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Sonal Badhan
Economist

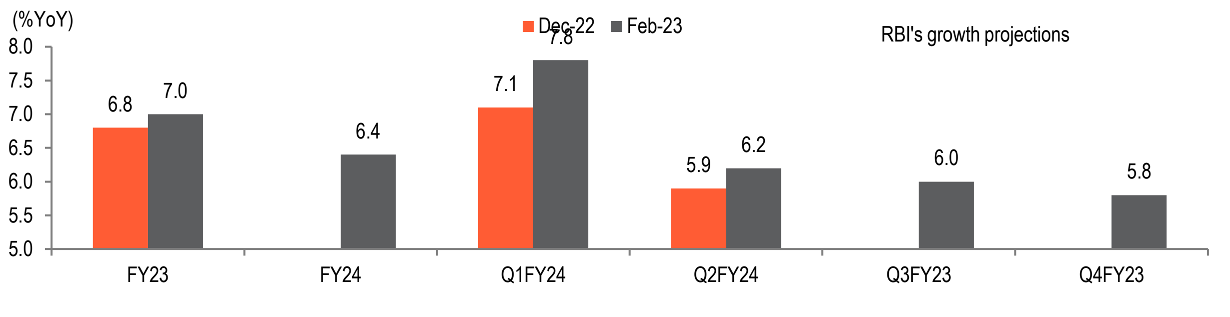
RBI to pause most likely in FY24

RBI has increased its policy rate by 25bps to 6.5%, taking the cumulative rate hike to 250bps since May'22. While the stance has been left unchanged against market expectation of changing it to "neutral", we still expect RBI to go on a prolonged pause now and also expect no rate cuts this year. Inflation next year is expected at 5.3%, with gradual increase expected towards end of FY24. Unless there is any significant deviation is noted in quarterly forecasts, we do not expect any rate hikes from RBI. Growth expectations for FY24 are more in line with Union Budget and Economic Survey. Our FY24 expectation for inflation (5-5.5%) and GDP (6-6.5%) are also in line with the central bank.

Monetary policy announcement: In line with our expectations, RBI hiked repo rate by 25bps today to 6.5%. Subsequently, SDF rate stands adjusted to 6.25% and MSF and Bank rate to 6.75%. Cumulatively, RBI has now raised repo rate by 250bps since May'22. The central bank has also decided to keep its focus on "withdrawal of accommodation", as against changing the stance to "neutral". This gives RBI the elbow room to hike rates in case of any price/external shocks.

GDP growth in FY24 to ease: Keeping in view that NSO is estimating 7% GDP growth in FY23 (higher than RBI's 6.8% forecast in Dec'22), RBI expects economy to slowdown in FY24. For next year, growth is estimated at 6.4%, in line with what economic survey and Union Budget are also expecting (BoB estimate: 6-6.5%). To meet this target, both Q1FY24 and Q2FY24 growth estimates have been revised upwards to 7.8% (7.1% as of Dec'22), and 6.2% (5.9% earlier), respectively. For Q3 and Q4, growth is estimated at 6% and 5.8% respectively. Downside risks to growth have been sighted as: weak global demand, tight financial conditions and ongoing geopolitical tensions.

Figure 1: RBI growth projections

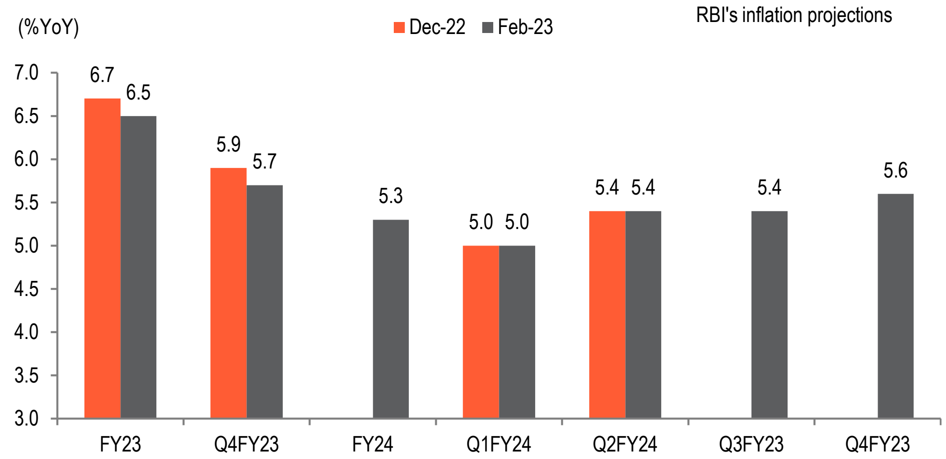


Source: RBI, Bank of Baroda Research

Inflation risks lowered: For the current financial year (FY23), RBI has revised its inflation projections downward by 20bps. It now expects CPI to average at 6.5% versus 6.7% estimated in Dec'22. This takes into account sharp dip in inflation in Nov-Dec'22 (-105bps from the peak of Oct'22) on account of food inflation, and drop in international crude oil prices. As a result, CPI in Q4FY23 is projected at 5.7% (5.9% earlier). Going ahead, oil prices are expected to average at US$ 95/bbl, down from US$ 100/bbl. In addition to this, expectation of bumper Rabi harvest, robust Kharif paddy procurement, and normal monsoon, will be beneficial for CPI outlook for FY24.

Next year, CPI will settle at 5.3%. In Q1FY24, CPI will be at 5% (unchanged from Dec'22) and then gradually increase to 5.4% by Q2 (unchanged from Dec'22) and Q3 and further to 5.6% by Q4. We also expect CPI inflation to average between 5-5.5% in FY24. However upside risks may emerge from continued pass through of higher costs onto end consumers, and any change in the course of monsoon. Sticky core inflation has also been highlighted as a key concern by the RBI, due to which it has decided to keep an elbow room available to take appropriate policy actions if needed.

Figure 2: Headline CPI forecast lowered for FY23



Source: RBI, Bank of Baroda Research

Impact

- As RBI kept its stance unchanged and reaffirmed its commitment to "withdrawal of accommodation", 10Y G-sec yields inched up (+5bps). The latest statement indicates that there will be no rate cuts this year, and instead RBI will opt for a prolonged pause. The 10-year rates will range between 7.20-7.40% this year.
- Rates of fresh deposits may increase by 20-25 bps and WALR on fresh loans by around 15 bps. This is based on what the Governor said about the impact of the past repo rate hikes - "weighted average domestic term deposit rate on fresh deposits and outstanding deposits increased by 213 bps and 75 bps respectively" and "(WALR) on fresh rupee loans and outstanding loans increased by 137 bps and 80 bps respectively".

- Pressure on liquidity cannot be ruled out, and the same has been reiterated by the Governor. Credit growth is still at a double digit pace of 16.5% and deposit growth is at 10.6%. So in the near term as well, a gap of around 5-6% cannot be ruled out. RBI Governor also highlighted that while liquidity surplus remains and will get support from higher government spending and forex inflows in the coming months, but it will also see pressure on account of scheduled redemption of LTRO and TLTRO funds between Feb-Apr'23. OMOs and term repo auctions may be expected to balance liquidity.
- GDP growth projection of 6.4% in in the range projected by us at 6-8.5%. Rationale is that as we are a domestic oriented economy, the hit from the recession in the west will be minimal.
- Inflation forecast of 5.3% is in the range we have projected at 5-5.5%. Upside risk is monsoon prospects and the China factor.

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For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
+91 22 6698 5143
chief.economist@bankofbaroda.com
sonal.badhan@bankofbaroda.com