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RBI Monetary Policy: A 50bps hike on expected lines

The RBI's Monetary Policy Committee (MPC) expectedly decided to hike the policy repo rate by another 50 bps to 5.9%, while maintaining focus on withdrawal of accommodation. Both decisions were taken on a 5:1 majority, with Dr. Ashima Goyal dissenting on the rate hike quantum (voted for 35bps hike) and Prof. Varma maintaining a divergent view on the stance. This has translated into a cumulative hike of 190bps since May'22. While the MPC acknowledged moderation in inflationary pressures, and retained their FY23 forecast at 6.7%, it recognized the need for continued calibrated monetary policy action to bring down inflation within the target band and anchor inflationary expectations, particularly in the light of persisting global uncertainty. GDP growth forecast for FY23 was downgraded from 7.2% to 7%, citing escalating concerns from external headwinds.

Overall, the policy was in line with expectations and focused on ensuring macro-economic stability in the light of recent mayhem caused by steep rate hikes by global central banks and attendant currency woes. Even as easing commodity prices should provide some respite to inflation trajectory over coming months—as reflected from the RBI's sub-6% inflation forecast for Q4FY23—high global uncertainty imparts upside risks. Rate hikes, therefore, are likely to continue, albeit at a tapered pace, to curb generalisation of price pressures, and would hinge on a confluence of factors including growth-inflation dynamics, Fed rate hikes and geopolitical risks.

- **RBI hiked repo rate by another 50bps:** The RBI's MPC, on a 5:1 majority, decided to hike the policy rate by another 50bps—the third in a row. With this, the Repo, Standing Deposit Facility (SDF) and Marginal Standing Facility (MSF) rates stand adjusted at 5.9%, 5.65% and 6.15% respectively. While the policy repo rate has been hiked by 190bps thus far, the introduction of SDF as the new floor of the Liquidity Adjustment Facility (LAF) at a 40bps higher rate than the erstwhile resverse repo has translated into an efefctive hike of 230bps. The MPC also voted, again on a 5:1 majority, to remain focused on withdrawal of accomodation. While Dr. Ashima Goyal voted for a 35bps hike, Prof J.R. Varma yet again expressed his reservation on the stance. Daily surplus liquidity has shrunk further from Rs. 3.8trn during Jun-Jul to Rs2.3trn over the last two months. In this regard, RBI further fine-tuned liquidity operations and decided to merge the 14-day and 28-day VRRRs.

RBI expectedly hiked policy repo rate by another 50bps, taking cumulative hike to 190bps since May'22.

- **Growth forecast cut; inflation forecast retained:** While the MPC acknowledged moderation in inflationary pressures, it remained wary of continued uncertainty emanating from geopolitical shock spill overs and cost-push pressures induced by heightened INR volatility. As such the RBI has retained its FY23 inflation forecast at 6.7%, expecting it to fall to sub-6% by the fourth quarter of the fiscal. Growth forecast for FY23, however, has been cut by 20bps to 7.0%, citing escalating concerns from external headwinds.

FY23 GDP growth forecast has been downgraded from 7.2% earlier to 7%.

Inflation forecast for FY23 retained at 6.7%.

- **Regulatory measures:** To foster digital banking in rural areas, RBI has rationalised the eligibility criteria for Regional Rural Banks (RRBs) to provide internet banking. Moreover, the RBI has proposed to extend the regulations for online Payment Aggregator (PAs) to offline PAs to bring about regulatory and operational synergies.

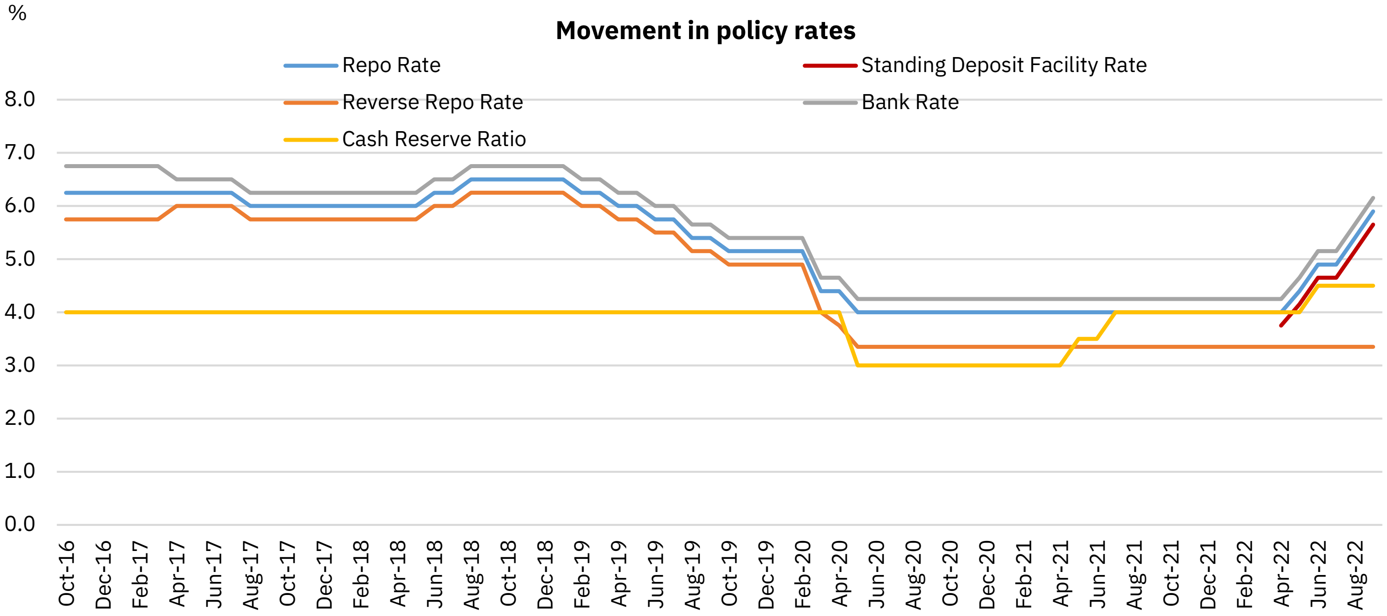
- **Rate hikes to continue, albeit at a tapered pace:** Overall, the policy was in line with expectations and focused on ensuring macro-economic stability in the light of recent mayhem caused by steep rate hikes by global central banks and attendant currency woes. Even as easing commodity prices should provide some respite to inflation trajectory over coming months—as reflected from the RBI's sub-6% inflation forecast for Q4FY23—high global uncertainty imparts upside risks. Rate hikes, therefore, are likely to continue, albeit at a tapered pace, to curb generalisation of price pressures, and would hinge on a confluence of factors including growth-inflation dynamics, Fed rate hikes and geopolitical risks.

Table 1: Current policy rates

Key rates	Unscheduled May Policy	Scheduled Jun Policy	Scheduled Aug Policy	Scheduled Sep Policy
Repo Rate	4.40%	4.90%	5.40%	5.90%
Standing Deposit Facility (SDF)*	4.15%	4.65%	5.15%	5.65%
Marginal Standing Facility (MSF)	4.65%	5.15%	5.65%	6.15%
Bank Rate	4.65%	5.15%	5.65%	6.15%
Cash Reserve Ratio (CRR)	4.50%	4.50%	4.50%	4.50%

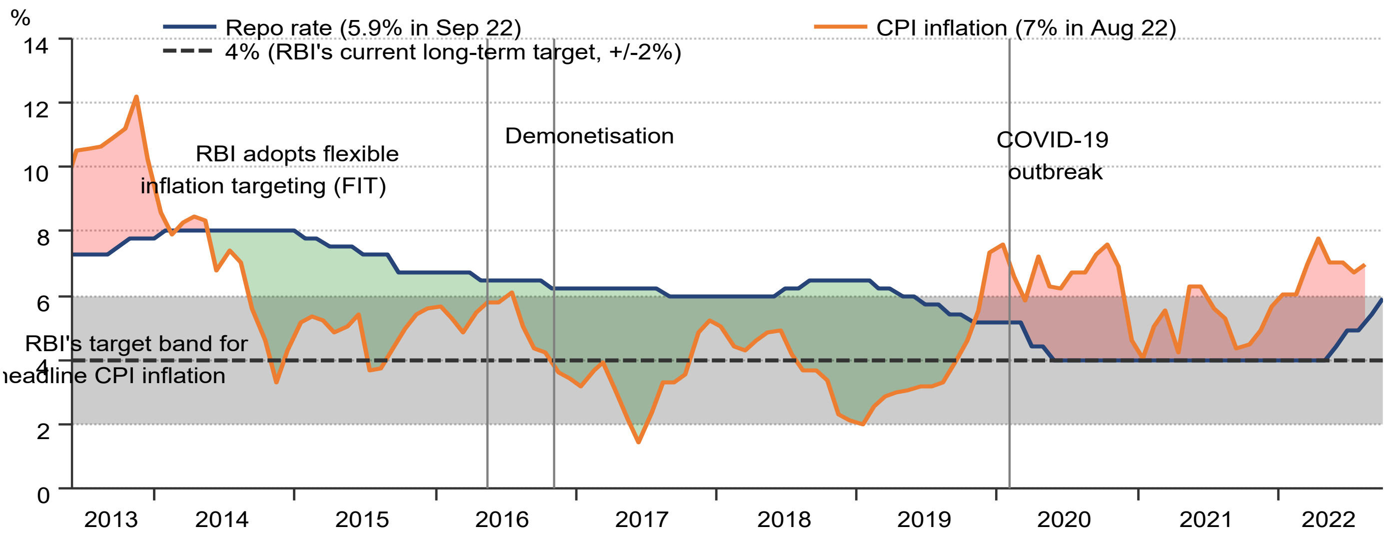
Source: RBI, NSE EPR. * Introduced in April 2022 policy as the new floor of the LAF corridor.

Figure 1: Policy repo rates hiked by another 50bps taking cumulative rate hikes to 190bps so far in FY23



Source: Refinitiv Datastream, NSE EPR.

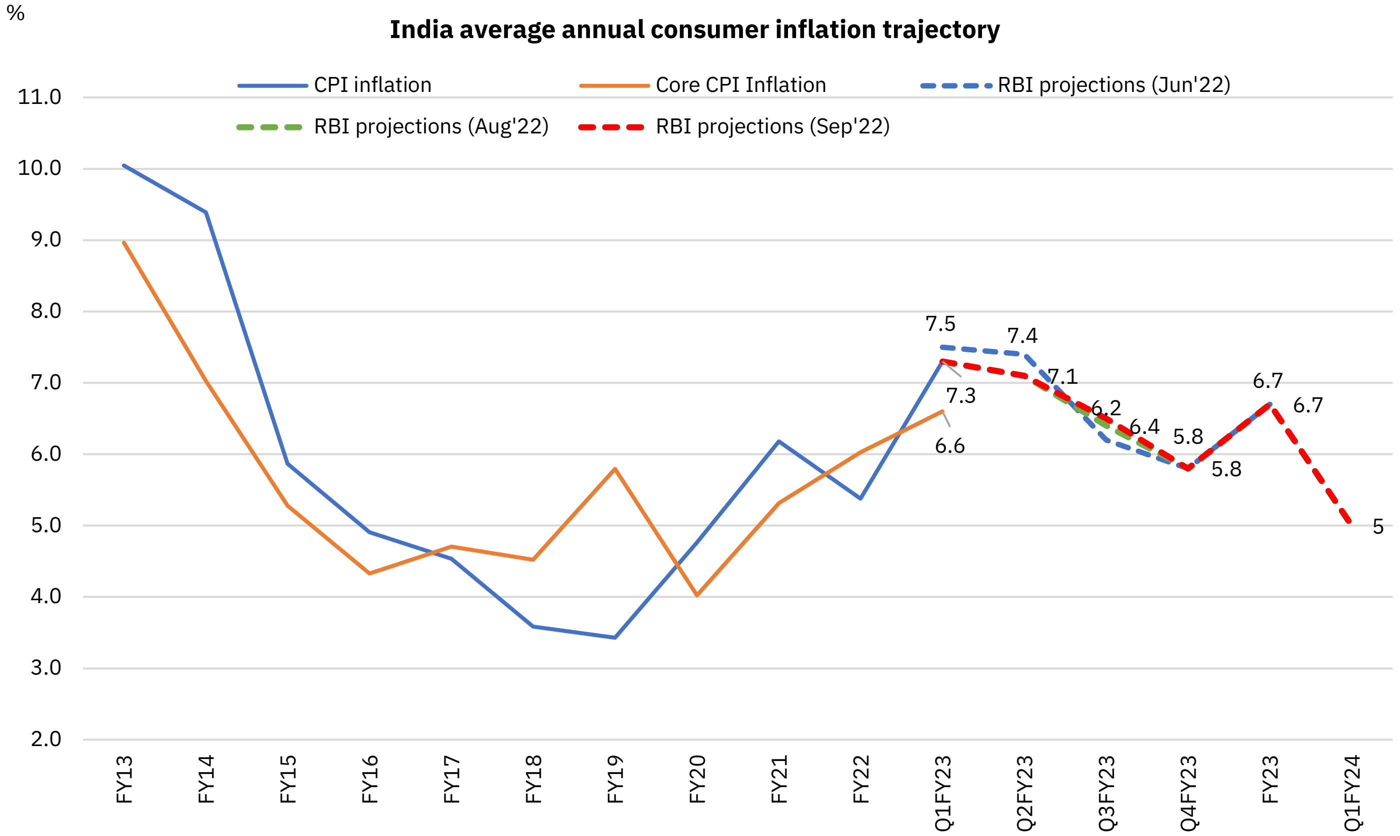
Figure 2: Real interest rates have remained negative for more than two years now



Source: Refinitiv Datastream, NSE EPR.

Figure 3: India's consumer inflation trajectory and RBI's forecasts

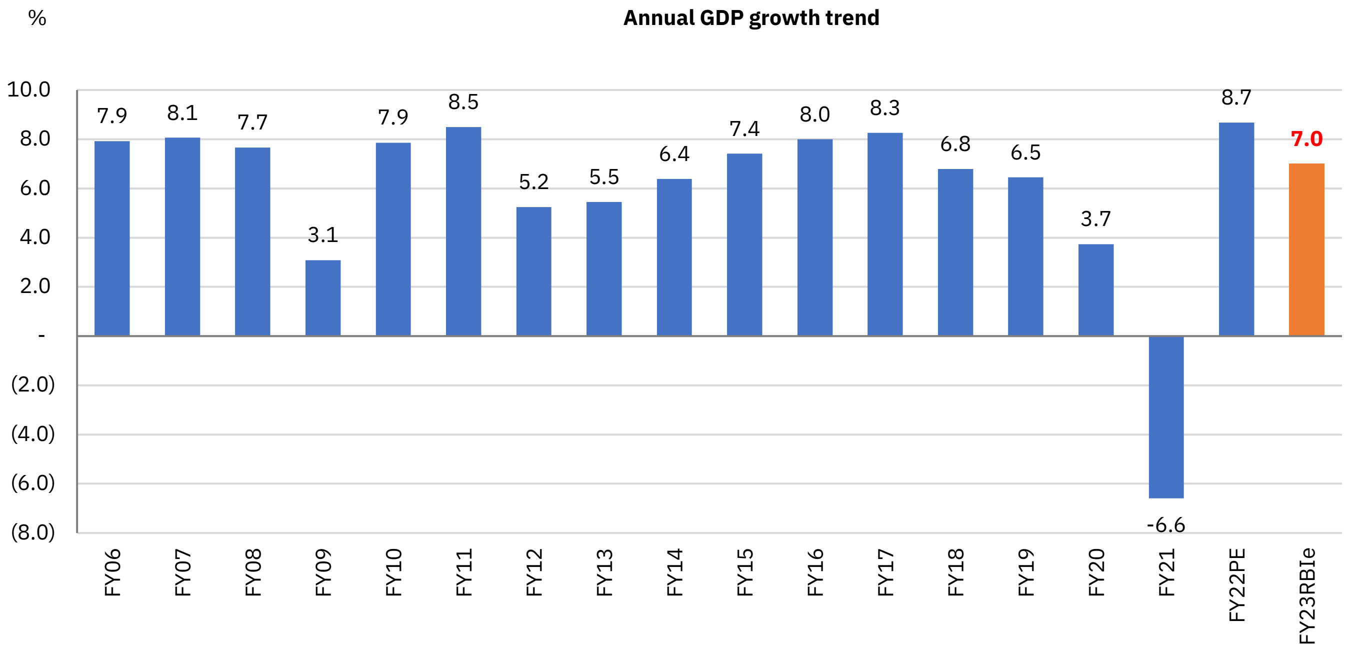
The RBI has retained its headline CPI inflation forecast at 6.7% for FY23 highlighting upside risks from food inflation.



Source: CMIE Economic Outlook, RBI EPR. Core inflation is calculated as CPI inflation excluding food, pan, tobacco & intoxicants and fuel & light.

Figure 4: GDP growth trend and estimate for FY23

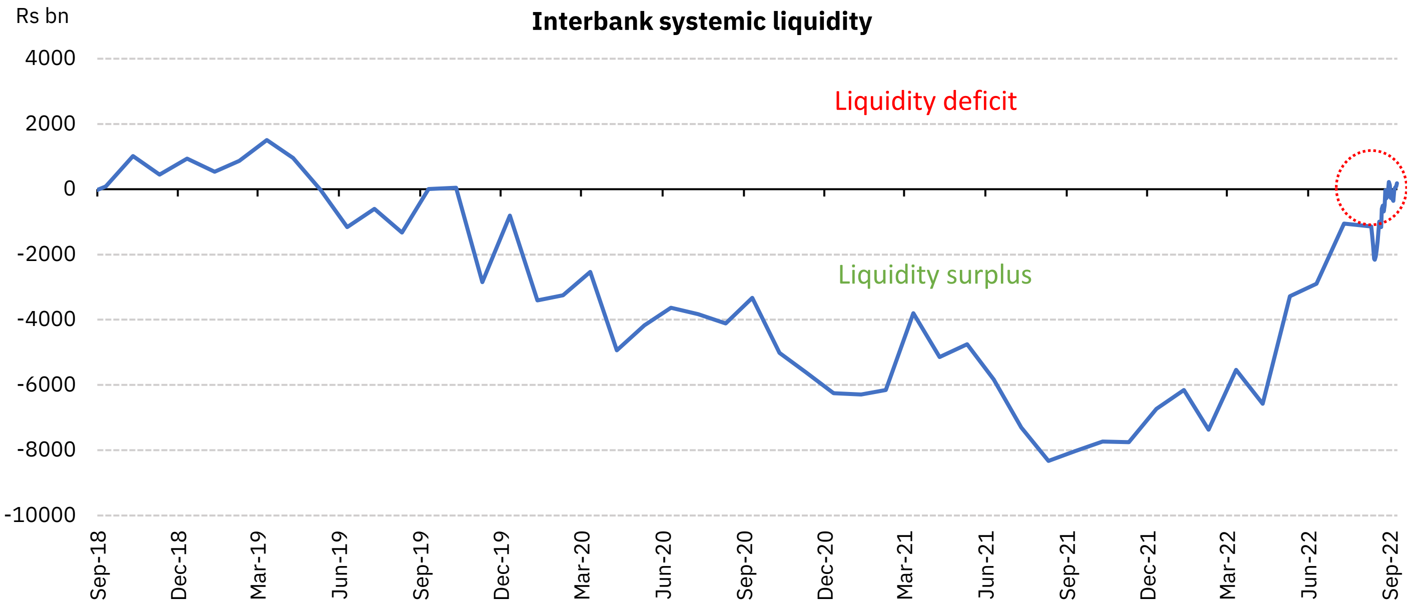
The RBI lowered FY23 GDP growth forecast to 7.0% from 7.2% on account of concerns arising from (i) geopolitical tensions, (ii) tightening global financial conditions, and (iii) slowing external demand. Estimated growth for Q2, Q3 and Q4 GDP is pegged at 6.3%, 4.6% and 4.6% respectively with risks broadly balanced.



Source: CMIE Economic Outlook, RBI, NSE EPR. RBIe = RBI estimate, FAE = First Advance Estimate, PE = Preliminary Estimate.

Figure 5: Net lending under RBI's Liquidity Adjustment Facility

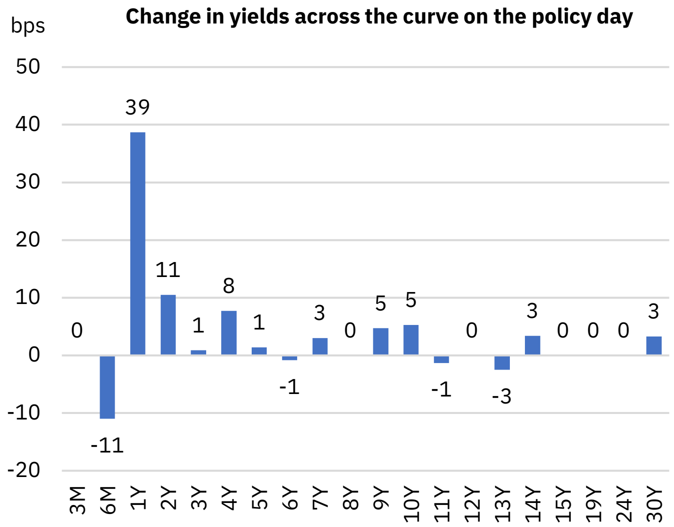
Although, overall system liquidity remained in surplus during Aug-Sep (Rs. 2.3trn vs. Rs. 3.8trn for Jun-Jul), it entered the deficit territory on September 20th for the first time since the pandemic. The average daily absorption under the LAF stood at Rs. 1.1trn for September.

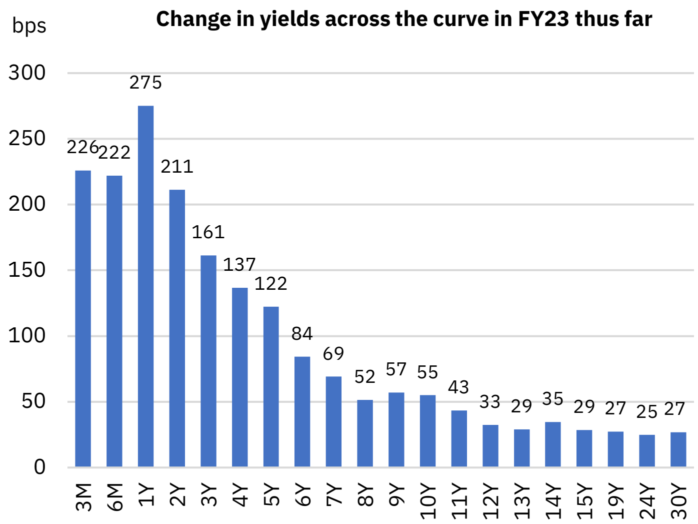


Source: CMIE Economic Outlook, Refinitiv Datastream, NSE EPR.

Figure 6: YTD change in yield curve on the policy day and FY23 till date (as on September 30th, 2022)

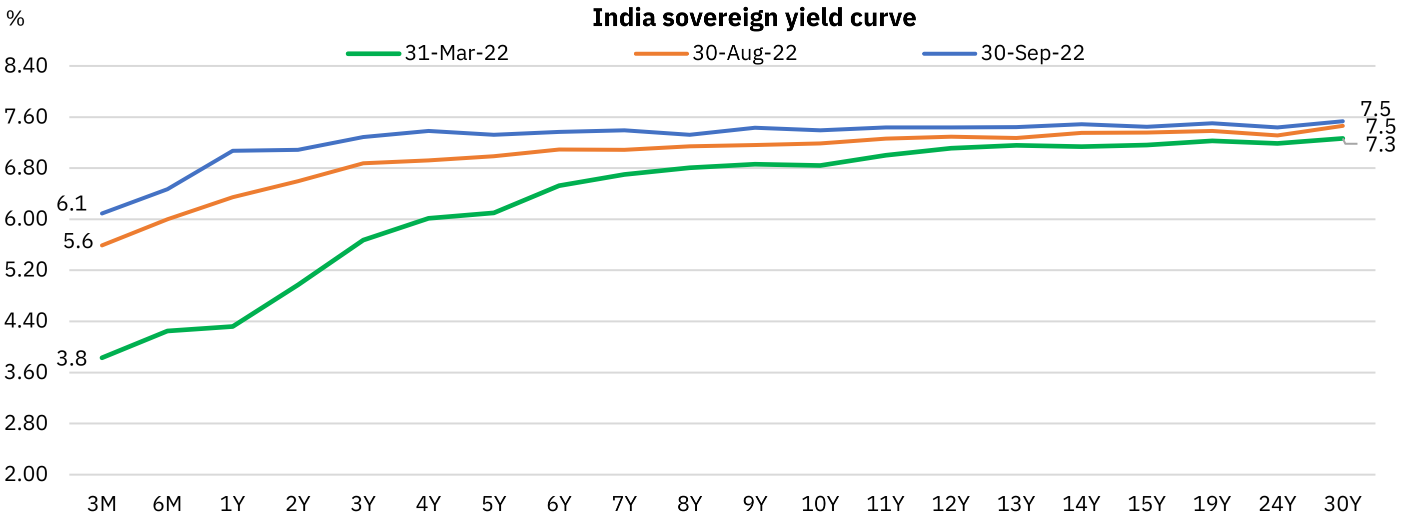
The RBI's move today was in line with expectations on rate hike quantum as well as stance. Barring near-end, the curve was broadly steady today. On a fiscal till date basis, yields have risen meaningfully at the short-end, while jump at the long-end has been fairly limited. This has led to flattening of the yield curve.





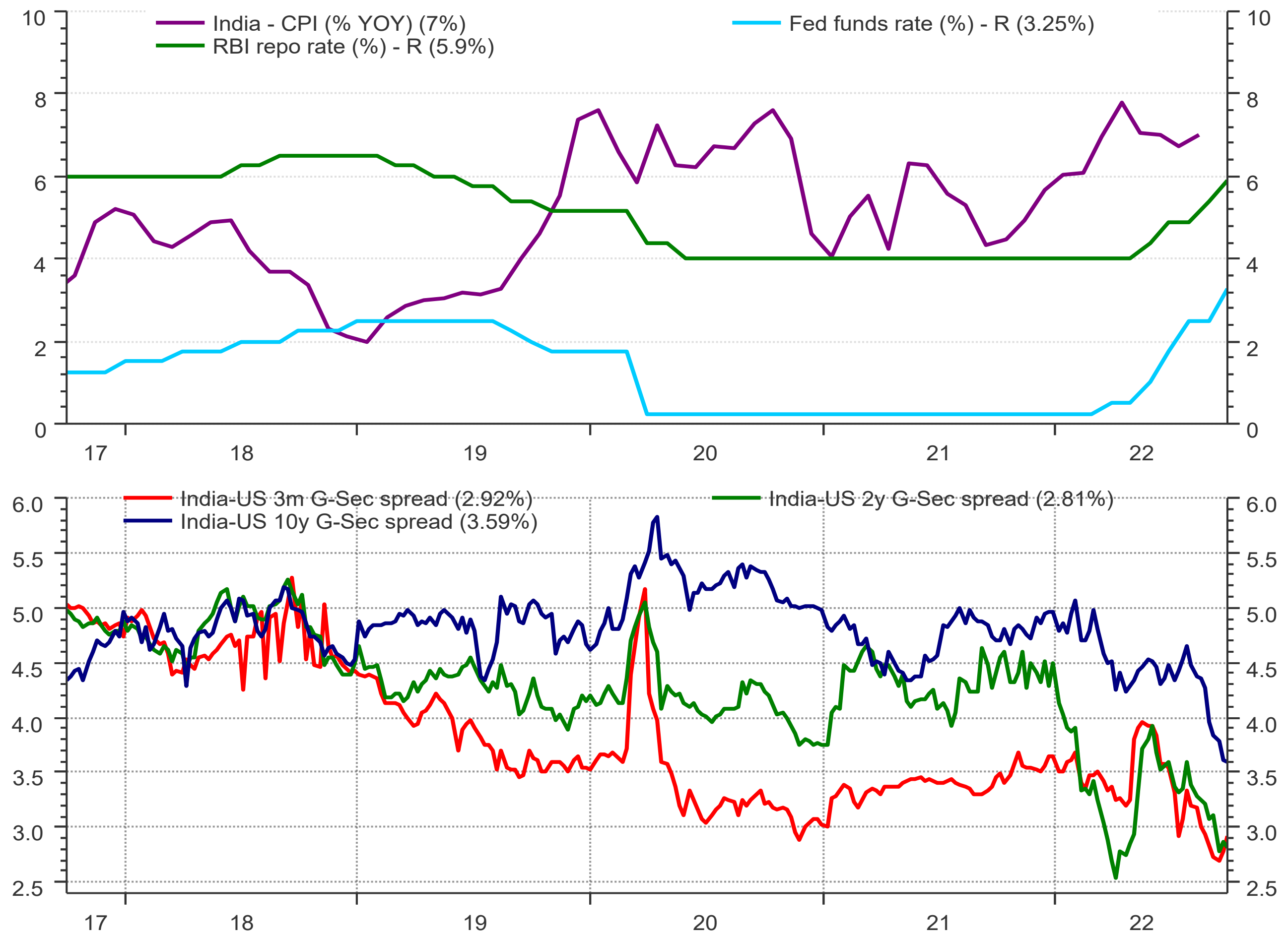
Source: Refinitiv Datastream, NSE EPR.

Figure 7: India sovereign yield curve



Source: Refinitiv Datastream, NSE EPR.

Figure 8: India vs. US policy rates and yield differential



Source: Refinitiv Datastream, NSE EPR.

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