RBI's Monetary Policy Review

8th June 2022

RBI Policy Stance

- MPC decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward while supporting growth.
- MPC decided to vote unanimously to increase the policy repo rate by 50 bps to 4.90%.

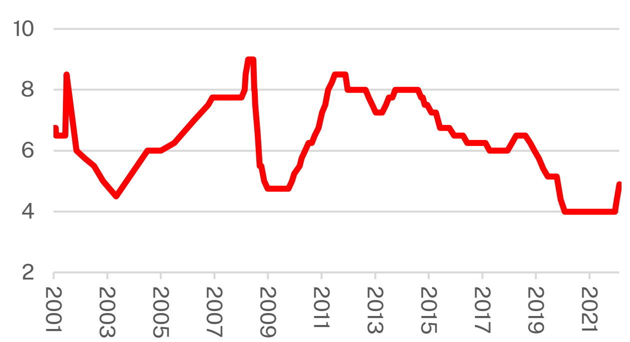
Policy Rates	Pre Policy	Post Policy	Status
Repo	4.40%	4.90%	50 bps inc
Reverse Repo	3.35%	3.35%	Unchanged
MSF	4.65%	5.15%	50 bps inc
Bank Rate	4.65%	5.15%	50 bps inc
CRR	4.50%	4.50%	Unchanged
SDF	4.15%	4.65%	50 bps inc
SLR	18.00%	18.00%	Unchanged

Time Frame	Projection – Inflation		Projection - Real GDP	
	Apr-22	June-22	Apr-22	June-22
Q1 FY 23	6.30%	7.50%	16.20%	16.20%
Q2 FY 23	5.80%	7.40%	6.20%	6.20%
Q3 FY 23	5.40%	6.20%	4.10%	4.10%
Q4 FY 23	5.10%	5.80%	4.00%	4.00%
FY 23	**5.70%**	**6.70%**	**7.20%**	**7.20%**

Key Highlights

- The liquidity in the system remains surplus with average daily absorption under LAF at ₹5.5 lakh crore during May 4-May 31 lower than ₹ 7.4 lakh crore during April 8 – May 3, 2022.
- The central bank iterated that going ahead while normalizing the pandemic related extraordinary liquidity accommodation, the RBI will ensure availability of adequate liquidity to meet the productive (i.e., credit) requirements of the economy.
- The inflation forecast for FY23 is now revised to 6.70% higher than earlier forecast of 5.70%.
- Growth forecast for FY23 is retained at 7.20%.
- Despite weakening recovery across major trading partners, India's exports have performed well. The impact of rising crude oil prices on POL import bill has been partly offset by export of petroleum products.
- Optimism on exports of both goods and services and remittances should help contain the current account deficit (CAD) at a sustainable level which can be financed by normal capital flows.

RBI Repo Rate Trajectory



RBI's Projection on Inflation and Growth

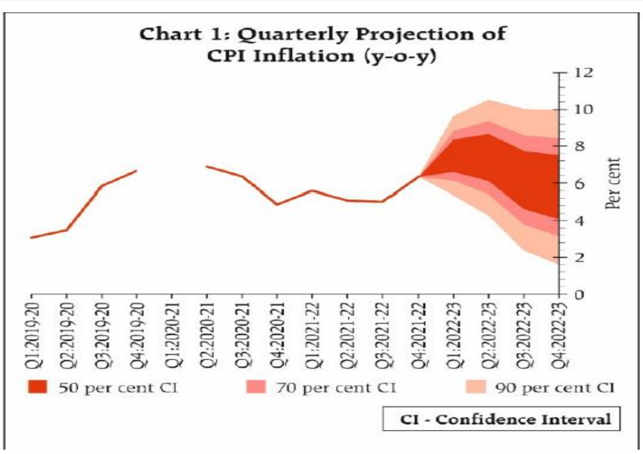


Chart 1: Quarterly Projection of CPI Inflation (y-o-y)

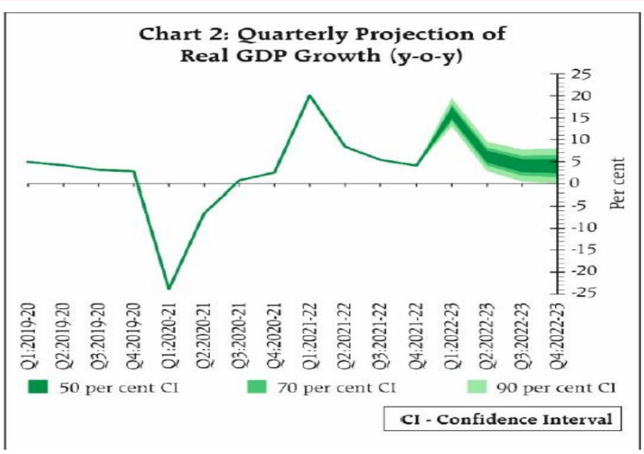


Chart 2: Quarterly Projection of Real GDP Growth (y-o-y)

RBI's Assessment of Global and Domestic Economy

- The CPI headline inflation in April registered a further sharp increase to 7.8% and the surge in inflation was seen across all major categories. It was the fourth consecutive month when inflation touched or was above the upper tolerance level of 6%.

- Certain positive developments like expectations of normal south-west monsoon and kharif agricultural season, the recent supply side measures taken by the government, lifting of palm oil export ban by Indonesia and signs of commodity price correction may help to ease the price pressures to some extent. The survey of urban households post the excise duty cuts on petrol and diesel on May 21st shows a significant moderation in inflation expectations.

- Upside risks to inflation persist due to various factors like continuing supply chain bottlenecks, rising input costs which could be passed through to the selling prices, recent spike in tomato prices, elevated commodity prices especially crude oil, etc. Prudent monetary policy would ensure that the second-round effects of supply side shocks on the economy are contained, and long-term inflation expectations remains firmly anchored.

- According to the estimates released by NSO on May 31st, 2022, India's real GDP for FY22 is estimated at 8.7%. The level of real GDP has exceeded the pre-pandemic level (FY20). The economic recovery for April and May 2022 remains firm with growth impulses getting broad based.

- The surveys done by the RBI reveal that capacity utilization in manufacturing sector increased further to 74.5% in Q4:2021-22 from 72.4% in Q3: 2021-22. Expectation is the utilization levels would increase further in 2022-23 and other factors like government's capex push and deleveraged corporate balance sheet, together would drive the investment activity. The forecast of normal monsoon should support rural consumption and rebound in contact intensive services is expected to sustain urban consumption.

- Factors like geopolitical tensions, elevated commodity prices, tightening of global financial conditions and slowdown in global growth may continue to weight on the outlook on growth.

Outlook

- *Focus solely on Inflation and stance drops "remain accommodative"*– This policy is the continuation of the May policy with the focus squarely on inflation. The RBI dropped from its resolution the emphasis that policy "remains accommodative", signaling that MPC sees rates closer to the pre pandemic level and hence pandemic induced accommodation have been removed.

- We believe the increase in commodity prices and supply side disruptions pose two challenges – a) margin compression for corporates if price hikes are not taken on timely basis and b) derailed consumption for households if prices become too high. In lieu of these factors, we believe government policies and spending and export opportunities would be the primary drivers of GDP.

- The policy announcements were in line with the market expectation, and we had seen during the day, the 10-year bond yield moving down to 7.43% from 7.55%.

- Investors could look to invest in short term bond funds as the recent upward move in yields makes the 1–3-year segment attractive. Investors who are looking for visibility of returns could invest in high quality roll down strategies across 2-5 years duration. We believe the longer end of the curve may remain volatile till clarity emerges on fiscal situation of the government and how the government borrowing program is supported by RBI. Investors could also look to invest in well managed credit funds (on AIF platform) where the focus is on capital preservation and current income.

- We would wait to get greater clarity with respect to chances of **recession** in US (hiking rates in a slowing economy may be a way to re-engineer recessionary outcome), **rates** (a function of inflation) and **risk** (volatility coming down) before recommending lump sum investments in equities. We continue to focus on funds which benefit from domestic growth led by government spending and export opportunities or transformation to "war economy" and recommend investors to add to equities in large declines. Allocation to equities should be consistent with the risk profile of an investor and the holding period should be 3-5 years.

- The next policy statement is due on 4th August 2022.

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