

07 December 2022

## RBI hikes Repo Rate for the fifth time in a row, albeit to a lower extent

RBI's Stance

Withdrawal of Accommodation

### Key Highlights:

- **Hiked Repo Rate by 35 bps to 6.25%** 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
- **FY23 Inflation** projection retained at **6.7%**
- **FY23 Growth** projection cut from **7.0% in September to 6.80%**
- **Both the bond and the equity markets closed the day in the negative territory**

Policy Rates / Reserve Ratio	30 Sep '22	07 Dec '22	Status
CRR	4.50%	4.50%	↔
SLR	18.00%	18.00%	↔
SDF	5.65%	6.00%	↑
Repo Rate	5.90%	6.25%	↑
MSF	6.15%	6.50%	↑
Bank rate	6.15%	6.50%	↑
Fixed Reverse Repo Rate	3.35%	3.35%	↔

In a scheduled policy meeting held from **December 05 to 07, 2022** amid inflation peeking out, the MPC decided by a majority of 5 members out of 6 to **increase the policy repo rate by 35 bps to 6.25%**, 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 fifth time in a row on December 07, 2022.

**Liquidity:** Overall system liquidity remains in surplus. During October-November, the average **total absorption under the liquidity adjustment facility (LAF)** was ₹1.4 lakh crore, down from the average of ₹2.2 lakh crore during August-September. 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.

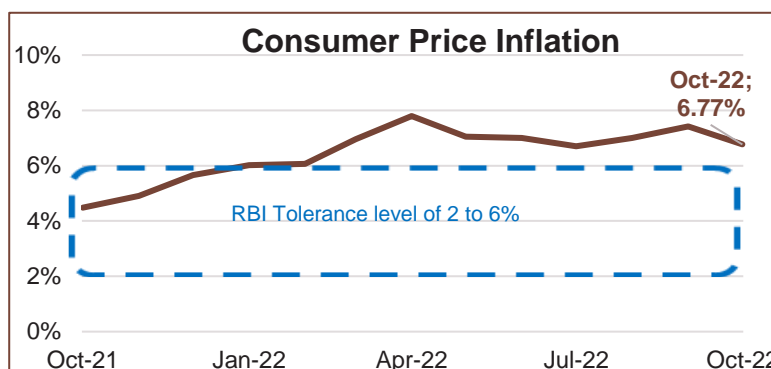
### Growth Outlook:

- **Real GDP grew by 6.3% (y-o-y) in Q2FY23**, led by robust growth in private consumption and investment demand.
- **High frequency data in October 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, with rising farm activity. Investment activity is also gaining traction.
- In the **supply side**, the agricultural sector remains resilient. Rabi sowing got off to a strong start. The manufacturing and services PMIs for India in November are among the highest in the world.
- 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 FY23 is projected at 6.8% down from 7.0% projected in September 2022.**

Period	FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
<b>Growth Projection</b>	<b>6.8%</b>	4.4%	4.2%	7.1%	5.9%

### Inflation Outlook:

- The inflation trajectory has largely evolved in line with the outlook given by the RBI in June 2022.
- **Going forward**, food inflation is likely to moderate with the usual winter softening and the likelihood of a bountiful rabi harvest, but pressure points remain in the form of prices of cereals, milk and spices in the near-term.



Source: RBI DBIE

- The main risk is that **core inflation** (CPI excluding food and fuel) **remains sticky and elevated**. Overall, the CPI price momentum remains high.
- The below data assumes an average **crude oil price (Indian basket) of US\$ 100 per barrel**.

Period	FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
<b>Inflation Projection</b>	<b>6.7%</b>	6.6%	5.9%	5.0%	5.4%

### Currency:

- The **appreciation of the US dollar this year, which precipitated large scale depreciation of all major global currencies** including the Indian rupee (INR), has drawn wide attention.
- Through this episode of US dollar appreciation, the INR's movements have been the least disruptive, relative to peers. In fact, **the INR has appreciated against all other major currencies** except a few (Swiss franc, Canadian dollar, Singapore dollar, Russian ruble, etc.)
- **Cross-country comparisons of exchange rate movements** are often made on an inflation-adjusted basis or what is called in **real effective terms**.
- On a financial year basis (i.e., from April 2022 to October 2022), the INR has appreciated by 3.2% in real terms, even as several major currencies have depreciated.

### Market Reaction:

**Both the bond market and the equity markets reacted negatively on a rather hawkish stance by MPC.** The 10-year India Government bond yields rose from 7.25% close of 6 Dec '22 to close at 7.28% on 7 Dec '22 after touching a high of 7.31% during the day; while the Nifty 50 closed lower by 0.44%.

### View:

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 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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