

8 April 2022

Key Highlights - RBI Policy Measures

RBI's Stance

Accommodative

Key Highlights

- Policy rates, Reserve Ratio and Stance kept unchanged
- RBI stays accommodative, warns of 'tectonic shifts'
- SDF was introduced as the floor of the LAF corridor.
- Growth target for FY23 was cut to 7.2% from 7.8%
- Inflation for FY23 was hiked to 5.7% from 4.5%
- This shifted the pivot to focusing on inflation while supporting growth
- RBI Policy was surprisingly hawkish in the light of the current background

Policy Rates / Reserve Ratio	Prior Policy	8 Apr '22	Status
CRR	4.00%	4.00%	↔
SLR	18.00%	18.00%	↔
SDF	--	3.75%	★
Repo Rate	4.00%	4.00%	↔
MSF	4.25%	4.25%	↔
Bank rate	4.25%	4.25%	↔
Reverse Repo Rate	3.35%	3.35%	↔

The RBI for the 11th consecutive bi – monthly Monetary Policy Committee (MPC) Meeting kept the key policy rates unchanged, on unexpected lines. RBI had last revised its policy rate on 22 May 2020, in an off-policy cycle to perk up demand by cutting the interest rate to a historic low. MPC voted unanimously for keeping the interest rate unchanged. However, with respect to the stance though it decided to continue with its “accommodative” stance, however he did not use the words “as long as necessary” but said “while focussing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth” and this time the decision was unanimous.

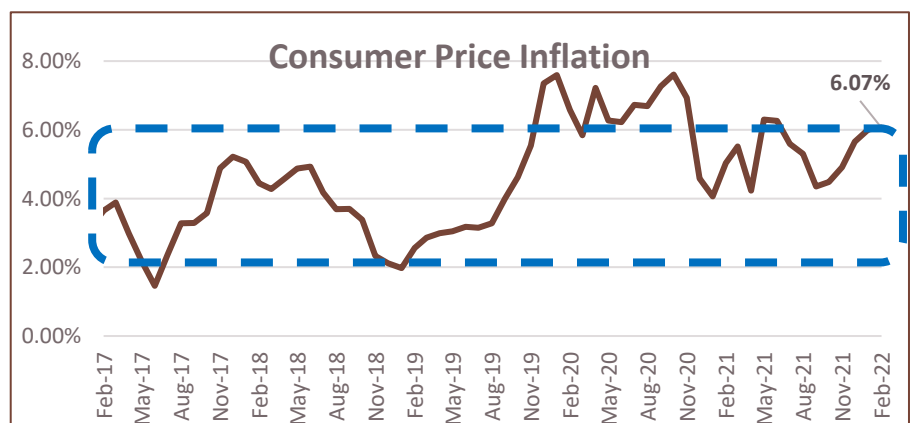
Growth Outlook

- Private consumption and fixed investment – key drivers of domestic demand – however, remain subdued, with these two components being only 1.2% and 2.6% respectively, above their pre-pandemic levels. On the supply side, contact intensive services still trail the 2019-20 level.
- Capacity utilisation in the manufacturing sector recovered to 72.4% in Q3FY21-22 from 68.3% in the previous quarter, surpassing the pre-pandemic level of 69.9% in Q4FY19-20.
- However, the backdrop of escalating geopolitical tensions has cast a shadow on our economic outlook.
- Thus, the RBI projected the Real GDP growth at 7.2% in 2022-23, 60 bps below the earlier projection of 7.8%.

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

Inflation Outlook

- CPI inflation is projected at 5.7% during 2022-23, in line with the number projected earlier. Medium-term target for consumer price index (CPI) inflation remains at 4% within a band of +/- 2%, while supporting growth.



Source: RBI DBIE

8 April 2022

- The February 2022 meeting of the MPC had projected a moderating path for inflation during 2022-23. **Geopolitical tensions** since end-February have, however, **upended the earlier narrative and considerably clouded the inflation outlook for the year.**
- **The hardening of crude oil prices presents** a major upside risk to the inflation outlook through both direct and indirect effects.
- **The conduct of monetary policy is primarily focused on controlling inflation, followed by growth and financial condition.**

Period	FY23	Q1FY23	Q2FY23	Q3FY23	Q4FY23
Inflation Projection	5.7%	6.3%	5.8%	5.4%	5.1%

Key Liquidity Measures Announced

- **The LAF corridor is now normalised to 50 bps to the pre-Covid levels.**
- Liquidity management being the focal point for RBI – thus RBI introduction of a new tool - **Standing Deposit Facility (SDF) rate at 3.75% (which will now be the floor of LAF corridor instead of reverse repo rate).** This window does not require g-sec as collateral.
- **SLR holdings in HTM (Held to maturity) category limit has been enhanced to 23% of NDTL (net demand and time liabilities)** and banks have been allowed to include securities acquired between April 1, 2022, and March 31, 2023 under the enhanced limit of 23%. HTM limits would be restored from 23% to 19.5% in a phased manner starting from the quarter ending June 30, 2023.
- Commitment has also been made to start **withdrawal of liquidity from FY2023 and over the next few years.**

Summary

The policy was under a **background** of a) rising commodity prices; b) a hawkish global central bank commentary; and c) an economy that was no longer in a crisis.

The **RBI changed its stance away from accommodative without actually calling it so**; made an effective rate hike of 40 bps without actually hiking any rates and has introduced the SDF tool to sterilise unlimited surplus liquidity but added that it would drain it over a multi-year horizon.

The policy has clearly **shifted gear from being dovish to a more hawkish guidance and undertone.** The accommodative stance is now geared towards being withdrawn to ensure inflation remains within target. The Governor was specific here in mentioning that RBI's order of **priorities is now inflation before growth.**

We had in our post policy review note in February stated that “There is a possibility that the **rate hikes may not be that fast both domestically and globally as market is assuming to be,** however investors should expect that interest rates on both deposits rates and lending rates will rise in the calendar year, albeit gradually.” We still believe as stated by RBI time and again that it would see to the “**orderly evolution of the yield curve**” **going forward, given a large borrowing program, by policy interventions at appropriate junctures.**

With the RBI stance of **taking out excess liquidity from the system** 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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