Monetary Policy– September 2022

MPC hiked Repo Rate, Retained Stance on Withdrawal of Accommodation

The Reserve Bank of India's six-member Monetary Policy Committee (MPC) met from September 28-30th to decide on the fifth monetary policy for the fiscal. The RBI announced a 50bps increase in the repo rate to 5.9% amid rising concerns over surging inflation, global headwinds and a slump in rupee to its record lows. The MPC has increased the policy repo rate by 190bps since May to quell inflationary pressure (4% in April and 5.90% currently). The country is expected to have a real GDP of 7%, which has been lowered from 7.2% predicted earlier. The inflation target however has been unchanged at 6.7% for FY23. The rate setting panel has taken cues from its global counterparts, including the US Federal Reserve, to raise the key policy rate for the fourth time in a row.

RBI hiked the repo rate by 50bps at 5.90% and continues to focus on withdrawal of Accommodative Stance; reverse repo rate remains unchanged at 3.35%.

Highlights of Monetary Policy:

- **Repo Rate:** 5.90% (5.40% in August 2022)
- **Reverse Repo Rate:** 3.35% (3.35% in August 2022)
- **Standing Deposit Facility:** Stands adjusted at 5.65%
- **Marginal Standing Facility:** 6.15% (5.65% in August 2022)
- **Bank Rate:** 6.15% (5.65% in August 2022)
- **GDP Projection**: Real GDP growth for FY23 projected at 7% from earlier 7.2%. Q2FY23 at 6.3%, Q3&Q4FY23 at 4.6% and Q1FY24 at 7.2%
- **CPI Inflation:** CPI forecast for FY23 maintained at 6.7%. Q2FY23 at 7.1%, Q3FY23 at 6.5%, Q4FY23 at 5.8% and Q1FY24 at 5%

Some Highlights:

- The economic activity in India remains stable. While real GDP growth in Q1FY23 turned out to be lower than expectation, the late recovery in kharif sowing, the comfortable reservoir levels, improvement in capacity utilisation, buoyant bank credit expansion and government's continued thrust on capital expenditure are expected to support aggregate demand and output in H2FY23
- Currently, inflation is hovering around 7% and is expected to remain elevated at around 6% in H2FY23. Liquidity remains surplus, with average daily net absorption of Rs1.1lk-cr under the LAF in September 2022 (up to 28th September). Moreover, as government expenditure picks up on the back of high GST and direct tax collections; the system liquidity will go up further. In view of the moderation in surplus liquidity, it **has been decided to merge the 28 day VRRR with the fortnightly 14 day main auction.** Consequently, henceforth, only 14 day VRRR auctions will be conducted. Fine-tuning operations of various maturities for absorption as well as injection of liquidity will continue as may be necessary from time to time
- The Indian basket crude oil price was around $104 per barrel in H1FY23 and is further anticipated to be at $100 per barrel in H2FY23
- The CAD for Q1FY23 is placed at 2.8% of GDP with trade deficit at 8.1% of GDP. India's import growth, though decelerating, outpaced export growth. Consequently, the trade deficit remained high in July-August 2022
- Net FDI improved to USD18.9bn in April-July 2022 from USD13.1bn a year ago. FPIs have returned to the domestic market with net inflow of USD7.5bn during July-September after an outflow for nine consecutive months

Other Measures Announced:

(1) Regulation and Supervision:

- **Discussion paper on expected loss based approach for loan loss provisioning by banks:** The inadequacy of the incurred loss approach for provisioning by banks and its pro-cyclicality, one of the major elements of the global response to these findings have been a shift to Expected Credit Loss (ECL) regime for provisioning. As a further step towards converging with globally accepted prudential norms, it is proposed to adopt expected loss approach for loss allowances required to be maintained by banks in respect of their exposures. As a first step, a discussion paper on the various aspects of the transition would be issued in due course
- **Discussion paper on Securitisation of Stressed Assets Framework (SSAF):** The SARFAESI Act, 2002 currently provides a framework for securitisations to be undertaken by ARCs licensed under the Act. However, it has been decided to introduce a framework for securitisation of stressed assets in addition to the ARC route, similar to the framework for securitisation of standard assets. Accordingly, a discussion paper detailing relevant contours of the proposed framework will be issued in due course

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Other Measures Announced (contd.):

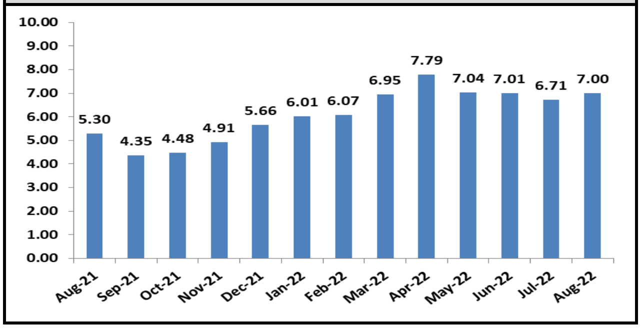
(1) Regulation and Supervision:

- **Internet banking facility for customers of Regional Rural Banks (RRBs):** The RRBs are currently allowed to provide internet banking facility to their customers with prior approval of the RBI, subject to fulfillment of certain financial and non-financial criteria. Keeping in view the need to promote the spread of digital banking in rural areas, the criteria for RRBs to be eligible to provide internet banking are being rationalised

(2) Payment and Settlement Systems:

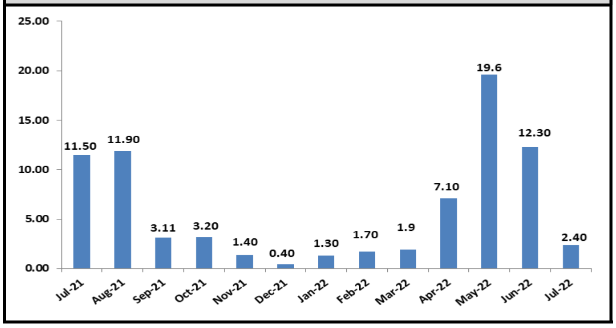
- **Regulating Offline Payment Aggregators (PAs):** The current regulations are applicable to PAs processing online or e-commerce transactions. These regulations do not cover offline PAs who handle proximity/face-to-face transactions. Keeping in view the similar nature of activities undertaken by online and offline PAs, it is proposed to apply the current regulations to offline PAs as well. This measure is expected to bring in synergy in regulation covering activities and operations of PAs apart from convergence on standards of data collection and storage

Inflation Rate-CPI (%)



Source: tradingeconomics.com

Index of Industrial Production-IIP (Change y-o-y %)



Source: tradingeconomics.com

Our View:

It was pretty expected that the sticky inflation and aggressive Fed coupled with no global economy hinting towards any kind of moderation would prompt the RBI to hike rates. Inflation continues to concern all the economies with India being no exception. And thereby the 50bps hike in the repo rate was very much expected. On the flip, there was reaffirmation of the India resilient theme alongwith CAD being financed comfortably which was taken as a positive. Furthermore, crude to be at $100 for rest of the year was also reassuring. Economic activity in India remains stable which gives the confidence to deal with aggressive policies of other central banks going forward as well. The MPC is expected to continue with the hikes going ahead too considering the adverse global backdrop and overall pressure on the rupee. However, inflation would be watched to assess the impact of the monetary tightening so far. So the reaction of the RBI will be a function of global disruption although the frontloading done consciously should give some breather for sure.

FINAL VERDICT			
MPC Meetings	**REPO**	**REVERSE**	**CURRENT STANCE**
September 2022	*5.90%*	*3.35%*	**Retained Stance on Withdrawal of Accommodation**
August 2022	**5.40%**	**3.35%**	

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