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RBI’s Monetary Policy Review

7th Dec 2022

RBI Policy Stance

- MPC decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward while supporting growth.
- MPC decided to increase the policy repo rate by 35 bps to 6.25%.

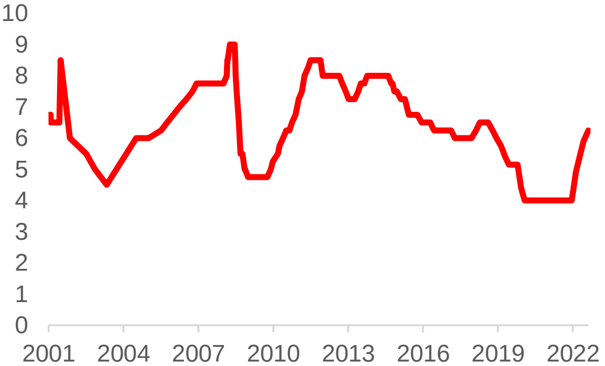
Policy Rates	Pre Policy	Post Policy	Status
Repo	5.90%	6.25%	35 bps inc
Reverse Repo	3.35%	3.35%	Unchanged
MSF	6.15%	6.50%	35 bps inc
Bank Rate	6.15%	6.50%	35 bps inc
CRR	4.50%	4.50%	Unchanged
SDF	5.65%	6.00%	35 bps inc
SLR	18.00%	18.00%	Unchanged

Key Highlights

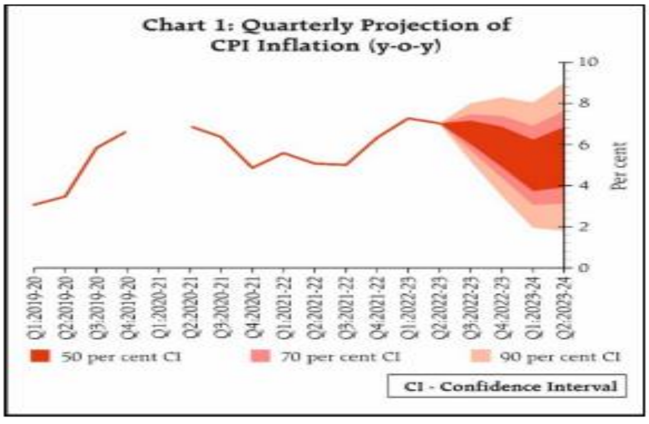
- The liquidity in the system remains surplus with average daily absorption under LAF at ₹1.4 lakh crore during Oct–Nov’22 from ₹ 2.2 lakh crore during Aug–Sep’22.
- The inflation forecast for FY’23 and Q1FY’24 remains unchanged at 6.70% and 5.0% respectively while it is projected to hover around 5.4% in Q2FY’24.
- Growth forecast for FY’23 is revised lower to 6.8% vs earlier forecast of 7.00%.
- During the current FY (up to 31st Oct’22), INR has appreciated by 3.2% in terms of real effective exchange rate, highlighting a stable trajectory in the face of a sharp upsurge in USD Index.
- Net FDI improved to $22.7 bn in Apr–Oct’22 from $21.3 bn a year ago. FPIs have returned to the domestic market with net inflow of $11.8 bn during July - 5th Dec’22.

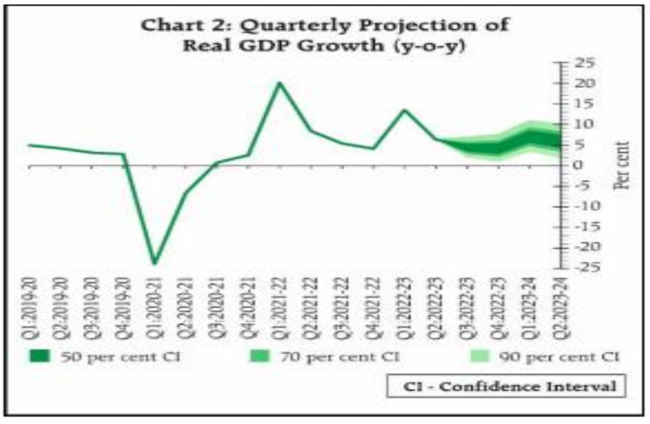
Time Frame	Projection – Inflation		Projection - Real GDP	
	Sep-22	Dec-22	Sep-22	Dec-22
Q3 FY’23	6.40%	6.60%	4.60%	4.40%
Q4 FY’23	5.80%	5.90%	4.60%	4.20%
Q1 FY’24	5.00%	5.00%	7.20%	7.10%
Q2 FY’24		5.40%		5.90%
FY’23	**6.70%**	**6.70%**	**7.00%**	**6.80%**

RBI Repo Rate Trajectory



RBI’s Projection on Inflation and Growth





RBI's Assessment of Global and Domestic Economy

- The global economy continues to be mired in uncertainty with mixed signals emerging out of geopolitical situations and financial market volatility. As per the IMF's October projections, nearly one third of the global economy is expected to contract by the end of this year or next year, and emerging market economies which are dependent on food, energy and commodity imports continue to be the worst impacted.

- The Indian economy continues to display resilience, primarily driven by a robust financial system even as healthier corporate and bank balance sheets aid double digit credit growth for the eighth consecutive month.

- Demand is expected to be aided primarily from continued urban consumption as is evident via growth in discretionary spends in travel, tourism and hospitality and pick up in rural consumption which is noticeable via pick up in tractor and two-wheeler sales.

- The supply side is expected to be aided via the Agriculture sector via stronger Rabi sowing with the sown area increasing by 6.8% as compared to last year as on 2nd Dec'22. It is also expected that there will be a pick-up in manufacturing and services sector as highlighted in PMI releases of 55.7 and 55.1 respectively in November which are the highest in the world for that month.

- Outlook for growth – The government's continued thrust on capex, improvement in consumer confidence as well as higher optimism from manufacturing, infrastructure and service sector firms is expected to aid overall economic growth. However, headwinds from geopolitical tensions, tightening global financial conditions and slowing external demand pose downside risks.

- Outlook for inflation – Food inflation is expected to be moderate, primarily owing to an anticipated bountiful Rabi harvest and the usual winter softening. However, prices of cereal, milk and spices may remain elevated in the near term. Core inflation (non-food non-fuel led) however is expected to remain sticky primarily driven by imported inflation and higher cost pass on from surging domestic services sector.

Outlook

- The rate hike by 35 bps shows the RBI's focus on reigning consumer prices back into its target range. The policy announcement was on expected lines although the overall commentary was more hawkish than market expectations, as more emphasis was laid on controlling inflation in times of resilient domestic growth. We expect a further rate hike may take place in Feb'23 policy meeting in order to anchor inflation and bring CPI back to the targeted range of 2 – 6%.

- The RBI highlighted that monetary transmission (hike in lending and deposit rates)still continues to lag current hike in repo rates. We believe, even though the RBI may cap repo rates at a particular level, the continued transmission of higher policy rates can lend upward pressure on bond yields.

- As we move into 2023, we believe that the direction of yields going forward would be dictated by factors like policy tightening across economies (chief being US), growth inflation trade offs (the upcoming policy meets this year. Next year would give more updates on inflation trajectory and clarity on external demand) and geopolitical risks.

- We believe, towards the fag end of the current financial year, the RBI may pause the rate hike cycle and revisit the growth inflation trade-off as the global economy is anticipated to enter an economic slowdown. While the much-awaited Fed pivot is currently looking unlikely, it is expected to gain further traction in Q2 CY'23 with the US economy anticipated to witness an economic slowdown, lending further credence towards probable cut in rates from the RBI around Q3 FY'24.

- Investors could look to invest in short term bond funds as the upward move in yields in recent months makes the 1–3-year segment attractive. Investors who are looking for visibility of returns and carry opportunity could invest in high quality roll down strategies across 3-5 years duration. Investors could also look to invest in well managed credit funds (on AIF platform) where the focus is on capital preservation and current income.

- We prefer not to add significant duration because of insufficient risk premia (spreads between longer end and 5 year) for investing in longer duration bonds.

- The next policy statement is due on 8th Feb 2023.

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