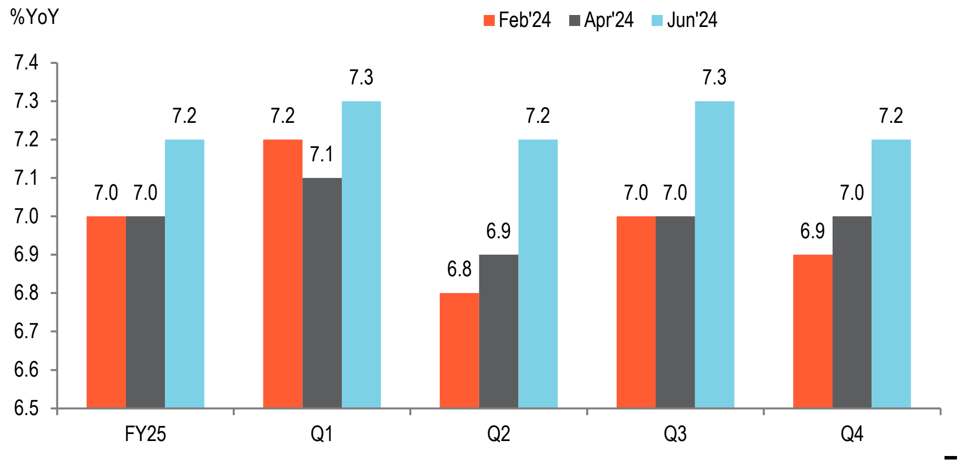
RBI retains rates

MPC for the 8th 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 4-2, compared with a vote of 5-1 in Apr'24 policy. Dr Goyal joined Dr Varma in voting for 25bps cut and change in stance to neutral. However, Governor highlighted that interest rate transmissions are still not complete and inflation expectations still need to be anchored to targeted level. In this context, stance was left unchanged. RBI revised its GDP growth projections upward from 7% earlier to 7.2% now (closer to our estimates of 7.3-7.4%), supported by government capex, domestic consumption and corporate profits. Inflation projection was retained at 4.5% for FY25, awaiting more information on spatial distribution of rainfall in the coming months. We foresee no change in RBI's position before Oct'24, that too if monsoon is normal and supportive of food inflation.

Status Quo: 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 4-2 vote, a change from 5-1 vote in Apr'24. Dr. Goyal and Prof Varma voted for 25bps cut in rates and change of stance to neutral. Governor Das stressed stance has been left unchanged in order to "anchor inflation expectations" and for "fuller policy transmission". We continue to expect earliest possible change in RBI's position only in Oct-Dec'24 period, that too if rainfall is adequate this year and inflation falls significantly below RBI's expectations.

GDP growth: Following 8.2% growth in FY24 (up from 7.6% as per NSO's advanced estimates), RBI has upwardly revised its FY25 GDP projection to 7.2% (7% as of Apr'24 policy). Quarterly projections have also been revised higher, with growth in Q1 now estimated at 7.3% (versus 7.1% in Apr'24 policy), Q2 at 7.2% (6.9% earlier), Q3 at 7.3% (7% earlier) and Q4 at 7.2% (7% earlier). Robust growth in FY25 is predicted on the back of: sustained momentum in urban demand (PV sales, air passenger traffic); revival in rural demand (2-wheeler sales, decline in MGNREGA demand); continued improvement in investment activity (steel consumption, cement/capital goods production, government led infrastructure development and PLI scheme investments) and robust credit growth. Going forward, above normal monsoon is likely to support Kharif output and thus boost rural demand further. Expansion in services sector will be driven by urban consumption. Government spending will also help investment activity.

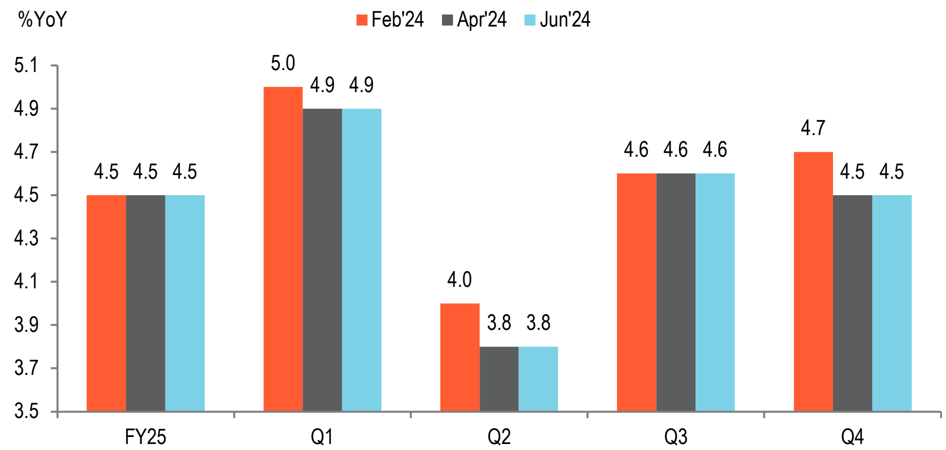
Figure 1: RBI's FY25 growth projections revised upwards



Source: RBI, Bank of Baroda Research

Inflation projections retained: For FY25, RBI has held its inflation projection at 4.5%. Even the quarterly projections remain unchanged, with Q1 at 4.9%, Q2 at 3.8%, Q3 at 4.6% and Q4 at 4.5%. No revisions have been made, as it is yet to be seen how IMD's above normal monsoon forecast for this season will play out. For the time being, RBI has taken note of upside risks to inflation emanating from ongoing heat wave conditions and low reservoir levels, putting pressure on summer vegetable and fruit crops. Further, current increase in global food and commodity (non-oil) prices, and volatility in oil prices, may also add to the pressure. However, in case of abundant rainfall, domestic pressures will dissipate, thus helping bring down cereal and pulses inflation. LPG price cut announced in Mar'24 is already helping disinflationary trend in fuel inflation, according to RBI.

Figure 2: Headline CPI forecasts for FY25 unchanged



Source: RBI, Bank of Baroda Research

Key regulatory developments:

- For SCBs (excluding RRBs) and SFBs, the bulk deposits limit was enhanced to "Single Rupee term deposits of Rs 3 crore and above, from Rs 2 crore above earlier (changed in 2019). For Local Area Banks, bulk deposits will now be defined as "Single Rupee term deposits of Rs 1 crore and above", same as RRBs.

- RBI will be setting up a Digital Payments Intelligence Platform which will harness advanced technologies to mitigate payment fraud risks. A committee will be constituted under the chairmanship of Shri A.P. Hota, former MD & CEO, NPCI, to examine various aspects of setting up a digital public infrastructure.

- Framework for processing of e-mandate has been widened from including recurring periodic transactions, to now also include recurring but non-periodic transactions. For instance, replenishment of balances in Fastag, NCMC etc. The automatic replenishment will be triggered when the balance in Fastag or NCMC falls below a threshold amount set by the customer.

- UPI-Lite has been included now in the e-mandate framework. Currently UPI Lite allows customers to maintain upto Rs 2,000 in their wallets and make payments upto Rs 500. Now, customers will also have the facility of auto-replenishment for loading the UPI Lite wallet, if the balance goes below a threshold amount set by the customer.

Impact of RBI's credit policy decisions:

- As RBI's policy statement was broadly in line with market expectations, 10Y yield is currently trading flat at 7.01%. Governor stressed that the Central Bank is focused on bringing inflation back to targeted levels while sustaining growth momentum. No change in stance should be looked at from the point of view of anchoring inflation expectations and still incomplete transmission of rates.

- On the liquidity front, RBI noted that liquidity has moved from deficit to surplus in early Jun'24. In order to remain "nimble and flexible in liquidity management and in view of the shifting liquidity dynamics" the central will continue conducting VRRR auctions to mop up the surplus, and VRR auctions to inject liquidity. Further, noting robust economic conditions in the country, RBI has retained risk provisioning under the contingent reserve buffer (CRB) at 6.5%. Going forward, RBI will "deploy an appropriate mix of instruments to modulate both frictional and durable liquidity".

- RBI's upward revision to GDP projection for FY25 (7.2%) is now closer to our previously forecasted growth estimate of 7.3-7.4% for the current fiscal year. Our baseline scenario assumes above normal monsoon (as predicted by IMD), which will augur well for rural demand. Further, with NDA government back in power, we also expect policy continuity. Hence, infrastructure development and focus on PLI schemes will remain, which is expected to boost investment activity. However, downside risks may emerge in the event of, lacklustre rainfall, heightened geo-political tensions, or more than expected slowdown in the US.

- We expect inflation to swing between 4.5-5% 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 ongoing heat-wave conditions in the country, rise in global food and commodity prices and volatility in oil prices. Any deviation from normal monsoon will also have an impact on domestic food prices.

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