RBI Monetary Policy December 2022: Major Highlights

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- The RBI has increased repo rate to 6.25%, by 35 bps from 5.90%.
- The standing deposit facility (SDF) rate stands adjusted to 6.00 per cent from the previous 5.65 per cent.
- The marginal standing facility (MSF) rate and the Bank Rate have been increased to 6.50 per cent from the previous 6.15 per cent.
- The MPC has decided to remain focused on "withdrawal of accommodation" to ensure that inflation remains within the target going forward, while supporting growth.

Reasons for Today's (7 Dec'22) Monetary Policy Stance:

- Inflation is still above the upper tolerance band since January 2022 and core inflation is persisting around 6 per cent.
- Headline inflation is expected to remain above or close to the upper threshold in Q3 and Q4:2022-23.
- It is likely to moderate in H1:2023-24 but will remain well above the target.
- Net exports would remain subdued due to the drag from evolving external demand conditions.
- Further calibrated monetary policy action is warranted to keep inflation expectations anchored, break the core inflation persistence, and contain second round effects.

Growth will be resilient, but expected to be moderated:

- The RBI has revised growth projections downward in Q3:2022-23 in Dec'22 policy to 4.4% compared to its Sept'22 policy 4.6% and for Q4: its growth is revised downwards to 4.2%. The overall growth projections for 2022-23 remain at 6.8%, while for Q1:2023-24 it is slightly up bit at 7.1%, while for Q2 it is 5.9%.

Battle against inflation is not over:

- Pressure points remain in the form of prices of cereals, milk and spices in the near-term. The main risk is that core inflation (CPI excluding food and fuel) remains sticky and elevated.
- The outlook for the US dollar and hence imported inflation also remains uncertain.
- Moreover, the resurgence in domestic services sector activity could also lead to price increases, especially as firms pass on input costs.
- Based on the assumptions crude oil (Indian basket) at $100/barrel and normal mansoon, the inflation projection is revised marginally upwards for both Q2 and Q4 of 2022-23 at 6.6% and 5.9% from Q2 and Q4 at 6.5% and 5.8% of the previous policy projections respectively. Headline inflation is projected at 6.7% for 2022-23. CPI inflation for Q1:2023-24 is projected at 5.0 per cent and for Q2 at 5.4 per cent, on the assumption of a normal monsoon.

Liquidity Condition

- Overall system liquidity remains in surplus. During October-November, the average total absorption under the liquidity adjustment facility (LAF) was ₹1.4 lakh crore, down from the average of ₹2.2 lakh crore during August-September.

(Refer to **table 1 in the Annexure** showing in recent months, liquidity has been absorbed by the RBI on a net basis operations (-) signs, whereas during 20- 31st Oct'22 RBI had to inject liquidity).

The Governor has highlighted: "although the Reserve Bank remains in absorption mode, we are ready to conduct LAF operations that inject liquidity as may be needed through our main operations. In doing so, however, we will look for a durable sign of a turn in the liquidity cycle when banks draw down large part of their standing deposit facility (SDF) and variable rate reverse repo (VRRR) balances. The Reserve Bank remains committed to flexibility and two-sidedness in liquidity operations, but market participants must wean themselves away from the overhang of liquidity surpluses."

- The weighted average lending rates (WALRs) on fresh and outstanding rupee loans have increased by 117 bps and 63 bps, respectively, during the period May to October 2022.
- On the deposit side, the weighted average domestic term deposit rate on fresh and outstanding deposits increased by 150 bps and 46 bps, respectively, during the same period.

INR remains relatively stable compared to its peers and we are taking solace from its REER[1]; (though recently it faces certain stress)

- INR remains very volatile in last two days. Possible spot sale of dollar and buying $ in forward market may distort the equations in premium further (see this link: https://www.tradingview.com/symbols/USDINR/history-timeline/#rupee-runs-down-the-chart-2022-12-06). The November forward premium was at 1.3650 rupees against 1.3450. (Reuters)[2]
- Certain companies face headwinds, even with headging the time lag of booking contract and receipt of materials; pose challenges due to such volatility.

[1] Real Effective Exchange Rate.

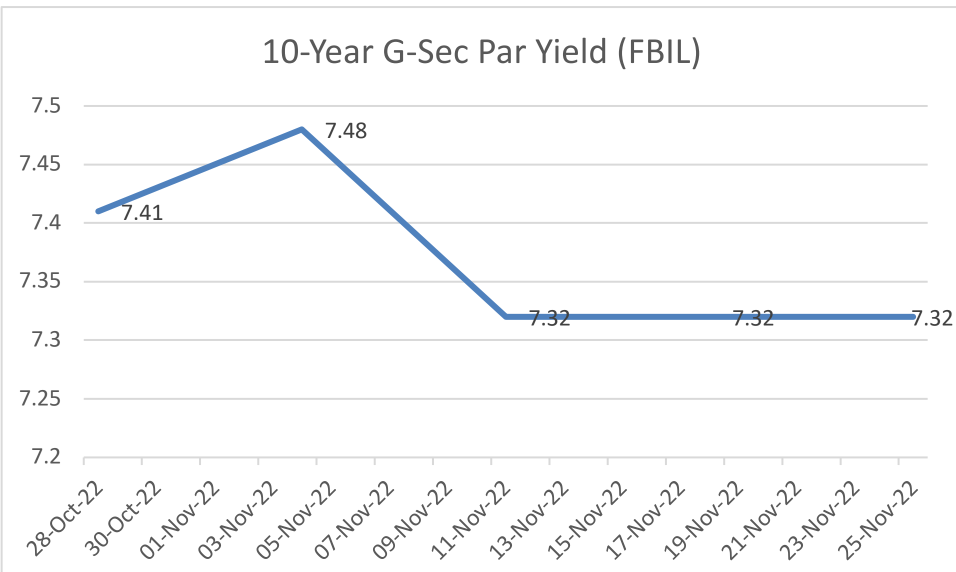
[2] https://www.reuters.com/markets/currencies/india-rupee-rupee-forward-premiums-tad-up-after-rbis-inflation-comments-2022-12-07/#:~:text=The%20November%20forward%20premium%20was,to%20keep%20inflation%20expectations%20anchored.

The External Sector faces challenges due to subdued exports, and higher trade deficit.

- India has faced a downside in its external balances/current accounts in October 2022, as its export has declined 16.5% to $29.8 billion whereas imports has increased 5.8% to $56.7 billion resulting in a trade deficit of $26.9 billion (this was $17.9 billion in the last year).
- A concerning factor is that fewer countries like Netherlands, Brazil, and Singapore have shown export growth for the Indian market among the top ten destination during this month.
- Further, while electronic goods export has shown positive trend thanks to the thrust in domestic manufacturing, certain major exportable like gems and jewellery, engineering goods, chemicals, pharmaceuticals, and readymade garments have experienced a dip.
- In the import side, barring machinery and non-ferrous metals, petroleum and fertilizers have seen major growth with Russia emerging as a major source whereas the share of US, China and Australia have shown decline among the top ten major import sources for India.
- However, on the positive side, the growth of services exports, mainly contributed by software, business and travel services remained robust at 29.1 per cent in April-October 2022.
- Remittances are scaling new heights and the outlook is optimistic with pick-up in activity in the middle east.
- The net balance under services and remittances remains in large surplus, partly offsetting the trade deficit.
- One positive is that the size of forex reserves is comfortable and has also increased. It has gone up from US$ 524.5 billion on October 21, 2022 to US$ 561.2 billion as on December 2, 2022 covering around nine months of projected imports for 2022-23. Further, India's external debt ratios are low by international standards.

Market Impact

BSE Sensex remains at 62,410.68, [−215.68 (0.34% decline)], with Asian paints, HUL, L&T, AXIS Bank, ITC, ICICI bank remain gainers, where most others remain losers like HDFC Bank, TCS, SBI, WIPRO, Bajaj Finance, HDFC among others, possibly due to a bit hawkish tone of the RBI. Nifty is down at 18,560.50 (−82.25 (0.44% decline). Major indices also declined like DJIA, S&P500, NASDAQ Composite, Russell 2000 index, NYSE due to possible Fed rate hike and looming recession.



Year	USD/INR	GBP/INR	EURO/INR	YEN/INR
07/12/2022	82.5391	100.0088	86.2820	59.9300
06/12/2022	82.2800	100.2000	86.2558	59.9400
05/12/2022	81.5855	100.5840	86.2718	60.6200
02/12/2022	81.1771	99.3099	85.4643	60.0700
01/12/2022	81.1512	98.1670	84.7467	59.4900
30/11/2022	81.5970	97.7543	84.4507	58.9500
29/11/2022	81.7121	98.0665	84.8248	58.9600
28/11/2022	81.7545	98.6880	84.7881	59.1300

Source: RBI.

Regulatory and Developmental Measures

(a) **HTM**: In the other measures, banks have been provided further fexibility in managing their investment portfolios; as banks are allowed to include securities acquired between September 1, 2020 and March 31, 2024 in the enhanced held to maturity (HTM) limit (23%)[3] .

(b) **UPI**:The capabilities in UPI will be further enhanced by introducing single-block-and-multiple-debits functionality. This facility will enable a customer to block funds in his/her account for specific purposes, which can be debited whenever needed.

(c) **Scope of the Bharat Bill Payment System (BBPS) is enhanced**: the scope of BBPS is being enhanced to include all categories of payments and collections, both recurring and non-recurring, and for all category of billers (businesses and individuals), to enable the BBPS platform accessible to a wider set of individuals and businesses who can benefit from the transparent payments experience, faster access to funds and improved efficiency.

(d) **Hedging of Gold in the International Financial Services Centre (IFSC):** Resident entities will now be permitted to hedge their gold price risk on recognised exchanges in the IFSC, which will benefit importers/exporters of gold such as jewellers and industries which use gold as an intermediate or raw material.

The Governor in his speech has highlighted paragraph 15 of his speech which is as follows:

"What do these growth and inflation scenarios convey? Let me summarise. GDP growth in India remains resilient and inflation is expected to moderate; but the battle against inflation is not over. Pressure points from high and sticky core inflation and exposure of food inflation to international factors and weather-related events do remain. While being

[3] The HTM limits would be restored from 23 per cent to 19.5 per cent in a phased manner starting from the quarter ending June 30, 2024.

watchful of the impact of our earlier monetary policy actions, we will keep Arjuna's eye on the evolving inflation dynamics and be ready to act as may be necessary. Our actions will be nimble and in the best interest of the economy. The aspect of growth will obviously be kept in mind."

From the above, let's extract the following:

(a) GDP growth in India remains "resilient". (be hopeful and optimistic-growth may not decline too much)

(b) inflation is expected to "moderate". (be hopeful and optimistic-inflation will cool down gradually)

(c) battle against inflation is not over. (be cautious and remain watchful).

The importance of (c) is due to the fact that if (a) and (b) turn opposite going forward, then there might be a need to re-balance between 'hawkish' (if inflation increases going forward) and 'dovish' (keeping growth in mind). The RBI is providing a policy space of 25 bps going forward; e.g. if inflation does not cool down much but at the same time does not increase also much going forward, then RBI might increase repo rate by 25 bps taking the terminal rate towards 6.50%.

Broadly, either a pause or 25 bps incremental increase possibly in next monetary policies, it may stop at 6.25%, or 6.50% or at 6.75%. This will largely depend on the future trend of global as well as domestic inflation rates and forthcoming monetary policy stance by the Fed.

Possibility	Prabable Policy Rate
Inflation declines	Pause
Inflation does not decline, but marginally increase (still not in 'red zone')	25 bps hike taking repo rate to 6.50% (or pause)
Inflation continue increasing in a sustained manner in next quarter too	Further 25 bps hike taking repo rate at 6.75%
Inflation increase high (exceeding the comfort level)	50 bps hike taking repo rate at 6.75% (less likely)

Annexure: Table 1: Liquidity Operations

Sl No.	Date	Net liquidity injected from today's operation (Rs. Crore)	Net liquidity injected from outstanding operations (Rs. Crore)	Net liquidity injected (+)net liquidity deficit (-)net liquidity surplus, i.e absorbed (Rs. Crore)
1	15 Nov'22	- 1,51,689.00	71,315.11	-80,373.89
2	14 Nov'22	- 1,37,917.00	71,315.11	-66,601.89
3	13Nov'22	- 1,943.00	- 69,657.89	- 71,600.89
4	11Nov'22	- 1,37,357.00	71,315.11	- 66,041.89
5	10Nov'22	- 1,22,360.00	76,205.11	- 46,154.89
6	8Nov'22	- 6,457.00	5,540.11	- 916.89
7	7Nov'22	-67,170.00	72,710.11	5,540.11
8	6Nov'22	2,220.00	-83,619.62	-85,839.62
9	5Nov'22	-11,074.00	- 72,545.62	- 83,619.62
10	4Nov'22	-1,75,244.00	1,01,698.38	- 73,545.62
11	3Nov'22	- 1,90,016.00	96,050.38	- 93,965.62
12	2Nov'22	- 1,89,419.00	96,255.38	- 93,163.62
13	1Nov'22	- 1,26,608.00	1,00,467.11	-26,140.89
14	31Oct'22	1,03,231.81	1,03,231.81	20,125.81
15	30Oct'22	-1,713.00	61,804.53	60,091.53
16	29Oct'22	-2,213.00	64,017.53	61,804.53

17	28 Oct’22	-38,979.00	1,02,996.53	64,017.53
18	27 Oct’22	-48,078.00	1,02,996.53	54,918.53
19	26 Oct’22	-25,076.00	98,372.89	73,296.89
20	25 Oct’22	-4,276.00	1,02,648.89	98,372.89
21	24 Oct’22	-6,140.00	68,975.70	62,835.70
22	21 Oct’22	-35,159.00	1,08,019.70	72,860.70
23	20 Oct’22	-32,142.00	46,029.70	13,887.70
24	19Oct’22	-52,467.00	46,029.70	-6,437.30
25	18Oct’22	-76,033.00	46,029.70	-30,003.30
26	16 Oct’22	8,128.00	-19,528.30	-11,400.30
27	15Oct’22	-29,486.00	9,957.70	-19,528.30
28	13 Oct’22	-43,471.00	46,029.70	2,558.70
29	12Oct’22	-38,887.00	46,026.70	7,139.70
30	11Oct’22	-57,333.00	46,026.70	-11,306.30
31	10Oct’22	-36,757.00	45,521.43	8,764.43
32	9Oct’22	-2,153.00	-48,464.57	-50,617.57
33	7Oct22	-1,48,000.00	1,07,511.43	-40,488.57
34	6Oct’22	-1,77,978.00	1,03,763.43	74,214.57
35	5Oct’22	-14,696.00	-100,374.57	-115,070.57
36	4Oct’22	-2,04,138.00	1,03,763.43	-1,00,374.57
37	3Oct’22	-1,77,391.00	60,144.03	-1,17,246.97
38	2Oct’22	-9,199.00	-1,05,500.97	-1,14,699.97
39	1Oct’22	-72,550.00	-32,950.97	-1,05,500.97
40	30Sept’22	-93,095.00	60,144.03	-32,950.97
41	29 Sept22	-41,416.00	60,144.03	18,728.03
42	28Sept’22	-56,469.00	65,388.43	8,919.43
43	27Sept’22	-65,137.00	70,933.43	5,796.43
44	26Sept’22	-72,575.00	70,933.43	-1,641.57

Source: RBI.