



ICRA COMMENTS ON RBI'S FIRST BI-MONTHLY MONETARY POLICY MEETING FOR 2023-24

MPC voted for a surprise pause; door for future rate hike open given hawkish tone and evolving inflation risks

APRIL 2023



HIGHLIGHTS



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The MPC voted for a surprise pause in its April 2023 policy review

While the FY2024 GDP growth forecast has been raised by 10 bps to 6.5% from 6.4%, that for CPI inflation has been pared to 5.2% from 5.3% earlier

With the MPC stating its readiness to act should the situation warrant, and Governor's reiteration that today's decision should be construed as a pause and not a pivot, the door for future rate hikes remains open

In a surprise move, the Monetary Policy Committee (MPC) unanimously voted to keep the policy repo rate unchanged at 6.5% in its First Bi-monthly monetary policy review for FY2024. While it retained the stance of 'withdrawal of accommodation' (5:1), it revised the wordings to "ensure inflation progressively aligns with the target, while supporting growth". Compared to the Feb 2023 policy, the GDP growth and CPI inflation projections have undergone marginal upward and downward revisions, respectively, by 10 basis points (bps) each to 6.5% and 5.2%. Given the heightened uncertainty around financial conditions in advanced economies, as well as evolving domestic inflation risks emanating from adverse weather conditions and El Nino, the MPC has highlighted that it will continue to stay vigilant, and would not hesitate to take further action as may be required in its future meetings. Overall, the hawkish tone of the policy document portends that if inflation does not fall in line with the MPC's assessment for Q1 FY2024, another hike could be in the offing, especially if financial stability concerns recede. Moreover, we believe that the changed wording of the policy stance is intended to sharpen the focus on the 4% target for inflation, from the range of 2-6%, with inflation expected to print between 5-6% for most months of FY2024.

- In its first Bi-monthly Monetary Policy meeting for FY2024, the MPC unanimously decided to keep the policy repo rate unchanged at 6.50%, and retained the stance of withdrawal of accommodation (with a majority vote of 5:1) with a slight revision in wordings to "ensure inflation progressively aligns with the target, while supporting growth". Accordingly, the standing deposit facility (SDF) rate stands unchanged at 6.25% and the marginal standing facility (MSF) rate and the Bank Rate at 6.75%.
- The MPC seemed optimistic about the recovery in rural demand, while highlighting that sustained buoyancy in contact-intensive services would support urban demand, amid healthy supply side conditions. It revised the real GDP growth projection marginally upwards to 6.5% for FY2024 from the 6.4% projected in February 2023. While it has kept the GDP growth forecasts unchanged for Q1 FY2024 (+7.8%) and Q2 FY2024 (+6.2%), those for Q3 FY2024 (to +6.1% from the earlier +6.0%) and Q4 FY2024 (to +5.9% from +5.8%) have been revised upwards in the April 2023 policy review, relative to the February 2023 projections, with risks evenly balanced.
- The MPC has mildly pared its FY2024 CPI inflation forecast to 5.2% from the 5.3% projected in Feb 2023, and stated potential upside risks to the outlook including adverse weather conditions, crude oil prices, global financial market volatility, etc. It has raised its CPI inflation projection for Q1 FY2024 (to +5.1% from the earlier +5.0%), while that for Q2 FY2024 (+5.4%) and Q3 FY2024 (+5.4%) was retained. However, the projection for Q4 FY2024 has been pared by 40 bps to 5.2% from 5.6% earlier, with risks evenly balanced.

Outlook: The hawkish tone of the policy documents portends that if inflation does not fall in line with the MPC's assessment for Q1 FY2024, another hike could be in the offing, especially if financial stability concerns recede. The yield on the 10-year Government security eased by 6-8 bps to 7.21% after the policy announcement. A further decline in the US 10-year treasury yields from the current levels could exert some intermittent downward pressure on the 10-year G-sec yield, although it is unlikely to trade below the 7.2% mark on a sustained basis. If the market expectations crystallise around another rate hike in mid-2023, then the 10-year G-sec yield could retest the 7.5% mark.

The MPC unanimously kept the policy repo rate unchanged at 6.50%, while highlighting that it would continue to focus on withdrawal of accommodation, with a majority of 5:1

The MPC pared its FY2024 CPI inflation projection to 5.2% from 5.3%, with the upward revision in Q1 FY2024 being offset by the sharper downward revision in Q4 FY2024

MPC KEPT REPO RATE UNCHANGED IN APR 2023 POLICY; MONETARY POLICY STANCE MAINTAINED, WITH 5:1 MAJORITY

In its first bi-monthly policy meeting for FY2024, the MPC unanimously decided to keep the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 6.50% (refer Exhibit 1). Accordingly, it also retained the SDF, Bank rate and MSF rates at 6.25%, 6.75% and 6.75%, respectively. Additionally, the Committee decided to remain focused on the withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth, albeit with a majority of five out of six members.

CPI inflation projection revised marginally downwards 5.2% in FY2024 from 5.3% earlier: The MPC highlighted that the moderation in inflation during Nov-Dec 2022 proved to be transient, with two consecutive above-6% prints in Jan-Feb 2023, mainly led by an uptick in food inflation. The year-on-year (YoY) CPI inflation eased only marginally to 6.44% in February 2023 from 6.52% in January 2023 (refer Exhibit 2), with upticks in inflation for cereals, milk and fruits, as well as pan, tobacco and intoxicants, and housing nearly offsetting the dips in the other three categories.

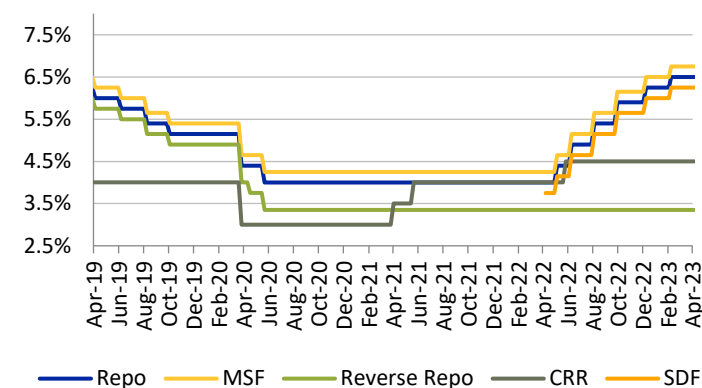
Going forward, the Committee expects a healthy rabi harvest and a correction in wheat prices to augur well for the food inflation trajectory. Moreover, the global commodity prices and cost conditions have also witnessed a correction, amidst a moderation in inflation expectations of households. However, the impact of unseasonal rainfall in March 2023, rising milk prices led by demand-supply imbalances and high fodder cost, as well as rising uncertainties in the global financial markets (that could lead to depreciation in the INR and push up the landed cost of imports) are likely to impart upside pressure to the inflation trajectory, going ahead.

Taking these factors into account, as well as the assumption of the annual price of the Indian crude oil basket averaging at \$85/bbl (as against \$95/bbl in the Feb 2023 meeting), the Committee mildly reduced its average CPI inflation forecast for FY2024 to 5.2% from the 5.3% projected in Feb 2023. While the MPC revised its CPI inflation projection for Q1 FY2024 upwards (to +5.1% from the earlier +5.0%), that for Q2 FY2024 (+5.4%) and Q3 FY2024 (+5.4%) was kept unchanged. Further, the projection for Q4 FY2024 has been pared by 40 bps to 5.2% from 5.6% projected in Feb 2023, with risks evenly balanced. **ICRA projects the CPI inflation to ease to ~5.3% in FY2024, slightly higher than the MPC's estimate, with the expectation of similar prints in H2 (ICRA's exp.: +5.3% vs. MPC's exp.: +5.3%) notwithstanding ICRA's assessment of relatively weaker domestic growth during this period.**

The Committee stated that it remains watchful of the evolving situation, assessing the impact of the cumulative 250 bps rate hikes during FY2023 on the overall real economy, while remaining focused to act appropriately to facilitate a durable decline in inflation. With the Governor highlighting that the pause in the repo rate was for this particular meeting only, the window remains open for rate hike(s) if inflation exceeds the MPC's Q1 FY2024 projection, especially if financial stability concerns recede.

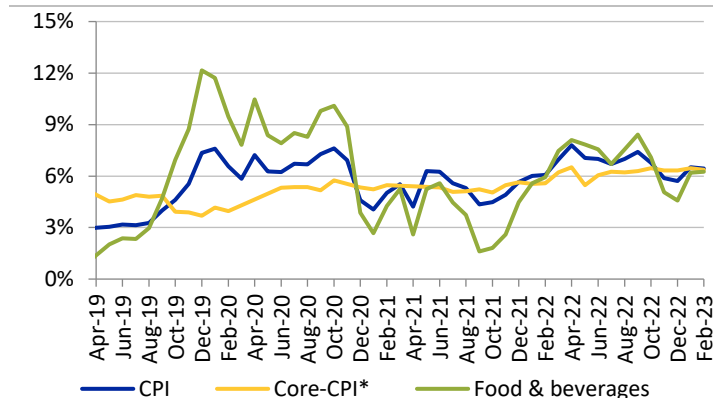
The RBI Governor highlighted that the pause in the repo rate was for this particular meeting only, which suggests that the window remains open for further rate hike(s)

EXHIBIT 1: Movement in Key Rates



Source: RBI; CEIC; ICRA Research

EXHIBIT 2: CPI Inflation, CPI-food and core-CPI inflation (YoY)



*Due to unavailability of data for March-May 2020, we have not excluded petrol and diesel indices for vehicles in computation of core CPI index for these months;
Source: NSO; CEIC; ICRA Research

EXHIBIT 3: RBI's earlier and current GDP growth and CPI inflation forecasts

YoY (%)	CPI Inflation*		GDP Growth (at constant 2011-12 prices)	
	February 2023	April 2023	February 2023	April 2023
MPC Policy Reviews				
Q1 FY2024	5.0%	5.1%	7.8%	7.8%
Q2 FY2024	5.4%	5.4%	6.2%	6.2%
Q3 FY2024	5.4%	5.4%	6.0%	6.1%
Q4 FY2024	5.6%	5.2%	5.8%	5.9%
FY2024	5.3%	5.2%	6.4%	6.5%

* Assuming average crude oil price (Indian basket) at \$85/bbl; Source: RBI; ICRA Research

The MPC highlighted that urban consumption has gained momentum driven by the recovery in service-related activities, while the rural segment shows signs of improvement as seen in the healthy tractor and two-wheeler sales

MPC raised its FY2024 GDP growth forecast to 6.5% from 6.4% earlier: The Second Advance Estimates (SAE) released by the National Statistical Office (NSO) kept the real GDP growth for FY2023 unchanged at 7.0%, similar to the First Advance Estimates (FAE). This was 20 bps higher than the MPC's Dec 2022 projection of 6.8%. Additionally, the YoY GDP growth slowed to a weaker-than-anticipated 4.4% in Q3 FY2023 from 6.3% in Q2 FY2023 (albeit higher than the MPC's projection: +4.2%), reflecting a combination of the continued input price pressures on margins in certain sectors, weakening momentum of exports, as well as a normalising base, even as the demand for services was resilient.

The Committee stated that healthy corporate investment, capex push by Govt, and improved capacity utilisation are likely to support boost investment activity

The Committee revised the GDP growth projection for FY2024 upwards to 6.5%, led by upward revision for Q3-Q4 FY2024; MPC's growth outlook for H2 FY2024 is higher than ICRA's projections

The MPC highlighted that supply-side factors remain healthy, amidst expectations of a robust rabi foodgrains production in FY2023, expansion in the manufacturing PMI and a buoyant services sector. Moreover, the uptick in passenger vehicle sales and credit card spending in February 2023 point to a recovery in urban demand, even as consumer durables volumes contracted in January 2023. Additionally, the rural segment continues to show signs of improvement as seen in the healthy growth of consumer non-durables, tractor and two-wheeler sales. While services sector exports remain robust, merchandise exports and non-oil non-gold imports recorded a YoY contraction in February 2023, highlighting the impact of the global slowdown.

Going ahead, the MPC expects higher rabi production to support the agricultural and rural sectors, while a durable recovery in contact-intensive services is likely to support urban consumption. In addition, Govt's focus on capital formation, capacity utilisation above the long-period average and a correction in global commodity prices should create a favourable investment climate in the near-term. However, the impact of a global slowdown on merchandise exports, protracted geopolitical tensions, and global financial market volatility continue to act as headwinds to the current growth trajectory.

Taking all these factors into consideration, the Committee has revised the real GDP growth projection marginally upwards to 6.5% for FY2024 from the 6.4% projected earlier in February 2023. While the GDP growth forecasts for Q1 FY2024 (+7.8%) and Q2 FY2024 (+6.2%) have been kept unchanged, those for Q3 FY2024 (to +6.1% from the earlier +6.0%) and Q4 FY2024 (to +5.9% from +5.8%) have been revised upwards in the April 2023 policy review, relative to the February 2023 projections, with risks evenly balanced.

ICRA expects India's real GDP to grow by 6.0% in FY2024. While our H1 FY2024 GDP growth projections are quite similar to the MPC's, those for H2 FY2024 differ materially. We expect GDP growth to slow to 4.5-5.0% in H2 FY2024, lower than our assessment of the potential GDP growth for the Indian economy.

Given our growth and inflation forecasts, particularly for H2 FY2024, we believe that the MPC should go in for an extended pause to assess the impact of the cumulative rate hikes on economic activity. However, the hawkish tone of the policy documents portends that if inflation does not fall in line with the MPC's assessment for Q1 FY2024, another hike could be in the offing, especially if financial stability concerns recede. Besides, we believe that the changed wording of the policy stance is intended to sharpen the focus on the 4% target for inflation, from the range of 2-6%, with inflation expected to print between 5-6% for most months of FY2024.

After a sharp contraction between Q4 FY2022 and Q3 FY2023, liquidity tightened further in Q4 FY2023, with the daily average net systemic liquidity surplus easing to Rs. 194 billion in the quarter from Rs. 393 billion in Q3 FY2023

Amidst a sharp moderation in systemic liquidity, the RBI conducted two 14-day VRRs and one fine tuning 5-day VRR auction in Feb-Mar 2023, which injected liquidity worth Rs. 1.88 trillion

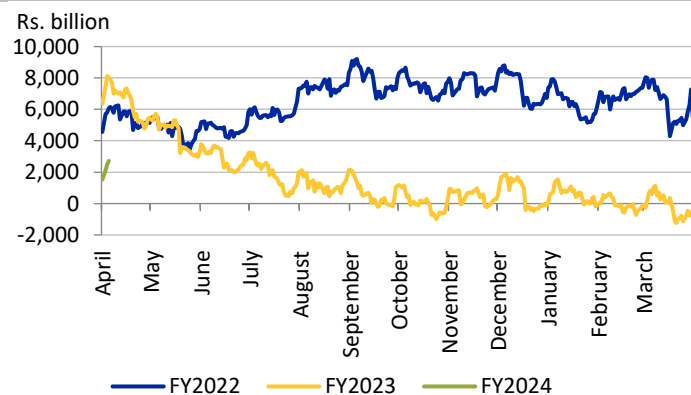
Durable liquidity moderated through Q4 FY2023, touching a multi-year low of Rs. 1.01 trillion (0.6% of NDTL) as on Mar 10, 2023, from Rs. 2.86 trillion (1.6% of NDTL) as on Dec 30, 2022, albeit remaining in surplus mode

After a sharp contraction between Q4 FY2022 and Q3 FY2023, liquidity tightened further in Q4 FY2023, with the daily average net systemic liquidity surplus easing to Rs. 194 billion in that quarter from Rs. 393 billion in Q3 FY2023. As a % of NDTL, it narrowed from 0.8% in Q2 FY2023 on an average to 0.2% in Q3 FY2023, and further to just 0.1% in Q4 FY2023.

The moderation in the liquidity surplus in Q4 FY2023 relative to Q3 FY2023 was on account of an increase in the currency with the public (to Rs. 32.8 trillion as on March 24, 2023 from Rs. 31.2 trillion as on Dec 30, 2022), as well as net dollar sales of \$0.4 billion in the spot market in January 2023, after the net purchases of \$7.3 billion in Q3 FY2023. Subsequently, while the RBI's forex reserves have risen to \$578.4 billion on March 31, 2023 from \$576.8 billion on January 27, 2023, a part of this increase may have been on account of the revaluation effect. The drain on systemic liquidity imposed by the increase in CWP was partly offset by a moderation in the GoI cash balances (to Rs. ~1.0 trillion on March 10, 2023 from Rs. 2.3 trillion on Dec 30, 2022).

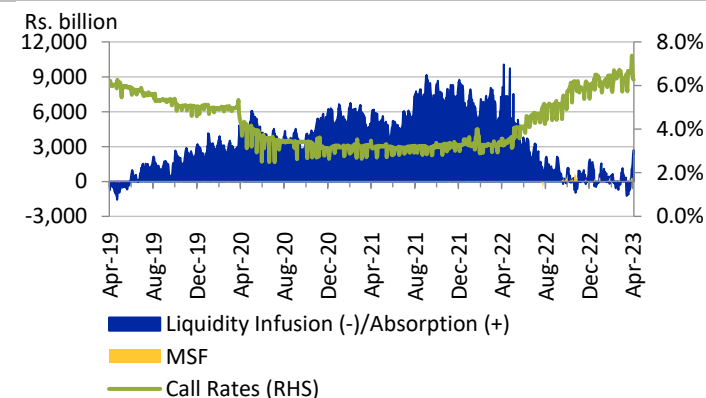
On a monthly basis, after witnessing a surplus of Rs. 562 billion in Jan 2023, systemic liquidity turned to a deficit of Rs. 35 billion in February 2023 - this was the first instance of an average monthly deficit since the onset of the pandemic. Subsequently, it reverted to a small surplus of Rs. 25.0 billion in March 2023. Nevertheless, systemic liquidity continued to fluctuate between deficits and surpluses during each month since September 2022.

EXHIBIT 4: Liquidity Infusion (-)/ absorption (+) (Net Overnight & Term Repos/Reverse Repos; MSF; SLF; MSS)



*Data for FY2024 is available upto April 5, 2023; Source: RBI; ICRA Research

EXHIBIT 5: Call money rates



Source: RBI; ICRA Research

The systemic liquidity has turned to a sizeable surplus of Rs. 2.1 trillion in April 2023 so far (till April 5, 2023), with daily average absorption standing at an elevated Rs. 3.5 trillion on April 5, 2023

The WACR surged to a 54-month high of 6.40% in March 2023 owing to tighter liquidity conditions; thereafter it has declined to 6.29% in the ongoing month with a sharp improvement in systemic liquidity to a surplus of Rs. 2.1 trillion

The Governor stated that the Central Bank will remain flexible in meeting the productive requirements of the economy through two-way operations, as may be necessary

Owing to tighter liquidity conditions in February 2023 and March 2023 amid advance tax and GST payment outflows in latter month, the RBI conducted one 14-day VRR auction in February 2023 (worth Rs. 500 billion), and another 14-day VRR (worth Rs. 1.0 trillion) auction and a fine-tuning 5-day VRR auction (worth Rs. 750 billion) in March 2023, which cumulatively infused liquidity in the system to the tune of Rs. 1.88 trillion in Q4 FY2023. **LTROs worth Rs. 611.3 billion are set to mature in April 2023; we expect the RBI to inject liquidity in the system via 14-day VRRs to offset a portion of the maturity of these long-term repos.**

Durable liquidity moderated through Q4 FY2023, touching a multi-year low of Rs. 1.01 trillion (0.6% of NDTL) as on Mar 10, 2023, from Rs. 2.86 trillion (1.6% of NDTL) as on Dec 30, 2022, albeit remaining in surplus mode.

Subsequently, the systemic liquidity has turned to a sizeable surplus of Rs. 2.1 trillion in April 2023 so far (till April 5, 2023), with daily average absorption standing at an elevated Rs. 3.5 trillion on April 5, 2023.

The RBI conducted net OMO sales of G-secs of Rs. 36.7 billion in Q4 FY2023 (till March 26, 2023), lower than the net sales of Rs. 102.8 billion conducted in Q3 FY2023.

The daily weighted average call money rate (WACR) rose from 6.13% in Dec 2022 and to 6.38% in Feb 2023 and further to a 54-month high of 6.40% in March 2023 owing to tightening of liquidity conditions and back-to-back rate hikes. Thereafter, it has corrected sharply to 6.29% in April 2023 so far (till Apr 5, 2023), benefitting from a sharp improvement in the systemic liquidity surplus in the ongoing month. The average rates for the 91-day T-bills, 182-day T-bills, and 364-day T-bills rose from 6.38%, 6.75% and 6.91%, respectively, in Q3 FY2023 to 6.66%, 7.07% and 7.14%, respectively, in Q4 FY2023, and further to 6.92%, 7.18%, and 7.22%, respectively, in April 2023 so far (till Apr 5, 2023). Notably, the daily WACR rate has risen by 313 bps between Apr 2022 and March 2023, much higher the quantum of the cumulative increase in the repo rate (250 bps) during this period.

Going ahead, the Governor stated that the Central Bank will remain flexible in meeting the productive requirements of the economy through two-way operations, as may be necessary. In addition, it would ensure the completion of the Government borrowing programme in a non-disruptive manner while maintaining orderly market conditions during FY2024. Post this, the India's 10-year G-sec yield cooled off by 7-8 bps intraday from the opening level of 7.28% on April 6, 2023. **A further decline in the US 10Y treasury yields from the current levels could exert some intermittent downward pressure on the 10-year G-sec yield, although it is unlikely to trade below the 7.2% mark on a sustained basis. If the market expectations crystallise around another rate hike in mid-2023, then the 10 year G-sec yield could retest the 7.5% mark.**

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