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RBI Monetary Policy

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Repo Rate Hiked by 40 bps, CRR by 50 bps

- In a surprise move, RBI hiked the policy repo rate by 40 bps to 4.40% in an unscheduled meeting. It is the first reversal in policy rate action since May 2020.
- LAF corridor was maintained at 50 bps with the standing deposit facility (SDF) rate adjusted to 4.15% as the floor and marginal standing facility (MSF) at the upper end of the band at 4.65%.
- Reverse Repo rate was left unchanged at 3.35%.
- RBI retained the monetary policy stance as 'accommodative' with a focus on withdrawal of accommodation.
- Cash Reserve Ratio (CRR) has been increased by 50 bps to 4.50% of NDTL, effective from May 21, 2022. This would amount to a liquidity withdrawal of Rs 87,000 crore.

The decision of hiking the policy rate while maintaining an accommodative policy stance was unanimous by all members of the MPC.

Inflationary Pressures Aggravate

The surprise rate hike by the RBI has come against the backdrop of intensifying inflationary pressures in the global and domestic economies. With domestic economic activities gaining traction, RBI has shifted gear to prioritise controlling inflation.

Key Highlights of RBI Governor's Statement:

Inflation:

- Global supply bottlenecks and elevated global commodity prices pose upside risks to India's inflation trajectory set out in the April 2022 MPC resolution.
- Inflation to intensify further as International crude oil prices continue to hover above USD 100 per barrel.
- Food inflation is likely to remain elevated due to shortages of key food items like wheat and edible oil in international markets. Elevated feed costs and fertilizer prices to further intensify food price pressures.
- Concerns on the second-round effect on inflation of high commodity prices.
- Need to anchor inflationary expectations.

Growth:

- With the return to economic normalcy post the third wave of Covid, private consumption is gaining traction and discretionary spending is on the rise.
- Normal monsoon will support rural demand and private investment could gather pace with pick-up in capacity utilisation.
- Downside risks remain owing to heightened geo-political tensions, intensifying inflationary pressures and volatile financial markets.

CareEdge View

The hike in the repo rate as announced by RBI was much required at this point. The very fact that the RBI has announced the repo rate hike in an unscheduled meeting, highlights the urgency of this move. The hike in CRR will reduce the surplus liquidity in the system and thus improve the effectiveness of the policy rate hike.

While there were already inflationary concerns in the domestic and global economy, the Ukraine-Russia war has aggravated the inflationary concerns. Moreover, the persistence of inflationary pressure has also shown that inflation is not just transient in nature as was being anticipated earlier. Inflation is mainly because of high global commodity prices and supply-side factors. However, it is being witnessed across most categories of CPI and the Central Bank is worried about the second-round effects of high commodity prices.

The spike in domestic inflation is still not as sharp as that being witnessed in other developed economies like the US and UK. But, it is very critical for the RBI to anchor inflationary expectations to avoid a wage-price spiral. The global developments in the last few weeks have highlighted that this battle against inflation could be a long-drawn affair and the Central Bank has aptly accelerated its fight against inflation.

The 10-year G-sec yield shot up in response to the rate hike and closed at 7.38%. We feel that going forward the RBI will hike the repo rate by another 60 bps in FY23. We expect the 10-year G-Sec yield to rise to 7.75-8% by the end of FY23.

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