4 May 2022

RBI surprises the markets on the mega LIC IPO opening day

RBI's Stance	→	Accommodative

Key Highlights

- **Repo Rate hiked by 40 bps to 4.40%**. This is the first-rate hike in 4 years.
- Cash reserve ratio **(CRR) hiked by 50 bps to 4.50%.**
- **Stance kept "accommodative"** while focusing on **withdrawal of accommodation** to ensure that inflation remains within the target going forward.
- Both the **bond and the equity market reacted negatively.**
- The off-cycle policy meeting in summary was an **extremely hawkish** one with clear emphasis on inflation rather than growth.

Policy Rates / Reserve Ratio	8 Apr '22	4 May '22	Status
CRR	4.00%	4.50%	↑
SLR	18.00%	18.00%	↔
SDF	3.75%	4.15%	↑
Repo Rate	4.00%	4.40%	↑
MSF	4.25%	4.65%	↑
Bank rate	4.25%	4.65%	↑
Fixed Reverse Repo Rate	3.35%	3.35%	↔

In an unscheduled policy meeting held on **May 2 & 4** amid high inflationary pressure and allegation that it is behind the curve the MPC **unanimously announced a repo rate hike of 40 bps to 4.40%**. Consequently, the standing deposit facility (SDF) rate stands adjusted to 4.15%; and the marginal standing facility (MSF) rate and the Bank Rate to 4.65%. This is the **first-rate hike announced in 4 years**. The MPC **unanimously voted to remain "accommodative"** while focusing on **withdrawal of accommodation** to ensure that inflation remains within the target going forward, while supporting growth.
Further, keeping with the stance of withdrawal of accommodation and in line with the earlier announcement of gradual withdrawal of liquidity over a multi-year time frame, it has been decided to increase the **cash reserve ratio (CRR) by 50 bps to 4.5% of net demand and time liabilities (NDTL),** effective from the fortnight beginning May 21, 2022. The **withdrawal of liquidity** through this increase in the CRR would be of the order of **Rs. 87,000 crore**.

The background

Repo Rate hike: The Governor also added that it may be recalled that in response to the pandemic, monetary policy had shifted gears to an **ultra-accommodative mode**, with a large reduction of **75 bps** in the policy repo rate on **March 27, 2020** followed by another reduction of **40 bps on May 22, 2020**. Accordingly, the decision of the MPC to raise the policy repo rate by 40 bps to 4.40% may be seen as a **reversal of the rate action of May 22, 2020 in keeping with the announced stance of withdrawal of accommodation set out in April 2022.**

CRR hike: Since the April policy announcement, **banking system liquidity has remained comfortable**. **Average surplus liquidity in the banking system** – reflected in total absorption through SDF and variable rate reverse repo (VRRR) auctions – amounted to **Rs.7.5 lakh crore** during April 8-29, 2022. The **large liquidity overhang** in the form of daily **surplus funds parked under the SDF** has resulted in the **weighted average call money rate (WACR) – the operating target of monetary policy – dipping below the SDF rate.**

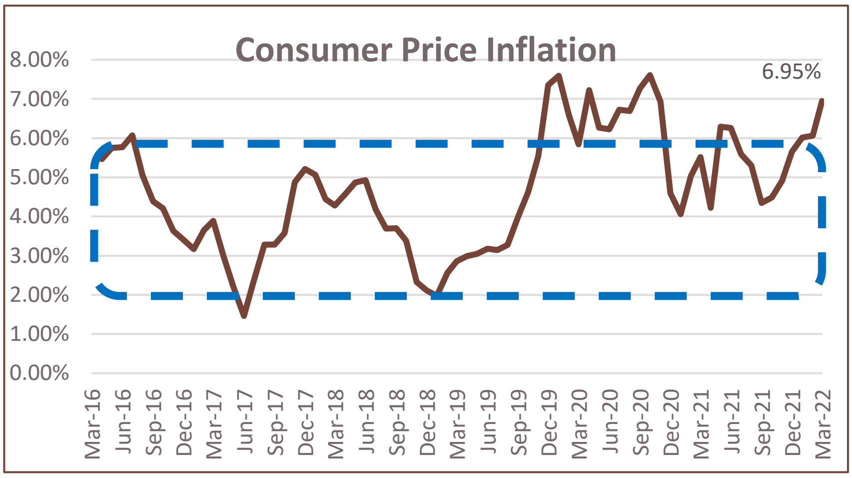
Growth Outlook

- The **rebound in domestic economic activity** that took hold with the ebbing of the Omicron wave is turning out to be increasingly broad-based.
- **Private consumption is regaining traction** on the back of recuperating contact-intensive services and rising discretionary spending.

- The forecast of a **normal southwest monsoon in 2022 for the fourth successive year** has brightened agricultural prospects and this should **support rural consumption**.
- There are also **signs of an incipient revival taking place in the investment cycle**. This is reflected in high-frequency indicators like **imports and production of capital goods**; **rising capacity utilisation** supported by conducive financial conditions; and stronger corporate balance sheets. **Export growth** has remained buoyant while persisting high growth in non-oil non-gold imports reflects a durable revival in domestic demand.

Inflation Outlook

- The sharp acceleration in headline **CPI inflation in March 2022 to 7.0%** was propelled, in particular, by **food inflation** due to the impact of adverse spill overs from unprecedented high global food prices.
- The direct impact of the increases in **domestic pump prices of petroleum products** – beginning the second fortnight of March – **is feeding into core inflation prints** and is expected to have intensified in April.



Source: RBI DBIE

- **Food price indices** of the Food and Agriculture Organisation (FAO) and the World Bank **touched historical highs in March and remain elevated.**

Summary

The policy was under a **background** of a) Rising global commodity prices – especially food; b) U.S. Fed meeting to be held tonight – where there is likelihood of a rate hike; c) an economy that was no longer in a crisis and d) the perception that the Indian central bank is behind the curve.

The RBI by raising interest rates and reserve ratios on the opening day of the LIC Mega-IPO – when liquidity is already an issue; has **proven its independence from the government**.

The off-cycle policy meeting in summary was an **extremely hawkish** one with clear emphasis on inflation rather than growth.

Both the bond and the equity market reacted negatively. The 10-year India Government bond yields rose from 7.12% close of 2 May 2022 to a day high of 7.40%, while the Nifty 50 closed near the day's low down 2.3%.

With the RBI stance of **taking out excess liquidity from the system directly through CRR hike and 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**. For **longer term investments Short Term Funds / Corporate Bond 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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