RBI’s Monetary Policy Review

8th Feb 2023

RBI Policy Stance

- The MPC decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward while supporting growth.
- The MPC decided to increase the policy repo rate by 25 bps to 6.50%.

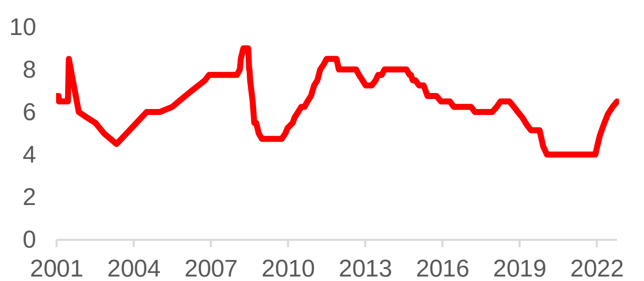
Policy Rates	Pre Policy	Post Policy	Status
Repo	6.25%	6.50%	25 bps inc
Reverse Repo	3.35%	3.35%	Unchanged
MSF	6.50%	6.75%	25 bps inc
Bank Rate	6.50%	6.75%	25 bps inc
CRR	4.50%	4.50%	Unchanged
SDF	6.00%	6.25%	25 bps inc
SLR	18.00%	18.00%	Unchanged

Key Highlights

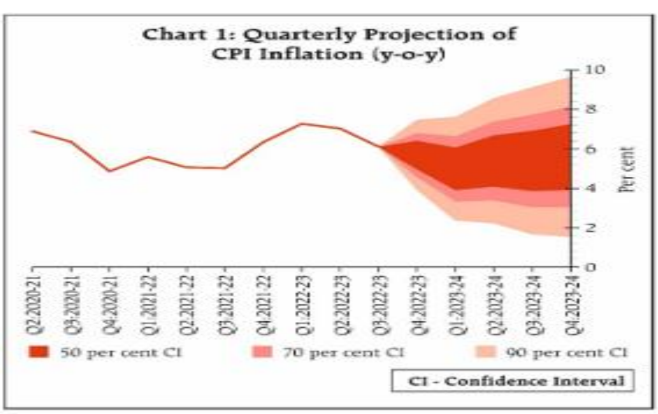
- The liquidity in the system remains surplus with average daily absorption under LAF at ₹1.6 lakh crore during Dec’22 – Jan’23, higher than ₹ 1.4 lakh crore during Oct – Nov’22.
- The inflation forecast for FY’23 stands marginally revised downwards to 6.5% from 6.7% previously while it is projected to hover around 5.3% in FY’24.
- Growth forecast for FY’23 is revised upwards to 7.00% vs earlier forecast of 6.80%.
- Net FDI flows were US$22.3 bn in April-Dec’22 marginally down from $24.8 bn a year ago. FPI flows between Jul’22 till 6th Feb’23 amounted to US$8.5 bn
- Foreign exchange reserves have rebounded from a low of US$524.5 bn as on 21st Oct’22 to US$576.8 bn as on 27th Jan’23

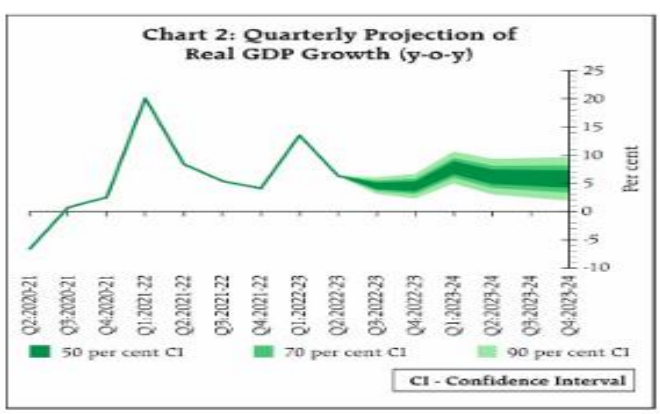
Time Frame	Projection – Inflation		Projection - Real GDP	
	Dec-22	Feb-23	Dec-22	Feb-23
Q4 FY’23	5.90%	5.70%	4.20%	4.40%
Q1 FY’24	5.00%	5.00%	7.10%	7.80%
Q2 FY’24	5.40%	5.40%	5.90%	6.20%
Q3 FY’24		5.40%		6.00%
Q4 FY’24		5.60%		5.80%
FY’23	**6.70%**	**6.50%**	**6.80%**	**7.00%**

RBI Repo Rate Trajectory



RBI’s Projection on Inflation and Growth





RBI's Assessment of Global and Domestic Economy

- The outlook for the global economy has improved over the past couple of months even though headline GDP growth numbers are expected to decelerate in CY'23. Inflation is showing signs of easing, but Central banks continue to tread the path of caution and maintain a hawkish rhetoric on interest rates. Further weakening of demand from advanced economies, rise in protectionist policies, volatile capital flows and debt distress could impact growth prospects of emerging economies in the year ahead.

- The Indian economy continues to display resilience and is expected to grow at 7.0% in FY'23 , led by continued resilience in Urban demand and improving rural consumption.

- Urban Demand is supported via continued growth in travel, tourism and hospitality as well as pick up in passenger vehicle sales. ***Domestic Air passenger traffic has touched pre pandemic levels for the first time in Dec'22.*** Rural demand continues to show signs of improvement as tractor sales and two-wheeler sales expanded in Dec'22.

- On the Supply side, increase in Rabi sowing area by 3.3% as compared to last year as on 3rd Feb'23, as well as factors such as higher reservoir levels, good soil moisture, favorable winter temperature and comfortable availability of fertilizers, are all expected to support bumper agricultural output. Meanwhile Manufacturing and Services PMIs remained in expansion at 55.4 and 57.2 respectively in Jan'23

- Outlook for Growth – The Government's continued thrust on capex, rebound in contact intensive sectors, higher rabi harvest output, broad based credit growth and higher capacity utilizations augur well for sustained economic growth. However, headwinds from geopolitical tensions, tightening global financial conditions and slowing external demand pose downside risks.

- Outlook for Inflation – Food inflation is expected to moderate primarily owing to an anticipated bountiful rabi harvest . Core inflation (non-food non-fuel led) however is expected to remain sticky primarily driven by pass through in input costs, mainly in services sector. Crude is expected to be volatile and an average price of US$95/bl has been considered for Indian crude basket to arrive at inflation projections

Outlook

- The rate hike by 25 bps shows the RBI's focus on reigning consumer prices back into its target range which has now been spelt out at 4%. The policy announcement was on expected lines although overall commentary was more hawkish than market expectations . ***This may not be the last rate hike from RBI as was widely anticipated with inflation target of 4% and FY'24 CPI expectations at 5.4%***

- The RBI would be keeping a keen eye on US Fed action as the economy continues to show signs of expansion and labor markets continue to display resilience which increases the probability of further rate hikes. As such, we believe another 25-bps hike may still be a probable outcome in the next MPC meeting which would follow the US Fed's FOMC meeting as on 21st and 22nd Mar'23.

- 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 and carry opportunity 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 prefer not to add significant duration yet because of insufficient risk premia (spreads between longer end and 5 year) and we would also await release of the RBI's borrowing calendar in the new financial year

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