

08 February 2023

RBI MPC increases repo rate by 25 bps, pegs FY24 inflation at 5.3%

RBI's Stance

Withdrawal of Accommodation

Key Highlights:

- **Hiked Repo Rate by 25 bps to 6.50%** 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
- **FY24 Inflation** expected to be at 5.3%
- **FY24 Growth** rate pegged at 6.4%.
- **Both the bond and the equity markets closed the day in the positive territory**

| Policy Rates / Reserve Ratio | 07 Dec '22 | 08 Feb '23 | Status |
|------------------------------|------------|------------|--------|
| CRR | 4.50% | 4.50% | ↔ |
| SLR | 18.00% | 18.00% | ↔ |
| SDF | 6.00% | 6.25% | ↑ |
| Repo Rate | 6.25% | 6.50% | ↑ |
| MSF | 6.50% | 6.75% | ↑ |
| Bank rate | 6.15% | 6.50% | ↑ |
| Fixed Reverse Repo Rate | 3.35% | 3.35% | ↔ |

In a scheduled policy meeting held from **February 06 to 08, 2023** amid inflation peeking out, the MPC decided by a majority of 4 members out of 6 to **increase the policy repo rate by 25 bps to 6.50%**, 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 this hostile international environment, the Indian economy remains resilient, drawing strength from its macroeconomic fundamentals. India’s financial system remains robust and stable. Banks and corporates are healthier than before the crisis. **India is widely seen as a bright spot in an otherwise gloomy world.** Yet, India’s inflation remains elevated, as in most parts of the world. Under this backdrop, the RBI hiked rates for the sixth time in a row on February 08, 2023.

Liquidity: Overall system liquidity remains in surplus with an average daily absorption of Rs. 1.6 lakh crore under the Liquidity Adjustment Facility (LAF) in January 2023. In the period ahead, liquidity conditions are likely to improve due to several factors which would include moderation in currency in circulation in the post-festival period, pick up in government expenditure in the last few months of the financial year and higher forex inflows due to the return of portfolio investors.

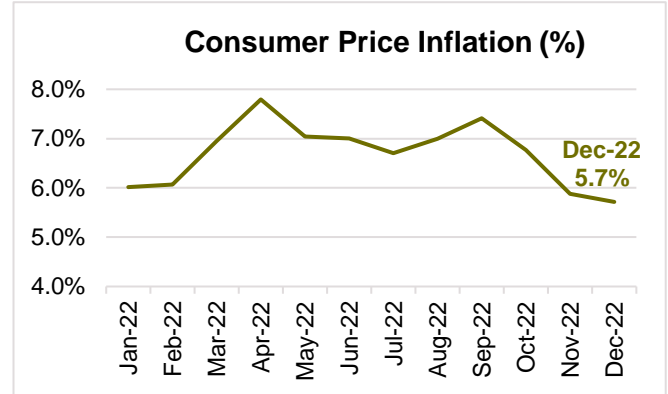
Growth Outlook:

- **Real GDP grew by 6.8% (y-o-y) in Q3FY23**, led by robust growth in private consumption and investment demand.
- **High frequency data in January indicated that economic activity remained resilient. Urban consumption** firmed up further, driven by sustained recovery in discretionary spending, especially on services such as travel, tourism and hospitality. **Rural demand** is recovering as reflected in the pace of tractor and retail two-wheeler sales expanding in January with rising farm activity. Investment activity is also gaining traction.
- On the **supply side**, the agricultural sector remains strong with good Rabi sowing, high reservoir levels, good soil moisture and favourable winter temperatures. The manufacturing and services PMIs for India in January are among the highest in the world at 55.4 & 57.2 respectively.
- The **biggest risks** to the outlook continue to be the headwinds emanating from protracted geopolitical tensions, global slowdown and tightening of global financial conditions.
- Taking all these factors into consideration, **real GDP growth for FY24 is projected at 6.4% down from 6.8% projected in December 2022.**

| Period | FY24 | Q1FY24 | Q2FY24 | Q3FY24 | Q4FY24 |
|--------------------------|-------------|-------------|-------------|-------------|-------------|
| Growth Projection | 6.4% | 7.8% | 6.2% | 6.0% | 5.8% |

Inflation Outlook:

- Headline inflation excluding vegetables has been rising well above the upper tolerance band and may remain elevated, especially with high core inflation pressures. Inflation, therefore, remains a major risk to the outlook.
- The governor stated the RBI's current objectives remained the 3 simultaneous targets - to keep inflation expectations anchored, break core inflation persistence and thereby strengthen medium-term growth prospects.
- The below data assumes an average **crude oil price (Indian basket) of US\$ 95 per barrel.**



| Period | FY24 | Q1FY24 | Q2FY24 | Q3FY24 | Q4FY24 |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|
| Inflation Projection | 5.3% | 5.0% | 5.4% | 5.4% | 5.6% |

External Sector:

- The **Current Account Deficit (CAD)** has shown signs of improvement in December as imports moderated in the wake of lower commodity prices.
- **Services exports rose by 24.9%** driven by software, business and travel services.
- **Remittance growth for India in H1 of FY23 was around 26%** more than twice the World Bank's Projection.
- On the financing side, **Net Foreign Direct Investment (FDI) flows remain strong USD 22.3 Bn** during April – December 22.

Market Reaction:

Both the bond market and the equity markets reacted positively as the RBI policy rate hike was on expected lines. Given the 25 bps rate hike was widely expected, there was limited impact on the bond market. Bond yields moved up 3-5 basis points after the policy announcement. The 10-year India Government bond yields closed at 7.34% on 8 Feb '23 after hitting a high of 7.36% ; while the Nifty 50 closed higher by 0.85%.

View:

The policy was broadly on expected lines, but some sections of the markets expected a change in stance to neutral. The RBI seems concerned about the sticky "core inflation" while they are relatively more comfortable with the growth outlook. It is expected that, apart from the domestic inflation trajectory, RBI actions will continue to be influenced by the actions of global central banks, especially the US Fed. . For short term investments, investors can consider money market, ultra-short and low duration funds. For medium to long-term **investments, a combination of duration and accrual strategies including Target Maturity Funds** continue to be our preferred categories. Along with Mutual Funds, 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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