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RBI MONETARY POLICY

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INTRODUCTION

The RBI Monetary Policy Committee (MPC) has Increased the policy repo rate by 25 basis points to 6.50 per cent. The standing deposit facility (SDF) rate stands adjusted to 6.25 per cent and the marginal standing facility (MSF) rate and the Bank Rate to 6.75 per cent.

The MPC also decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

Brief Overview of the Global and Indian Economy

The global economic outlook has shown some upgrades. Growth prospects in major economies have improved, while inflation is on a downward spiral, though it remains well above the target in major economies.

According to the International Monetary Fund's January 2023 update of World Economic Outlook, the global growth for 2022 has been revised upwards from 3.2 per cent to 3.4 per cent, while that of 2023 has been raised to 2.9 per cent from 2.7 per cent projected in October 2022.

The US dollar has recoiled from its highest level in two decades. Nevertheless, tighter financial conditions caused by aggressive monetary policy actions, volatile financial markets, debt distress, protracted geopolitical hostilities and fragmentation continue to impart high uncertainty to the outlook for the global economy.

Amidst these volatile global developments, the Indian economy remains buoyant. Real GDP growth is estimated at 7.0 per cent in 2022-23.[1] Better rabi acreage, sustained urban demand, expanding rural demand, strong credit expansion, improved consumer and business optimism and the government's push on capital expenditure and infrastructure in the Union Budget 2023-24 are expected to support economic activity in the coming year.

On the other hand, weak external demand and the uncertain global environment would be a drag on domestic growth prospects.

Reasons for the decision on the policy rate

Going forward, while inflation is expected to moderate in 2023-24, it is likely to rule above the 4 per cent target.

The outlook is obscured by continuing uncertainties from geopolitical tensions, global financial market volatility, rising non-oil commodity prices and volatile crude oil prices.

On balance, the MPC was of the view that further calibrated monetary policy action is warranted to keep inflation expectations anchored, break the persistence of core inflation and thereby strengthen the medium-term growth prospects.

Accordingly, the MPC decided to raise the policy repo rate by 25 basis points to 6.50 per cent. The MPC will continue to maintain strong vigil on the evolving inflation outlook to ensure that it remains within the tolerance band and progressively aligns with the target.

Reasons for decision on Stance

Inflation is expected to average 5.6 per cent in Q4:2023-24 while the policy repo rate is 6.50 per cent.

Adjusted for inflation, the policy rate still trails its pre-pandemic levels.

Liquidity remains in surplus, with an average daily absorption of ₹1.6 lakh crore under the LAF in January 2023.

The overall monetary conditions, therefore, remain accommodative and hence, the MPC decided to remain focused on withdrawal of accommodation.

[1] According to the first advance estimate of the National Statistical Office (NSO).

Assessment of Growth

Urban consumption demand has been improving, driven by sustained recovery in discretionary spending, especially on services such as travel, tourism and hospitality.

Passenger vehicle sales and domestic air passenger traffic posted healthy year-on-year (y-o-y) growth.

Domestic air passenger traffic crossed pre-pandemic levels for the first time in December 2022.

Rural demand continues to show signs of improvement as tractor sales and two-wheeler sales expanded in December.

Non-food bank credit expanded by 16.7 per cent (y-o-y) as on January 27, 2023. The total flow of resources to the commercial sector has increased by ₹20.8 lakh crore during 2022-23 so far as against ₹12.5 lakh crore a year ago.

Indicators of fixed investment – cement output; steel consumption; and production and import of capital goods have registered robust growth in November and December.

According to the RBI's survey, seasonally adjusted capacity utilisation increased to 74.5 per cent in Q2:2022-23.

The drag from net external demand, on the other hand, continued as merchandise exports contracted in Q3:2022-23.

The expected higher rabi output has improved the prospects of agriculture and rural demand.

According to the RBI surveys, manufacturing, services and infrastructure sector firms are optimistic about the business outlook.

On the other hand, prolonged geopolitical tensions, tightening global financial conditions and slowing external demand may continue as downside risks to domestic output.

- Taking all these factors into consideration, real GDP growth for 2023-24 is projected at as follows:
- 6.4 per cent with Q1 at 7.8 per cent;
- Q2 at 6.2 per cent;
- Q3 at 6.0 per cent;
- Q4 at 5.8 per cent.
- The risks are evenly balanced.
- In previous policies, 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%.

Inflation Outlook

Headline CPI inflation moderated by 105 basis points during November-December 2022 from its level of 6.8 per cent in October 2022, due to a softening in food inflation on the back of a sharp deflation in vegetable prices, which more than offset the inflationary pressures from cereals, protein-based food items and spices.

Core CPI inflation (i.e., CPI excluding food and fuel), however, remained elevated.

Food inflation outlook seems better due to good rabi harvest (led by wheat and oilseeds). Mandi arrivals and kharif paddy procurement have resulted in improvement in buffer stocks of rice, such developments augur favourably for the food inflation outlook in 2023-24.

However, substantial worries remain on the likely trajectory of global commodity prices, including price of crude oil.

The ongoing pass-through of input costs, especially in services, could keep core inflation at elevated levels.

With the assumption of an average crude oil price (Indian basket) of US$ 95 per barrel, inflation is projected at 6.5 per cent in 2022-23, with

Q4 at 5.7 per cent.

On the assumption of a normal monsoon, CPI inflation is projected at 5.3 per cent for 2023-24, with Q1 at 5.0 per cent,

Q2 at 5.4 per cent,

Q3 at 5.4 per cent

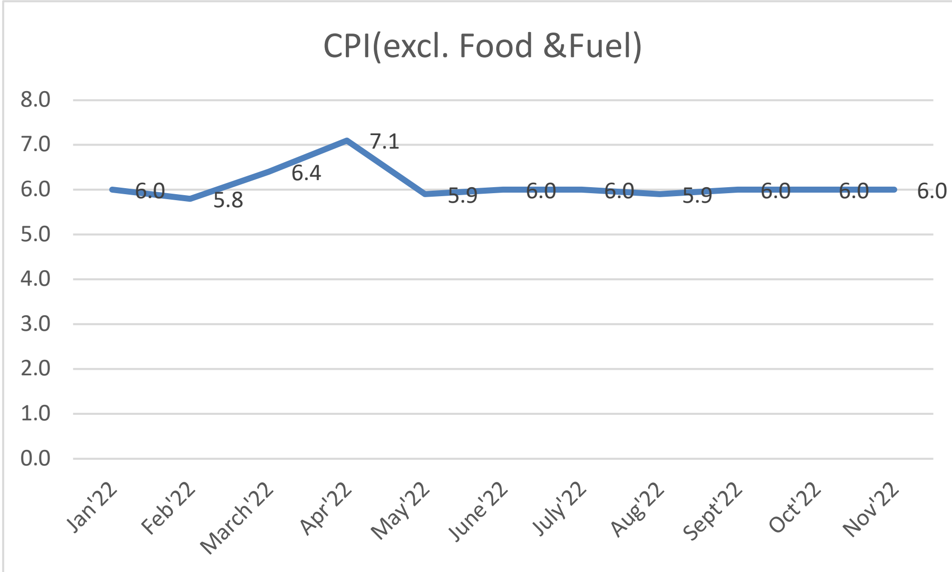
Q4 at 5.6 per cent.

The risks are evenly balanced.

In previous policies, based on the assumptions crude oil (Indian basket) at $100/barrel and normal mansoon, the inflation projection was 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 was projected at 6.7% for 2022-23. CPI inflation for Q1:2023-24 was projected at 5.0 per cent and for Q2 at 5.4 per cent, on the assumption of a normal monsoon.

One of the major justifications for the 25 bps rate hike is that though the Headline inflation has moderated with negative momentum in November and December 2022, but the stickiness of core or underlying inflation is a matter of concern.



Source: RBI Bulletin, Dec'22

External Sector Developments

The current account deficit (CAD) for the first half of 2022-23 stood at 3.3 per cent of GDP.

The situation has shown improvement in Q3:2022-23 as imports moderated in the wake of lower commodity prices, resulting in narrowing of the merchandise trade deficit.

Further, services exports rose by 24.9 per cent (y-o-y) in Q3:2022-23, driven by software, business and travel services.

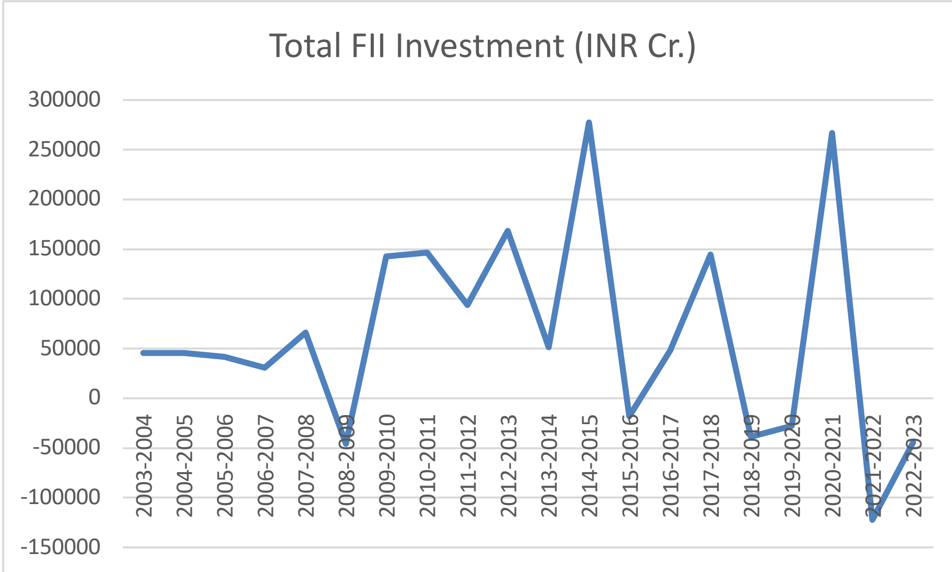
Global software and IT services spending is expected to remain strong in 2023.

Remittance growth for India in H1 of 2022-23 was around 26 per cent – more than twice the World Bank's projection for the year, which is likely to remain robust owing to better growth prospects of the Gulf countries.

The net balance under services and remittances are expected to remain in large surplus, partly offsetting the trade deficit.

On the financing side, net foreign direct investment (FDI) flows remain strong at US $ 22.3 billion during April-December 2022 (US$ 24.8 billion in the corresponding period last year).

Foreign portfolio flows have shown signs of improvement with positive flows of US$ 8.5 billion during July to February 6, led by equity flows (foreign portfolio flows are, however, negative during the financial year so far). [Refer Annexure for details].



Source: CDSL [https://www.cdslindia.com/Publications/FIIFPIInvstmntFinYrData.aspx]

Net inflows under nonresident deposits increased to US$ 3.6 billion during April-November 2022 from US $ 2.6 billion a year ago, boosted by the Reserve Bank's July 6th measures.

Foreign exchange reserves have rebounded from US$ 524.5 billion on October 21, 2022 to US$ 576.8 billion as on January 27, 2023 covering around 9.4 months of projected imports for 2022- 23. India's external debt ratios are low by international standards.

Liquidity and Financial Market Conditions

The RBI has expressed that they will be proactive towards meeting the productive requirements of the economy through operations on either side of the LAF, depending on the evolving liquidity conditions.

While higher government expenditure and the anticipated return of forex inflows are likely to augment systemic liquidity, it would get lessened by the scheduled redemption of LTRO and TLTRO funds during February to April 2023. The Reserve Bank provided low cost funds at the repo rate of up to 3-years maturity to banks during February to April 2020 to improve monetary transmission, mitigate the impact of the COVID-pandemic and alleviate liquidity stress in entities/specific sectors under long-term repo operations (LTROs) and targeted long-term repo operations (TLTROs).

The Indian Rupee has remained one of the least volatile currencies among its Asian peers in calendar year 2022. During the global financial crisis, the Indian Rupee depreciated by 23 per cent against the US dollar between April 1, 2008 and March 3, 2009.

Similarly, it depreciated by 22 per cent during the taper tantrum between May 01, 2013 and Aug 28, 2013. However, the extent of Rupee depreciation was lower in each subsequent episode of turbulence.

In the initial days of the pandemic, i.e., between February 17, 2020 and April 21, 2020, the Rupee depreciated by only 7 per cent. Even during the period of geopolitical tensions emerging out of Ukraine in 2022, while the Rupee lost 9 per cent against the US dollar between February 24, 2022 and October 19, 2022, it outperformed the currencies of most advanced and many emerging market economies.

The 1-month implied volatility of the Rupee touched a high of 25 per cent during the global financial crisis on October 10, 2008 and 20 per cent during the taper tantrum period on August 29, 2013. During the COVID-19 pandemic, however, the implied volatility peaked at 10% on March 24, 2020.

The weighted average lending rates (WALR) on fresh rupee loans and outstanding loans increased by 137 bps and 80 bps respectively, during May to December 2022. The weighted average domestic term deposit rate on fresh deposits and outstanding deposits increased by 213 bps and 75 bps respectively.

Statement on Developmental and Regulatory Policies

Lending and Borrowing in G-Secs: In order to bring depth and liquidity to the Government securities market, and for efficient price discovery, the RBI has proposed to permit lending and borrowing of Government securities which will augment the existing market for 'special repos'.[2] Further, the RBI has decided to restore market hours for the Government Securities (G-secs) market to the pre-pandemic timing of 9 am to 5 pm.

Penal Charges on Loans: At present, Regulated Entities (REs) follow divergent practices on levying of such charges. In certain cases, these charges are founded to be excessive. The RBI will float draft guidelines on levy of penal charges to enhance transparency and for consumer protection purposes.

Climate risks and sustainable finance: Recognizing the importance of climate related financial risks which may have financial stability implications, the Reserve Bank had issued a Discussion Paper on Climate Risk and Sustainable Finance in July 2022. Based on the feedback received, it has been decided to issue guidelines for Regulated Entities (REs) on (i) a broad framework for acceptance of Green Deposits; (ii) disclosure framework on Climate-related Financial Risks; and (iii) guidance on Climate Scenario Analysis and Stress Testing.

Expanding the Scope of Trade Receivables Discounting System (TReDS): For the benefit of MSMEs, the Reserve Bank had introduced a framework in 2014 to facilitate financing of their trade receivables through Trade Receivables Discounting System (TReDS). It is now proposed to expand the scope of TReDs by (i) providing insurance facility for invoice financing; (ii) permitting all entities/institutions undertaking factoring business to participate as financiers in TReDS; and (iii) permitting rediscounting of invoices (that is, developing a secondary market in TReDS). These measures are expected to improve the cash flows of the MSMEs.

Extending UPI for Inbound Travellers to India: UPI has become hugely popular for retail digital payments in India. It is now proposed to permit all inbound travellers to India to use UPI for their merchant payments

[2] This will provide investors with an avenue to deploy their idle securities, enhance portfolio returns and facilitate wider participation. This measure will also add depth and liquidity to the g-sec market.

(P2M) while they are in the country. To begin with, this facility will be extended to travellers from G-20 countries arriving at select international airports.

QR Code based Coin Vending Machine - Pilot project: The Reserve Bank of India will launch a pilot project on QR Code based Coin Vending Machine (QCVM) in 12 cities. These vending machines will dispense coins against debit to the customer's account using UPI instead of physical tendering of banknotes. This will enhance the ease of accessibility to coins. Based on the learnings from the pilot, guidelines will be issued to banks to promote distribution of coins using these machines.

Market Impact

BSE Sensex remains positive at 60,753.27 +467.23 +0.78%, with Bajaj Finance, Ultra cement, INFY, Reliance, TCS, BajajFinserv, HCLTech, WIPRO, MARUTI, TATA Motor, ICICI Bank, TITAN, HDFC, ITC, SUNPHARMA, POWERGRID, ASIANPAINT, TATASTEEL, SBIN, HDFCBANK, NTPC, INDUSIND Bank, NestleIndia, have shown positive gains.[3] NIFTY 50 remains at 17,869.10 +147.60 (0.83%)

Concluding Remarks

The tone of the RBI policy seems a bit worried regarding core inflation and external volatile situations. It seems that the RBI is at the final leg of its rate hike and will take a pause henceforth. Nevertheless, a further 25 bps rate hike (not immediately) cannot be ruled out if the inflation situation does not improve going forward. Further, it banks on a favourable brent price to average at $98 a barrel in 2022 and $75 in 2023. An RBI paper (20Dec'22)[4] in Dec'22 while showed that price pressures in sub-groups such as clothing, household goods and services, personal care and effects, education and housing imparted persistence to core inflation.

That's a bit interesting, as while initial push factors from supply side, especially food and fuel is getting subsided (at least seem to be under control to some extent), demand side/household components are keeping core inflation still sticky, thus providing scope for lower inflation through the current and apparently seeming terminal rate hike (which will work in a lag impact). A positive external factor is that the Fed has shown somewhat a less hawkish tone, nevertheless, given the robust job market, the rate hike possibility seems not absent, especially in the face of persistent services sector (especially services ex-housing components) inflationary trends, while food and fuel inflation have shown somewhat softening trends.

[3] https://www.bseindia.com/sensex/code/16/

[4] "Anatomy of Inflation's Ascent in India"(https://rbi.org.in/Scripts/BS_ViewBulletin.aspx?Id=21468#CH1)

Annexures

Exchange Rate Movements of INR with other Currencies

Date	USD	GBP	EURO	YEN
08/02/2023	82.67	99.61	88.75	63.01
07/02/2023	82.69	99.67	88.82	62.57
06/02/2023	82.45	99.49		62.58
03/02/2023	82.22	100.48	89.59	63.94
02/02/2023	81.95	101.53	90.25	63.68
01/02/2023	81.84	100.83	88.99	62.84
31/01/2023	81.73	100.89	88.59	62.77
30/01/2023	81.65	101.19	88.73	63.04
27/01/2023	81.54	100.95	88.65	62.77
25/01/2023	81.62	100.65	89.01	62.59
24/01/2023	81.60	101.09	88.78	62.71
23/01/2023	81.27	100.89	88.54	62.49
20/01/2023	81.21	100.53	87.98	62.92
19/01/2023	81.35	100.40	87.88	63.63

Source: RBI

Government Securities Market

7.26% GS 2033	: 7.2763% #
7.26% GS 2032	: 7.3102% #
7.38% GS 2027	: 7.1681% #
5.74% GS 2026	: 7.1326% #

as on end of previous working day

Infomerics Ratings

FPI/FII Investment Details (Financial Year) [INR Crores]

Financial Year	INR crores				
	Equity	Debt	Debt-VRR	Hybrid	Total
1998-1999	29973.2	-147.4	0	0	29825.8
1999-2000	9669.5	452.6	0	0	10122.1
2000-2001	10206.7	-273.3	0	0	9933.4
2001-2002	8072.2	690.4	0	0	8762.6
2002-2003	2527	162	0	0	2689
2003-2004	39959.7	5805	0	0	45764.7
2004-2005	44122.7	1758.6	0	0	45881.3
2005-2006	48800.5	-7333.8	0	0	41466.7
2006-2007	25235.7	5604.7	0	0	30840.4
2007-2008	53403.8	12775.3	0	0	66179.1
2008-2009	-47706.2	1895.2	0	0	-45811
2009-2010	110220.6	32437.7	0	0	142658
2010-2011	110121.1	36317	0	0	146438
2011-2012	43737.6	49987.9	0	0	93725.5
2012-2013	140032.6	28334.4	0	0	168367
2013-2014	79708.68	-28059.89	0	0	51648.8

2014-2015	111332.6	166127.1	0	0	277460
2015-2016	-14171.57	-4003.76	0	0	-18175
2016-2017	55702.67	-7291.64	0	0	48411
2017-2018	25634.19	119035.7	0	10.29	144680
2018-2019	-87.73	-42355.97	0	3514.24	-38929
2019-2020	6152.26	-48710.23	7331.17	7697.63	-27529
2020-2021	274032	-50443.62	33264.6	10247.1	267100
2021-2022	-140009.6	1628.53	12642.8	3498.41	-122240
2022-2023	-47314.22	-3383.89	7580.34	-1239.43	-44357
Total	980767.9	275931.3	61014.2	29448.5	1347162

Source: CDSL