



Focus on managing inflation; Forward guidance a little more hawkish

Brickwork Ratings, Bengaluru, 05 August 2022: The Reserve Bank of India (RBI), in its Monetary Policy Committee (MPC) statement announced today, has increased the policy repo rate by 50 basis points to 5.4% with immediate effect in a unanimous decision. The statement continues to focus on the withdrawal of accommodation without a change in the policy stance to neutral.

Key Takeaways from RBI Governor's Statement

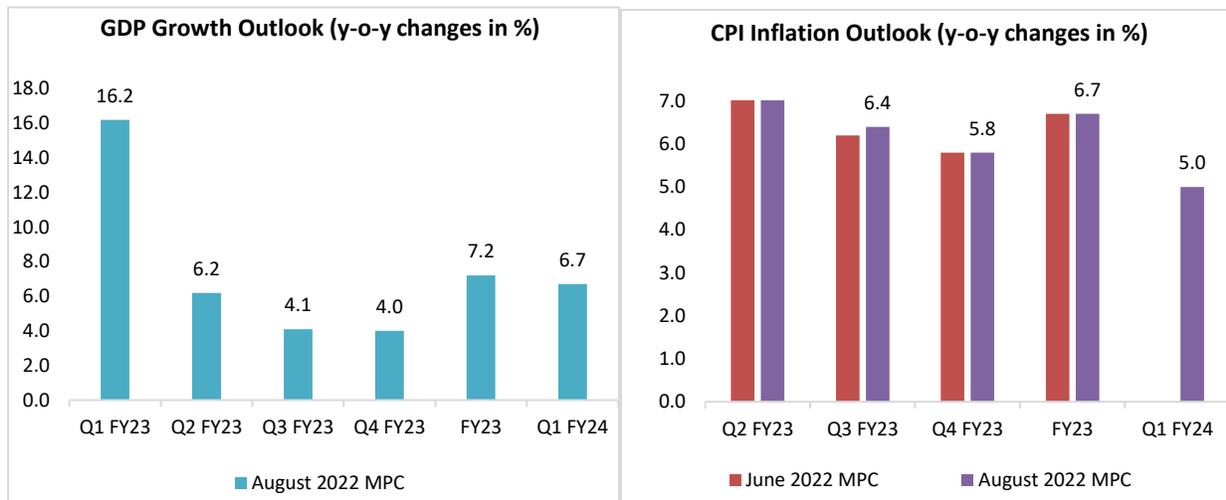
- The repo rate has been increased by 50 bps to 5.4%, the Standing Deposit Facility (SDF) rate stands adjusted to 5.15% and the Marginal Standing Facility (MSF) rate and bank rate have been increased to 5.65%.
- The MPC members decided unanimously to increase the repo rate, and the decision on the policy stance is also kept unchanged, with 4-1 votes.
- The RBI reiterated it would ensure adequate liquidity in the system to meet the productive requirements of the economy in supporting credit offtake and growth.
- The growth and inflation outlook for FY23 remained unchanged at 7.2% and 6.7%, respectively.
- The growth outlook for Q1FY24 is projected at 6.7%, while the inflation outlook is projected at 5%.

Regulatory Measures Announced by the RBI

- The RBI proposed to enable Standalone Primary Dealers (SPDs) to offer all the foreign exchange market-making facilities as currently permitted to Category-I Authorised Dealers, subject to prudential guidelines to provide customers with a wider set of market makers to manage their foreign currency risk.
- The RBI has proposed to enable Bharat Bill Payment System (BBPS) to accept cross-border inward bill payments. This will enable Non-Resident Indians (NRIs) to undertake bill payments for utility, education and other such payments on behalf of their families in India.
- To make the Reserve Bank-Integrated Ombudsman Scheme (RB-IOS) more broad-based, the RBI has decided to include Credit Information Companies (CICs) under the RB-IOS framework. This will provide a cost-free alternative redress mechanism for grievances against CICs. Furthermore, with a view to strengthen the internal grievance redress by CICs themselves, the RBI has also decided to mandate the CICs to have their own Internal Ombudsman (IO) framework.

- The RBI has proposed to set-up a committee to undertake an in-depth examination of the issues, including the need for transition to an alternative benchmark for MIBOR, and suggest the way forward.

Growth and Inflation Outlook Remain Unchanged



Source: RBI's Monetary Policy Statements

In the policy statement, the growth outlook remained unchanged at 7.2% for FY23, but the RBI cautioned about the possible downside risks to domestic growth emanating from the global economic downturn. However, it also assured that the resilient and strong domestic fundamentals are expected to provide a cushion against external shocks and keep up the growth momentum. Another major positive in support of the growth prospects is the normal southwest monsoon and comfortable reservoir levels. Urban demand indicators suggest improvements, while rural demand indicators have continued to exhibit mixed signals. Despite the prevailing uncertainty, particularly on the external front, maintaining the growth projections at 7.2% looks promising, given the gradual improvement seen on the domestic front.

On the inflation front too, the outlook for FY23 has remained unchanged at 6.7% projected in the June meeting. The RBI has possibly estimated a higher Rabi output, but there is a fear of higher energy and food prices in the near term due to erratic monsoons, and hence, the RBI has chosen to maintain the inflation estimate above the upper threshold in Q2 and Q3. The RBI also cautioned that higher inflation may destabilise inflation expectations and harm growth prospects in the medium term.



Says Dr M Govinda Rao, Chief Economic Advisor, Brickwork Ratings, "As against market expectations, the RBI in the monetary policy announcement today has frontloaded the policy action by raising the repo rate by 50 basis points to 5.4%. With the repo rate hike of 50 bps, which is higher than our expectation of 25 to 35 bps, the policy rates have moved above the pre-pandemic level of 5.15%. The MPC has taken cognizance of the impending fear of inflationary expectations. The decision to increase the policy rates by 50 bps is perhaps due to higher liquidity levels in the economy, as reflected in the average daily absorptions under the LAF (both SDF and variable rate reverse repo auctions), which stood at Rs 3.8 lakh crore during June-July 2022. The sharp increase in policy rates by the US and Eurozone is also a factor, as the MPC considered the need for frontloading the interest rate hikes to attract foreign capital inflows".

Says Rajee R, Chief Ratings Officer, Brickwork Ratings, "The RBI continued its focus on controlling inflation and 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 5.40% with immediate effect. The RBI retained the FY23 GDP growth projection at 7.20% based on the resilience of the domestic economy and positive signs emanating from various high-frequency indicators. The retention of the FY23 inflation projection at 6.70% factors the lingering geo-political instability in Europe with its spillover effect on global energy, food and commodity markets. The proposal to enable Bharat Bill Payment System to accept cross-border inward bill payments is expected to benefit Indian families and senior citizens. The proposal to set-up a committee on MIBOR-related issues is a welcome step towards the development of an alternate benchmark for the interest rate derivative market. The decision to bring Credit Information Companies (CICs) under the ambit of RB-IOS 2021 and Internal Ombudsman (IO) framework will provide a cost-free alternative redress mechanism for grievances against CICs."



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