8 June, 2023

The RBI maintains status quo in the June monetary policy meeting; stance still cautiously hawkish

- Against the backdrop of easing inflationary pressure and resilient domestic economic conditions, the **RBI maintained the status quo on policy rates** while also keeping its **stance unchanged at "withdrawal of accommodation"**.

- The slight change in the language of the stance from ***"to ensure that inflation remains within the target going forward while supporting growth"*** to ***"to ensure that inflation progressively aligns with the target, while supporting growth"*** reflects that the central bank will look for durable signs of inflation aligning to the 4% target rather than just being satisfied with it having moderated to below its upper threshold of tolerance of 6%.

- Despite maintaining the status quo on the rates and stance, we assess **the policy tone to be cautiously hawkish**; with the central banks of Australia and Canada resuming rate increases following their policy pauses, the RBI does not want to declare victory over higher inflation prematurely.

- With the RBI's commitment to bringing inflation down to its target, we believe the central bank will continue to hold the rates at the existing levels in FY24. That said policy space for future rate hikes remains, should the inflation, and more importantly core inflation, surprise on the upside.

- The RBI revised its FY24 inflation forecast downwards from 5.2% in the April policy to 5.1% (in line with our estimate). This was driven by a downward revision in its forecast for H1 FY24 which was likely due to quicker-than-expected moderation in the headline rate of inflation in April and an expectation of a robust rabi harvest.

- The RBI retained its growth projection for FY24 at 6.5% with revisions in the quarterly forecasts. While the RBI remains optimistic about growth projections it outlines the risks from uncertainty in weather conditions and the global landscape.

- On liquidity management, the central bank reiterated that its actions going forward would continue to be nimble and two-sided as per the productive requirements of the economy while also ensuring the orderly completion of the government's borrowing programme.

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RBI maintains a status-quo on key policy rates and the accommodative stance

Against the backdrop of easing inflationary pressure and resilient domestic economic conditions, the RBI maintained the ***status quo on policy rates while also keeping its stance unchanged at "withdrawal of accommodation***". Consequently, the key rates remained unchanged at their respective levels with the ***Repo Rate at 6.50%,*** the Standing Deposit Facility rate at 6.25%, and Marginal Standing Facility Rate and Bank Rate at 6.75%. The underlying rationale to hold the policy rate at current levels was broadly similar to the previous policy where the governor emphasized the need to assess the overall impact of the cumulative rate hikes which has not been fully transmitted to the system. With the RBI's decision mostly on the expected lines, the movement in 10-year yields remained range-bound.

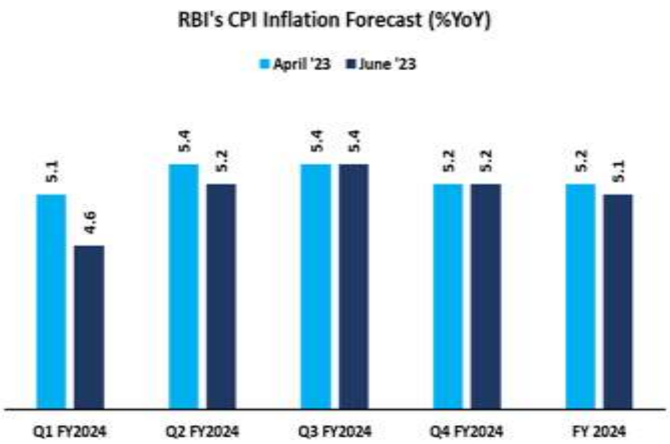
Regarding the policy stance, while the decision reflected an unchanged stance, there was a slight change in the language of the stance from ***"to ensure that inflation remains within the target going forward while supporting growth"*** to ***"to ensure that inflation progressively aligns with the target, while supporting growth"***, which reflects that the central bank will look for durable signs of inflation aligning to the 4% target rather than just being satisfied with it having moderated to below its upper threshold of tolerance of 6%. As opposed to the policy rate where the decision was unanimous, the decision to continue with the withdrawal of accommodation noted a dissent by MPC member Prof. Jayanth Varma and resulted in a 5:1 vote in favour of the unchanged stance.

Despite the RBI maintaining the status quo on the rates and stance, we assess the ***policy tone to be cautiously hawkish*** as the governor reiterated that the MPC remains resolutely focussed on aligning headline inflation with the 4% target and will take further monetary policy actions promptly and appropriately – leaving the policy space for future rate hikes, should the inflation, and more importantly core inflation, surprise on the upside. Today's decision when seen in conjunction with central banks of Australia and Canada resuming interest rate increases following the policy pause, implies that the RBI does not want to declare victory over higher inflation prematurely. With its commitment to bringing down inflation to its target ***we believe the central bank will continue to hold the rates at the existing levels in FY24.***

Headline Inflation forecast revised marginally downwards for FY24

A key factor that has allowed the MPC to continue with the pause is the moderation in the headline CPI, which has declined for the third consecutive month and printed at 4.7% below the RBI's upper threshold in April. Encouragingly, the core inflation which had been a cause of concern has also eased to 5.4% in April. For the outlook ahead, the RBI noted that the risk to near-term inflation has moderated but the pressure in the H2 FY24 is likely to remain. Accordingly, it revised its FY24 inflation forecast downwards from 5.2% in the April policy to 5.1% (in line with our estimate) today. This is driven by the downward revision in its quarterly projection of Q1 FY24 and Q2 FY24 to 4.6% and 5.2% respectively from 5.1% and 5.4% earlier potentially due to a quicker than expected moderation in headline rate of inflation in April and an expectation of robust rabi harvest. Further, the easing of the global commodity prices, is likely to aid inflation as reflected in deflation in the WPI in April. However, as per the RBI's estimates, the inflation is expected to accelerate in H2 FY24 with the waning of the base effect and potential risks from geopolitical tensions, uncertainties around the monsoon with the forecast of El Nino conditions (recent probability pegged at 70% by Australia's Met office), global commodity prices and volatility in global financial markets. Overall, even though the projections for FY24 suggest an easing of price pressures the governor noted that the headline inflation remains above the target and that the MPC will take appropriate action to bring down inflation to the target.

The RBI expects inflation for FY24 at 5.1%

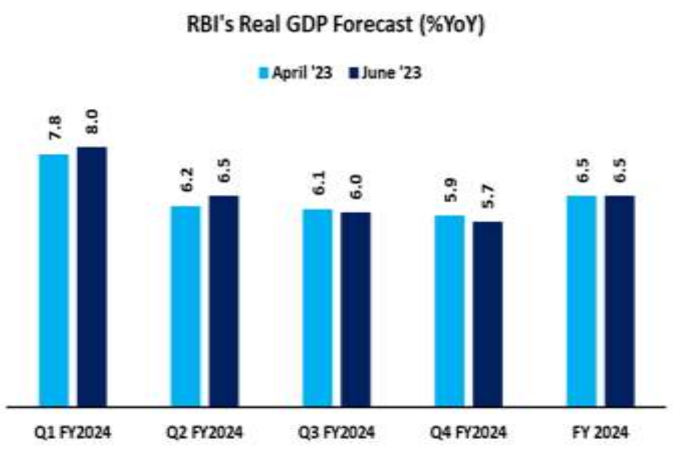


Source: RBI; Note: April '23 and June '23 refer to projections given by the RBI in its April and June 2023 MPC updates, respectively.

RBI remains optimistic about growth; notes risks from uncertainty in weather conditions and global landscape

The governor highlighted that domestic economic growth continues to hold up as it grew by 7.2% in FY23 beating the market and the RBI's expectations of around 7%. This was driven by the stronger-than-anticipated growth in Q4 with real GDP rising by 6.1% aided by the government's thrust on capex and improvement in external sector. Looking ahead, the momentum in the economic recovery is expected to be sustained with high-frequency data, including manufacturing and services PMIs, showing a pick-up in activity. On the demand front, the robust rabi production and the forecast of a normal monsoon should boost agricultural output and, in turn, support rural consumption. Meanwhile, steady growth in contact-intensive services coupled with the easing in inflation should aid urban demand. The RBI expects the investment activity to gather pace, supported by the government's CAPEX push, improved corporate and bank balance sheets and normalization of supply chain. However, the central bank noted that ongoing spillovers from weak external demand, volatility in global financial markets, protracted geopolitical tensions and high probability of El Nino conditions could weigh on the growth outlook. Accordingly, the RBI retained its growth projection for FY24 at 6.5% with revisions in the quarterly forecasts. On the quarterly basis, while the growth projections for Q1 and Q2 are revised upwards to 8.0% and 6.5% (v/s 7.8% and 6.2%), the estimates for Q3 and Q4 are revised downwards to 6.0% and 5.7% (vs 6.1% and 5.9% respectively).

RBI retains growth forecast for FY24 at 6.5% with changes in quarterly profile

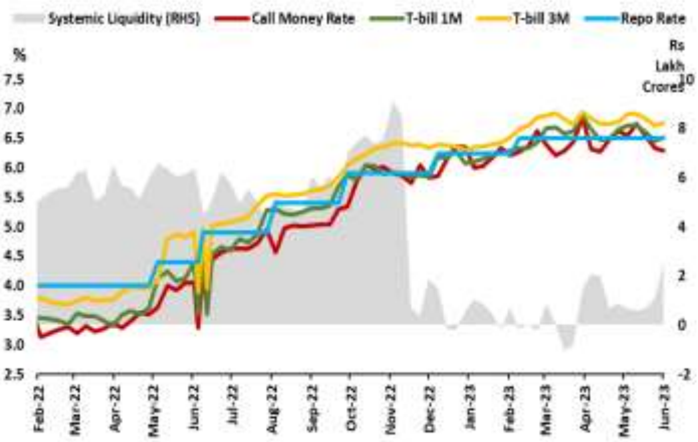


Source: RBI; Note: April '23 and June '23 refer to projections given by the RBI in its April and June 2023 MPC updates, respectively.

The RBI will conduct two-sided operations as per the productive requirements of the economy

In April-May the surplus liquidity moderated to ~Rs 1.7 lakh crore from an average of ~Rs 2.9 lakh crore in FY23. The moderation was led by maturing of the Covid-era Targeted Long-Term Repo Operations (TLTROs), seasonal expansion in currency in circulation and a build-up of government finances. The moderation in system liquidity along with its skewed distribution (in favour of large banks and the consequent increase in MSF) resulted in firming up of money market rates even beyond the repo rate in early May. Indeed, the average call money rate peaked on May 9 at 6.8% (~30bps above the repo rate). To address this, the RBI announced Rs 50,000 crore VRR auction on May 19. Following this, when liquidity expanded rapidly (tracking above 2 lakh crores in the past one week) due to an increase in government spending, a decline in currency circulation and rush of deposits of Rs 2,000 banknotes in banks (almost Rs 1.8 lakh crores have been returned out of which 85% of notes are in form of deposits), it responded by conducting VRRR auctions in early June, amounting to Rs 4.5 lakh crore which received offers of ~Rs 1.5 lakh crore. In the post press conference, the central bank noted that the focus of liquidity management is to align the overnight call rate with the policy rate rather than targeting a specific level of liquidity. Accordingly, the central bank actions going forward would continue to be nimble and two-sided as per the productive requirements of the economy while also ensuring the orderly completion of the government's borrowing programme.

The RBI conducted liquidity operations to align call money rate with the repo rate



Source: CMIE

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

Financial markets

- **Borrowing in Call and Notice Money Markets by Scheduled Commercial Banks:**
  The RBI has decided to provide Scheduled Commercial Banks (excluding Small Finance Banks) with the flexibility to manage their money market borrowings by allowing them to set their own limits for borrowing in Call and Notice Money Markets within the prudential limits for inter-bank liabilities prescribed by the Reserve Bank of India. Necessary directions are being issued today.

Regulation and Supervision

- **Widening of the Scope of Prudential Framework for Stressed Assets:**

To update "The Prudential Framework for Resolution of Stressed Assets" dated June 7, 2019, it is proposed to (i) issue a comprehensive regulatory framework governing compromise settlements and technical write-offs covering all regulated entities; and (ii) rationalise the extant prudential norms for implementation of resolution plans in respect of exposures affected by natural calamities, using the Covid-19 experience. Detailed guidelines on the above will be issued separately.

- **Default Loss Guarantee Arrangement in Digital Lending:**
  Based on extensive consultations with various stakeholders, it has been decided to put in place a regulatory framework for permitting Default Loss Guarantee arrangements in Digital Lending. Detailed guidelines on the matter will be issued separately.

- **Priority Sector Lending (PSL) Targets for Primary (Urban) Cooperative Banks (UCBs):**
  The PSL targets for UCBs were revised in 2020. With a view to ease the implementation challenges faced by the UCBs, it has been decided to extend the phase-in time for achievement of the said targets by two years, i.e., up to March 31, 2026. A detailed circular on the matter will be issued separately.

- **Rationalisation of Licensing framework for Authorised Persons (APs) under Foreign Exchange Management Act (FEMA), 1999:**
  It has been decided to rationalise and simplify the licensing framework for APs to achieve operational efficiency in the delivery of forex facilities to common persons, tourists and businesses, while maintaining appropriate safeguards. A revised framework to be issued for public feedback.

Payment and Settlement Systems

- **Expanding the Scope and Reach of e-RUPI vouchers:**
  By (a) permitting non-bank Prepaid Payment Instrument (PPI) issuers to issue e-RUPI vouchers (currently only banks are allowed) and (b) enabling issuance on behalf of individuals (currently only enabled for Central and State Govt and Corporates). Separate instructions will be issued shortly.

- **Streamlining Bharat Bill Payment System processes and membership criteria:**
  The scope of BBPS was recently expanded in Dec 2022. To enhance the efficiency of the system and to encourage greater participation, the process flow of transactions and membership criteria for onboarding operating units in BBPS will be streamlined. Revised guidelines will be issued shortly.

- **Internationalising Issuance and Acceptance of RuPay Cards:**
  It has been decided to allow issuance of RuPay Prepaid Forex cards by banks in India for use at ATMs, PoS machines and online merchants overseas. Further, RuPay Debit, Credit, and Prepaid Cards will be enabled for issuance in foreign jurisdictions, which can be used internationally, including in India. These measures will expand the reach and acceptance of RuPay cards globally. Necessary instructions will be issued separately.

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