RBI Monetary Policy Review

L&T Financial Services
Mutual Fund

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

- The MPC members unanimously voted for keeping the policy Repo Rate unchanged at 4.0%
- The Reverse Repo Rate under LAF and the MSF rate have also been kept unchanged at 3.35% and 4.25%, respectively
- The MPC introduced the Standing Deposit Facility (SDF), which will henceforth be the floor of the LAF corridor, currently at 3.75%. Correspondingly the LAF corridor has been restored back to 50 bps
- The MPC unanimously decided to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remained within the target going forward while supporting growth

In light of the recent developments around geopolitical tensions between Russia and Ukraine, soaring energy and commodity prices and global supply chain disruptions, the MPC revised the growth and inflation projection from the previous policy. Considering a base case assumption of a normal monsoon and average crude price (Indian basket) of USD 100/bbl the projections have been revised below:

- Real GDP growth for FY2023 has been revised downwards to 7.2% (from an earlier estimate of 7.8%) with the following quarterly projections: Q1 FY2023 at 16.2%, Q2 at 6.2%, Q3 at 4.1% and Q4 at 4.0%
- CPI projection for FY2023 has been revised upwards to 5.7% (from an earlier estimate of 4.5%) with the following quarterly projections: Q1 FY2023 at 6.3%, Q2 at 5.8%, Q3 at 5.4% and Q4 at 5.1%

Although the Governor reiterated the RBI's commitment to ensure the availability of adequate liquidity to meet the productive requirements of the economy, he also mentioned that the RBI will engage in a gradual and calibrated withdrawal of the surplus liquidity (injected in the wake of the pandemic) over a multi-year time frame in a non-disruptive manner. The Governor also mentioned that the RBI remains focused on the completion of the Government borrowing program and will deploy various instruments as and when required. As a step towards this, the RBI enhanced the limit for inclusion of SLR eligible securities in the HTM category from 22% to 23% of NDTL.

One important inference from the Governor's speech was that the RBI is looking to prioritize inflation over growth after a period of 3 years, which is evident from the sharp revision in inflation estimates. Additionally, there were also first signs of communication from the MPC talking about focusing on withdrawal of accommodation.

With the MPC now turning hawkish, markets witnessed a sharp sell-off across the curve. Money market rates moved higher by 20-25 bps. G-Sec and Corporate Bonds in the 2-5 year segment moved higher by 20-25 bps while longer tenor papers sold off by around 15-20 bps.

Markets were clearly looking toward the Central Bank for some support to narrow the supply-demand gap for the heavy Government borrowing. However, there was no concrete communication towards achieving that. Today's policy seems to be the first step towards the inevitable policy normalization, which probably will begin with a stance change from accommodative to neutral followed by a hike in the repo rate. For RBI, the next few quarters will be a testing time, in terms of balancing out its various mandates – managing the growth inflation tradeoffs, ensuring that Government borrowing goes through smoothly while still maintaining its hard-earned credibility. ***From our fund's perspective, we continue to remain cautious in our positioning across our actively managed funds till further clarity emerges on geopolitical risks, crude prices and also RBI's tolerance levels for critical yield levels - before they come in to support the markets.***

Source: RBI Press Release, internal