RBI Monetary Policy Review

Economic Update| 7th December 2022

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MPC Hikes Repo Rate By 35 Basis Points, Trims Growth Forecast

Event	Actual	Consensus	Previous
Repo rate	6.25%	6.15% - 6.25%	5.90%
Standing deposit facility (SDF)	6.00%	-	5.65%
Marginal standing facility (MSF)	6.50%	-	6.15%

Highlights:

- India's Monetary Policy Committee (MPC) has hiked the benchmark repo rate by 35 basis points to the highest since February 2019to quell inflation.
- The committee had first raised rates by 40 basis points at an unscheduled meeting in May, followed by 50 basis points each in June, August and September.
- The MPC also decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.
- Four of the six members voted to remain focused on withdrawal of accommodation to ensure that inflation remains within the target while supporting growth, with Ashima Goyal and Jayanth R. Varma voting against this part of the resolution.

Inflation Outlook:

- The committee has retained the inflation projections at 6.7% for FY23. Inflation is expected to remain above or close to the upper threshold in Q3 and Q4FY23 and is likely to moderate in H1FY24 but will still remain well above the target.
- MPC highlighted that pressure points in form of high and sticky core inflation and exposure of food inflation to international factors and weather related events still persists and that the battle against inflation still persists and is not yet over.
- MPC projected inflation at 6.7% in FY23, with Q3 at 6.6% and Q4 at 5.9%. CPI inflation for Q1FY24 is projected at 5% and for Q2 at 5.4%, on the assumption of a normal monsoon.

Growth Outlook:

- MPC continued to lower the GDP growth forecast from 7.2% in August 2022 meet to 7.0% in September 2022 and further down to 6.8% in December 2022 meet.
- The committee highlighted that economic activities are exhibiting resilience during Q3FY2, supported by expansion across industry and services sectors as reflected in purchasing managers' indices (PMIs) and other high frequency indicators.
- MPC projected Q3 growth at 4.4% and Q4 at 4.2%. Real GDP growth is projected at 7.1% for Q1 FY24 and at 5.9% for Q2.

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Liquidity Conditions:

- Overall system level liquidity remained surplus with average total absorption under Liquidity Adjustment Facility at 1.4 lakh Crs during Oct-Nov (down from 2.2 Lakh Crs in Aug-Sept).
- Going forward, the committee highlighted that liquidity conditions are expected to improve and would be led by moderation in currency in circulation in post festival season, pick up in Govt. expenditure and higher Forex inflows due to return of portfolio investors.

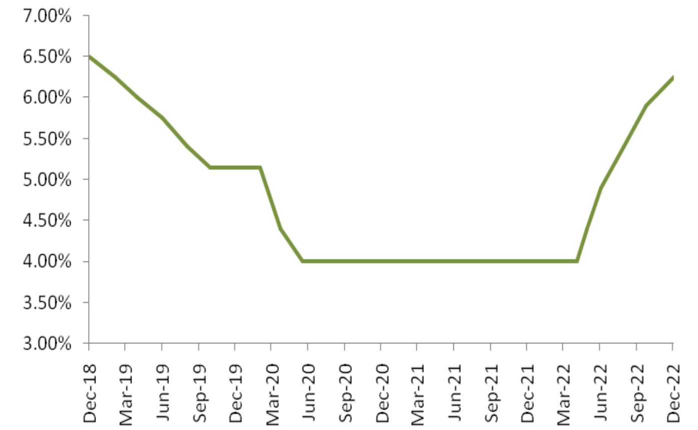
External Sector:

- The external sector has been affected by strong global headwinds resulting in lower global demand (affecting the merchandise exports). However, on a positive note, remittances are scaling new heights and the outlook remained optimistic with pick-up in activity in the middle-east.
- Net FDI flows remained robust and rose to US $ 22.7 billion during April-October 2022 from US$ 21.3 billion in the corresponding period last year. The size of Forex reserves has also remained comfortable and has gone up from US$524.5 billion on October 21, 2022 to US$ 561.2 billion as on December 2, 2022.

Regulatory measures:

- RBI had increased the limits under held to maturity (HTM) category from 19.5% to 23% of net demand and time liabilities (NDTL) with respect to statutory liquidity ratio (SLR) eligible securities acquired on or after September 1, 2020, up to March 31, 2023. This dispensation of enhancement in HTM limit was made available up to March 31, 2023.
- With a view to enable banks to better manage their investment portfolios, it has been decided to extend the dispensation of enhanced HTM limit of 23% up to March 31, 2024 and allow banks to include securities acquired between September 1, 2020 and March 31, 2024 in the enhanced HTM limit.
- The HTM limits would be restored from 23% to 19.5% in a phased manner starting from the quarter ending June 30, 2024.
- **View:** According to our view, the interest rate cycle is nearing its end. The split vote on the policy with one supporting a pause and two dissents against the current stance suggests that the rate hiking cycle is nearing its end. We are expecting a final quarter-point hike in February followed by a hold. With H1FY24 CPI projected at 5.2%, repo rate at 6.5% offers real rate of 1.25%, which falls under RBI's target range of 1-2%.

Fig 1: Interest Rate Trend

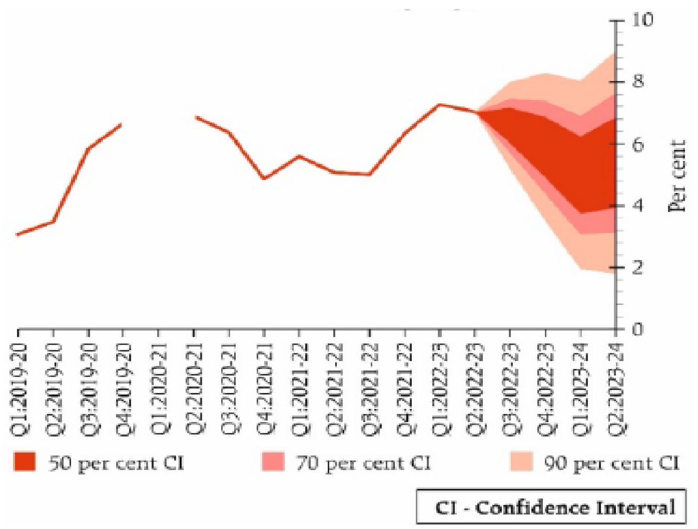


Source: RBI, SMIFS Research

Fig 2: CPI Inflation YoY% and Index Value Trend

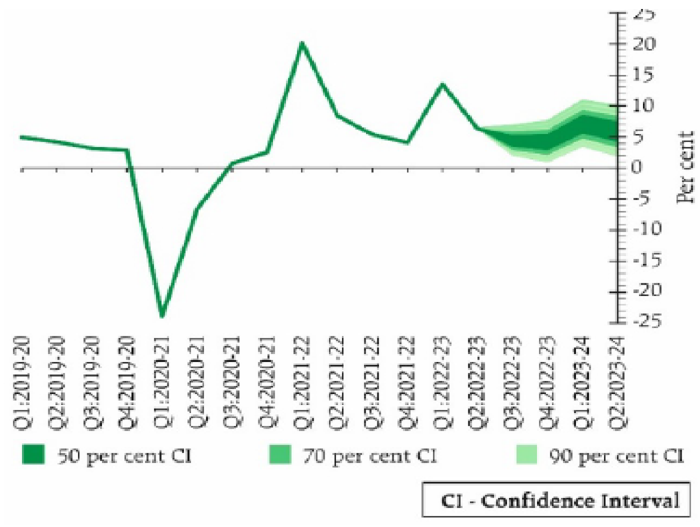
Source: RBI, SMIFS Research

Fig 3: Quarterly CPI Projection YoY%



Source: RBI, SMIFS Research

Fig 4: Quarterly CPI Projection YoY%



Source: RBI, SMIFS Research

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