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# RBI's Monetary Policy Review (FY22-23)

May 5, 2022

## Central Bank Surprises With Unplanned Repo Rate, CRR Hikes

**The inflation outlook needs a resolute and timely response to ensure that long-term inflation expectations are anchored, according to the MPC.**

- India's monetary policy committee raised rates by 40 basis points in an out-of-turn meet on Wednesday amid rising inflation concerns.
- The central bank raised the cash reserve ratio for banks by 50 basis points in an effort to pull out a large surplus of liquidity in the system.
- The repo rate was increased to 4.4% from 4%. The standing deposit facility will be offered at 4.15%, 25 basis points below the repo rate. The marginal standing facility will be offered at 4.65%; 25 basis points above the repo rate. The reverse repo rate stands unchanged at 3.35%.
- The MPC raised the benchmark repo rate for the first time in four years. The last rate hike was in August 2018 during the tenure of former governor Urjit Patel. Between February 2019 and May 2020, India reduced rates by 250 basis points. Of this, 115 basis points was after the Covid-19 crisis hit.
- The MPC also decided to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.
- Alongside, the cash reserve ratio has been raised by 50 basis points to 4.5%, effective May 21, 2022. The withdrawal of liquidity due to this increase would be to the order of Rs 87,000 crore.
- The average surplus liquidity in the banking system was at over Rs 7 lakh crore in April. This had led to the weighted average call rate dipping below the standing deposit facility rate. Even with the CRR hike, the RBI will ensure adequate liquidity for productive needs of the economy.

**The MPC expects inflation to rule at elevated levels, warranting resolute and calibrated steps to anchor inflation expectations and contain second round effects.**

**Outlook: The hike in repo rate and cash reserve ratio is an attempt by the RBI to preempt the rising inflationary pressures. The bigger surprise was the CRR hike which indicates the RBI's intent on withdrawing liquidity at a quicker pace.**

**We expect a 25 basis points repo rate hike in the upcoming June meeting and the repo rate at 5.40% by end-2022.**

**The RBI would also look to deliver another CRR hike in the next policy meeting.**

Research Analysts

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## Inflation & Growth Outlook

**The MPC expects inflation to rule at elevated levels, warranting resolute and calibrated steps to anchor inflation expectations and contain second round effects.**

- Global commodity price dynamics are driving the path of food inflation in India, including prices of inflation-sensitive items that are impacted by global shortages due to output losses and export restrictions by key producing countries.
- International crude oil prices remain high but volatile, posing considerable upside risks to the inflation trajectory through both direct and indirect effects.
- Core inflation is likely to remain elevated in the coming months, reflecting high domestic pump prices and pressures from prices of essential medicines.
- The worsening external environment, elevated commodity prices and persistent supply bottlenecks pose formidable headwinds, along with volatility spillovers from monetary policy normalisation in advanced economies.
- On balance, the Indian economy appears capable of weathering the deterioration in geopolitical conditions but it is prudent to continuously monitor the balance of risks.
- Taking into account the continuing pick-up in inflation, the central bank had revised its inflation projection to 5.7% in 2022-23 from an earlier projection of 4.5%. Inflation is projected at 6.3% in the April-June quarter, exceeding the RBI's upper target of 6%. GDP growth for 2022-23 is now projected at 7.2% from an earlier projection of 7.8%.

## Justified move by the RBI

- Although, after the rate hike, stock markets tumbled and bond yields spiked in response, it was a justified decision by the RBI as a delay in rate hikes would have put the central bank further behind the curve. Inflation, at 7% in March, is already above the central bank's target and is likely to rise in April. The MPC move is expected to help anchor inflation expectations and prevent the second round effects of higher input costs.
- The timing of the hike is also important as it just precede a hike in the policy rate by the U.S. Federal Reserve. This is possibly to ensure that the rupee is safe from any speculative attacks as forex reserves are down by around $30 billion from peak levels.

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