

RBI's Monetary Policy Review

5th August 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 5.40%.

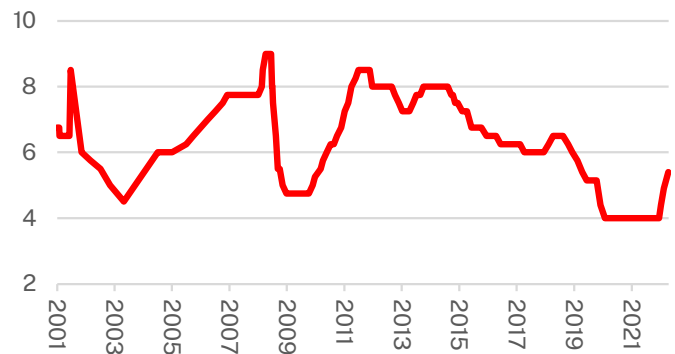
Key Highlights

- The liquidity in the system remains surplus with average daily absorption under LAF at ₹3.8 lakh crore during Jun - Jul 2022 from ₹ 6.7 lakh crore during April - May 2022.
- Going forward, RBI will remain vigilant on the liquidity front and conduct two-way fine-tuning operations as and when warranted - both variable rate repo and variable rate reverse repo depending on the evolving liquidity and financial conditions.
- The inflation forecast for 2022-23 is retained at 6.70%. For Q1 2023-24, CPI forecast is at 5%.
- Growth forecast for 2022-23 is retained at 7.20% and for Q1 2023-24 GDP forecast is at 6.70%.
- During the current FY (up to 4th Aug 2022), US Dollar Index (DXY) has appreciated by 8%. In the same period, INR has moved in a relatively orderly fashion depreciating by 4.7% - faring much better than Emerging market economies and Asian peers.
- Net FDI stood at USD 13.6bn in Q1 2022-23 vs USD 11.6 bn in Q1 2021-22. Foreign portfolio investment, after remaining in exit mode had turned positive in July 2022.

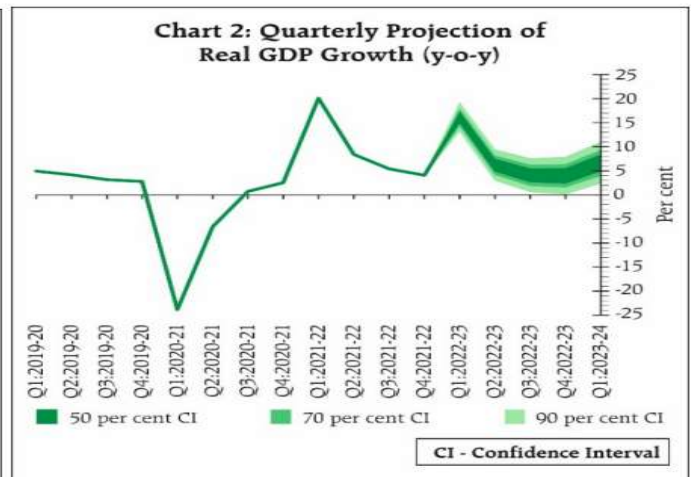
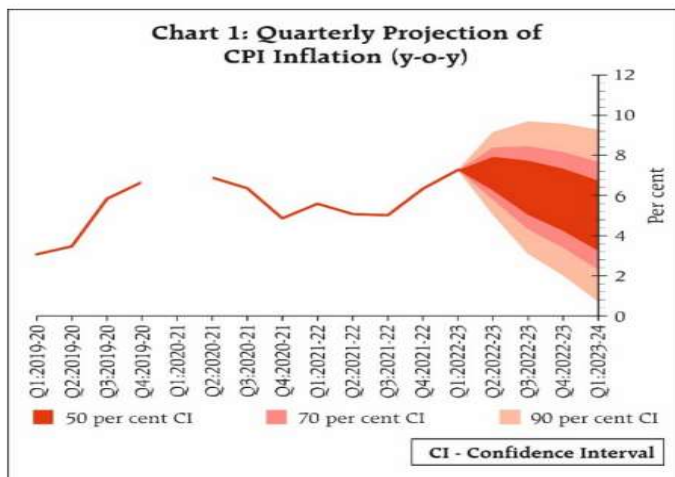
Policy Rates	Pre Policy	Post Policy	Status
Repo	4.90%	5.40%	50 bps inc
Reverse Repo	3.35%	3.35%	Unchanged
MSF	5.15%	5.65%	50 bps inc
Bank Rate	5.15%	5.65%	50 bps inc
CRR	4.50%	4.50%	Unchanged
SDF	4.65%	5.15%	50 bps inc
SLR	18.00%	18.00%	Unchanged

Time Frame	Projection - Inflation		Projection - Real GDP	
	June-22	Aug-22	June-22	Aug-22
Q2 2022-23	7.40%	7.10%	6.20%	6.20%
Q3 2022-23	6.20%	6.40%	4.10%	4.10%
Q4 2022-23	5.80%	5.80%	4.00%	4.00%
Q1 2023-24	--	5.00%	--	6.70%
2022-23	6.70%	6.70%	7.20%	7.20%

RBI Repo Rate Trajectory



RBI's Projection on Inflation and Growth



RBI's Assessment of Global and Domestic Economy

- Domestic economic activity is showing signs of broadening – south-west monsoon rainfall and reservoir levels are above normal, kharif sowing is progressing well (although marginally below last year due to uneven rainfall distribution), demand side indicators such as production of consumer durables, air passenger traffic and sale of PVs suggest improvement in urban demand, high frequency indicators like railway and port freight traffic, e-way bills, toll collections, etc showing robust signs in June and July 2022, PMI manufacturing rose to 8 month high and PMI services continued expansion in July.
- However rural demand indicators exhibited mixed signals – while two-wheeler sales increased, tractor sales contracted in June. Looking ahead a good progress of the southwest monsoon and kharif sowing would support rural consumption.
- Looking ahead increase in capacity utilization, government's capex push and large expansion in bank credit should support investment activity. As per RBI survey, manufacturing firms, expect sustained improvement in production volumes and new orders in Q2 2022-23 which is likely to sustain through Q4. Moreover surveys, also define that the capacity utilization in the manufacturing sector is now above its long-term average (Q4 2021-22 was 75.3% vs LTA: 73.7%) signaling the need for fresh investment activity.
- Since the last MPC meeting, there has been some let up in global commodity prices, particularly in prices of industrial metals and some softening in global food prices. Domestic edible oil prices are expected to come down on back of improved supplies, resumption of wheat supply from Black Sea if sustained could soften global prices and supply side pressures are also on easing trajectory. Household inflation expectations have eased but they remain elevated.
- Factors which lead to uncertainty on inflation front are - unseasonal and excessive rainfall which can have an impact on food prices (especially vegetable prices), transmission of input cost pressures to selling prices across manufacturing and services sectors and higher wages due to increased cost of living could lead to further price pressures.

Outlook

- Rate hike by 50 bps shows RBI's aim is to anchor inflation expectations and focus on reigning consumer prices back into its target range. We also believe the policy indirectly may help to support INR as rising USD can feed into imported inflation pressures – RBI's latest estimate of exchange rate pass through suggests a 1% depreciation of INR pressures CPI inflation by 8 bps (Source – JPM).
- Markets perceived the policy announcements as hawkish on account of policy rate hike at higher end of rate hike expectation band (25 to 50 bps), reiterated focus on with drawl of accommodation and no forward guidance. We have seen the 10-year bond yield moving up from 7.107% to 7.30%.
- As we have iterated in our previous publications and citing the recent corporate results (for Q1FY23), companies are witnessing margin pressures on account of rising raw material, power and freight costs. Moreover, if we refer to the Consumer Confidence Survey by RBI for May 2022, we get a sense that sentiments around spending on non-essential items remains weak among consumers and the consumption patterns may further get derailed if prices are too high (especially on account of margins being protected). In lieu of these factors and weak external demand, we believe government policies and spending would be the primary driver of GDP.
- We continue to believe that the direction of yields going forward would be dictated by factors like policy tightening across economies (chief being US), growth inflation trade offs (next 2 policy meets would give more updates on FY24 forecasts and clarity on external demand) and support to government borrowing program from RBI. Investors could look to invest in short term bond funds as the upward move in yields in recent months makes the 1–3-year segment attractive. Investors who are looking for visibility of returns could invest in high quality roll down strategies across 3-5 years duration. 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), **risk** (volatility coming down) and **earnings** before recommending lump sum investments in equities. We continue to focus on funds which benefit from domestic growth led by government spending and policies and selective 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 30th Sept 2022.

Disclaimer

The contents of this document are confidential and are meant for intended recipient only. If you are not the intended recipient, please delete all copies of this document and notify the sender immediately.

This document, provided as a general commentary, is for informational purposes only and is not to be construed as an offer to sell or solicit an offer to buy any financial instruments in any jurisdictions. This does not constitute any form of regulated financial advice, and your independent financial advisor should be consulted prior to taking any investment decision(s). This document is based on information from sources which are reliable but has not been independently verified by LC Capital India Private Limited ("LCIL"). LCIL has taken reasonable steps to verify the contents of this document and accepts no liability for any loss arising from the use of any information contained herein. Please also note that past performances are not indicative of future performance.

This document is prepared by LC Capital India Private Limited ("LCIL") which is incorporated in India and is an Association of Mutual Funds in India ("AMFI") registered Mutual Fund Distributor (ARN 171014) and registered Authorized Person of Axis Securities Ltd (BSE:AP01316301116454; NSE:AP2064002463). The contents of this document may not be reproduced or referenced, either in part or in full, without prior written permission of LCIL.

LC Capital India Private Limited ("LCIL") is not affiliated to Lighthouse Canton Pte Ltd ("LCPL"), Singapore, and any views and/or advice provided by LCIL does not represent nor constitute as the views held by LCPL. Lighthouse-Canton brand and logo are owned by Lighthouse Canton Investment Holdings Pte Ltd ("LCIH") and have been granted for use to LCIL and LCPL by means of Licensing agreements.