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RBI Monetary Policy: A (hawkish) “pause not a pivot”

The RBI’s Monetary Policy Committee (MPC) unanimously decided to keep the policy repo rate unchanged at 6.5%, while expressed caution on inflation, reiterating its determined focus on reining generalisation of price pressures and anchoring inflation expectations. The *‘withdrawal of accommodation’* stance was also retained, albeit with a 5:1 majority, as the MPC assesses the impact of past rate hikes with the commitment to do more as needed. The headline inflation is projected at 5.2% for FY24, a tad lower than 5.3% estimated in February, and 4.5% for FY25. Heightened global financial market volatility, uncertain crude oil price outlook, adverse climate conditions and lagged pass-through of input costs are likely to impart upside pressures, with downside support provided by record rabi foodgrains production and easing commodity prices. Growth outlook remains resilient; estimate for FY24/25 is pegged at 6.5% each (SPF’s FY24 est.: 6%), aided by strong urban demand, and reviving investment activity. Muted external demand, protracted geopolitical tensions, tight financial conditions and rising market volatility pose risks to the outlook.

A hawkish pause today as opposed to expectations of a dovish 25bps hike has positively surprised the markets, despite the Governor’s clarification on this not to be construed as a pivot and that further action on rates/liquidity will be taken as necessary. This is evident from an intra-day drop of 10-15bps in short-term yields and 7-8bps in long-term yields. Modest downgrade in RBI’s inflation forecasts and relatively sanguine growth outlook, coupled with support from easing global commodity prices and favourable base, seem to be hinting towards an extended pause. Liquidity management as a monetary policy tool is likely to take centre stage now.

- **Status quo on rates:** The RBI’s MPC unanimously decided to retain the policy rate at 6.5% as they assess the impact of 250bps rate hikes delivered in the current cycle—a large part of which has already been transmitted. As such, the Standing Deposit Facility (SDF) and the Marginal Standing Facility (MSF) rates—the upper and lower bounds of the Liquidity Adjustment Facility (LAF) corridor—remain unchanged at 6.25%, and 6.75% respectively. Notwithstanding a surprise pause, the MPC’s focus resolutely remains on ensuring price stability, aligning headline inflation to the target, curtailing of generalisation of price pressures and containing inflation expectations. The members also voted, with a 5:1 majority, in favor of keeping the *“withdrawal of accomodation”* stance intact, with Prof. Jayanth Varma expressing reservation yet again.

Contrary to market expectations, the RBI retained the policy repo rate at 6.5%.

- **Growth forecast upgraded…:** Notwithstanding a cautious view on inflation and global landscape, the RBI has remained constructive on growth-inflation dynamics. GDP growth forecast for FY24 has been revised upwards by 10bps to 6.5% (vs. RBI’s SPF 6% est.), on the back of a robust *rabi* season, sustained buoyancy in contact-intensive services, and strong capex push by the Government. The latter, coupled with rising capacity utilisation and easing commodity prices, bodes well for manufacturing and investment activity. GDP growth for FY25 is also estimated at 6.5%, assuming a normal monsoon and no major exogenous or policy shocks.

GDP growth forecast upgraded by 10bps to 6.5%, with FY25 estimate pegged at similar levels.

- **…Inflation estimates trimmed:** The headline inflation is projected at 5.2% for FY24, a tad lower than 5.3% estimated in the last policy review. This assumes a normal monsoon, average crude oil price of US$85/bbl and average exchange rate of Rs 82/US$. Heightened global financial market volatility, uncertain crude oil price outlook, adverse climate conditions and lagged pass-through of input costs are likely to impart upside pressures, with downside support provided by record rabi foodgrains production and easing commodity prices. Inflation forecast for FY25 is pegged at 4.5%—closer to the RBI’s mid-point target.

Headline inflation for FY24 is projected at 5.2% vs. 5.3% estimated in February; FY25 inflation estimated pegged at 4.5%.

- **Liquidity surplus progressively waned during the year:** Liqudity surplus in the banking system shrunk meaningfully during the year, with net average daily liquidity absorption under the LAF moderating to Rs 0.4trn during the second half of the fiscal from Rs 3.3trn in the first half. In fact, it moved into deficit for brief periods during the second half. This resulted in weighted average call money rate hovering very close to the repo rate in the second half, averaging at 6.2%.

- **Regulatory measures:** After the recent decision to link RuPay credit cards with the Unified Payment Interface (UPI), the RBI proposed to further expand its scope by way of allowing operations of pre-sanctioned credit lines at banks through UPI. This will drive innovations in credit access and help in development of unique products for Indian markets. In addition, the RBI also proposed to develop the onshore Non-deliverable Derivatives Contracts (NDDCs) market by permitting IFSC Banking Units to offer NDDCs to residents as well.
- **Extended pause:** A hawkish pause today as opposed to expectations of a dovish 25bps hike has positively surprised the markets, despite the Governor's clarification on this not to be construed as a pivot and that further action on rates/liquidity will be taken as necessary. This is evident from a 10-15bps drop in short-term yields and 5-7bps drop in long-term yields. Modest downgrade in RBI's inflation forecasts and relatively sanguine growth outlook, coupled with support from easing global commodity prices and favourable base, seem to be hinting towards an extended pause. Liquidity management as a monetary policy tool is likely to take the centre stage now.

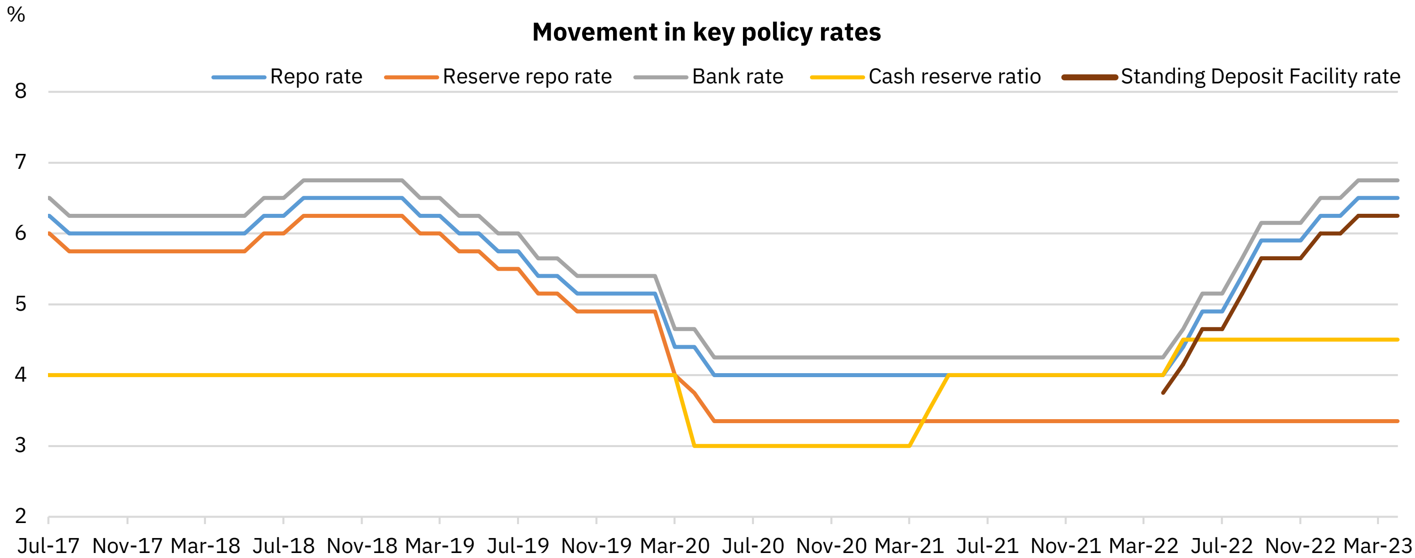
Table 1: Current policy rates

Key rates	Sep 2022	Dec 2022	Feb 2023	Apr 2023
Repo Rate	5.90%	6.25%	6.50%	6.50%
Standing Deposit Facility (SDF)*	5.65%	6.00%	6.25%	6.25%
Marginal Standing Facility (MSF)	6.15%	6.50%	6.75%	6.75%
Bank Rate	6.15%	6.50%	6.75%	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

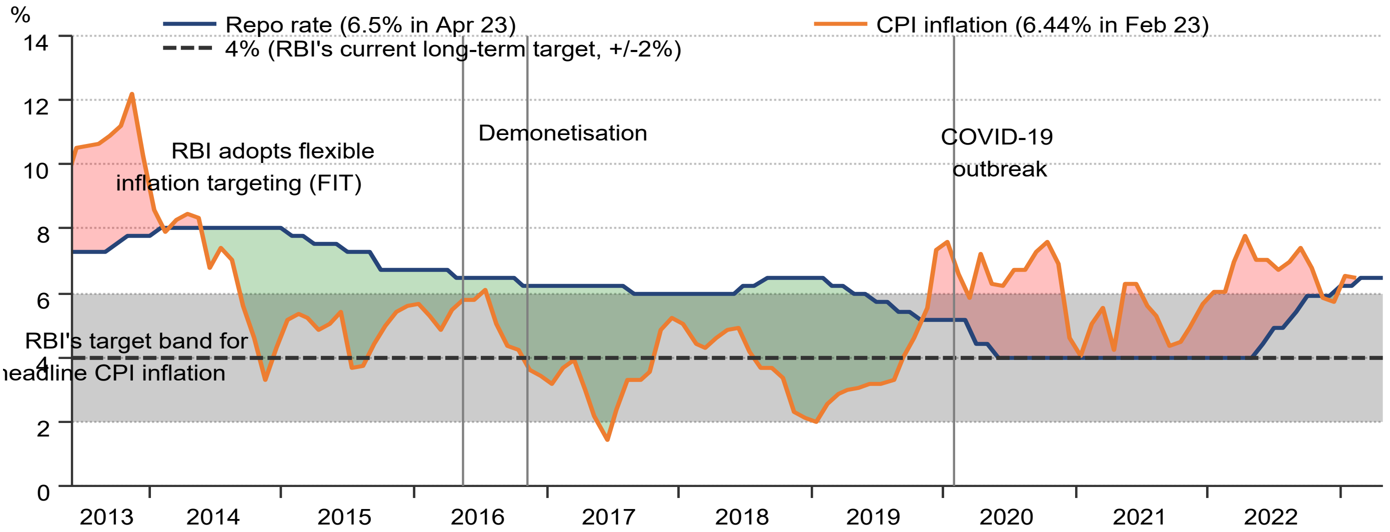
Policy repo rate was retained at 6.5% in the April policy, accompanied with continuation of "withdrawal of accommodation stance.



Source: Refinitiv Datastream, NSE EPR.

Figure 2: Real interest rates

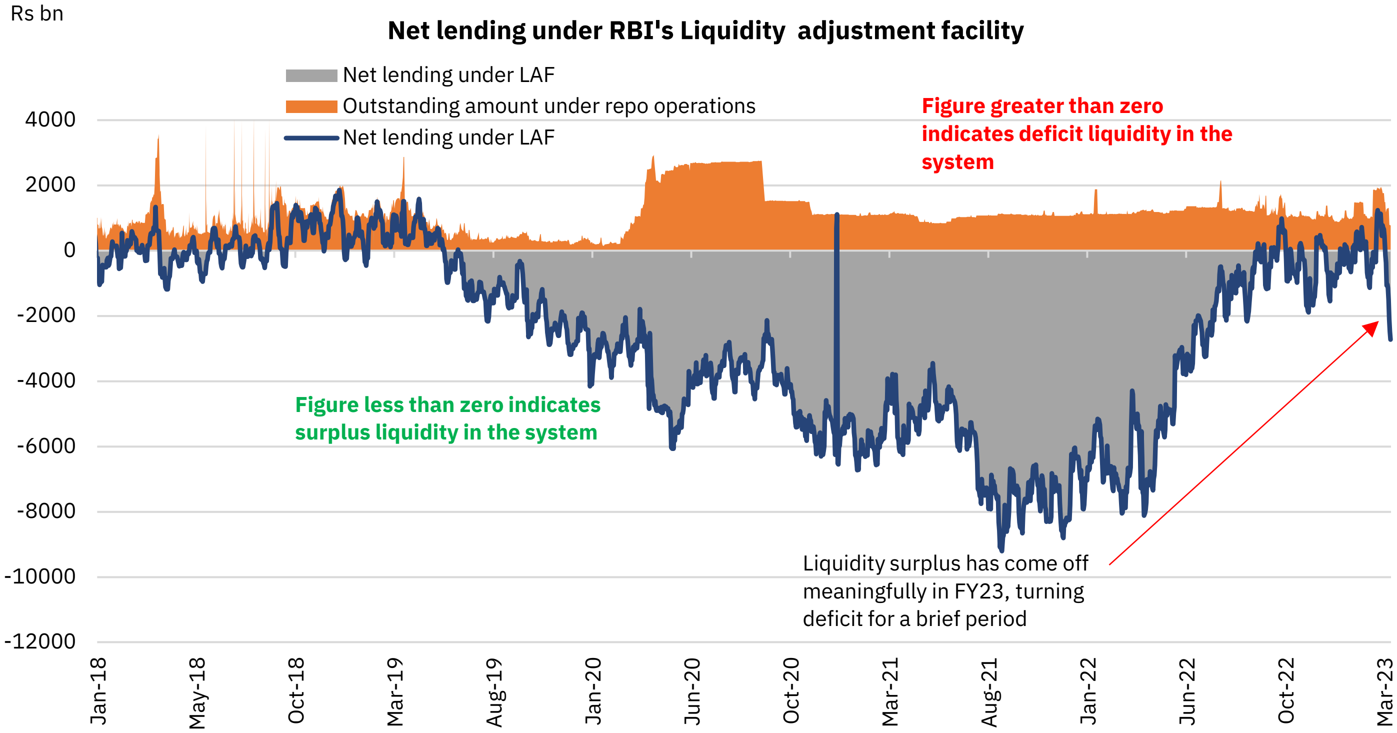
Real interest rates turned positive after remaining in the negative territory for over three years.



Source: Refinitiv Datastream, NSE EPR.

Figure 3: Net lending under RBI's Liquidity Adjustment Facility

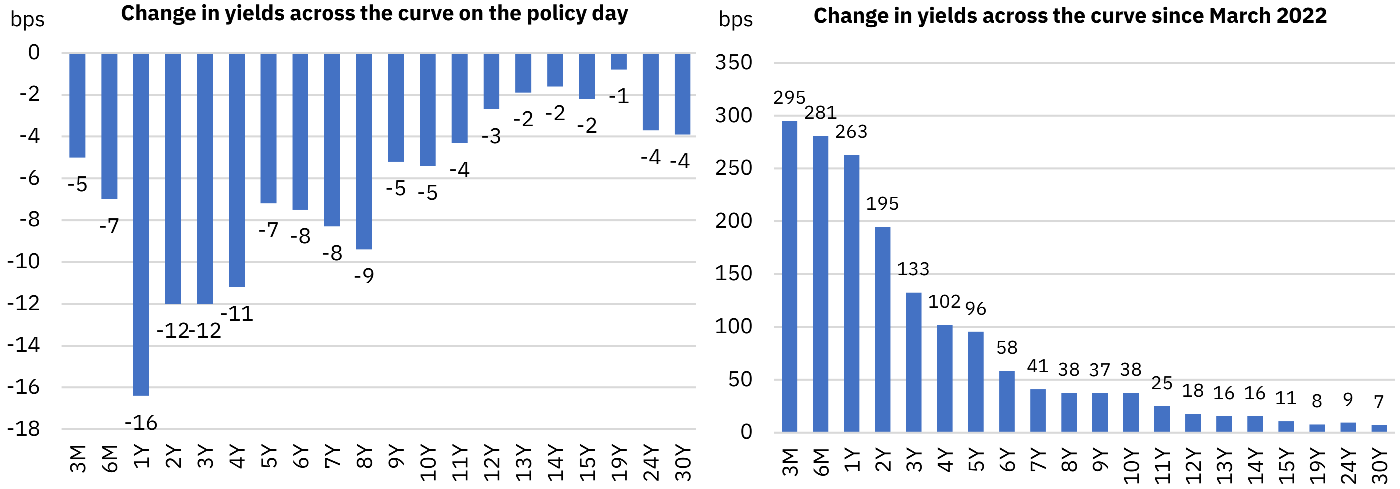
Liqudity surplus in the banking system shrunk meaningfully during the year, with net average daily liquidity absorption under the LAF moderating to Rs 0.4trn during the second half of the fiscal from Rs 3.3trn in the first half.



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

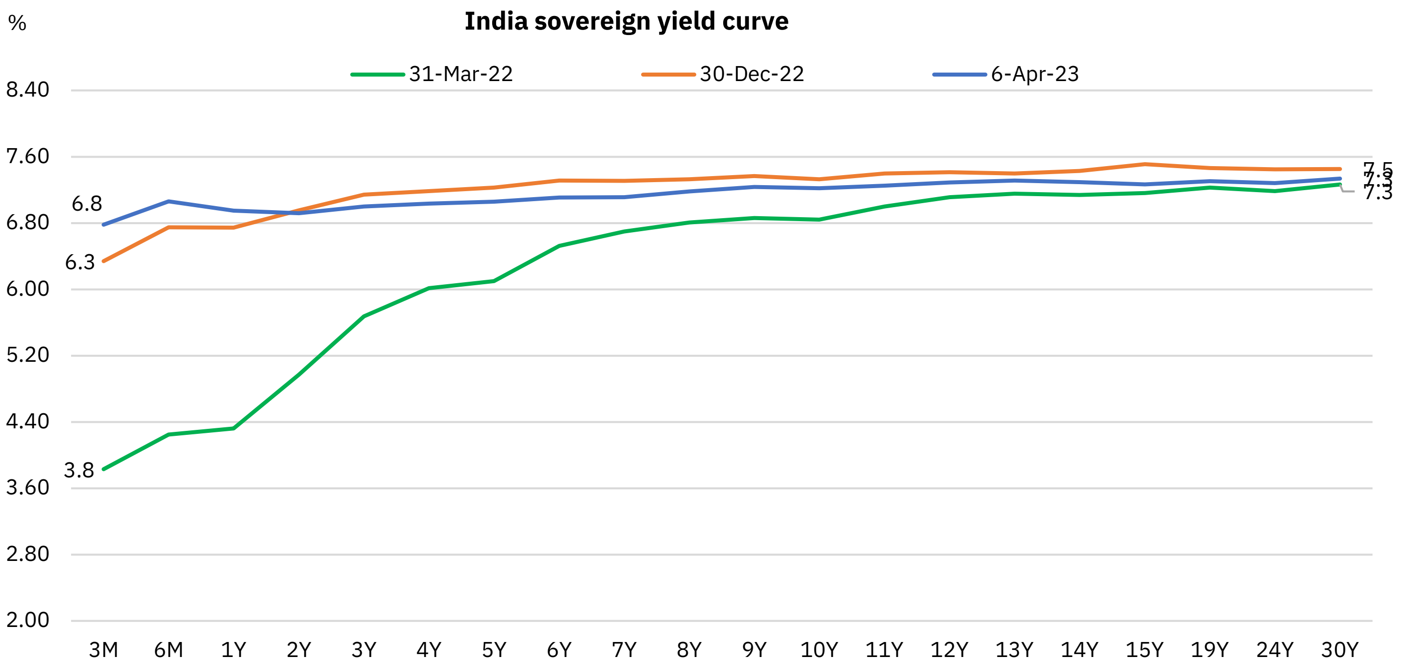
Figure 4: Change in yield curve on the policy day and since March 2022 (As on April 6th, 2023)

A hawkish pause today as opposed to expectations of a dovish 25bps hike has positively surprised the markets, and resulted in drop in yields across the curve.



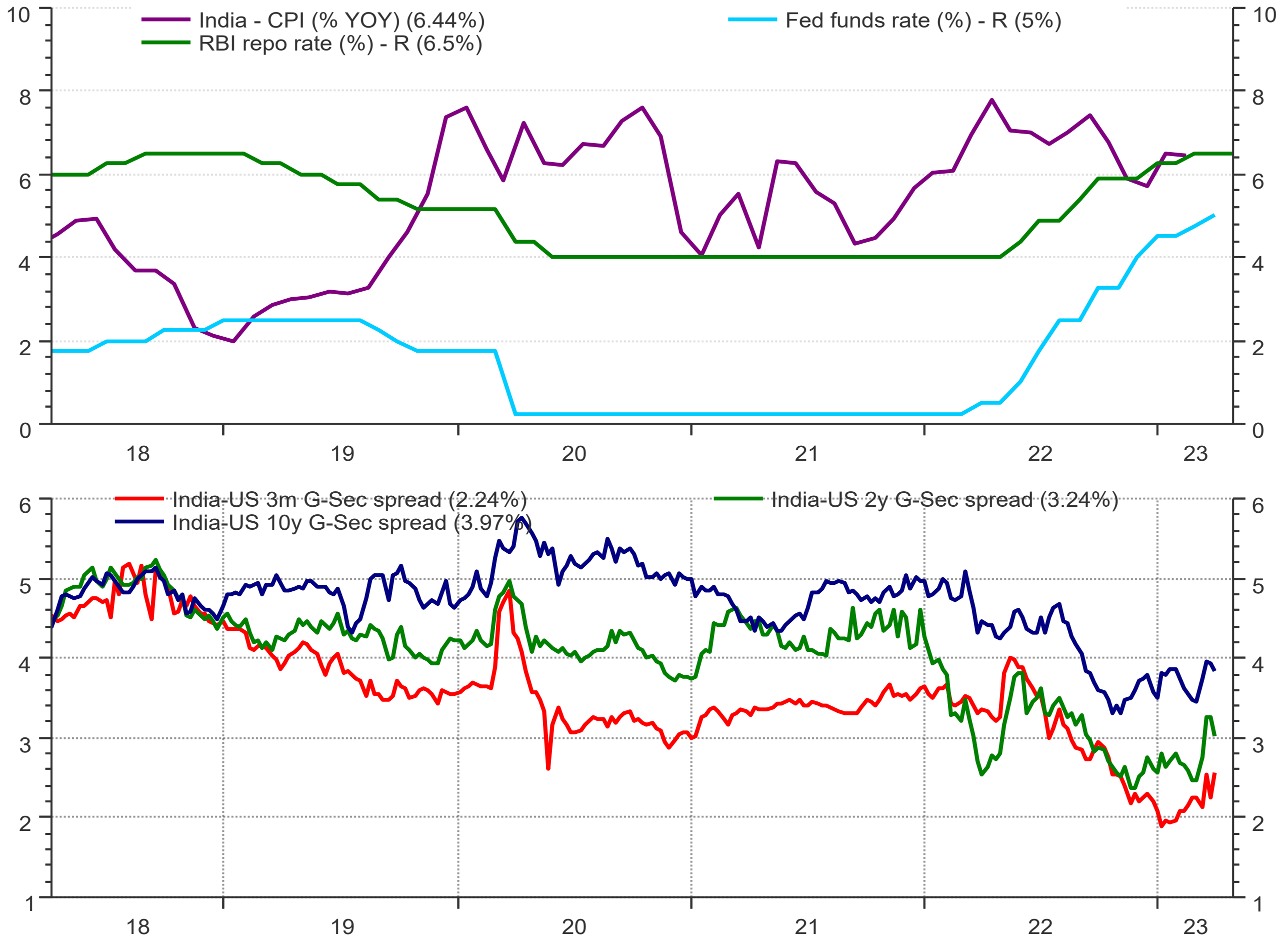
Source: Refinitiv Datastream, NSE EPR.

Figure 5: India sovereign yield curve



Source: Refinitiv Datastream, NSE EPR.

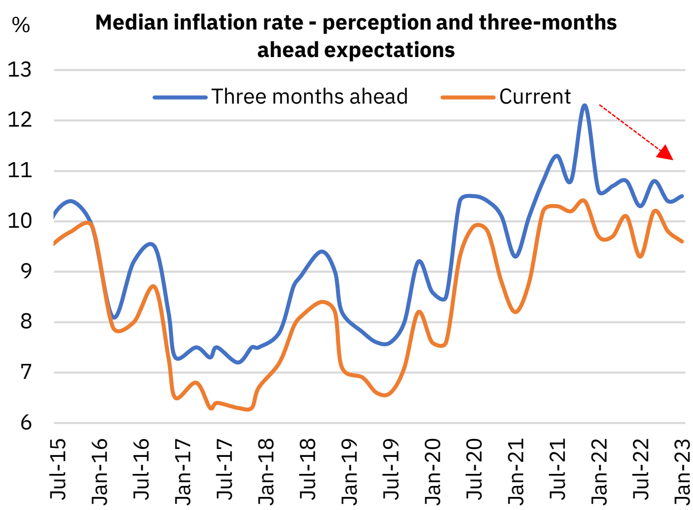
Figure 6: India vs. US policy rates and yield differential

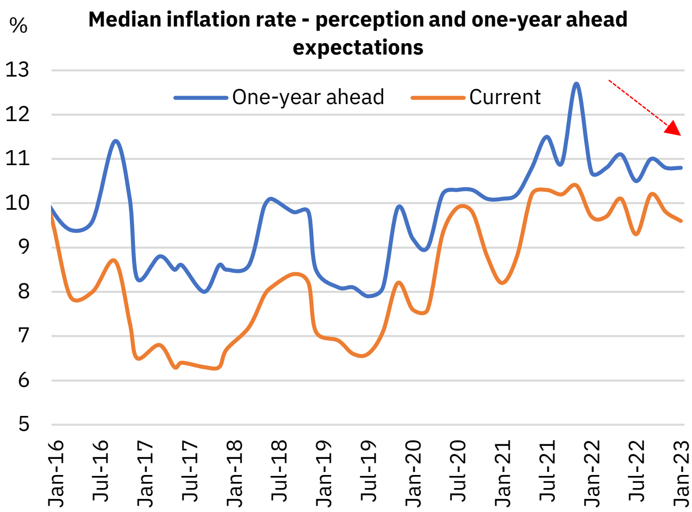


Source: Refinitiv Datastream, NSE EPR.

Figure 7: Household inflation expectation: 3-months and one-year ahead

Household inflation expectations –both 3-months and one year ahead—have been tapering off signalling anchored inflation expectations.

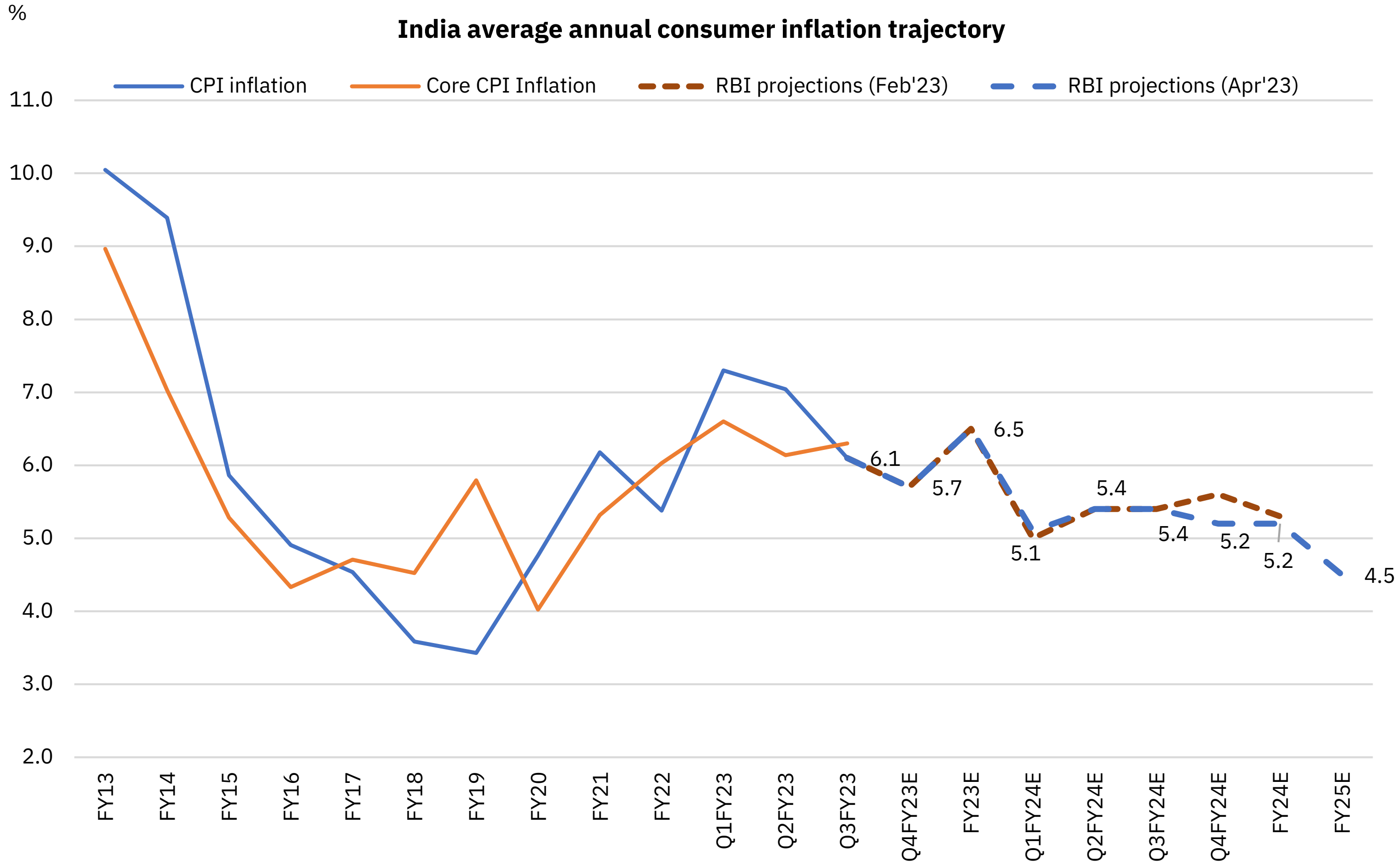




Source: RBI, NSE EPR.

Figure 8: India's consumer inflation trajectory and RBI's forecasts

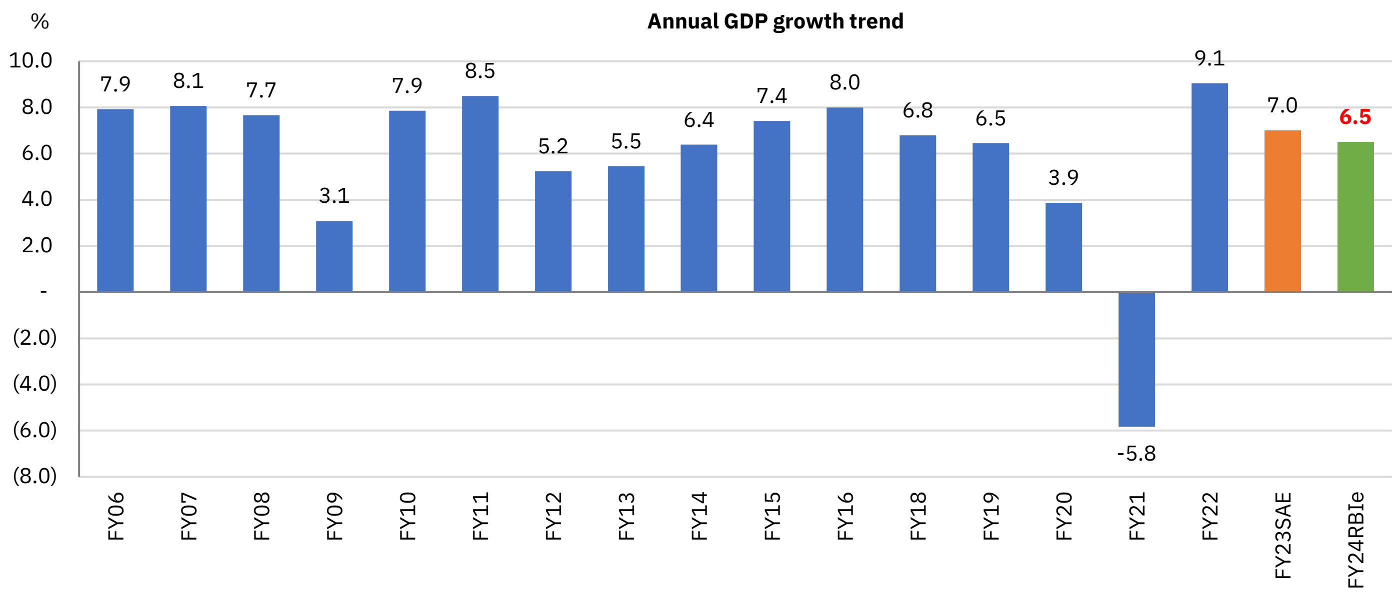
RBI has revised its headline CPI inflation forecast for FY24 to 5.2% from 5.3%, assuming a normal monsoon, average crude oil price of US$85/bbl and average exchange rate of Rs82/US$.



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

Figure 9: GDP growth trend and estimate for FY24

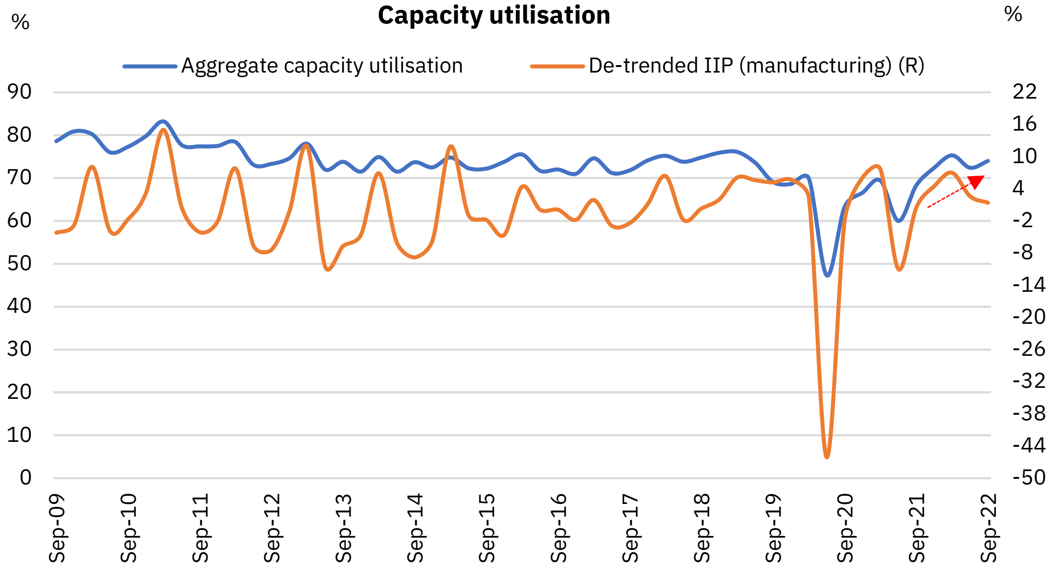
The RBI revised its growth forecast upwards to 6.5% for FY24 from 6.4% estimated in the last policy supported by strong urban demand, capex thrust by the government and reviving manufacturing activity. This is much higher than 6% estimated by the RBI's Survey of Professional Forecasters.



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

Figure 10: Capacity utilization trend

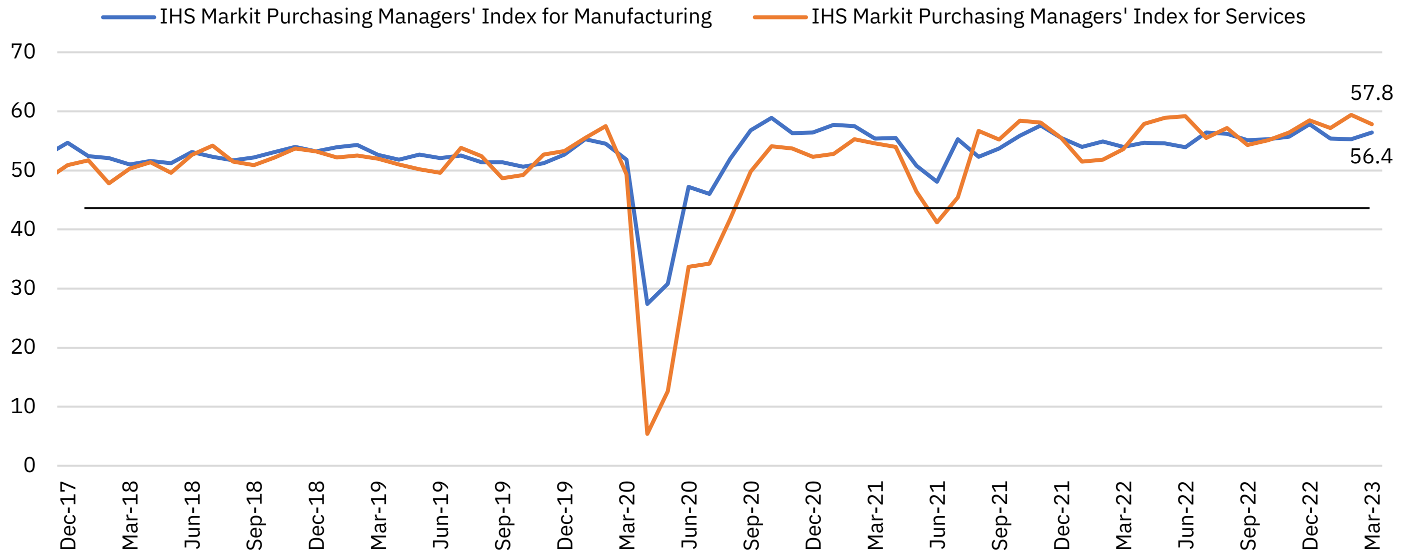
Uptick in capacity utilisation bodes well for manufacturing going forward.



Source: CMIE Economic Outlook, NSE EPR.

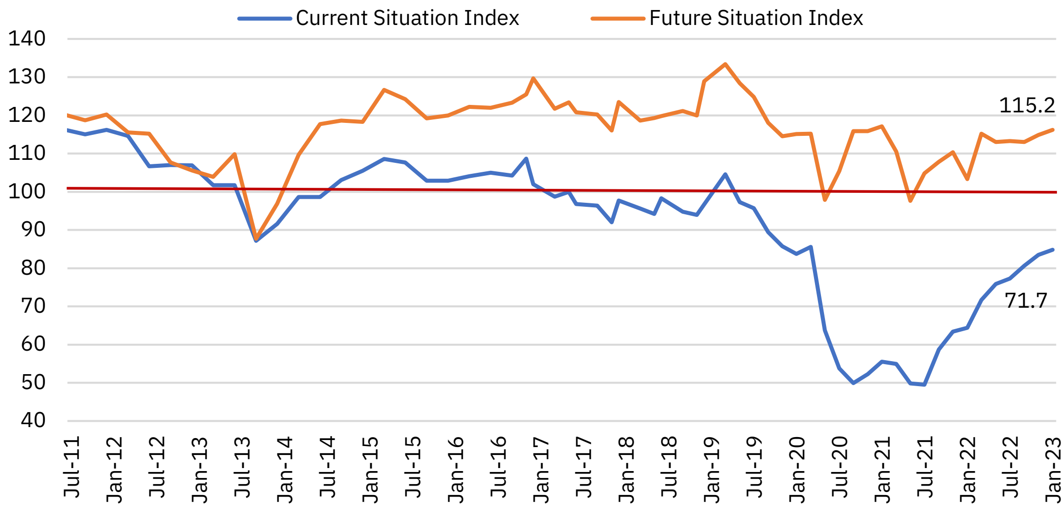
Figure 11: India's manufacturing and services PMI trend

Capex thrust by the Centre, increasing capacity utilization in manufacturing and easing commodity prices are likely to boost manufacturing and investment activities, thereby supporting growth in FY24.



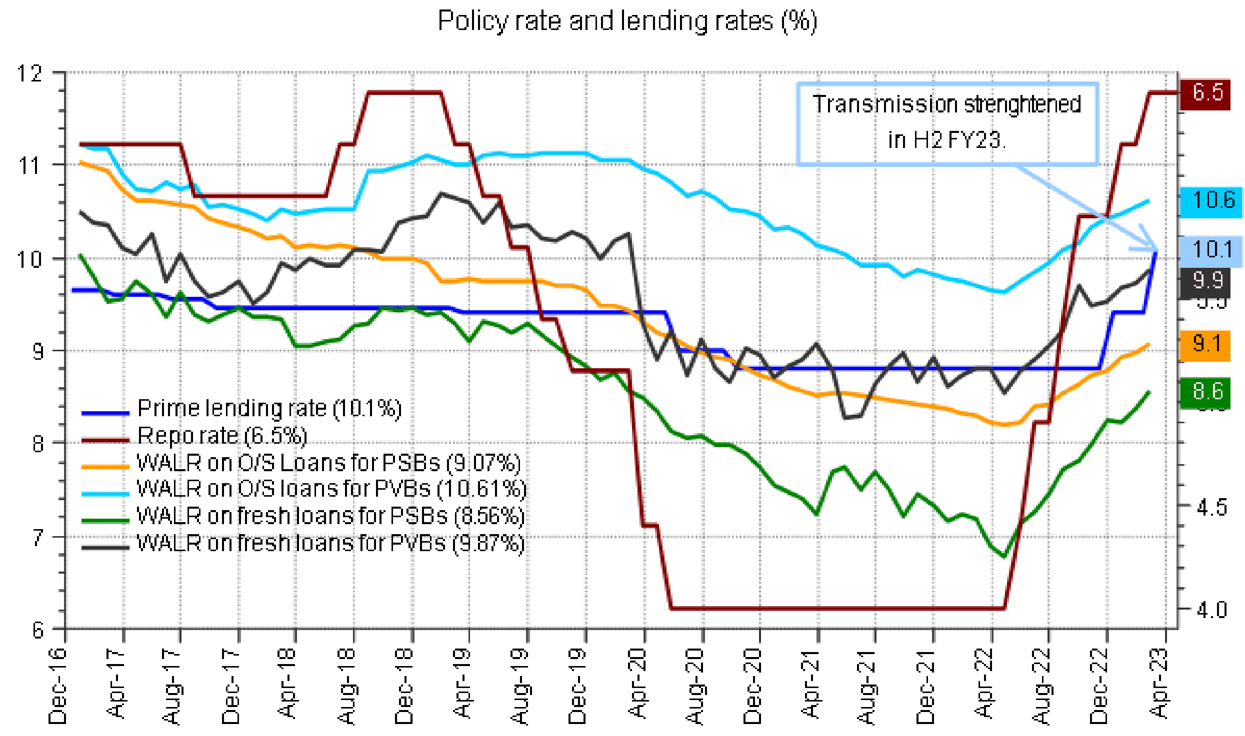
Source: CMIE Economic Outlook, NSE EPR.

Figure 12: Consumer Confidence Indices



Source: CMIE Economic Outlook, NSE EPR.

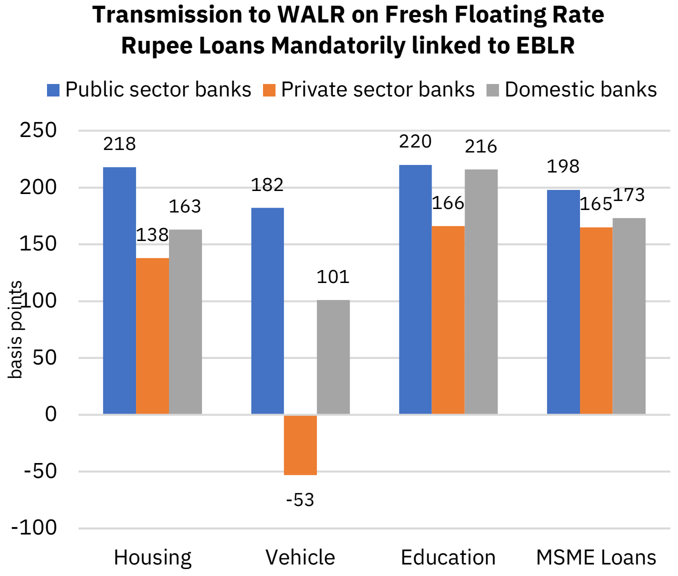
Figure 13: Policy transmission in credit markets

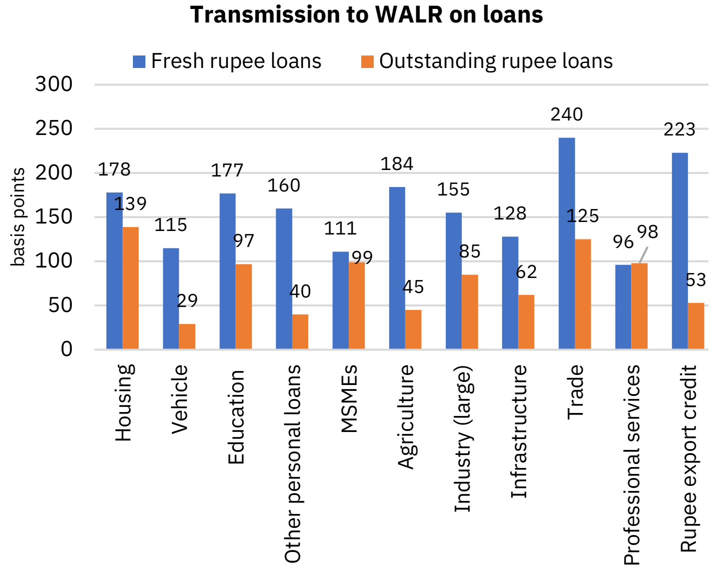


Source: CMIE Economic Outlook, Refinitiv Datastream, NSE EPR.

Figure 14: Sector-wise policy transmission in credit markets

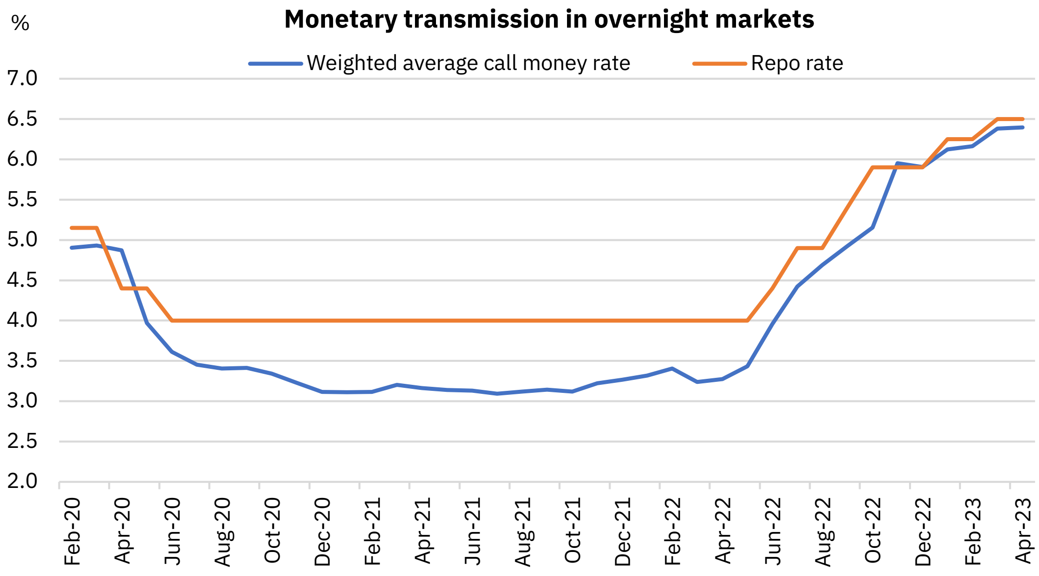
Fresh floating rate rupee loans linked to EBLR have seen strong pass-through of rate hikes, particularly in public sector banks. Loans issued in sectors like trade and rupee export credit have already observed around 90% transmission.





Source: CMIE Economic Outlook, NSE EPR.

Figure 15: Policy transmission in overnight markets



Source: CMIE Economic Outlook, NSE EPR.

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