Focus on managing inflation is the primary goal; more rate hikes expected

Brickwork Ratings, Bengaluru, 08 June 2022: The Reserve Bank of India (RBI), in its Monetary Policy Committee (MPC) meeting announcement today, has increased the policy repo rate by 50 basis points to 4.9% with immediate effect in a unanimous decision. The statement focuses on the withdrawal of accommodation without mentioning the neutralisation of the policy stance.

Key Takeaways from RBI Governor's Statement

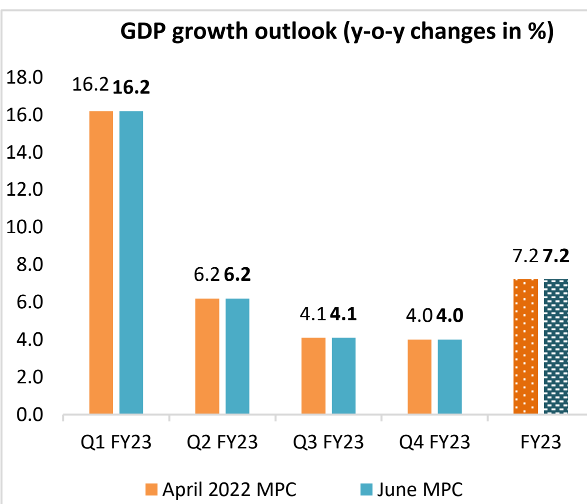
- The repo rate has been increased by 50 bps to 4.9%, the Standing Deposit Facility (SDF) rate stands adjusted to 4.65%, and the Marginal Standing Facility (MSF) rate and bank rate increased to 5.15%.
- The Cash Reserve Ratio (CRR) has remained unchanged at 4.5% of Net Demand and Time Liabilities (NDTL).
- The MPC members decided unanimously to focus on the withdrawal of the accommodative stance in a calibrated manner.
- The RBI reiterated that it will ensure adequate liquidity will be made available 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 have emerged due to continued supply chain disruptions and international commodity price increases. Almost 75% of the increase in the inflation rate has been attributed to food items. The inflation outlook for FY23 increased by 100 bps to 6.7% from 5.7% projected in the April meeting. This means the projected inflation rate is higher than the upper tolerance limit in the inflation targeting framework throughout the year.
- The growth outlook for FY23 remained unchanged at 7.2% as forecasted by the RBI in its April meeting.

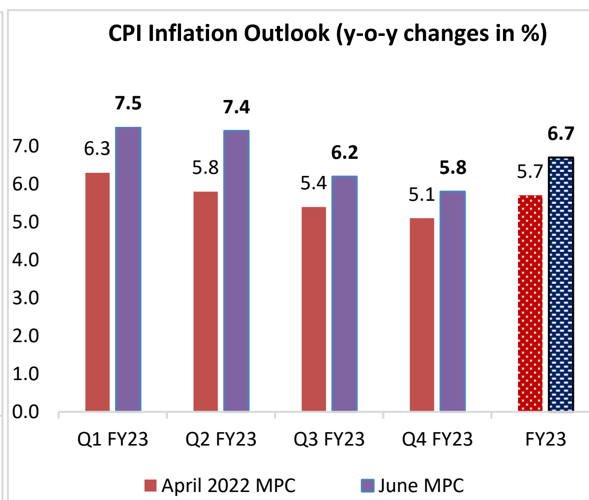
The repo rate hike of 50 bps is on expected lines, and the policy rates are still below the pre-pandemic level of 5.15%. The most important takeaway from the policy statement is that the RBI has recognised the need to neutralise the policy stance. Focus on the withdrawal of accommodation is significant since there has been considerable liquidity draining in the recent months. Surplus liquidity, as reflected in the average daily absorption under the Liquidity Adjustment Facility (LAF), that is, the absorption under the SDF and Variable Rate Reverse Repo (VRRR) of 14 days and 28 days, at Rs 5.5 lakh crore during 4 May to 31 May, was lower than Rs 7.4 lakh crore during 8 April to 3 May 2022.

Growth outlook remains unchanged; Inflation outlook increased significantly

The growth outlook for FY23 remained unchanged at 7.2%. However, there are downside risks to domestic growth projections made by the RBI due to the worsening external environment, elevated global commodity prices, tighter global liquidity conditions, persistent supply shortages, and supply chain disruptions and the pass through of input costs. The major positive in support of the growth prospects is the expectation of normal southwest monsoons, which remains to be seen. Overall, we believe the growth projections are optimistic, given the prevailing uncertainty on both the domestic and global fronts.

On the inflation front, the outlook for FY23 increased by 100 bps to 6.7% from 5.7% projected in the April meeting. The RBI has acknowledged that the price level will remain above the MPC's high tolerance limit in the current fiscal due to both domestic and external factors. Hence, there is a need for appropriate and timely policy actions. The alarming factor is 75% of the increase in inflation is attributed to a rise in food prices. This is concerning as it is going to hurt the marginalised sections of the society much harder and calls for immediate attention from the government.





Source: RBI's Monetary Policy Statements

Says Dr M Govinda Rao, Chief Economic Advisor, Brickwork Ratings, "As per market expectations, in the monetary policy announcement on 8 June, the RBI increased the repo rate by 50 basis points to 4.9% and kept the CRR unchanged. It has also stated that measures to withdraw the extraordinary accommodation given during the pandemic are being progressively withdrawn. The increase in the CRR in the May policy announcement has led to a reduction in the surplus liquidity from Rs 7.4 trillion in April to Rs 5.5 trillion in May. Significantly, the RBI has brought back focus on managing inflation as the primary goal and is moving towards neutrality from the accommodating stance it has adopted for a long time. While reaffirming the forecast of growth at 7.2% made in the April announcement, the RBI has revised the inflation forecast upwards to 6.7%, a clear one percentage point higher than the April forecast. The inflation forecast is significantly higher than the upper tolerance band and is clearly worrisome, and, not surprisingly, the RBI had to change its priority focus from growth to fighting inflation. The inflation estimate remains higher than 6% in the first three quarters of FY23. The continued commitment to draining out excess liquidity in a situation wherein a major part of the year will have inflation above the upper tolerance limit implies that there will be more rate hikes. Furthermore, the promise of the orderly and smooth completion of the government borrowing programme could mean the use of OMO from time to time to keep the yield curve in check. Considering the supply disruptions caused by the continued geopolitical disturbances, continued withdrawal of liquidity in developed countries and flight of foreign portfolio investment in both debt and equity investments, created by the war and the accompanying sanctions and domestic problems created by the power shortage, rising input costs, and other supply bottlenecks, both the GDP forecast at 7.2% and the inflation forecast at 6.7% look optimistic".

Says Rajee R, Chief Ratings Officer, Brickwork Ratings, "In line with BWR's expectations, the RBI has continued its focus on the withdrawal of accommodation to ensure that inflation remains within the target, going forward, while supporting growth. Accordingly, the policy repo rate was increased by 50 bps to 4.90% with immediate effect. Consequently, the SDF rate stands adjusted to 4.65%, and the MSF rate and Bank Rate, to 5.15%. Based on the NSO data of 31 May 2022 for FY22 GDP growth at 8.70% and the signs of the broadening of recovery in economic activity in the first two months of FY23, the RBI retained the FY23 GDP growth projection at 7.20%. The upward revision in the FY23 inflation projection from 5.70% to 6.70% factors the lingering geo-political instability in Europe with its spill-over effect on global energy, food and commodity markets. An enhancement in limits for individual housing loans by cooperative banks was long overdue; this will cater to the needs of homebuyers and increase the exposure of cooperative banks to the housing sector. Permitting Rural Co-operative Banks (RCBs) to lend to the Commercial Real Estate - Residential Housing (CRE-RH) sector could be a positive step for the affordable housing segment. The linking of RuPay Credit Cards to Unified Payment Interface (UPI) platforms would provide a significant boost to RuPay card transactions".

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