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RBI Monetary Policy

June 8, 2023

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

- The MPC unanimously decided to keep the policy Repo Rate unchanged at 6.50%
- Consequently, the Standing Deposit Facility (SDF) rate remains unchanged at 6.25% and the Marginal Standing Facility (MSF) rate and Bank Rate at 6.75%
- The MPC also decided by a majority of 5 out of 6 members to remain focused on the withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth. Prof. Jayanth Varma voted against this part of the resolution

FY2024, the growth forecast has been retained at 6.5%, with quarterly projections of Q1 at 8.0%, Q2 at 6.5%, Q3 at 6.0% and Q4 at 5.7%, with risks evenly balanced with the growth forecasts revised marginally upwards for Q1 and Q2, and marginally downwards for Q3 and Q4. Inflation forecast for FY2024 has been marginally reduced to 5.1% (from earlier expectations of 5.2%). Quarterly projections of Q1 at 4.6% and Q2 at 5.2% have been revised lower from 5.1% and 5.4% respectively while inflation forecasts for Q3 and Q4 have been left unchanged. The governor mentioned that while incoming data suggests that risks to near term inflation have moderated somewhat, inflationary pressures in the second half need to be carefully monitored and noted uncertainties around the monsoon, international commodity prices and geopolitical tensions could impact the inflation outlook.

On liquidity, the Governor mentioned that there was a relatively skewed liquidity distribution within the banking system and noted that RBI remained nimble in its liquidity management conducting both sided operations including14-day variable rate repo (VRR) and variable rate reverse repo auctions (VRRR). RBI noted that the decline in currency in circulation and the pick up in government spending have expanded the system liquidity since the third week of May, which has got further augmented by deposits of INR 2,000 bank notes in banks (the governor further mentioned in the press conference, that out of INR 3.62 lakh crore of 2,000 rupee notes in circulation as of March 31, 2023, ~INR 1.8 lakh crore has now come back either via exchange or deposits). The governor also mentioned that RBI will ensure that adequate liquidity is available for productive requirements of the economy and will also ensure orderly completion of the Government of India (GOI) market borrowing programme.

The policy statement mentioned that the MPC took note of moderation in CPI inflation in March- April into the tolerance band of 4% +/- 2%. While it noted that headline inflation is projected to decline in FY 24 from FY 23, it mentioned that it would still remain above the 4% target, warranting continuous vigil. The statement noted that the progressive impact of cumulative rate hikes of 250 bps undertaken in FY 23 will transmit through the economy and help keep inflationary pressures contained in the coming months. The governor's statement reiterated that inflation needs to progressively align closer to the target of 4% and "being within the tolerance band is not enough" and the stance of "withdrawal of accommodation" should be viewed from this perspective.

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Outlook

Given the policy actions in line with consensus, the policy was largely a non-event from the market perspective. However, given the aforementioned tone in the policy and the expectation of a small segment of the market for a change in stance, there was a mild uptick in yields of 2-5 bps across various points on the G-Sec curve. This was more pronounced at the 4-5 year point of the curve (4-5 bps) v/s the 10-year segment (2 bps). Corporate bond yields were also marginally higher.

The unchanged rate and stance were largely in line with market expectations. The revision in growth and inflation forecasts in Q1 and Q2 was also largely expected, given recent trends. Overall, the MPC statement and governor's comments appeared to sound fairly sanguine on growth while on the other hand, noting risks on the inflation front, especially from the progress of the monsoon and it also continued to reiterate the need for sustained durable disinflation to ensure sustained alignment of inflation with the target.

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

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