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RBI'S Monetary Policy Review FY2022-23

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MPC Hikes Repo Rate By 50 Basis Points

As widely expected, RBI's Monetary Policy Committee has unanimously decided to increase policy Repo rate by 50 bps to 4.90%.

- India's Monetary Policy Committee hiked the benchmark repo rate by 50 basis points—its second increase in two months.
- The committee had first raised rates by 40 basis points at an unscheduled meeting in May.
- MPC unanimously decided to increase policy Repo rate to 4.90% while also remaining focused on 'withdrawal of accommodation' to ensure that inflation remains within the target going forward, all the while supporting growth.
- SDF rate stands adjusted to 4.65% and the MSF rate and the Bank Rate to 5.15%.
- RBI has retained its real GDP growth forecast for FY2022-23 at 7.2% with risks broadly balanced. However, inflation projection for FY2022-23 has been revised upwards by 100 bps to 6.7% on account of several factors including tense global geopolitical situation, elevated commodity prices, adverse global supply conditions and heightened crude oil prices.
- Average crude oil price (Indian basket) assumption is now taken at $105 per barrel from $100 per barrel. With recent average 6% MSP hike for the kharif crops, there will be an upside pressure of 15 to 20 bps on inflation.
- In terms of liquidity, net LAF has declined to Rs 3.2 trillion from Rs 5.54 trillion as on March end. Core liquidity has also declined to Rs 7.1 trillion from Rs 8.3 trillion, of which Government cash balances is at Rs 3.5 trillion.
- Although global uncertainties are in abundance, growth numbers continue to show optimism locally. Capacity utilization rates have now moved up to 74.5%, with new investment announcements at a record high of Rs 20 trillion in FY22.
- Against this background, we are now expecting that the RBI could factor in a rate hike in August, having concluded the process of withdrawal of accommodation as far as repo rate is concerned. Assuming RBI's near term inflation forecasts are met and there are no fresh commodity shocks, the pace of hikes after 5.15% (likely to be achieved by August policy) will probably slow down further.

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Research Analysts

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Inflation forecast increased for FY2022-23: Inflation is projected at 6.7% in FY2022-23 with Q1 at 7.5%; Q2 at 7.4%; Q3 at 6.2%; and Q4 at 5.8%. The tense global geopolitical scenario and the consequent higher commodity prices add significant uncertainty to the domestic inflation outlook. The restrictions on wheat exports will improve domestic supply but a shortage in rabi crops due to the heat wave will be an offsetting risk. The prognosis of a normal southwest monsoon good news for Kharif agricultural productivity and the food price outlook. Despite a recent correction due to lifting an export ban by a key supplier, edible oil prices remain under pressure due to weak global supply conditions. Domestic retail prices of petroleum products have moderated due to the recent reduction in excise duties. However, international crude oil prices remain elevated, raising the possibility of further pass-through to domestic pump prices. There is also the risk of rising prices of electricity. Preliminary results from the RBI's surveys of businesses in the manufacturing, services and infrastructure sectors indicate that further input and output price pressures are underway.

Overall GDP forecast retained: The real GDP growth for FY23 is retained at 7.2%, with Q1FY2022-23 at 16.2%, Q2 at 6.2%, Q3 at 4.1% and Q4 at 4.0%. Rural consumption will gain from the expected normal southwest monsoon and improved agricultural prospects. Going forward, a rebound in contact-intensive services is likely to boost urban consumption. Improved capacity utilization, the government's Capex push and strengthening bank credit are likely to boost investment activity. Nonetheless, pullovers from geopolitical tensions, rising commodity prices, ongoing supply bottlenecks weigh on the outlook.

Other Measures:

- Bank term deposit rates are rising, bolstering stable funding resources in response to rising credit demand. The RBI will ensure that adequate liquidity is available to meet the economy's productive requirements.

- Individual housing loan limits extended by Urban Cooperative Banks (UCBs) and Rural Cooperative Banks (RCBs- State Cooperative Banks and District Central Cooperative Banks), which were last fixed in 2011 and 2009, respectively, are being revised upwards by over 100% owing to the increase in house prices. This will facilitate an efficient flow of credit to the housing sector.

- It is suggested the Rural Cooperative Banks (RCBs- State Cooperative Banks and District Central Cooperative Banks) be permitted to extend finance to 'commercial real estate – residential housing' within the existing aggregate housing finance limit of 5% of total assets. This measure will further boost credit flows from cooperative banks to the housing industry.

- It has also been decided to authorize UCBs to provide customers with doorstep banking services. This will help UCBs serve their consumers better, particularly the seniors and the disabled.

- The Reserve Bank is implementing margin requirements for non-centrally cleared OTC derivatives to strengthen the market's resilience and align with G20 reforms.

- To further facilitate recurring payments like subscriptions, insurance premium, education fee, etc. of larger value under the framework, the limit is being enhanced from INR 5,000 to INR 15,000 per transaction. This will further leverage the benefits available under the framework and augment customer convenience.

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