HSBC Mutual Fund

RBI Monetary Policy

February 8, 2023

Key Announcement

The Monetary Policy Committee (MPC) came out with their bi-monthly policy statement today. Some of the key announcements are as follows:

- The MPC decided by a majority of 4 out of 6 members to increase the policy Repo Rate by 25 bps to 6.50%
- Consequently, the Standing Deposit Facility (SDF) rate was adjusted to 6.25% and the Marginal Standing Facility (MSF) rate and Bank Rate were adjusted to 6.75%
- The MPC also decided by a majority of 4 out of 6 members to remain focused on the withdrawal of accommodation to ensure that inflation remained within the target going forward while supporting growth

Among the MPC members, Prof. Jayanth Varma and Dr. Ashima Goyal voted against the Repo Rate hike and also against maintaining the stance at “withdrawal of accommodation”.

For FY2024, the growth forecast is at 6.4% with Q1 and Q2 growth forecasts having been revised upwards. On the inflation front, FY2024 inflation forecast is at 5.3% while the Q4 FY2023 forecast has been revised downwards to 5.7%.

The RBI policy statement mentioned that the easing of inflation in the last two months was driven by strong deflation in vegetables, while noting that elevated and sticky core inflation remained a matter of concern. While prospects for rabi crop have improved, global commodity price outlook is uncertain. The governor noted that in this backdrop, monetary policy needs to be tailored to bring about a durable disinflation process. The governor also noted that the reduction in size of the rate hike to 25 bps provides the opportunity to evaluate the impact of policy actions taken till now.

On the liquidity side, the governor noted that while higher government expenditure and anticipated return of forex inflows would augment systemic liquidity, it would be modulated by scheduled redemptions of erstwhile Long Term Repo Operation (LTRO) and Targeted Long Term Repo Operation (TLTRO) funds during February to April 2023. The governor mentioned that RBI would remain flexible towards meeting the productive requirements of the economy and would conduct liquidity operations depending on the evolving liquidity conditions.

Market Movement

The policy action was broadly in line with market expectations. However, some sections of the market had anticipated a shift in monetary policy stance to neutral. In the absence of a firm indication that the rate hiking cycle was nearing its end, the market saw some amount of negative reaction with G-Sec yields moving higher by 3-4 bps at the longer end (beyond 5 years) and 6-8 bps on the shorter end (up to 5 years). Similarly, on the money market side, CP/CD yields are higher by ~5 bps in the up to 1-year segment.

Outlook

The hike of 25 bps was largely a unanimous expectation of the market in the immediate run up to the policy and the RBI delivered the same. The dissent by some of the MPC members on the rate hike and policy stance, were also in line with the views expected by those members during the previous MPC's minutes.

However, the tone and messaging of the Governor's statement was mildly on the hawkish side. The MPC statement noted that "headline inflation excluding vegetables has been rising well above the upper tolerance band and may remain elevated, especially with high core inflation pressures" with the governor reiterating that RBI was **"unwavering in its commitment to bring down inflation".** The statement was also more sanguine on growth prospects, noting that the outlook on global growth has improved in recent months while domestic demand remains strong. This was also reflected in the RBI's GDP growth projection for FY2024, which at 6.4%, remains above market consensus.

The governor's statement did mention that the "rate hikes taken thus far provides elbow room to weigh all incoming data" which was a slight moderation in commentary from earlier MPC meetings. However, overall, given the commentary on growth, concern on core inflation, and the lack of any clear indication on future rate trajectory, **the possibility of a further rate hike does not appear to be off the table as yet – it would depend on incoming data as well as the global economic environment. Markets may have to accordingly reprice its terminal rate hike expectations to factor in this possibility.**

Overall – in this backdrop, we think that **G-Sec yields are likely to consolidate around the 7.25%-7.50% levels (10-year G-Sec).** At the same time, **markets will remain sensitive to incoming data and changes in global rates/commodity prices/ global central bank actions, which could induce volatility on either side.**

Past performance is not an indicator of future returns. Source: RBI Policy Statement, HSBC MF. Data as of Feb 8, 2023

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