30 September 2022

RBI hikes Repo Rate for fourth time in a row, to fight inflation

RBI's Stance → **Withdrawal of Accommodation**

Key Highlights:

- **Hiked Repo Rate by 50 bps to 5.90%** by a majority vote
- Cash reserve ratio **(CRR) kept unchanged at 4.50%**
- The MPC voted on **"withdrawal of accommodation"** to ensure that inflation remains within the target going forward, while supporting growth
- **Inflation** projection for FY23 retained at **6.7%**
- **FY23 Growth** projection cut from **7.2% in August to 7.0%**
- While the **bond market** reacted negatively; the **equity markets closed in the positive territory**

Policy Rates / Reserve Ratio	05 Aug '22	30 Sep '22	Status
CRR	4.50%	4.50%	↔
SLR	18.00%	18.00%	↔
SDF	5.15%	5.65%	↑
Repo Rate	5.40%	5.90%	↑
MSF	5.65%	6.15%	↑
Bank rate	5.65%	6.15%	↑
Fixed Reverse Repo Rate	3.35%	3.35%	↔

In a scheduled policy meeting held from **September 28 to 30, 2022** amid inflation peeking out, the MPC decided by a majority of 5 members out of 6 to **increase the policy repo rate by 50 bps to a 3 year high of 5.90%**, with immediate effect. The MPC **voted** on **"withdrawal of accommodation"** to ensure that inflation remains within the target going forward, while supporting growth; however, this decision too was not unanimous.

The Background:

Repo Rate hike: In the last two and half years, the world has witnessed three major shocks – **the COVID-19 pandemic, the conflict in Ukraine** and now in the midst of the third one arising from **aggressive monetary policy actions** and even more aggressive communication **from Advanced Economy (AE)** central banks. Since April 2022, the RBI has started increasing the rates.

Liquidity: Surplus liquidity in the banking system, as reflected in average daily absorptions under the liquidity adjustment facility (LAF) [both SDF and variable rate reverse repo (VRRR) auctions], **moderated to ₹2.3 lakh crore during August - September 2022** (up to September 28) from ₹3.8 lakh crore during June-July. **Drawdown of excess cash reserve ratio (CRR) and excess statutory liquidity ratio (SLR) holdings of banks can also augment system liquidity**.

Growth Outlook:

- **Real GDP grew by 13.5% (y-o-y) in Q1FY23, surpassing the pre-pandemic level by 3.8%.** This was led by robust growth in private consumption and investment demand.
- **High frequency data for Q2 indicate that economic activity remains resilient.** Private consumption has been holding up. **Bank credit** grew at an accelerated pace of 16.2% y-o-y as on September 9, 2022 as against 6.7% a year ago.
- In the **supply side**, the agricultural sector remains resilient. The monsoon rainfall was 7.0% above the long period average (LPA) as on September 29. Kharif sowing was 1.7% above the normal sown area as on September 23.
- The **headwinds** from extended geopolitical tensions, tightening global financial conditions and possible decline in the external component of aggregate demand can pose downside risks to growth.
- Taking all these factors into consideration, **real GDP growth for FY23 is projected at 7.0% down from 7.2% projected in August 2022.**

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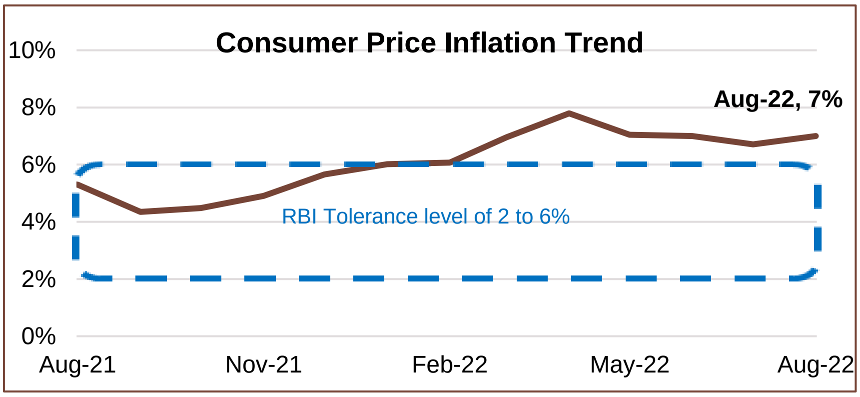
Period	FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24
Growth Projection	**7.0%**	6.3%	4.6%	4.6%	7.2%

Inflation Outlook:

- **Global geopolitical developments are weighing heavily on the domestic inflation trajectory.** Inflation inched up to 7.0% in August from 6.7% in July.
- Acute **imported inflation pressures** felt at the beginning of the financial year have eased but remain elevated across food and energy items.



Source: RBI DBIE

- The extraordinary global circumstances that caused the **heightened inflationary pressures have impacted both Advanced Economies and Emerging Market Economies**. India is, however, better placed than many of these economies. If high inflation is allowed to linger, it invariably triggers second order effects and unsettles expectations. Therefore, **monetary policy has to carry forward its calibrated action on policy rates and liquidity conditions consistent with the evolving inflation growth dynamics.**
- The below data assumes a **normal monsoon in 2022** and average **crude oil price (Indian basket) of US$ 100 per barrel.**

Period	FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24
Inflation Projection	**6.7%**	7.1%	6.5%	5.8%	5.0%

Currency:

- **67.0% of the decline in the foreign exchange reserves** since April was due to **valuation changes** arising from strengthening US dollar and higher American bond yields.
- The forex reserves, which stood at USD 606.475 bn as on April 2, have declined to USD 537.5 bn as on September 23. It was also the **eighth straight week when the reserves declined**.
- It has fared much better than several other currencies. The **Rupee has fallen 7.4% vs dollar from April 2022 till September 28.**
- **Rupee is a free-floating currency**, RBI does not have a fixed exchange rate for rupee; it intervenes in market only to curb excessive volatility and thus the RBI has been judicious in its intervention in the forex market.

Conclusion:

While the bond market reacted negatively on a rather hawkish stance by MPC; the equity markets closed in the positive territory. The 10-year India Government bond yields rose from 7.34% close of 29 Sep '22 to close at 7.40% on 30 Sep '22; while the Nifty 50 closed higher by 1.6% as market participants cheered the MPC meet outcome.

With the RBI stance of **taking out excess liquidity from the system directly through interest rate hike initiated in the economy;** we continue to maintain our stance of **investing in shorter end of the curve through mutual fund** categories like **Low Duration, Floating Rate Funds** till the time rates stabilize. For **longer term investments, Accrual strategies including Target Maturity Funds** continue to be our preferred categories. Along with MF good quality **Corporate Fixed Deposits and Bonds** can be looked at allocation in the debt portfolio for diversification and enhancing overall return.

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