No change in stance, RBI hints at more rate hikes

Policy rate increased by 25 bps to a 4-year high of 6.5%

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Mumbai, 8 February

In line with expectations, the six-member monetary policy committee (MPC) of the Reserve Bank of India (RBI) on Wednesday increased the policy repurchase or repo rate by 25 basis points (bps) to a four-year high of 6.5 per cent.

The committee retained its stance of withdrawal of accommodation, though many thought that it would change this to neutral.

With the latest increase, the policy rate completed a cycle under RBI Governor Shaktikanta Das, as the repo rate was 6.5 per cent when he took charge in December 2018.

In his first policy as MPC chair, the committee reduced the rate by 25 bps to 6.25 per cent in February 2019.

With the latest hike, the central bank has now increased the rate by 250 bps since May 2022. Though the quantum of increase was lower this time than previous hikes, the central bank refused to drop its guard against inflation, as there was no indication that this could be the last increase, as most market participants had expected.

On the contrary, the tone of the policy was a tad hawkish. "...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 medium-term growth prospects," Das said, while announcing the rate hike.

Four out of the six MPC members voted for the 25 bps hike, while external members Ashima Goyal and Jayanth Varma voted against it. This is the most divided outcome in terms of voting of the current rate-setting committeee. Goyal and Varma also voted against maintaining the stance of withdrawal of accommodation.

While justifying the stance, Das said, adjusted for inflation, the policy rate was still lower than pre-pandemic levels and that banks continued to have surplus liquidity.

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Reserve Bank of India Governor Shaktikanta Das during a press conference in Mumbai on Wednesday PHOTO: PTI

GROWTH, INFLATION PROJECTIONS FOR FY24

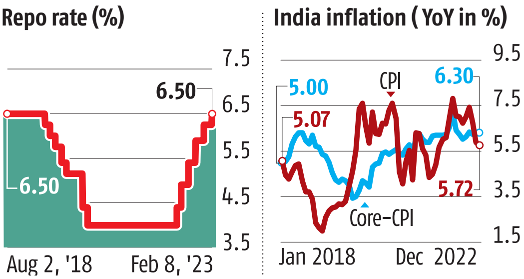
CPI inflation projected at 5.3% (assuming normal monsoon)

Q1	5.0%
Q2	5.4%
Q3	5.4%
Q4	5.6%

Real GDP growth pegged at 6.4%

Q1	7.8%
Q2	6.2%
Q3	6.0%
Q4	5.8%

REPO RATE COMPLETES CYCLE



Source Bloomberg/Mospi/RBI

Compiled by BS Research Bureau

> WHILE INFLATION IS EXPECTED TO MODERATE IN 2023-24, IT IS LIKELY TO RULE ABOVE THE 4 PER CENT TARGET
>
> **Shaktikanta Das**
> RBI, Governer

'Bank funding based on fundamentals'

Indian banks lend money to business houses not based on their market capitalisation but on parameters that depict the fundamentals of the business, said Reserve Bank of India Governor Shaktikanta Das on Wednesday. 7

No rate pause in sight, bond yields harden

Traders of government bonds were not surprised on the sixth consecutive increase in the repo rate on Wednesday. What did dampen the market's spirits, though, was the lack of a concrete sign from the RBI that it would pause rate hikes going ahead. 6

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"Liquidity remains in surplus, with an average daily absorption of ₹1.6 trillion under the LAF (liquidity adjustment facility) in January 2023. The overall monetary conditions, therefore, remain accommodative and, hence, the MPC decided to remain focused on withdrawal of accommodation," he said.

The MPC projected consumer price index (CPI)-based inflation for financial year 2023-24 (FY24) at 5.3 per cent. The inflation projection for the current financial year was lowered slightly to 6.5 per cent from 6.7 per cent. Real GDP growth for FY24 was projected at 6.4 per cent. The yield on the 10-year benchmark government paper rose by 3 bps as there was no indication of a pause in interest rate increases.

"As in Test cricket, the key question is whether the RBI is now set to declare the innings on its rate hike cycle," said Aurodeep Nandi, India economist at Nomura. "As such, the RBI governor's communication struck a somewhat hawkish note, flagging concerns on high core inflation, projecting headline inflation at 5.3 per cent for FY24, projecting confidence on growth, and flagging that monetary policy conditions are still not as tight as pre-pandemic levels – which doesn't bolt the door completely on further tightening," Nandi said.

Though the MPC did not indicate when it would change its stance, market participants believe this would depend on the liquidity situation. "Our view is that the RBI will move to 'neutral' stance in the April policy," said Suyash Choudhary, head of fixed income at IDFC AMC.

"The real rate will progressively increase without further change in nominal policy rates since projected inflation continues to fall," Choudhary said.

The rate hike will make loan rates dearer as around 40 per cent of banks' lending rates are linked to the repo rate. The central bank expects banks to increase deposit rates, too, to meet credit demand.

"The difference [between credit and deposit growth] has narrowed, but there is still a difference, and it is really up to the banks to mobilise deposits and make up the gap. They are doing so through certificate of deposits and reducing their non-SLR investments, but they need to mobilise deposits on their own to meet the gap," RBI Deputy Governor Michael Patra said.