6 April, 2023

The RBI "pauses", but does not "pivot"; maintains a cautiously hawkish stance

- The RBI decided to keep the policy rate, the repo rate, **unchanged at 6.50% with the readiness to act, should the situation so warrant,** in its first policy meeting for FY24.

- Furthermore, the stance was kept unchanged as **"focusing on withdrawal of accommodation to ensure that inflation remains within the target while supporting growth",** providing the RBI with the policy space for future meetings.

- The central bank's decision to pause is likely driven by the downside risks posed to economic growth from concerns over financial stability and its expectation of a moderation in inflation over the next couple of months.

- In this context, despite an unchanged policy repo rate ***we assess the underlying tone of the policy to be cautiously hawkish***. At present, we can see the central bank going for an ***extended pause*** throughout FY24. However, if inflation surprises on the upside, more hikes cannot be ruled out.

- The RBI revised its growth projection marginally upwards from 6.4% to 6.5% in FY24 with risks seen as evenly balanced. The main reasons for the revision are the base year effect and a lower oil price assumption (US$85/bbl from US$95/bbl previously).

- However, with recessionary fears solidifying in the major trade partner economies, uneven demand recovery in the rural sector, and patchy private sector investment, we believe that real GDP growth could be lower than the RBI's estimate.

- Considering the adjustment in the oil price assumption from US$95/bbl to US$85/bbl and favourable base effect, the RBI recalibrated its inflation projections downward for FY24 from 5.3% earlier to 5.2% in today's meeting.

- The governor noted that the current times continue to remain volatile and even though the projections for FY24 suggest an easing of price pressures, the path to disinflation is going to be gradual and protracted given the rigidity in core inflation.

- Positively, the governor also noted that current account deficit in Q3 FY23 narrowed to 2.2% of GDP (from 3.7% of GDP in the preceding quarter) and gave a reassurance that going ahead the current account deficit will remain viable and eminently manageable.

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The RBI surprised markets with no change in repo rate; focus remains on withdrawal of accommodation

The monetary policy committee (MPC) decided unanimously ***to keep the repo rate unchanged at 6.50% with the readiness to act, should the situation so warrant*** as it met for the first policy meeting in the current financial year (FY24)***.*** This decision was taken against the backdrop of global financial market volatility, progressive tightening of the financial conditions, regional bank failures in the Advanced Economies, and sticky core inflation at elevated levels. The central bank's decision to pause is likely driven by the downside risks posed to economic growth from concerns over financial stability and its expectation of a moderation in inflation over the next couple of months. The market welcomed the unprecedented flexibility in the policy statement, which was reflected in a ~7 basis points (bps) decline in the 10-year benchmark yields to 7.2% at the time of closing.

Explaining the rationale behind today's decisions, the governor noted that the RBI has raised the policy rates cumulatively by 250 bps since May'21. Complementing the rate hikes, the RBI had also introduced Standing Deposit Facility (SDF) at a rate 40 bps higher than the fixed rate reverse repo, taking the effective rate hikes to 290 bps since last year. Additionally, headline inflation as per the central bank is expected to moderate going forward. Therefore, the MPC decided to take a pause to assess the overall impact of the cumulative rate hikes. Furthermore, ***the governor emphasised that the pause in this meeting is not to be construed as a pivot*** and the MPC will continue to keep a strong vigil on the evolving inflation and growth outlook and will not hesitate to take further action as may be required in its future meetings.

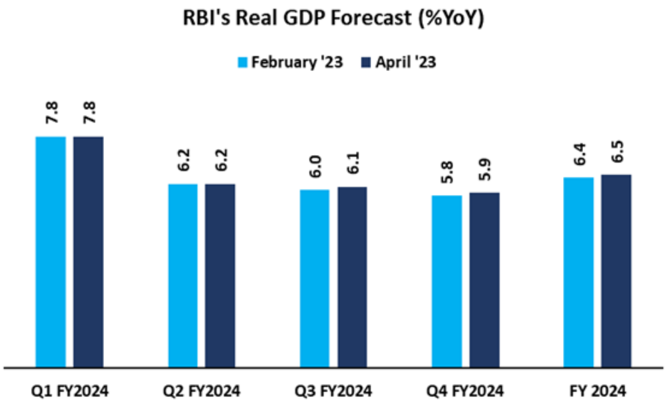
Furthermore, the RBI kept its stance unchanged as ***"focusing on withdrawal of accommodation to ensure that inflation remains within the target while supporting growth",*** providing the RBI with the policy space for future meetings. However, the decision was not unanimous with Prof. Jayanth Verma dissenting on this part of the resolution. The governor provided some insight for keeping the stance unchanged, referring to the Feb 2019 period when the stance was neutral. During that period the real policy rate was relatively higher at over 4% (CPI at 2% and repo rate at 6.50%). On the same measure, the real policy rate will remain only mildly positive at ~1.3% (using a policy rate of 6.50% and H1FY24 CPI estimate of 5.25%). Hence, this indicates that the real repo rate will need to be positive by a relatively larger margin for the stance to change.

In this context, ***despite an unchanged policy repo rate we assess the underlying tone of the policy to be cautiously hawkish***. At present, we can see the central bank going for an extended pause throughout FY24. However, if inflation surprises on the upside dramatically especially in light of the recent announcement by the OPEC+ group (which could lead to higher crude oil prices) and elevated core inflation, the central bank is likely to hike policy rates further.

The RBI revised its growth projection marginally upwards from 6.4% to 6.5% in FY24

The RBI governor acknowledged that the domestic economy has remained resilient in Q4 FY23 in the face of a highly volatile global environment and is on track to have grown by 7.0% in FY23. This is in line with the high frequency data observed including manufacturing and services PMIs for Jan-Mar, showing a sustained expansion in both sectors. In agriculture, Rabi foodgrains production is expected to have increased by 6.2 % in FY23. From the demand perspective, rural demand indicators which were somewhat lagging when compared to the urban counterpart have shown nascent signs of improvement as per two-wheeler registrations, tractor sales, and diesel consumption in Feb. Investment activity is likely to have picked up due to the government's continued push on capital spending. The external sector conditions have also somewhat improved with a lower trade deficit observed in Jan-Feb.

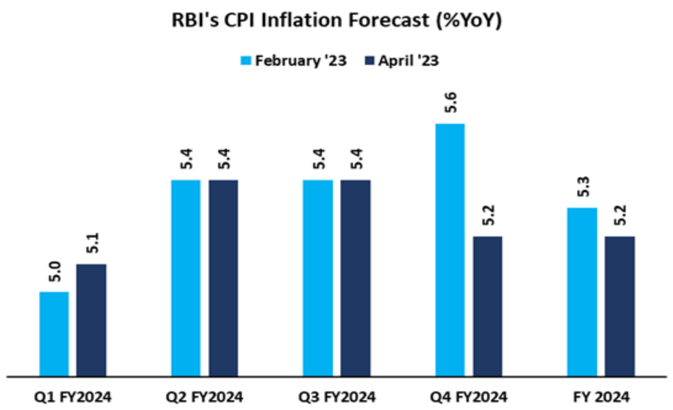
The RBI expects growth for FY24 at 6.5% YoY



Source: RBI. Note: April '23 and February '23 refer to projections given by the RBI in its April and February 2023 MPC updates, respectively.

Regarding the outlook, the central bank revised its forecast for FY24 marginally upwards to 6.5% YoY from 6.4% in the earlier policy. The marginal uptick in the FY24 projection (as mentioned in the press conference) is due to the base year effect and a downward revision in oil prices to US$85/bbl (from US$95/bbl earlier). Good prospects of Rabi output augur well for rural demand. Steady growth in contact-intensive services should aid urban demand. The improved capacity utilization of the private sector, and the government's focus on CAPEX should bode well for investment activity. However, we do see downside risks to the investment activity from lack of meaningful pick up in private investment. Furthermore, the RBI noted the downside risks to the above projection from the evolving geopolitical situation and global financial market volatility. We believe that with recessionary fear solidifying in the major trading economies, uneven demand recovery in the rural sector, and patchy private sector investment the real GDP growth could be lower than the RBI's estimate.

Headline Inflation forecast revised marginally downwards for FY24



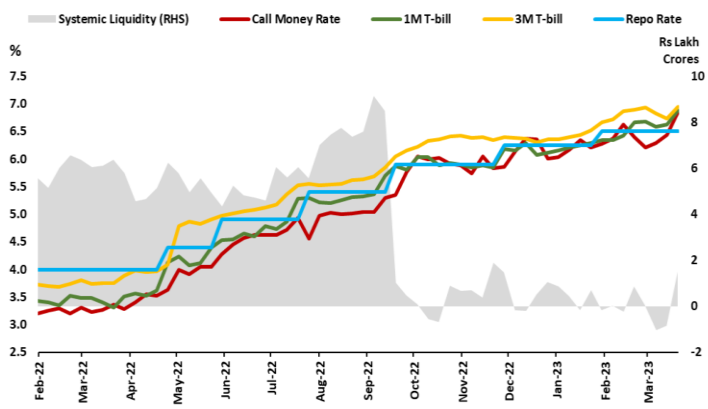
Source: RBI. Note: April '23 and February '23 refer to projections given by the RBI in its April and February 2023 MPC updates, respectively.

Considering the adjustment in the oil price assumption from US$95/bbl to US$85/bbl and higher than expected inflation in Q4 FY23 (which will lead to a favourable base for Q4 FY24) the RBI recalibrated its inflation projections downward for FY24 from 5.3% YoY earlier to 5.2% YoY in today's meeting. Its quarterly projections show that the RBI expects the inflation to significantly ease in Q1 FY24 potentially led by easing of food prices and a favourable base effect. The food inflation which was one of the primary culprits from the uptick in inflation in Jan-Feb is likely to come down because of government intervention. The daily food prices data already indicate a drop in retail prices of wheat and wheat flour in the month leading up to mid-Mar. The headline inflation is again expected to accelerate from Jul onwards as the base effect turns unfavourable before easing in the last quarter of FY24. The RBI governor highlighted the upside risks to inflation emanating from food price pressures stemming from adverse climate conditions and fodder cost pressures, volatility in the oil prices (given the recent announcement by the OPEC+ group to cut oil production), and the imported inflation amidst the rising uncertainty in the global financial market. This is counterbalanced by moderating global commodity prices which have come down from their peak and bright prospects for Rabi crops. The governor noted that the current times continue to remain volatile and even though the projections for FY24 suggest an easing of price pressures, the path to disinflation is going to be gradual and protracted given the rigidity in core inflation.

The RBI will continue to adopt an agile framework to manage the liquidity needs

On the liquidity management front, the central bank will continue to adopt an agile framework to manage the liquidity needs of the economy. The central bank assured that it will conduct the two-way fine tuning operations as and when necessary and will ensure smooth completion of government borrowing program. The same is being reflected in the announcement of smaller tenured variable repo operations in the past few weeks (on Feb 10, Mar 10 and Mar 24) as the systemic liquidity slipped into deficit mode in the second half of Feb and Mar. By end of FY23, the systemic liquidity had turned into a deficit compared to a surplus of around Rs 7 lakh crores in the first week of FY23. This has created pressure on the shorter end of the curve with the average call rate rising above the policy rate. Later in the first week of Apr, the liquidity turned into surplus mode of around Rs 2.2 lakh crores (as of 4th Apr) potentially due to an increase in government expenditure. We expect the liquidity conditions to be on the tighter end in FY24 with the maturing of the repurchase agreement with the central bank.This will provide the central bank the space to conduct long-term repo operations to infuse durable liquidity in the system.

Weighted average call rate tracking above the policy rate



Source: CMIE

External sector position improved; to remain manageable in FY24

The governor also noted some positive developments with regard to the external sector and gave a reassurance that going ahead the current account deficit will remain viable and eminently manageable. While in the first nine months of FY23 (Apr-Dec) the current account deficit (CAD) widened to 2.7% of GDP (from 1.1% in the corresponding period of FY22). Still on a quarterly basis, CAD has narrowed to 2.2%

of GDP in Oct-Dec, from 3.7% of GDP in the preceding quarter. The improvement is attributed to strong services exports, particularly IT services.

In Jan-Feb the trade deficit further narrowed, helped by a sustained decline in imports and continued strong growth in services exports. Looking further ahead, strong prospects of the Gulf Cooperation Council countries in 2023 will keep remittance inflows (which rose to a record high of US$107.5 billion in CY22, up from US$89.4 billion in CY21) strong. The country's forex reserves position (accounting for the forward book) has improved to over US$600 billion by end-Mar, compared with US$524.5 billion on Oct 21, 2022. Overall, the RBI assessed the external sector position to have improved in H2 FY23.

The RBI also announced the developmental and regulatory policy measures listed below:

Financial markets

- **Developing an Onshore Non-Deliverable Derivatives Market:**
  In order to provide flexibility related to hedging, the central bank has permitted domestic banks (which operate International Financial Services Centre (IFSC) Banking Units (IBUs) to offer INR NDDCs (Non-Deliverable Foreign Exchange Derivative Contracts) to resident users in onshore market. This facility was earlier available to banks to transact with non-residents and with each other.

Regulation and Supervision

- **Enhancing Efficiency of Regulatory Processes:**
  At present, the processes for entities to make applications seeking license/authorisation or regulatory approvals from the RBI under various statutes/regulations take place in both online and offline modes. To simplify and streamline such processes and in line with the Union Budget FY24 announcement, it has been decided to have a secured web based centralised portal named as 'PRAVAAH' (Platform for Regulatory Application, Validation and Authorisation) for such processes. This measure will bring greater efficiencies into regulatory processes and facilitate ease of doing business for the regulated entities of the RBI.

- **Development of a Centralised Web Portal for Public to Search Unclaimed Deposits:**
  At present, the depositors or beneficiaries of unclaimed bank deposits of 10 years or more have to go through the websites of multiple banks to locate such deposits. Now, to improve and widen the access of depositors/beneficiaries to information on such unclaimed deposits, it has been decided to develop a web portal to enable search across multiple banks for possible unclaimed deposits.

- **Grievance Redress Mechanism relating to Credit Information Reporting by Credit Institutions and Credit Information Provided by Credit Information Companies:**
  With the increase in customer complaints regarding credit information reporting and the functioning of credit information companies (CICs), it has been decided to put in place a comprehensive framework for strengthening and improving the efficacy of the grievance redress mechanism and customer service provided by the credit institutions (CIs) and CICs. For this purpose, the CICs have been brought under the purview of the Reserve Bank Integrated Ombudsman Scheme (RB-IOS). Additional measures relating to the compensation mechanism for delayed updating of credit information, provision for SMS alerts, timeframe for ingestion of data received by CICs and disclosures related to customer complaints are also proposed.

Payment and Settlement Systems

- **Operation of Pre-Sanctioned Credit Lines at Banks through the UPI:**
  In addition to transactions enabled between deposit accounts, the RBI has now proposed to expand the scope of UPI by enabling transfer to/from pre-sanctioned credit lines at banks. This can reduce the cost of such offerings and help in development of unique products for Indian markets. Detailed instructions in this regard will be issued separately.

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