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

December 07, 2022

In line with our expectations, the Reserve Bank of India (RBI) today slowed its pace of rate hikes, raising the repo rate by 35bps to 6.25%, focused on anchoring inflation expectations and maintaining its 'withdrawal of accommodation' stance. However, the monetary policy committee also pointed to further 'calibrated monetary policy action' to keep inflation in check, 'break the core inflation persistence' and manage its second round effects.

Highlights of the Policy:

- All but one member voted for a 35bps rate hike, while one member voted against the rate hike, in favor of a pause.
- The Standing Deposit Facility (SDF) rate stands adjusted to 6% while the marginal standing facility (MSF) rate and the Bank Rate now stands increased to 6.50%
- Four of the six members voted in favor of maintaining the policy stance remaining 'withdrawal of accommodation' while two voted against it.
- Cash Reserve Ratio (CRR) remains at 4.50%
- Growth forecast for FY23 was trimmed further to 6.8% from 7.0% earlier, with Q3 FY23 growth trimmed to at 4.4% (4.6% earlier) and Q4 at 4.2% (4.6% earlier).
- Inflation projection for FY23 retained at 6.7% for FY23 with Q3 FY23 inflation projected at 6.6% and Q4 at 5.9%, considering an average crude basket at USD 100 per barrel

Regulatory measures:

- Increased the limits under Held to Maturity (HTM) category from 19.5% to 23% of net demand and time liabilities (NDTL) for banks up to March 31, 2024. The HTM limits would then be restored from 23% to 19.5% in a phased manner starting from the quarter ending June 2024.

Payments and Settlement Systems:

- Introduction of single block and multiple debits functionality in the Unified Payments Interface (UPI) to enhance ease of making payments and towards investment in securities (to enable customers to create payment mandate by blocking funds in their bank account)

- Expand the scope of Bharat Bill Payment System (an interoperable payment platform operated by NPCI), to also include all categories of payments, both recurring and non-recurring in nature.

Financial Markets:

- Residents are now permitted to hedge their gold price risk on recognized exchanges in the International Financial Services Centre.

- Restoration of bond market trading hours as a move towards normal liquidity operations from 9AM to 5PM

RBI assessment on Global economy:

- The global economic outlook is skewed to the downside. Global growth is set to lose momentum as monetary policy actions tighten financial conditions and as consumer confidence weakens with the rising cost of livelihood.

- Inflation remains elevated and persistent across countries as they grapple with food and energy price shocks and shortages. More recently, however, there are some signs of moderation in price pressures, which have raised expectations of an easing in the pace of monetary tightening.

- Capital flows to emerging markets (EMs) remain volatile and global spillovers pose risks to growth prospects.

RBI assessment on domestic economy:

- In Q3 FY23, economic activity has been resilience. Aggregate demand conditions have been supported by pent-up spending and discretionary expenditures during the festival season. Urban demand has remained buoyant, and rural demand is recovering. Investment activity is in modest expansion. Merchandise exports contracted in October after an expansion for 19 consecutive months.

- CPI inflation moderated to 6.8% (y-o-y) in October 2022 from 7.4% in September, with favorable base effects mitigating the impact of pick-up in price momentum in October. Food inflation softened, aided by easing inflation in vegetables and edible oils, despite sustained pressures from prices of cereals, milk and spices.

- The overall liquidity remains in surplus, with average daily absorption under the liquidity adjustment facility (LAF) at INR 1.4tn during October-November. On a y-o-y basis, money supply (M3) expanded by 8.9% as on November 18, 2022 while bank credit rose by 17.2%. India's foreign exchange reserves were placed at USD 561.2 billion as on December 2, 2022.

- The inflation trajectory going ahead would be shaped by both global and domestic factors. In case of food, while vegetable prices are likely to see seasonal winter correction, prices of cereals and spices may stay elevated in the near-term on supply concerns. Global demand is weakening. Unabating geopolitical tensions continue to impart uncertainty to the food and energy prices outlook. The correction in industrial input prices and supply chain pressures could help ease pressures on output prices; but the pending pass-through of input costs could keep core inflation firm.

Our Analysis & Outlook

- Today's 35bps rate hike was on expected lines as the RBI continued its emphasis on tackling persistent elevated core inflation.

- The yield curve is very flat at the present, presenting an opportunity to be positioned in the shorter end of the curve rather than the longer end.

- A similar trend was visible in corporate bond yields – the shorter end of the duration rising higher than the longer end.

- Credit spreads over G-Secs have widened due to softer transmission of G-Sec yield movements onto corporate bond yields. Wide spreads are a feature of the growth phase of the economic cycle. In this phase, accrual strategy is more attractive compared to duration.

- We expect accruals to become a dominant source of returns going ahead.

- Also, going forward, we expect the RBI to continue hiking rates due to inflation persisting above the RBI's comfort level; and also to offset the US Fed's rate hikes in a bid to protect the INR against a stronger US dollar.

- We continue to hold 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 sixth Monetary Policy Meet statement for FY2022-23 dated 7th December, 2022

Note: FY refers to 1-year period ending March

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