RBI HIKES REPO RATE BY 50BPS AMID CONTINUING INFLATIONARY PRESSURE, MAINTAINS FY'23 GDP FORECAST AT 7.2%

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The Reserve Bank of India (RBI) on Wednesday announced 50 basis points (bps) hike in the repo rate to 4.90 percent which was decided unanimously in the three-day Monetary Policy Committee (MPC) meeting held between June 6 and 8. The present RR hike is the second in a row after India's central bank had raised a 40 bps RR hike in its previous MPC meeting held on May 4.

As against the cash reserve ratio (CRR) hike of 50 bps in the previous policy decisions last month, the RBI kept it unchanged today. RR is the rate at which the central bank lends money to commercial banks in the event of any shortfall of funds. It is used by monetary authorities to control inflation. CRR is a minimum amount that the commercial banks keep with the RBI.

Justifying the increase, the RBI governor Shaktikanta Das underlined the global economic challenges emanating from the lingering war in Europe which impacted supply chains worldwide. This disruption has caused a severe impact on food inflation which has now become a global issue. In these challenging times, the RBI continued to take economic measures to control retail inflation with favourable policy stance in place.

ECONOMIC BAROMETER
Growth forecasts of GDP and retail (Consumer Price Index or CPI) inflation

GDP growth		Retail inflation growth	
Period	**Projection (%)**	**Period**	**Projection (%)**
FY2022-23	7.2	FY2022-23	6.7
Apr-Jun '22	16.2	Apr-Jun '22	7.5
Jul-Sept '22	6.2	Jul-Sept '22	7.4
Oct-Dec '22	4.1	Oct-Dec '22	6.2
Jan-Mar '23	4.0	Jan-Mar '23	5.8

Source: Reserve Bank of India

"Higher interest rate may prove an impediment to the economic growth. And without economic growth, bringing down retail inflation seems challenging. Since the RBI continues to forecast strong growth, it is very likely that it delivers another 25 bps hike in its next MPC meeting scheduled on August 4 before, taking a pause. Our fear is that India's economic growth could see a serious deceleration in the second half of the financial year 2022-23 and also in the financial year 2024 on the back of such steep tightening and structural constraints," said Nikhil Gupta, Chief Economist, Motilal Oswal Financial Services Ltd (MOFSL) Group.

The RBI forecast India's retail inflation at 6.7 percent for the current financial year i.e. 2022-23 as against 5.7 percent reported for the previous year. Despite control measures in place, the retail inflation is projected to remain at 7.5 percent for the April-June 2022 quarter and 7.4 percent for the July-September quarter. For the October-December 2022 and January-March 2023 quarters, however, the RBI estimated India's retail inflation at 6.2 percent and 5.8 percent respectively.

"During these difficult and challenging times, the Indian economy remained resilient, supported by strong macroeconomic fundamentals and buffers. The recovery has gained momentum despite the pandemic and the war. On the other hand, inflation has steeply increased much beyond the upper tolerance level of 6 percent. A large part of the rise in inflation is primarily attributed to a series of supply socks linked to the war. In these circumstances, we have started a gradual and orderly withdrawal of extraordinary accommodation instituted during the pandemic," the RBI governor said.

Maintaining the economic growth (gross domestic product or GDP) forecast at 7.2 percent, the RBI estimated the Indian economy to grow at 16.2 percent for the April-June 2022 quarter and 6.2 percent for July-September 2022 quarter. For the quarters ending December 2022 and March 2023, the RBI estimated GDP growth at 4.1 percent and 4 percent respectively.

"The June policy was a continuation of the off-cycle stance with the focus maintaining squarely on inflation. Along with pushing the repo rate above the pre-pandemic level, a 35 bps hike to 5.25 percent would also signal a gradual normalization in the policy actions while being adequately hawkish. We also expect another 50 bps hike in CRR to 5.75 percent by the end of FY 2023 to move the liquidity conditions towards the pre-pandemic levels," said Suvodeep Rakshit, Senior Economist, Kotak Institutional Equities.

Rajani Sinha, Chief Economist, CareEdge, however, believes that the RBI's decision to raise the policy repo rate by a total of 90 bps and change in the policy stance to focus on withdrawal of accommodation are indicative of its strong commitment toward inflation control since the off-cycle policy review last month.

Domestic prices of commodities have been upward bound and show no signs of respite with increasing concerns over inflation. Thus, a challenge for the RBI would be to restrict the second-round effects of rising inflation. However, if RBI prioritizes inflation control, it will have to walk a tightrope in order to sustain the economic recovery that is underway through the foreign exchange reserve at US$601.1 billion and sustained rise in India's exports, among others.

"Going ahead, we expect the repo rate to be hiked by at least 100 bps in the current financial year. This will, however, be contingent on how the inflation-growth dynamics play out," Sinha added.