Hike in rate cycle begins...

Brickwork Ratings, Bengaluru, 04 May 2022: The Reserve Bank of India (RBI), in an unscheduled off-cycle Monetary Policy Committee (MPC) meeting, has increased the policy repo rate by 40 basis points to 4.4% with immediate effect and the CRR by 50 basis points to 4.5% from the midnight of 21 May 2022. Although the statement reiterates the MPC continuing with the accommodative stance, it also talks about its calibrated withdrawal to fight inflation. These decisions of the MPC members are unanimous.

Key Takeaways from Governor's Statement

- **The** Repo rate has been increased by 40 bps to 4.4%, the Standing Deposit Facility (SDF) rate stands adjusted to 4.15% and the Marginal Standing Facility (MSF) rate and bank rate were increased to 4.65%.
- The Cash Reserve Ratio (CRR) increased by 50 Basis Points to 4.5% of Net Demand and Time Liabilities (NDTL), effective from the fortnight beginning 21 May 2022. The withdrawal of liquidity through this increase in the CRR would be of the order of Rs 87,000 crore.
- This was a unanimous decision by the MPC members to retain the accommodative stance, while focusing on the withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.
- The RBI reiterated that it will ensure adequate liquidity in the system to meet the productive requirements of the economy in support of credit offtake and growth.
- Significant upside risks to the inflation trajectory emerged due to renewed lockdowns and supply chain disruptions in the major economies. Risks to the near-term inflation outlook are rapidly materialising, and inflation is expected to rule at elevated levels, warranting resolute and calibrated steps to anchor inflation expectations and contain second round effects.
- The worsening external environment, elevated global commodity prices, supply shortages of edible oil and fertilisers due to geopolitical developments and continued supply chain disruptions due to Covid infections in countries such as China pose formidable headwinds, along with volatility spillovers from monetary policy normalisation in advanced economies. Despite these challenges, the fundamentals of the Indian economy remain strong, and with adequate foreign exchange reserves, low external debt India is well placed to deal with the situation emanating from these developments.

Says Dr M Govinda Rao, Chief Economic Advisor, Brickwork Ratings, "The RBI's decision to call for an unscheduled meeting of the MPC to address the inflationary concerns emanating from geo-political factors, secondary effects of supply disruptions, global commodity prices and tightening monetary policy in advanced countries on inflationary expectations shows the sensitivity of the Central Bank towards maintaining macroeconomic stability. With the elevated prices of crude oil and continued supply-side bottlenecks in addition to the continuation of the lockdown, the increase in inflation is imminent. All these are likely to have a secondary impact on inflation, which will remain elevated above the upper limit of the target at least in the first two quarters of FY23. Therefore, the action on policy rates and managing liquidity are imminent, and the increases in the repo rate and CRR in an unscheduled manner represent the urgency to anchor inflation expectations. This heralds the increase in the rate cycle, and as the inflation is likely to remain elevated beyond the upper bound of the target, we expect a 1.5% to 2% hike in the policy rate in the current fiscal.

The RBI’s twin action of both increasing the policy rate and withdrawing liquidity through the CRR is timely and gives a clear signal. It also shows that the RBI is sensitive to anchoring inflationary expectations to ensure macroeconomic stability while ensuring adequate liquidity to revive economic growth in a calibrated manner”.

Contacts:

Dr M Govinda Rao
Chief Economic Adviser

Anita Shetty
Senior Research Analyst

Investors & Media Contact
+91 95133 99706
1-860-425-2742
investordesk@brickworkratings.com
media@brickworkratings.com

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