RBI's third policy meet for FY2022-23 – Impact Analysis

June 08, 2022

The Reserve Bank of India (RBI) in its third meeting for FY2022-23 today, raised the repo rate by 50bps to 4.9%, maintaining its focus on tackling inflation. The vote was unanimous, with all six members of the MPC also voting to "remain focused on the withdrawal of accommodation to ensure inflation remains within the target going forward, while supporting growth".

Highlights of the Policy:

- Raised the repo rate by 50bps to 4.9%, decision was unanimous
- The Standing Deposit Facility (SDF) rate stands adjusted to 4.65% while the marginal standing facility (MSF) rate and the Bank Rate now stands increased to 5.15%.
- The official stance now changed from 'accommodative' to 'withdrawal of accommodation'
- Cash Reserve Ratio (CRR) remains at 4.50%
- Real GDP growth forecast for FY23 maintained at 7.2%, with Q1FY23 growth projected at 16.1%, Q2 at 6.2%, Q3 at 4.1% and Q4 at 4%
- Inflation for FY23 projected higher at 6.7% from 5.7% earlier with Q1 at 7.5%, Q2 at 7.4%, Q3 at 6.2% and Q4 at 5.8%, considering crude oil at USD 105/bbl

Regulatory Measures:

- Enhancement in Limits on Individual housing loans by Tier I / Tier II Cooperative Banks from INR 0.3mn / INR 0.7mn earlier to INR 0.6mn/ INR 1.4mn, in light of the increase of housing prices since the last revision of limits

Payments and Settlement Systems:

- Enhancement of limits on e-mandates on credit/debit cards for recurring payments from INR 5,000 to INR 15,000 to facilitate payments of larger ticket recurring payments

- Proposed linkage of credit cards to the Unified Payments Interface (UPI) account of individuals, starting from 'RuPay' credit cards, to increase the reach and usage of UPI

RBI assessment on Global economy:

- Since the MPC's meeting in May 2022, the global economy continues to grapple with multi-decadal high inflation and slowing growth, persisting geopolitical tensions and sanctions, elevated prices of crude oil and other commodities and lingering COVID-19 related supply chain bottlenecks.

- Globally, financial markets have been turbulent amidst growing stagflation concerns, leading to a tightening of global financial conditions and risks to the growth outlook and financial stability.

RBI assessment on domestic economy:

- India's real gross domestic product (GDP) growth in FY22 came in at 8.7%. This works out to 1.5% above the pre-pandemic level (2019-20). In Q4:2021-22, real GDP growth decelerated to 4.1% y-o-y from 5.4% y-o-y in Q3, dragged down mainly by weakness in private consumption on the back of the Omicron wave.

- High frequency indicators in the April May 2022 period indicates a broadening of the recovery in economic activity. Urban demand is recovering and rural demand is gradually improving. Merchandise exports posted robust double-digit growth for the fifteenth month in a row during May while non-oil non-gold imports continued to expand at a healthy pace, pointing to recovery of domestic demand.

- Overall system liquidity remains in large surplus, with the average daily absorption under the LAF moderating to INR 5.5tn during May 4 - May 31 from INR 7.4tn during April 8 - May 3, 2022 in consonance with the policy of gradual withdrawal of accommodation.

- CPI headline inflation rose further from 7.0 per cent in March 2022 to 7.8 per cent in April 2022, reflecting broad-based increase in all its major constituents. Consequent to the recent reduction in excise duties, domestic retail prices of petroleum products have moderated. International crude oil prices, however, remain elevated, with risks of further pass-through to domestic pump prices. The restrictions on wheat exports should improve the domestic supplies but the shortfall in the rabi production due to the heat wave could be an offsetting risk. The forecast of a normal south-west monsoon augurs well for the kharif agricultural production and the food price outlook.

Our Analysis & Outlook

- Overall policy was on expected lines as inflation concerns continue to gain prominence over growth. However, we expect inflation levels to be comparatively higher despite the upwards revision by the RBI.

- The hike in the policy is expected to push the overall yields up and expect longer-end to more protected compared to shorter-end due to the high term premium.

- Going ahead, we expect the RBI to prioritize containing inflation over supporting growth with a series of rate hikes in the upcoming meetings.

- We expect yield curve to flatten and shorter-end to elevate in a bear flattening scenario. We continue to be positioned in floating-rate bonds as a defensive stance due to rising-rate environment and expect them to outperform all other fixed-income instruments in the current rising interest rate scenario.

Data source: RBI's Third Monetary Policy Meet statement for FY2022-23 dated 8th June, 2022

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