

8 June 2022

RBI hikes repo rate, in line with expectation, to fight inflation

RBI's Stance

Key Highlights

- **Unanimously hiked Repo Rate by 50 bps to 4.90%.**
- Cash reserve ratio (CRR) kept unchanged at 4.50%.
- The MPC unanimously voted on “**withdrawal of accommodation**” to ensure that inflation remains within the target going forward, while supporting growth.
- **Inflation** projection for FY23 increased by 100 bps to **6.7% assuming a normal monsoon and average crude basket at US\$ 105 / bbl.**
- **Growth** projection maintained at **7.2%** for FY23.
- Both the **bond and the equity market reacted positively.**

Withdrawal of Accommodation

Policy Rates / Reserve Ratio	4 May '22	8 Jun '22	Status
CRR	4.50%	4.50%	↔
SLR	18.00%	18.00%	↔
SDF	4.15%	4.65%	↑
Repo Rate	4.40%	4.90%	↑
MSF	4.65%	5.15%	↑
Bank rate	4.65%	5.15%	↑
Fixed Reverse Repo Rate	3.35%	3.35%	↔

In a scheduled policy meeting held from **June 6 to 8** amid high inflationary pressure the MPC **unanimously announced a repo rate hike of 50 bps to 4.90%**. Consequently, the standing deposit facility (SDF) rate stands adjusted to 4.65%; and the marginal standing facility (MSF) rate and the Bank Rate to 5.15%. The MPC **unanimously voted on “withdrawal of accommodation”** to ensure that inflation remains within the target going forward, while supporting growth.

The background

Repo Rate hike: When the pandemic struck the world in March 2020, the 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 in the off-cycle policy meet on 4 May and by 50 bps today i.e. 8 June, **keeping in line with the announced stance of withdrawal of accommodation set out in April 2022.**

On the **supply side measures taken by the government** in reducing excise duties on petrol and diesel, along with the other measures would help in mitigating the inflationary pressures to some extent. The MPC also recognised that **sustained high inflation could unhinge inflation expectations** and trigger second round effects. It is therefore, judged that further monetary policy measures are necessary to anchor the inflation expectations.

Liquidity: In April the RBI introduced the Standing Deposit Facility (SDF) as the floor of the liquidity adjustment facility (LAF) corridor which was at that time was 40 bps higher than the fixed rate reverse repo rate; as a result, the **weighted average call money rate (WACR) – the operating target of monetary policy** – moved.

Further, in line with the emphasis on gradual withdrawal of accommodation articulated in the April and May MPC resolutions, **systemic liquidity has moderated in the recent period. Surplus liquidity**, as reflected in average daily absorption under the liquidity adjustment facility (LAF) – that is, the absorption under SDF and variable rate reverse repo (VRRR) of 14 days and 28 days **has decreased significantly post the May announcement.**

Growth Outlook

- India's real **gross domestic product (GDP) growth in FY22 is estimated at 8.7%**. The level of real GDP in FY22 has exceeded the pre-pandemic i.e. FY20 level. On the supply side, major categories also surpassed the FY20 levels.

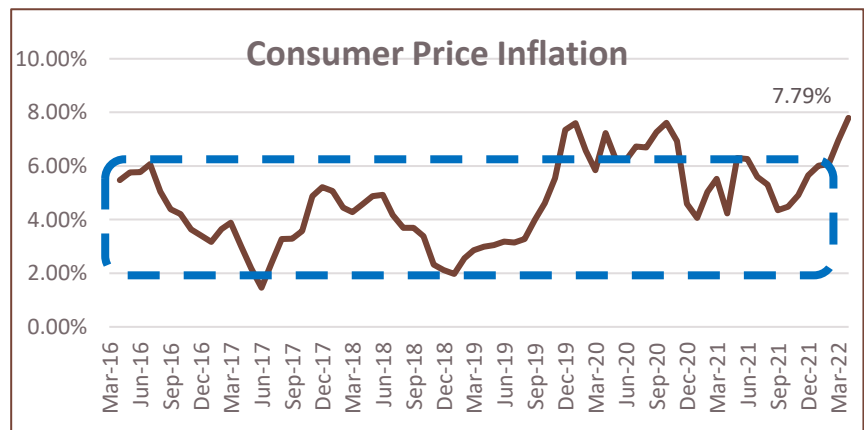
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- Available information for April and May 2022 indicates that the recovery in **domestic economic activity remains firm, with growth impulses getting increasingly broad based**. This is also **corroborated by** purchasing managers' indices (PMIs) numbers, and other fast moving macroeconomic indicators. The contact-intensive services related to trade, hotels and transport have recovered in Q4FY22.
- Going by the early results of RBI surveys, **capacity utilisation (CU) in the manufacturing sector increased**. Improvement in investment activity is also reflected in pick-up in demand for bank credit and persisting growth in imports of capital goods. **Merchandise exports have remained buoyant** with double digit growth for the fifteenth successive month in May, while **high growth of non-oil non gold imports is indicative of recovery in domestic demand conditions**.

Period	FY23	Q1FY23	Q2FY23	Q3FY23	Q4FY23
Growth Projection	7.2%	16.2%	6.2%	4.1%	4.0%

Inflation Outlook

- The CPI headline inflation in April registered a further sharp increase to 7.8%. It was the **fourth consecutive month when inflation touched or was above the upper tolerance level of 6.0%**.
- The **global geopolitical situation remains fluid** and commodity markets remain on the edge, rendering heightened uncertainty to the domestic inflation outlook.



Source: RBI DBIE

- The below data assumes a **normal monsoon in 2022** and average **crude oil price (Indian basket) of US\$ 105 per barrel**; however, it **does not take into account the impact of monetary policy actions taken today**.

Period	FY23	Q1FY23	Q2FY23	Q3FY23	Q4FY23
Inflation Projection	6.7%	7.5%	7.4%	6.2%	5.8%

Summary

The policy was under a **background** of a) The **global geopolitical situation remains fluid** and commodity markets remain on the edge, rendering heightened uncertainty to the domestic inflation outlook and b) the perception that the **RBI downplays inflation expectations**. The MPC unanimously increased the Repo rate by 50 bps to 4.9%, projected inflation for FY23 100 bps higher at 6.7% and stressed on “withdrawal of accommodation”.

Both the bond and the equity market reacted positively. The 10-year India Government bond yields fell from 7.52% close of 7 June 2022 to a day low of 7.44% when the policy was announced and to close at 7.49%, while the Nifty 50 closed marginally lower by 0.37% from a day's high of 16,490 when the policy was announced.

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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