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RBI Monetary Policy: 25bps hike with a hawkish tone

The **RBI's Monetary Policy Committee (MPC)** expectedly decided to hike the policy repo rate by another 25 bps to 6.5%, while maintaining focus on withdrawal of accommodation, both on a 4:2 majority. This has translated into a cumulative hike of 250**bps on the repo rate since May'22**. Dr Ashima Goyal and Prof. Varma voted against the rate hike action as well as the stance. Importantly, the MPC has reiterated the need for continued calibrated monetary policy action to ease pressures on core inflation and keep inflation expectations anchored, thereby keeping the room open for further rate hikes. While the inflation forecast for FY23 has been lowered to 6.5% from 6.7% earlier, primarily led by easing vegetable prices, persistence of core inflation at elevated levels has remained a matter of concern. For FY24, i**nflation is expected to remain well above the RBI's 4% mid**-point target, estimated at 5.3%, thanks to persistence of core inflationary pressures on continued pass-through of input costs, particularly in services, and high global uncertainty. Domestic economic activity, on the other hand, has remained resilient, with GDP growth for FY24 pegged at 6.4%, aided by strong capex push by the Government, and continued recovery in contact-intensive sectors and discretionary spending, partly offset by subdued external demand.

Overall, while the MPCs decisions were in line with market expectations, the commentary was mildly hawkish. With an unchanged stance, optimistic outlook on growth and concerns over elevated core inflation trajectory, the MPC has signalled that its **fight against inflation isn't over** yet, thereby diminishing hopes of a pause in the next policy. This also provides the MPC greater flexibility to act if inflation data surprises negatively or Fed continues to hike rates. That said, the sheer quantum of rate hikes delivered over the last 10 months warrants a wait-and-watch approach to monetary policy in the near-term, particularly in the light of weakening global demand and its **repercussions on India's growth trajectory**.

- RBI expectedly hiked repo rate by 25bps: The RBI's MPC, with a 4:2 majority, decided to taper the magnitude of hike by raising the policy rate by 25bps in the last scheduled meeting of FY23, citing elevated core inflation trajectory. This has translated into a cumulative hike of 250bps on the repo rate in the current cycle. With this, the Repo, Standing Deposit Facility (SDF) and Marginal Standing Facility (MSF) rates stand adjusted at 6.5%, 6.25% and 6.75% respectively. The MPC also voted in favor of keeping the "withdrawal of accomodation" stance intact with a 4:2 majority. Notably, while the dissent on the stance remained similar, the disagreement on the rate hike action has widened.

RBI expectedly hiked policy repo rate by another 25bps, taking cumulative hike to 250bps since May'22.

- Inflation to remain high, growth to remain resilient: While the inflation forecast for FY23 has been lowered to 6.5% from 6.7% earlier, primarily led by easing vegetable prices, persistence of core inflation at elevated levels has remained a matter of concern. For FY24, inflation is expected to remain well above the RBI's 4% mid-point target, estimated at 5.3% assuming a normal monsoon, thanks to persistence of core inflationary pressures on continued pass-through of input costs, particularly in services, and high global uncertainty. Domestic economic activity, on the other hand, has remained resilient, with GDP growth for FY24 pegged at 6.4%, aided by strong capex push by the Government, and continued recovery in contact-intensive sectors and discretionary spending, partly offset by subdued external demand.

RBI forecasts FY24 GDP growth at 6.4% and inflation at 5.3%

- **Liquidity still in surplus but of a lower order than Apr'22:** With the average daily absorption increasing to Rs1.6trn during December-January from Rs1.4trn during October-November, the overall liquidity remains in surplus though at a significantly lower level relative to Apr'22. The expected increase in government expenditure in Q4 coupled with the anticipated resumption of forex inflows amidst weakening Dollar is likely to improve liquidity. However, the scheduled redemption of LTRO

(Long Term Repo Operations) and TLTRO (Targeted Long Term Repo Operations) funds during Feb-Apr'23 is likely to curtail excess liquidity.

- Hawkish policy tone makes Apr'23 policy a close call: While the MPCs decisions were in line with market expectations, the commentary was mildly hawkish. With an unchanged stance, optimistic outlook on growth and concerns over elevated core inflation trajectory, the MPC has signalled that its fight against inflation isn't over yet, thereby diminishing hopes of a pause in the next policy. This also provides the MPC greater flexibility to act if inflation data surprises negatively or Fed continues to hike rates. That said, the sheer quantum of rate hikes delivered over the last 10 months warrants a wait-and-watch approach to monetary policy in the near-term, particularly in the light of weaking global demand and its repercussions on India's growth trajectory.

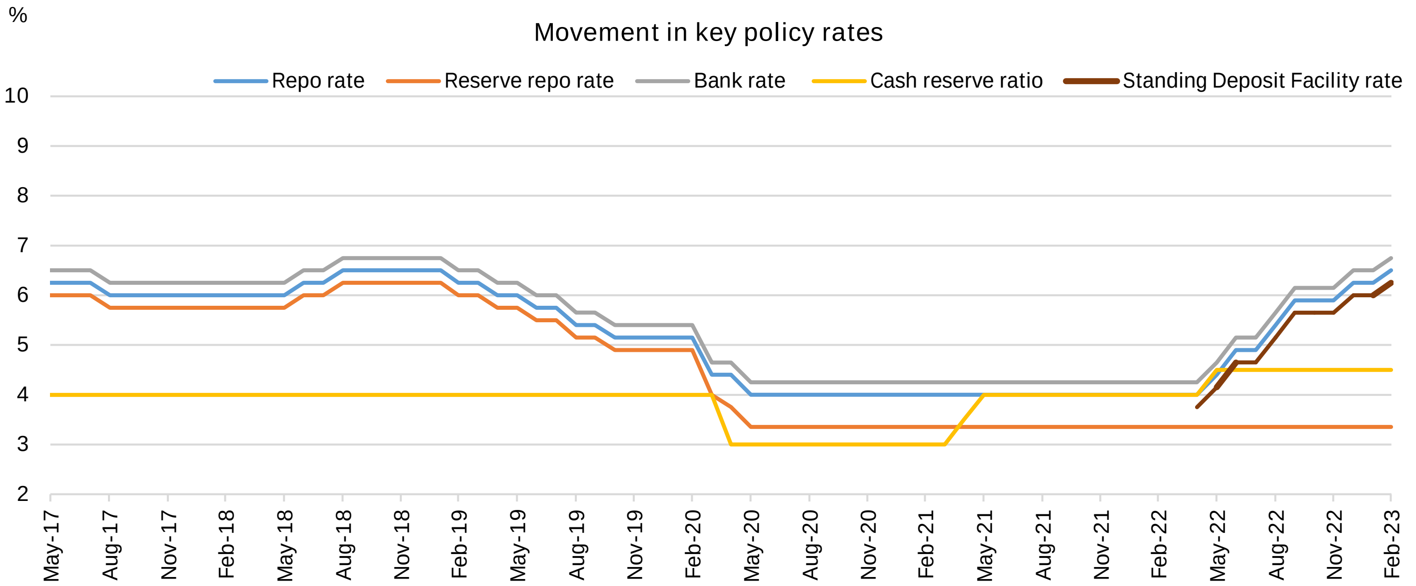
Table 1: Current policy rates

Key rates	Scheduled Aug Policy	Scheduled Sep Policy	Scheduled Dec Policy	Scheduled Feb Policy
Repo Rate	5.40%	5.90%	6.25%	6.50%
Standing Deposit Facility (SDF)*	5.15%	5.65%	6.00%	6.25%
Marginal Standing Facility (MSF)	5.65%	6.15%	6.50%	6.75%
Bank Rate	5.65%	6.15%	6.50%	6.75%
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: Movement in key policy rates

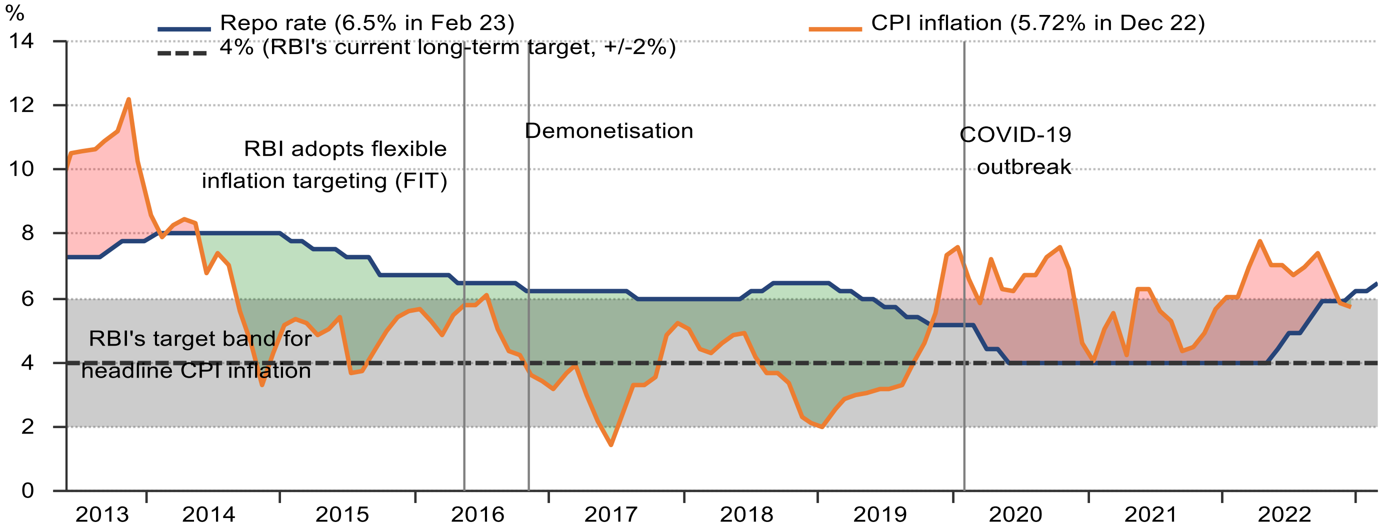
Policy repo rates hiked by another 25bps taking cumulative rate hikes to 250bps since May 2022.



Source: Refinitiv Datastream, NSE EPR.

Figure 2: Real interest rates

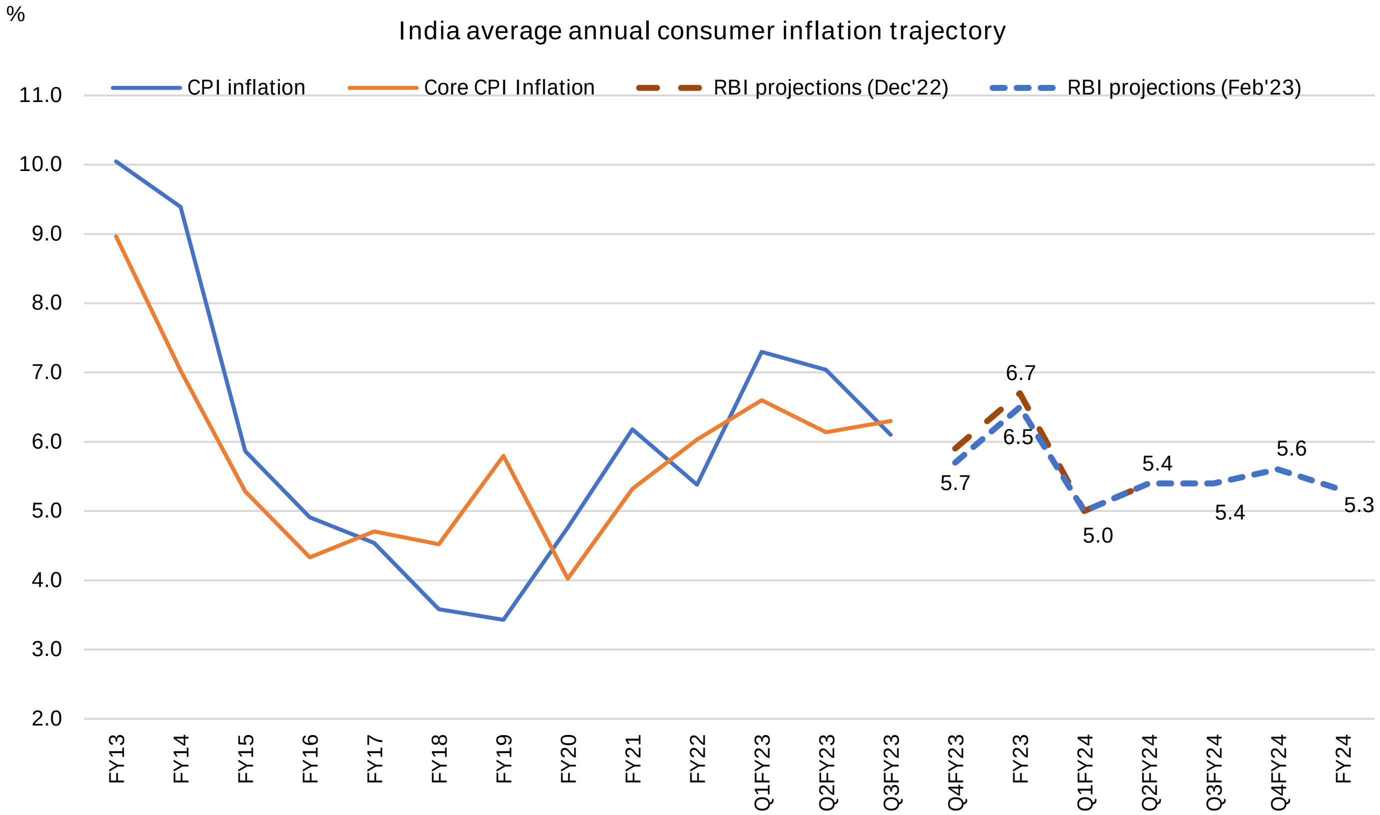
Real interest rates turned positive after remaining in the negative territory for over three years.



Source: Refinitiv Datastream, NSE EPR.

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

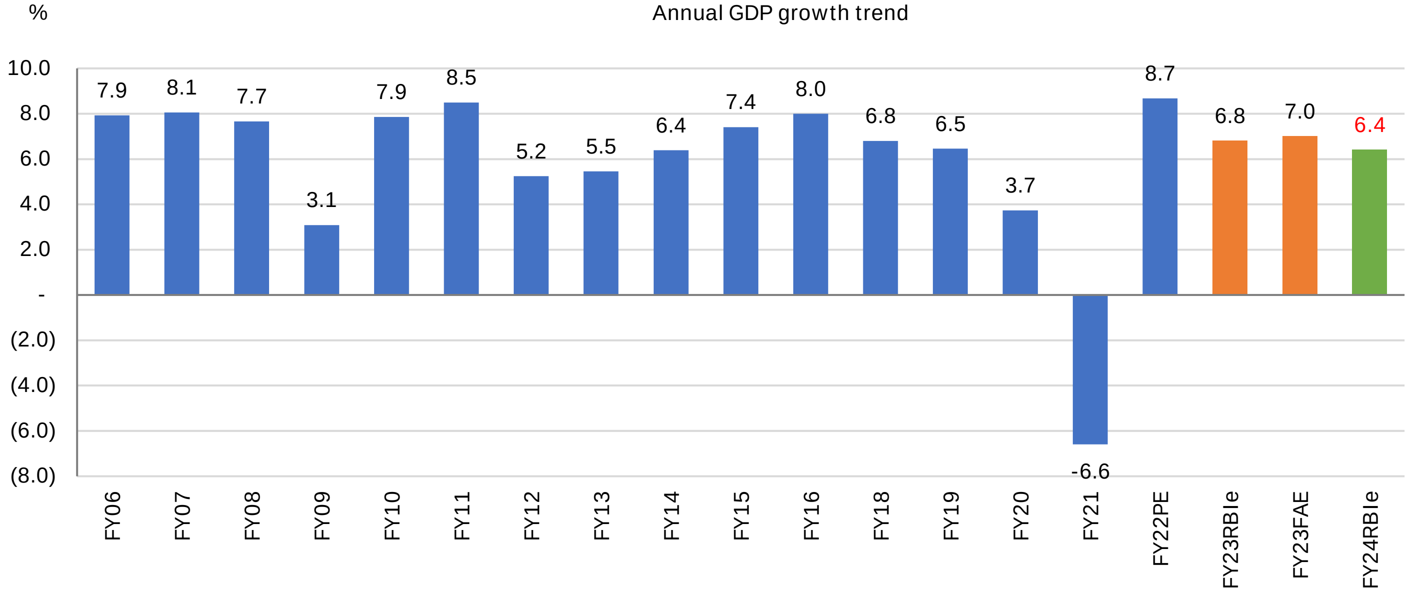
The RBI has revised its headline CPI inflation forecast to 6.5% from 6.7% for FY23. For FY24, RBI expects inflation to average at 5.3% assuming a normal monsoon.



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 FY24

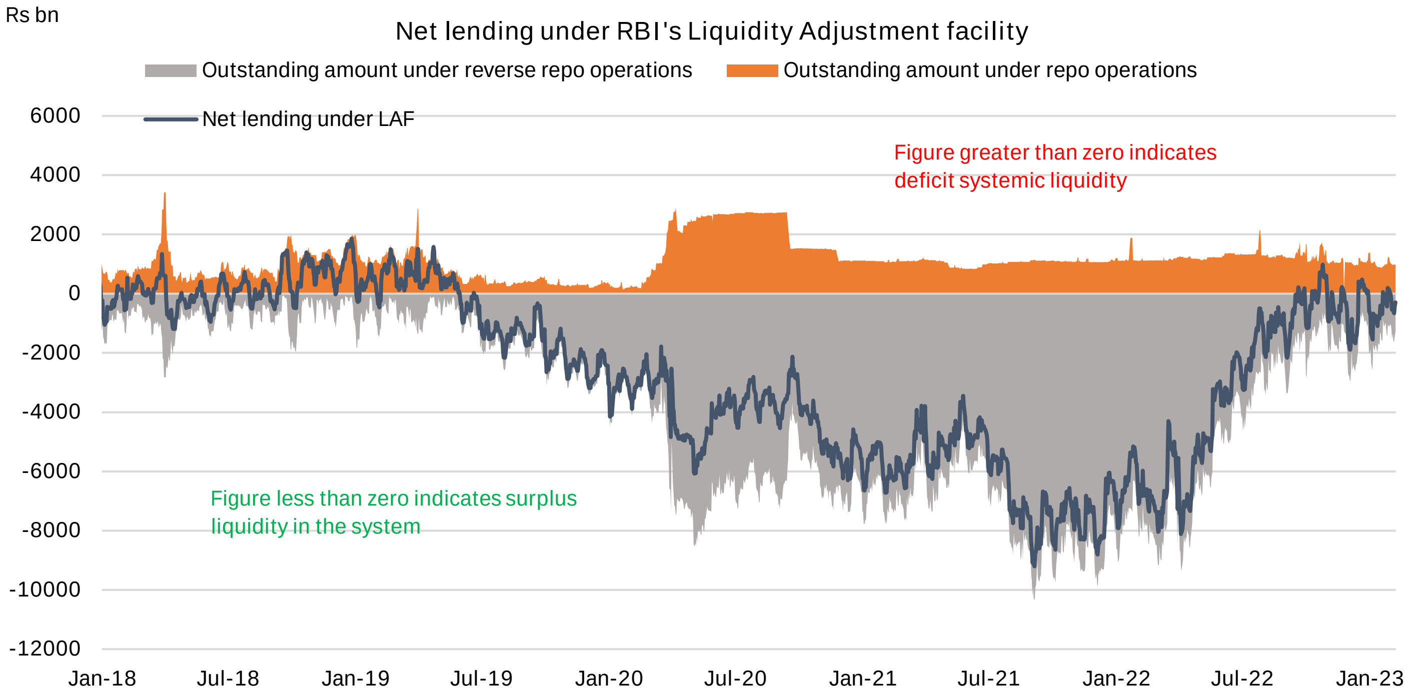
The RBI has retained the FY23 GDP growth forecast at 6.8% and has pegged FY24 GDP growth forecast at 6.4%, supported by existing robustness in growth momentum and brighter prospects for consumption and investment.



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**

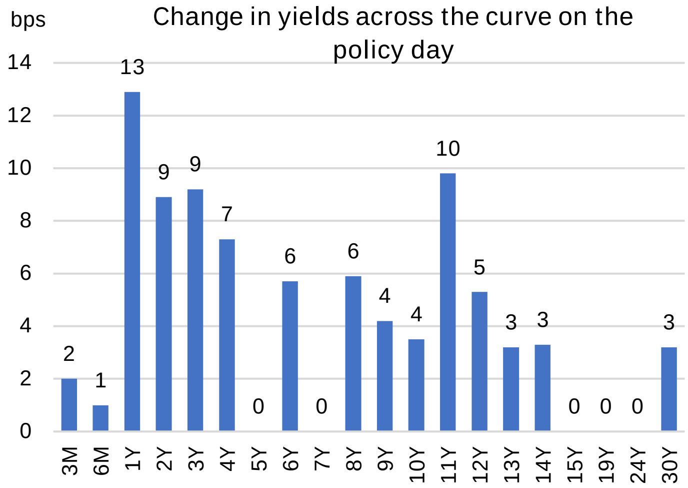
With the average daily absorption increasing to Rs1.6trn during December-January from Rs1.4trn during October-November, the overall liquidity remains in surplus though at a significantly lower level relative to Apr'22, on account of pickup in government spending in Q4 and resumption of forex inflows amidst weakening Dollar.

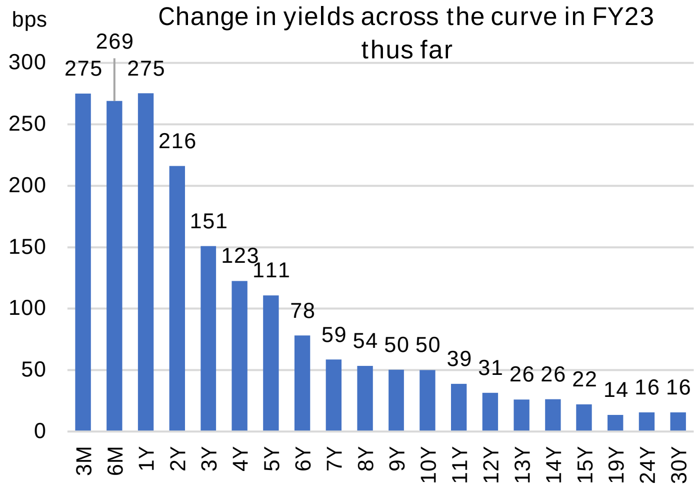


Source: CMIE Economic Outlook, Refinitiv Datastream, NSE EPR.

Figure 6: YTD change in yield curve on the policy day and FY23 till date (As on February 8th, 2023)

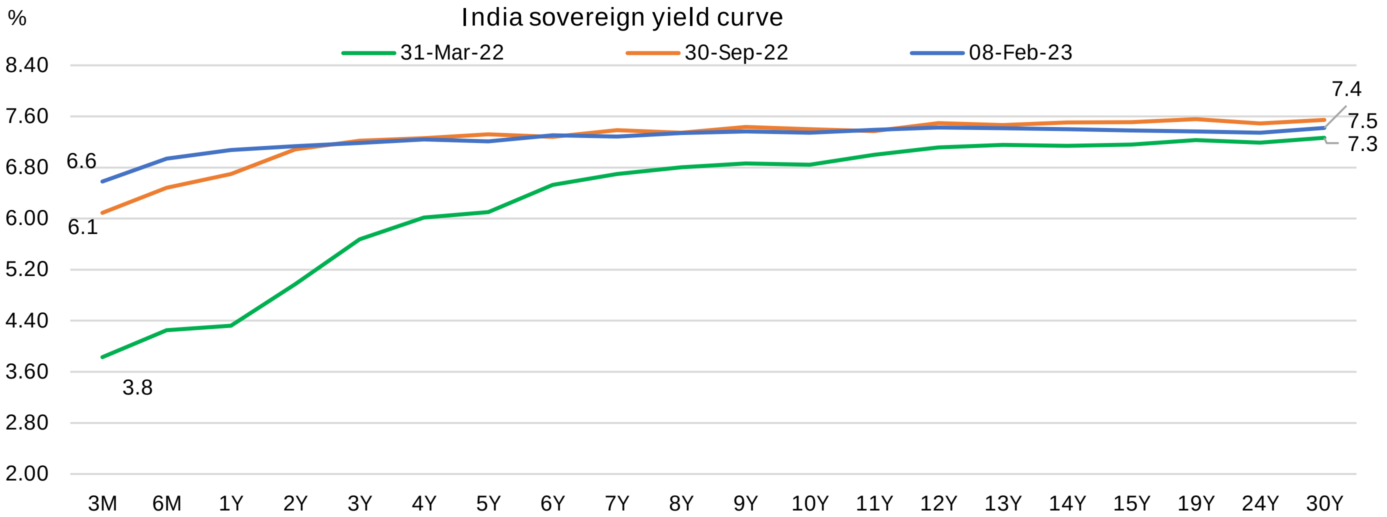
RBI's hawkish tone led to yields rising across the curve today. On a fiscal till date, yields have risen meaningfully at the short-end, while jump at the long-end has been fairly limited. This has led to a significant flattening of the yield curve.





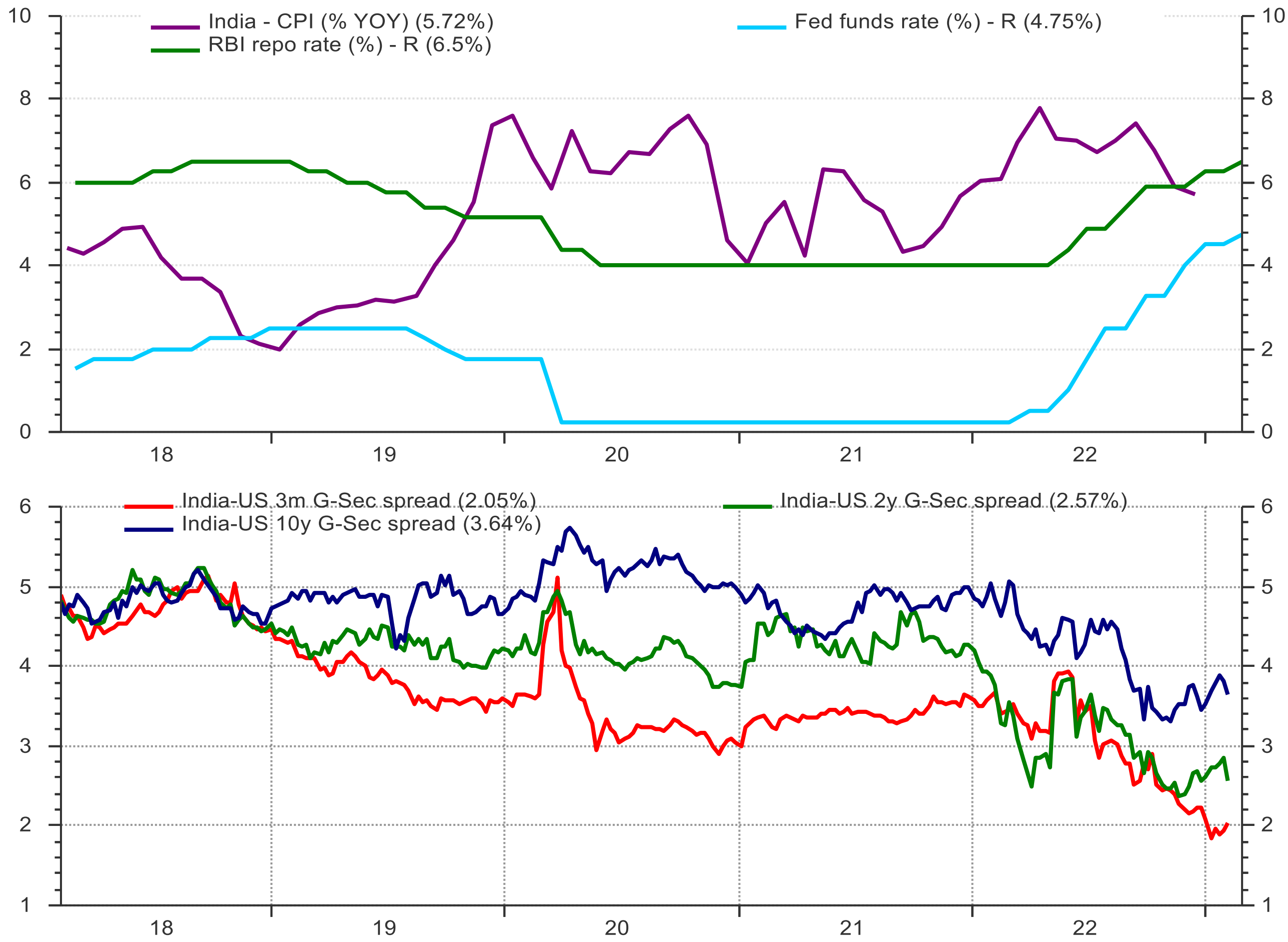
Source: Refinitiv Datastream, NSE EPR.

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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