Lower Quantum of Rate Hikes

Dilemma of supporting growth and controlling inflation continues

Brickwork Ratings, Bengaluru, 07 December 2022: The statement of the Monetary Policy Committee (MPC) announced today by the Governor of the Reserve Bank of India (RBI) is in line with the BWR expectations. In a 5-1 majority, the MPC has decided to increase the policy repo rate by 35 basis points with immediate effect. With this, the repo rate at 6.25% has reached the February 2019 level. The stance of the MPC remains unchanged, continuing with calibrated withdrawal of accommodation, but with 4-2 majority.

Key Takeaways from RBI Governor's Statement

- The repo rate has been increased by **35 bps** to 6.25%, the Standing Deposit Facility (SDF) rate stands adjusted to 6% and the Marginal Standing Facility (MSF) rate and bank rate have been increased to 6.5%.
- The overall monetary and liquidity conditions have remained accommodative and hence, the MPC decided to remain focused on the withdrawal of accommodation. While two committee members voted against this part of the resolution.
- RBI maintained the inflation outlook for FY23 at **6.7%**; but revised the Q2 and Q3 outlook marginally upwards.
- The GDP growth outlook for FY23 has been revised downwards to **6.8%** from 7% estimated earlier, with marginal downward revision in Q2 and Q3. The GDP outlook for Q1FY24, revised to 7.1% from 7.2% earlier and Q2FY24 is estimated at 5.9%.

Regulatory Measures Announced by the RBI

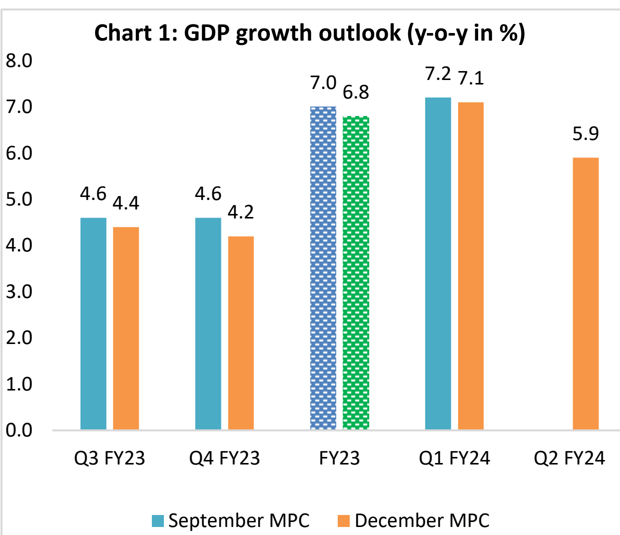
- SLR Holdings in Held to Maturity (HTM) category: To enable banks to better manage their investment portfolios, the dispensation of enhanced HTM limit has been extended till 31 March 2024. The HTM limits increased to 23% of Net Demand and Time Liabilities (NDTL) in respect of Statutory Liquidity Ratio (SLR) eligible securities acquired on or after 1 September 2020, up to 31 March 2023. The HTM limits would be restored to 19.5% in a phased manner starting from the quarter ending on 30 June 2024.

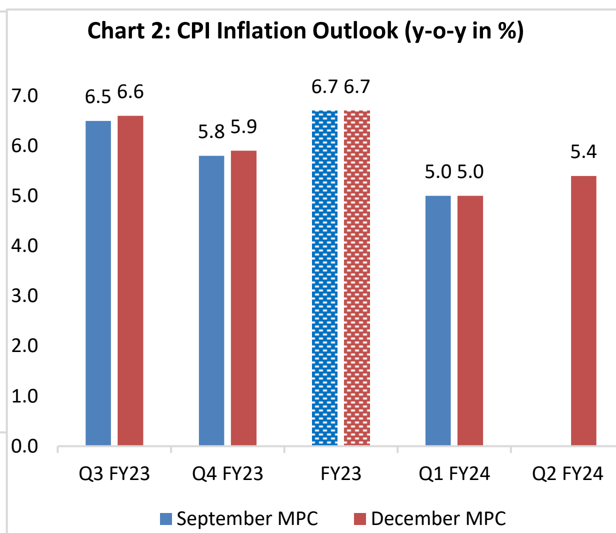
- Enhancements to Unified Payments Interface (UPI) – Processing Mandates with Single-Block-and-Multiple-Debits: To enhance the ease of making payments in e-commerce space and towards investments in securities, which would be helpful for hotel bookings, purchase of securities in the secondary capital market as also purchase of government securities using the RBI's Retail Direct scheme, e-commerce transactions etc.

- Expanding the Scope of Bharat Bill Payment System (BBPS) to include all Payments and Collections Hedging of Gold Price Risk in the International Financial Services Centre.
- Hedging of gold price risk in the International Financial Services Centre (IFSC): To provide greater flexibility to resident entities in India to hedge the price risk of their gold exposures efficiently.

Growth Outlook Moderated; Inflation Outlook Remain Unchanged

In the policy statement, the FY23 growth outlook has been revised downwards to 6.8% from 7.0%, accordingly the growth outlook for Q3 and Q4 has also been revised marginally downwards (See Chart 1). Although the domestic economy showing signs of resurgence, particularly in the services sector activities, the contraction in manufacturing sector growth (-4.3% in Q2FY23) is dragging the overall growth outlook. Thus, the RBI has kept the Q3 and Q4 GDP outlook muted. Despite the global headwinds, some high-frequency indicators are showing revival. Pick up in rural demand, improvement in private consumption, and rising demand for credit points to an optimistic recovery, while adverse geopolitical spillovers remain a concern. The growth for Q1FY24 is also projected slightly downwards at 7.1%, and Q2FY24 growth is pegged at 5.9%.





Source: RBI's Monetary Policy Statements, BWR Research

On the inflation front, the outlook for FY23 has remained unchanged at 6.7%, as projected in the June meeting. With some moderation in global commodity prices, the inflation is expected to soften in the coming months, while the sticky core inflation continued to be a major concern. With 6.8% higher sown area till 2 December 2022, than the normal sown area, there is a likelihood of bountiful Rabi output. The food inflation may moderate to some extent in H2FY23 and is likely to be better in the Rabi season due to better water levels in the reservoirs. The RBI has continued to maintain the inflation estimate above the upper tolerance level in Q3, while the inflation may slip below that level in the Q4. For the next fiscal, the inflation outlook for Q1 and Q2 is placed at 5% and 5.4%, respectively, largely based on the assumption of a normal monsoon and average crude oil price (Indian basket) of USD 100 per barrel.

Says Dr M Govinda Rao, Chief Economic Advisor, Brickwork Ratings, "The decision of the RBI's MPC to raise the repo rate by 35 basis points to 6.25% is in line with BWR expectations. The balanced approach of the MPC to maintain stability and to control inflation has continued, with no major change in its policy stance. However, there is a disagreement between the committee members to continue with the current stance of further withdrawal of accommodation. We expect the RBI to continue with tightening, though at a moderate level, in the next meeting. Maintaining the inflation outlook at 6.7% for FY23 is in line with our expectations. Expectations of better Rabi output, likely to ease food inflation and lower crude oil prices provide comfort on the imported inflation. The growth outlook provided by RBI is quite realistic in view of the contraction seen in the mining and manufacturing sectors. The growth outlook for the Q1FY23 too will not be rosy as the base effect will be large. This implies that the MPC will continue to face the dilemma of supporting growth on the one hand and controlling inflation on the other. This also implies that while the rate increase will continue into the next policy meeting, the increase is likely to be moderate".

Says Rajee R, Chief Ratings Officer, Brickwork Ratings, "RBI's decision to increase policy repo rate by 35 bps to 6.25% and remain focussed on withdrawal of accommodative stance indicates its continued stance on fight against inflation, while supporting growth. Marginal reduction in domestic GDP growth rate forecast from 7.00% to 6.80% for FY23 is primarily due to tightened global monetary supply, global slowdown and geopolitical uncertainties emanating from the other parts of the world. Retention of FY23 inflation projection at 6.70% appears justified due to the recent moderation in domestic headline inflation, likelihood of robust rabi harvest and some moderation in prospects of imported inflation. Extension of deadline for dispensation of extended Held to Maturity (HTM) securities for the banks to 31Mar2024 will provide them flexibility in managing their investment portfolios. Proposals to enhance the mandate of Unified Payments Interface (UPI) will further strengthen UPI as a preferred payment tool. Similarly, the expansion of the scope of Bharat Bill Payment System (BBPS) to include all categories of payments and collections, both recurring and non-recurring, and for all categories of billers (businesses and individuals), is expected to broaden the market for BBPS. Permission for the resident Indian entities to hedge their gold price risk on recognised exchanges in the International Financial Services Centre (IFSC) would benefit the gold-based industry".

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