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RBI Monetary Policy: A hawkish 35bps hike

The RBI's Monetary Policy Committee (MPC) expectedly decided to hike the policy repo rate by another 35 bps to 6.25%, while maintaining focus on withdrawal of accommodation. This has translated into a cumulative hike of 225bps on the repo rate since May'22. Notably, while this was the first dissent on the rate hike action itself, the dissent on the stance has widened. High and sticky core inflation with persisting upside risks, coupled with a resilient domestic economy, was the key reason behind the hawkish rate hike action today. While the MPC acknowledged moderation in inflationary pressures and retained their FY23 forecast at 6.7% (up 10bps for H2), it reiterated the need for continued calibrated monetary policy action to ease pressures on core inflation and keep inflation expectations anchored, thereby dashing any hopes of a pause for now. GDP growth forecast for FY23 was downgraded further from 7.0% to 6.8%, citing adverse spill overs from global economic slowdown on India's exports and overall economic activity.

Overall, while the quantum of rate hike and decision to keep the stance unchanged was in line with market expectations, the commentary was mildly hawkish. Contrary to providing hints of a pause in the next review, the MPC remained cautious and reiterated its commitment to continue to fight the battle against inflation. This, along with resilient economic activity in the light of global headwinds, leaves the room open for further rate hikes. Domestic growth-inflation dynamics apart, the FOMC's guidance on future rate hikes would also have a bearing on RBI's policy stance. This may keep bond yields under pressure.

- **RBI hiked repo rate by another 35bps:** Following three consecutive 50bps hikes, the RBI's MPC, with a 5:1 majority, decided to hike the policy rate by another 35bps, translating into a cumulative hike of 225bps 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 6.25%, 6.0% and 6.5% respectively. The MPC also voted, albeit with a reduced 4:2 majority, to remain focused on withdrawal of accomodation. Notably, while this was the first dissent on the rate hike action itself, the dissent on the stance has widened.

RBI expectedly hiked policy repo rate by another 35bps, taking cumulative hike to 225bps since May'22.

- **Liquidity conditions to improve:** Daily surplus liquidity has shrunk further from Rs 2.2trn in Aug-Sep to Rs 1.4trn in Oct-Nov, but is expected to increase over the next few months, thanks to lower post-festival currency in circulation, pick up in Government spending and revival in foreign capital outflows. Notwithstanding ongoing liquidity absorption cycle, the RBI remains flexible and is ready to inject liquidity, if needed, as may be signalled by a meaningful drawdown of SDF and VRRR (Variable Rate Reverse Repos) balances by banks.
- **Growth forecast cut; inflation forecast retained:** The RBI has reduced its FY23 GDP forecast from 7.0% to 6.8%, citing adverse spillovers from global economic slowdown on India's exports and overall economic activity, even as domestic consumption and investment outlook remains robust. Inflation forecast for FY23 has been retained at 6.7% but with a modest 10bps jump in estimate for the second half (6.25%), and is pegged to drop to 5.0% by Q1 FY24. Even as commodity prices have fallen, uncertainty emanating from prolonged geopolitical conflict, dollar strengthening and pass-through of higher prices in the services sector continue to impart uncertainty to near-term inflation outlook.

FY23 GDP growth forecast has been further downgraded from 7.0% to 6.8%.

Inflation forecast for FY23 retained at 6.7%.

- **Regulatory measures:** To enable banks better manage their investment portfolios, RBI has decided to enhance the limits of SLR holdings in Held to Maturity (HTM) category from 19.5% to 23% of NDTL. Moreover, RBI has proposed to: (i) introduce a single-block-and-multiple debits functionality in UPI, (ii) expand scope of Bharat Bill Payment System to include all categories of payments and collections, both recurring and non-recurring. RBI has permitted resident entities to hedge gold price risk in the overseas market.

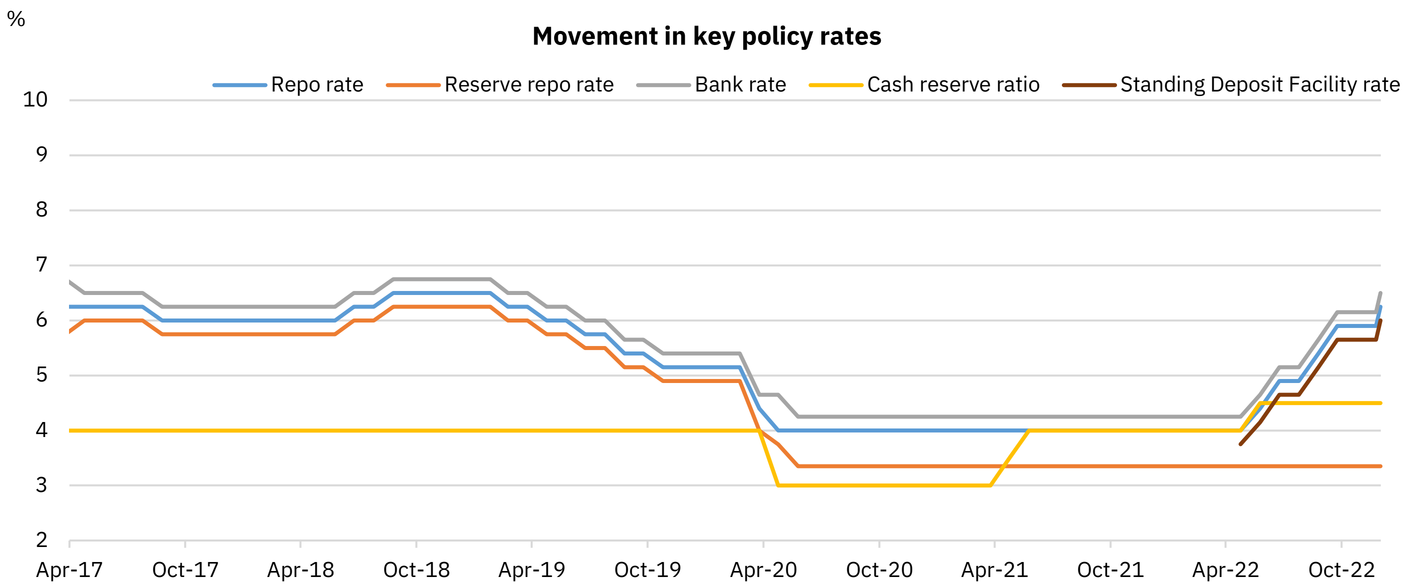
- **Hawkish policy tone leaves the room open for more rate hikes:** While the quantum of rate hike and unchanged stance were in line with market expectations, the commentary had a hawkish tilt, with the MPC providing no hints of a pause for now as was widely anticipated. In fact, the MPC's acknowledgement of high upside risks to inflation arising from unabating geopolitical tensions, pending pass-through of input costs and rupee depreciation, along with a resilient growth outlook, leaves the room open for further rate hikes. Domestic growth-inflation dynamics apart, the FOMC's guidance on future rate hikes would also have a bearing on RBI's policy stance. This may keep bond yields under pressure.

Table 1: Current policy rates

Key rates	Scheduled Jun Policy	Scheduled Aug Policy	Scheduled Sep Policy	Scheduled Dec Policy
Repo Rate	4.90%	5.40%	5.90%	6.25%
Standing Deposit Facility (SDF)*	4.65%	5.15%	5.65%	6.00%
Marginal Standing Facility (MSF)	5.15%	5.65%	6.15%	6.50%
Bank Rate	5.15%	5.65%	6.15%	6.50%
Cash Reserve Ratio (CRR)	4.50%	4.50%	4.50%	4.50%

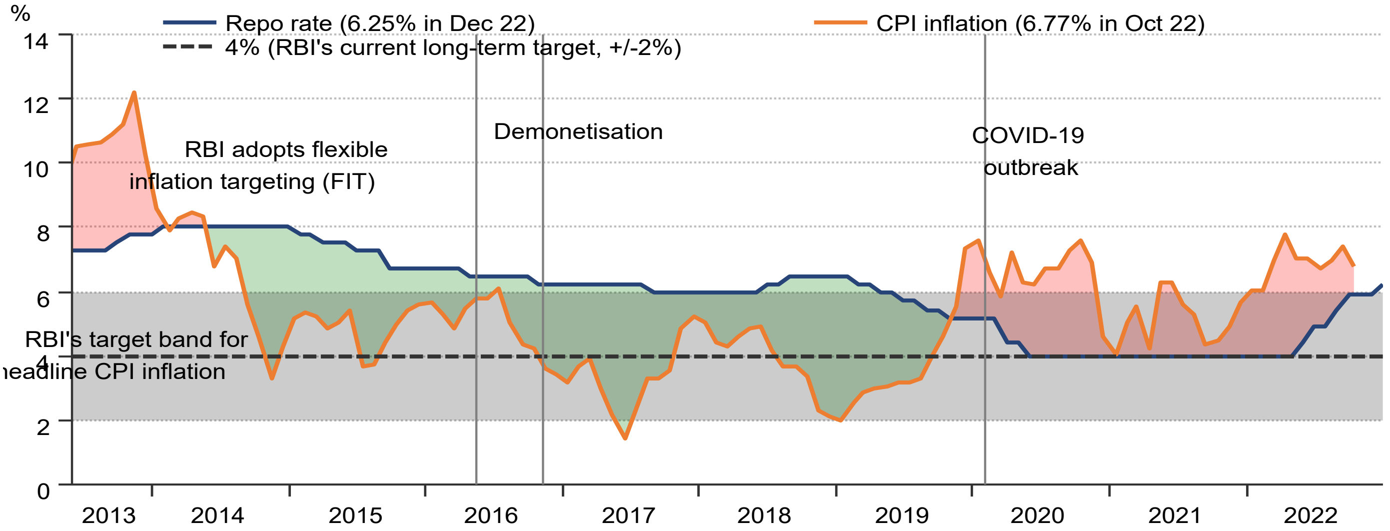
Source: RBI, NSE EPR. * Introduced in April 2022 policy as the new floor of the LAF corridor.

Figure 1: Policy repo rates hiked by another 35bps taking cumulative rate hikes to 225bps so far in FY23



Source: Refinitiv Datastream, NSE EPR.

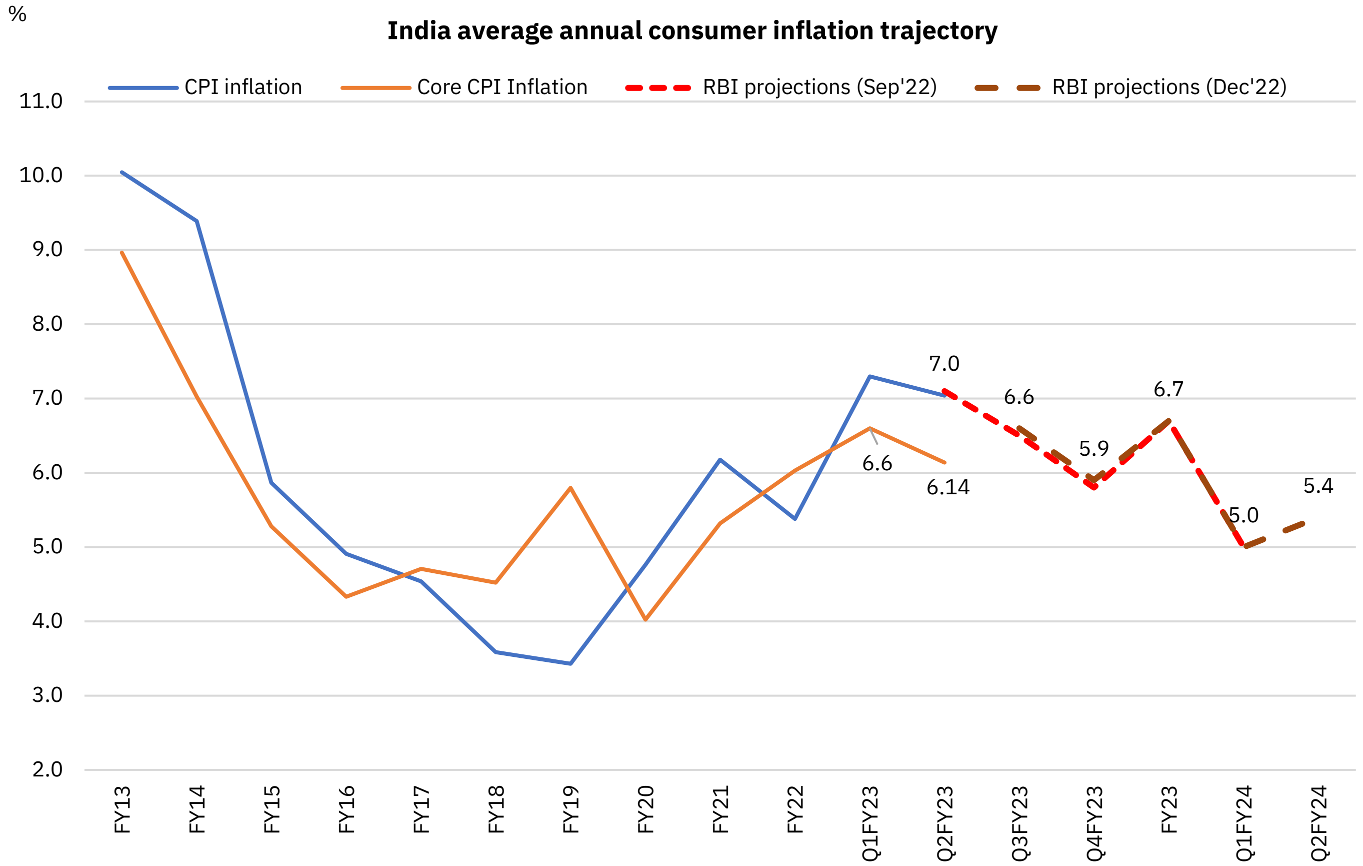
Figure 2: Real interest rates have remained negative for over three years now



Source: Refinitiv Datastream, NSE EPR.

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

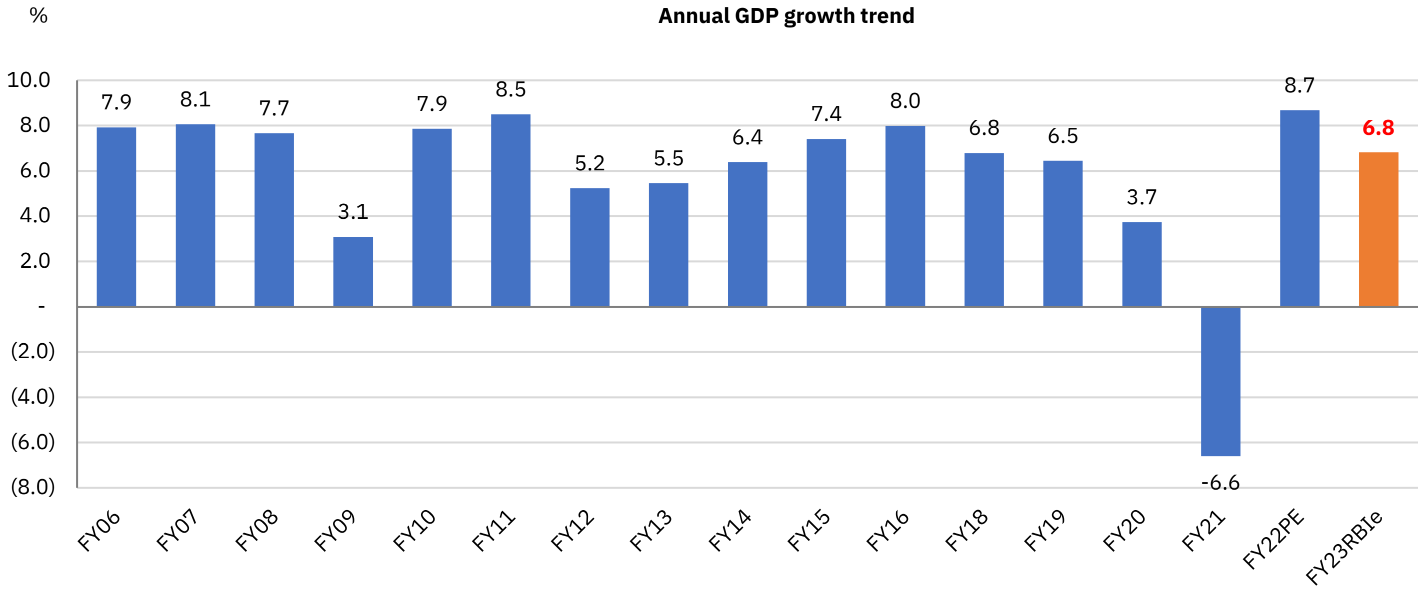
The RBI has retained its headline CPI inflation forecast at 6.7% for FY23, with Q3 at 6.6% and Q4 at 5.9%, 10bps higher than that forecasted in the previous policy. Inflation is expected to 5.2% in the first half of FY24 assuming a normal monsoon.



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 FY23

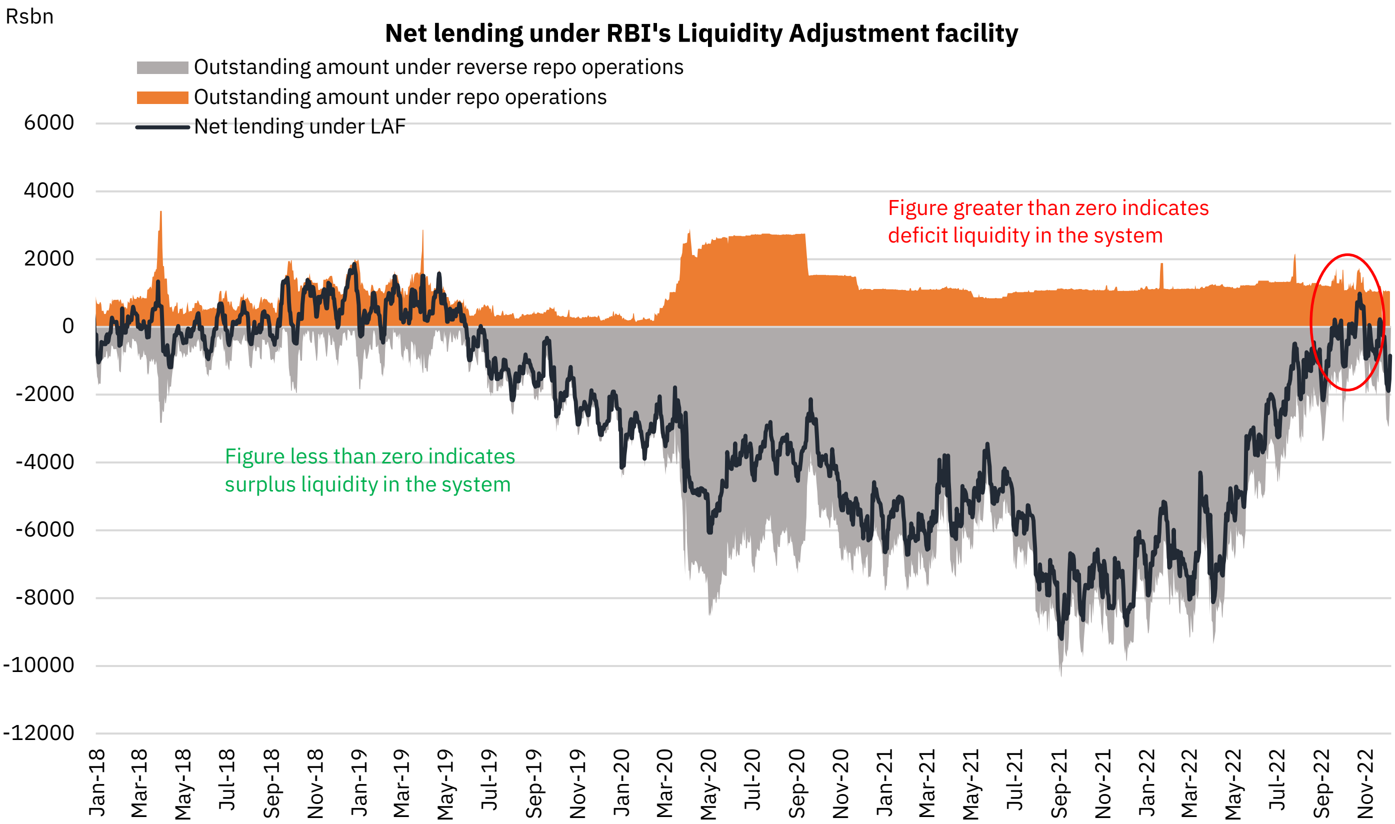
The RBI further lowered FY23 GDP growth forecast to 6.8% from 7.0% on account of global headwinds emanating from geopolitical tensions, (ii) tightening global financial conditions, and (iii) global economic slowdown. Estimated growth for Q3 and Q4 GDP is pegged at 4.4% and 4.2% respectively with risks evenly 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

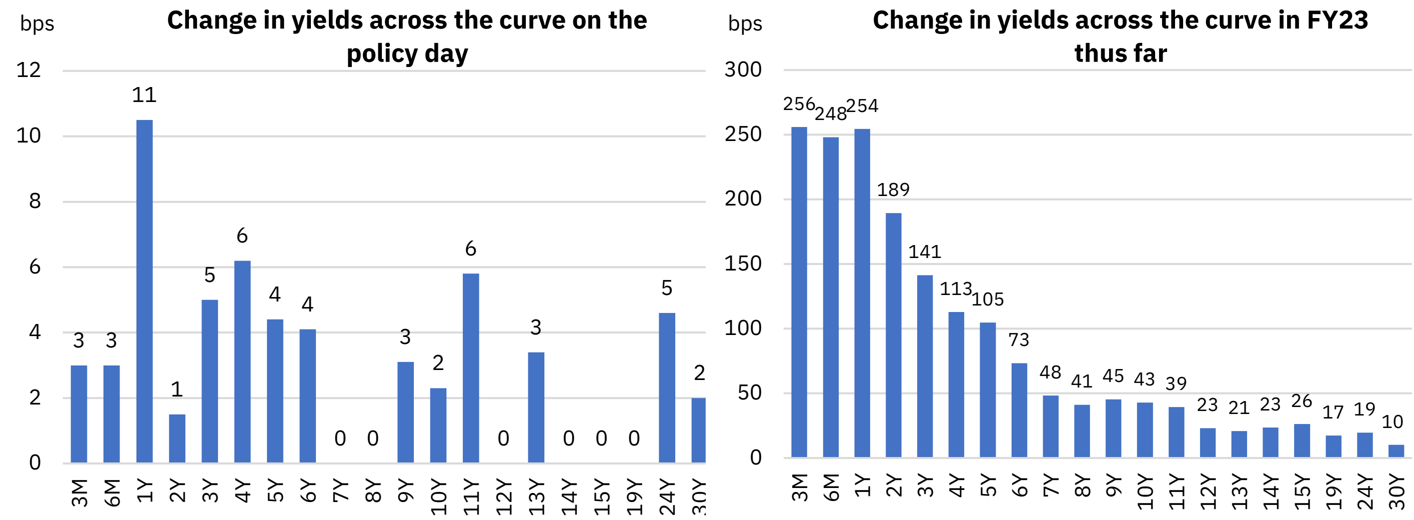
Daily surplus liquidity has shrunk further from Rs 2.2trn in Aug-Sep to Rs 1.4trn in Oct-Nov, but is expected to increase over the next few months, thanks to lower post-festival currency in circulation, pick up in Government spending and revival in foreign capital outflows.



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

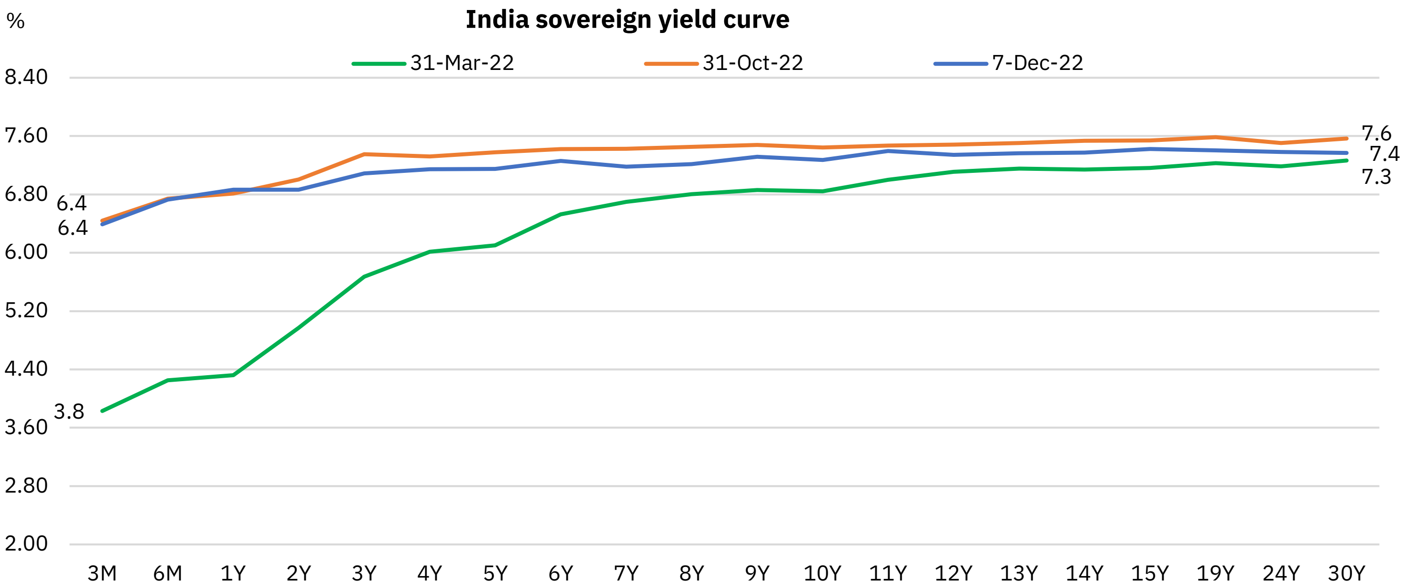
Figure 6: YTD change in yield curve on the policy day and FY23 till date (As on December 7th, 2022)

The RBI's hawkish undertone led to yields rising marginally across the curve 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 a significant flattening of the yield curve.



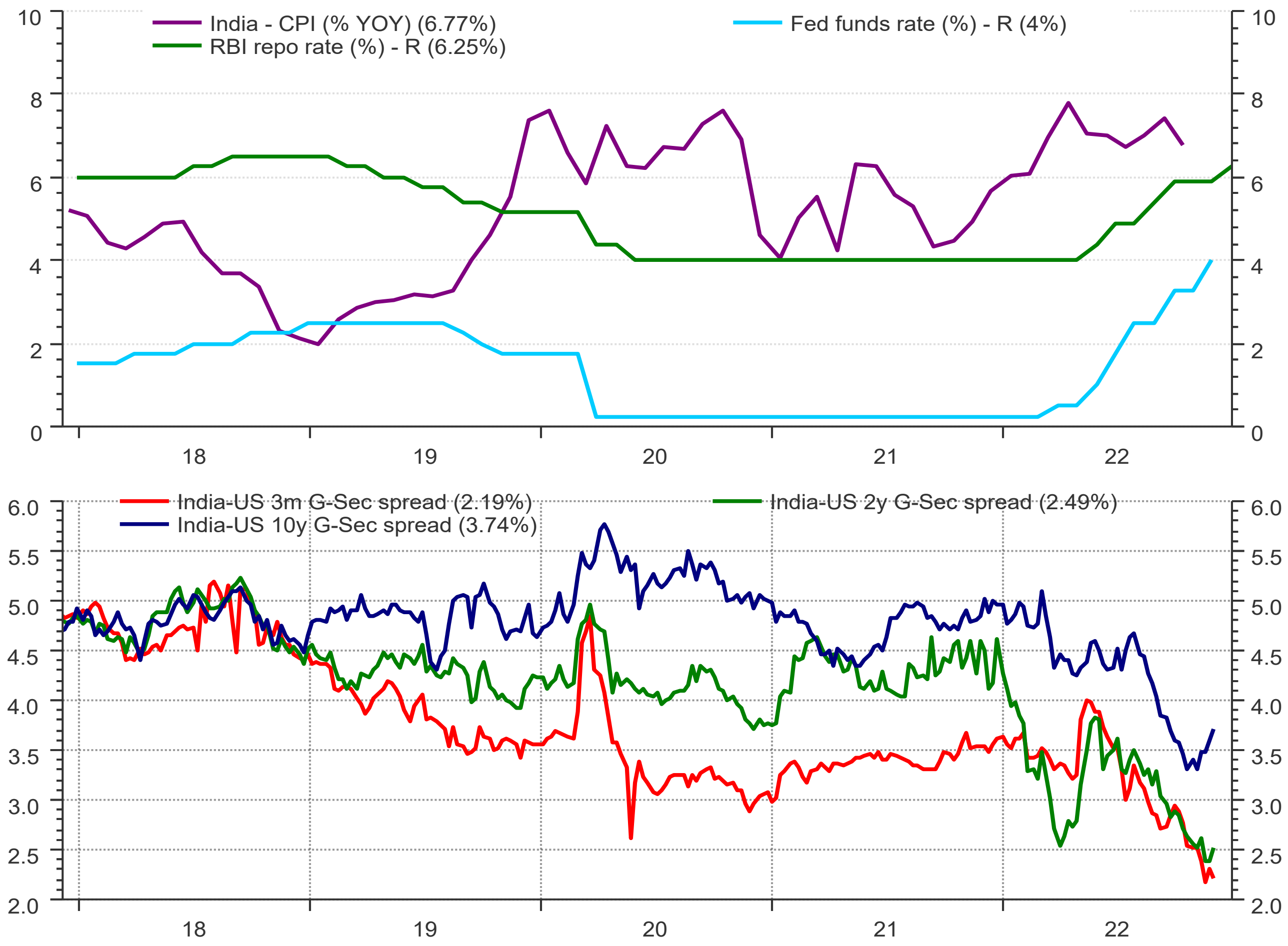
Source: Refinitiv Datastream, NSE EPR.

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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