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

August 05, 2022

The Reserve Bank of India (RBI) in its fourth meeting for FY2022-23 today, raised the repo rate by 50bps to 5.4%, maintaining its focus on tackling inflation. The rate hike seemed to be front loaded on account of elevated higher core inflation and current account deficit. The vote for 50bps hike was unanimous, with all but one 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". Furthermore, the RBI maintained its FY23 inflation projection at 6.7%, reiterating its commitment to keep inflation expectations anchored.

Highlights of the Policy:

- Raised the repo rate by 50bps to 5.4%, decision was unanimous
- The Standing Deposit Facility (SDF) rate stands adjusted to 5.15% while the marginal standing facility (MSF) rate and the Bank Rate now stands increased to 5.65%.
- The official stance remains '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 16.2%, Q2 at 6.2%, Q3 at 4.1% and Q4 at 4%
- Inflation projection for FY23 retained at 6.7% with Q2 at 7.1%, Q3 at 6.4% and Q4 at 5.8%, considering the average crude basket at USD 105 per barrel

Financial Markets:

- Allowed Standalone Primary Dealers (SPDs) to offer all foreign exchange market-making facilities as currently permitted to Category-I Authorized Dealers in order to increase the breadth of forex market in India

Payments and Settlement Systems:

- Bharat Bill Payment System (BBPS), an interoperable platform for standardized bill payment experience, centralized customer grievance redress mechanism, uniform customer convenience fee etc., shall now be available to non-resident Indians (NRIs) to undertake utility, education and other bill payments on behalf of their families in India

RBI assessment on Global economy:

- Since the MPC's meeting in June 2022, the global economic and financial environment has deteriorated with the combined impact of monetary policy tightening across the world and the persisting war in Europe heightening risks of recession.

- Global financial markets have experienced surges of volatility and large sell-offs.

- The US dollar index soared to a two-decade high in July. Both advanced economies (AEs) and emerging market economies (EMEs) witnessed weakening of their currencies against the US dollar.

- Emerging markets are experiencing capital outflows and reserve losses which are exacerbating risks to their growth and financial stability.

- International crude oil prices have eased in recent weeks but remain elevated and volatile on supply concerns even as the global demand outlook is weakening. The appreciation of the US dollar can feed into imported inflation pressures.

RBI assessment on domestic economy:

- Domestic economic activity remains resilient. High frequency indicators of activity in the industrial and services sectors are holding up. Urban demand is strengthening while rural demand is gradually catching up.

- On the other hand, elevated risks emanating from protracted geopolitical tensions, the upsurge in global financial market volatility and tightening global financial conditions continue to weigh heavily on the outlook.

- As on August 04, 2022, the south-west monsoon rainfall was 6 per cent above the long period average (LPA). Rising kharif (summer) sowing augurs well for the domestic food price outlook. The shortfall in paddy sowing, however, needs to be watched closely, although stocks of rice are well above the buffer norms.

- CPI inflation eased to 7.0% y-o-y during May-June 2022 from 7.8% in April, although it persists above the upper tolerance band. Food inflation has registered some moderation, while fuel inflation moved back to double digits in June primarily due to the rise in LPG and kerosene prices.

- While core inflation (i.e., CPI excluding food and fuel) moderated in May-June due to the full direct impact of the cut in excise duties on petrol and diesel pump prices, it remains at elevated levels.

- Overall system liquidity continues in surplus, with average daily absorption under the LAF at INR 3.8tn during June-July. Foreign exchange reserves were placed at USD 573.9 billion as on July 29, 2022.

Our Analysis & Outlook

- Today's 50bps rate hike was above consensus market expectations of 35bps

- Moreover, the RBI continues to remain data dependent, aligned to its global peers. Inflation and growth projections continues to remain unchanged.

- The yield curve post the policy has comparatively flattened. This means that the impact of any future rate hike might be visible across the curve, and may not be limited to the shorter-end.

- Expect rate hikes in the upcoming policies as Inflation is likely to remain above the RBI's target range of 4% +/- 2% on account of imported inflation due to dollar strengthening and elevated energy prices.

- Surplus liquidity from the banking system continues to be absorbed due to RBI interventions and strong credit growth. We expect this trend to continue and push overnight yields closer to the policy rate.

- Going forward, active management will play a key part in navigating fixed-income markets due to fast-evolving macros involving global central bank tightening monetary policy, rising inflation levels and recessionary pressures.

- 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 Fourth Monetary Policy Meet statement for FY2022-23 dated 5th August, 2022

Disclosures: