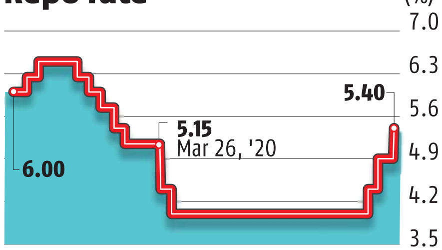
RBI stays hawkish in fight against inflation

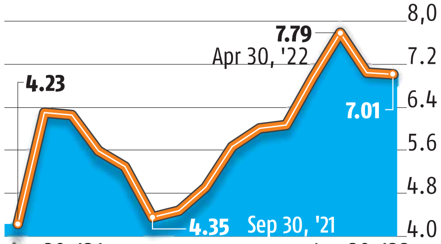
THE BIG PICTURE

A summary of rate hike, factors behind the move & its impact

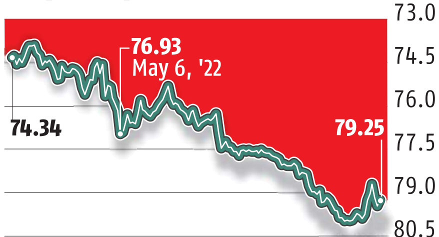
Repo rate



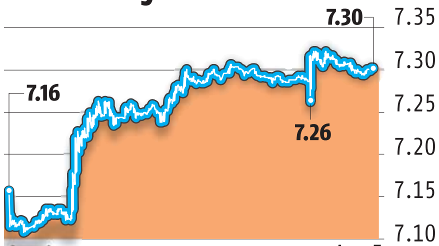
CPI-based Inflation



Rupee spot



India 10-yr GSec



Source Bloomberg/RBI/Mospi

Compiled by BS Research Bureau

WITH 50-BP RATE HIKE, MPC REVERSES COVID-ERA CUTS

KEEPS FY23 INFLATION, GROWTH FORECASTS AT 6.7% & 7.2%

HOME LOAN RATES SET TO EXCEED 8%

SUBRATA PANDA & MANOJIT SAHA
Mumbai, 5 August

The six-member Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) on Friday hiked the policy repo rate by 50 basis points to 5.4 per cent — a three-year high — owing to inflation concern and to shield the exchange rate, which has come under pressure since war broke out in Europe in February.

The home loan rates of some major lenders like State Bank of India will cross 8 per cent with this repo rate hike. The home loan rate linked to the external benchmark or the repo rate is 7.55 per cent for many lenders now.

While the six members were unanimous on the rate increase, external member Jayanth Varma dissented on the MPC's statement "focus on withdrawal of accommodation".

While the rate hike was at the higher end of the expectation spectrum, the hawkish tone of RBI Governor Shaktikanta Das stumped the bond market, which rallied this week in expectation of the central bank indicating that large rate hikes might not be in the offing after the August action.

The yield of the 10-year government bond, which fell 17 basis points in the past four days, ended 14 basis points higher to close at 7.30 per cent.

"We expect the RBI to continue with its rate hikes in the upcoming policies, taking rates up to 5.75 per cent by the end of the year," said Abheek Barua, chief economist, HDFC Bank.

"The bond market rally seen over the past few days is likely to reverse and we expect the 10-year paper to trade closer to 7.3-7.4 per cent by the end of the quarter as the markets reprice the RBI's action," Barua said.

Terming 7 per cent CPI inflation unacceptable and unsustainable, Das said there was a need to bring it back to 4 per cent, which is the target for the MPC.

"... with growth momentum expected to be resilient despite headwinds from the external sector, monetary policy should persevere further in its stance of withdrawal of accommodation to ensure that inflation moves close to the target of 4.0 per cent over the medium term," Das said during the post-policy interaction with the media.

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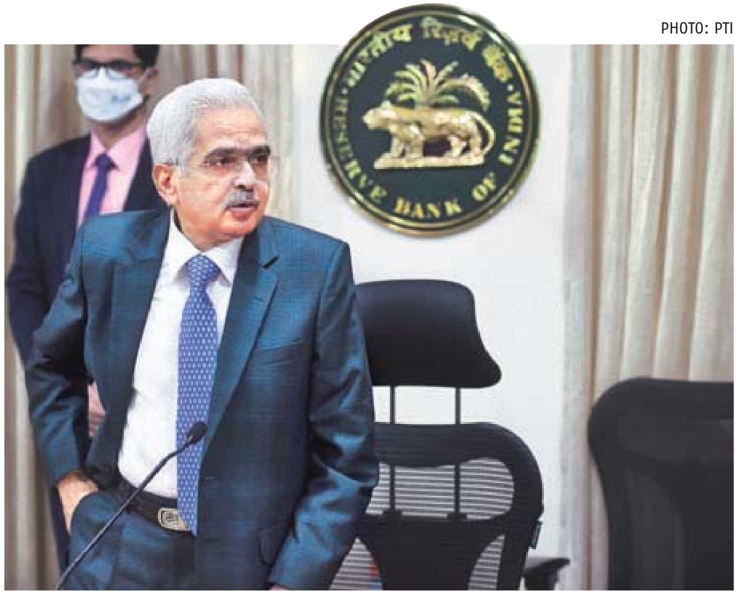
PHOTO: PTI



"IN AN OCEAN OF HIGH TURBULENCE AND UNCERTAINTY, THE INDIAN ECONOMY IS AN ISLAND OF MACROECONOMIC AND FINANCIAL STABILITY" **SHAKTIKANTA DAS,** GOVERNOR, RBI

Bond yields surge on fears of further hikes

BHASKAR DUTTA
Mumbai, 5 August

The sovereign bond market witnessed a sharp sell-off on Friday as the Reserve Bank of India's (RBI's) unequivocal commitment to bringing down inflation came as a surprise to the market, which had pinned its hopes on a softer approach by the central bank.

The yield on the 10-year benchmark 6.54 per cent 2032 paper jumped 14 basis points to close at 7.30 per cent on Friday, marking the sharpest single-day rise since the RBI unexpectedly announced a rate hike on May 4.

Bond prices and yields move inversely. A rise of one basis point in the 10-year bond yield corresponds to a fall of roughly 7 paise in price.

The RBI's Monetary Policy Committee, on Friday morning, announced a 50-basis-point rise in the repo rate to 5.40 per cent, and reiterated its stance to focus on withdrawal of accommodation.

More importantly for the market, the central bank did not lower its inflation forecast of 6.7 per cent for the current financial year, despite acknowledging that there were signs of inflation peaking.

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ECONOMISTS SEE RATE HITTING 6%

The RBI is likely to increase the repo rate by almost 60 basis points more, taking it close to 6 per cent, before holding off on further policy tightening in the current cycle, economists told *Business Standard*. According to the median of the inputs provided by 10 institutions, the terminal repo rate is seen at 5.98 per cent.

BHASKAR DUTTA writes 4

INDIA INC'S CAPEX COSTS TO SHOOT UP

Indian companies that are planning to invest thousands of crores of rupees in ramping up their capacities are staring at the prospect of higher costs of funds with the RBI hiking the repo rate. After a two-year lull due to the Covid-19 pandemic, many firms have accelerated their capital expenditure plans.

DEV CHATTERJEE, SHALLY MOHILE & VIVEAT SUSAN PINTO write 6

RBI ...

The MPC stressed sustained high prices could destabilise inflation expectations and harm growth in the medium term.

"Today's (Friday's) 50 basis point hike is an indication that the RBI is more concerned with the rupee and external situation, i.e. using the interest rate as a defence to protect the rupee," said Soumya Kanti Ghosh, group chief economic advisor, State Bank of India.

The central bank said liquidity in the banking system tightened at the end of July, which led to the firming up of money market rates above the repo rate.

Das said the RBI would remain vigilant on liquidity and conduct two-way fine-tuning operations as and when warranted —both variable rate repo (VRR) and variable rate reverse repo (VRRR) operations of different tenors.

On growth, the central bank sounded confident. Das pointed to improvement in urban demand while there were mixed signals on the rural side.

"Capacity utilisation in the manufacturing sector is now above its long-run average, signalling the need for fresh investment activity in additional capacity creation," Das said while pointing to 14 per cent y-o-y bank credit growth.

While credit is expanding at a healthy pace, deposit growth has been lagging, requiring banks to make their deposits more attractive by increasing interest rates.

"When there is credit off-take, banks can sustain and support it only if they have higher deposits. They cannot be relying on central bank money on a perennial basis ... For supporting credit off-take, banks will raise deposit rates and they will make efforts to mobilise more deposits," Das said.

According to SBI Research, while the weighted average lending rates for outstanding and fresh rupee loans have gone up by 19 and 31 basis points, respectively, from March 2022, the weighted average domestic term deposit rate for outstanding deposits has moved up 10 basis points during the same time.

According to the RBI data, the incremental credit-deposit ratio has risen from 77.2 per cent at the end of March to 246.8 per cent as on June 17.

Bond yields...

The clear takeaway for the market was that in a global environment rendered extremely volatile by the Ukraine war and the US Federal Reserve's aggressive policy tightening, the RBI was not going to take its foot off the pedal.

According to treasury officials, the magnitude of impact on the bond market on Friday had been amplified by increased speculation of the RBI signalling a less aggressive path ahead.

From August 1 to August