RBI Policy Review: Hikes by 50bps amidst a global storm

The RBI policy announcement today came with no major surprises and was broadly in line with our expectations. The central bank raised the repo rate by 50bps, aligning itself with aggressive monetary policy action globally. The decision was consistent with elevated inflationary risks and domestic growth that continues to hold up.

Policy rate announcement: *The RBI raised the policy rate to 5.90% and the SDF rate was accordingly raised to 5.65%. The policy rate announcement was not unanimous, with MPC member Ashima Goyal voting for a 35bps rate hike. On stance, all members voted for an unchanged stance, except for MPC member Jayant Verma who dissented.*

Inflation and Growth: *The RBI kept its inflation forecast unchanged at 6.7% for FY23, sounding caution on the uncertainty around inflationary pressures, despite the recent moderation in global crude oil, stemming from higher food inflation and continued pressure on services inflation. On growth, the RBI revised down its GDP forecast by 20bps to 7% for FY23 -- largely reflecting the lower-than-expected Q1 GDP numbers. The commentary on growth remained upbeat as the RBI highlighted continued improvement in domestic fundamentals, while recognising that there are global headwinds that could present downside risks going forward.*

Stance: *The central bank did little to remove the ambiguity and perceived deviation around its stance, keeping it unchanged at "withdrawal of accommodation", contrary to our expectations that a move to neutral was on the cards. The RBI justified its stance by emphasizing that liquidity conditions remain in surplus mode and that the nominal policy rate continues to trail inflation. This contrasts with 2019 – when the stance was last neutral – liquidity was in deficit and the policy rate was higher than inflation leading to positive real rates in the economy. However, in the post policy press conference, Governor Das abstained from committing to a definitive marker (or any forward guidance) either in the form of the liquidity level, the operating rate, or the level of real interest rate that would trigger a change in stance at this stage.*

Liquidity: *The central bank said that it will continue to undertake two-way operations to manage liquidity conditions. With moderation in liquidity surplus, the RBI has decided to merge the 28-day VRR auctions with the fortnightly 14-day main auction. Going forward, from now on only 14-day VRRR auctions will be conducted. <u>In the post policy press conference, Governor Das re-iterated that the central bank would continue to keep liquidity conditions comfortable</u> and as the impact of advance tax flows fades, there is drawn down on excess SLR and CRR by banks, and government spending increases, liquidity conditions are likely to improve. System liquidity surplus stood at INR 0.68 lakh cr as of 29th September 2022 (as compared to INR 2 lakh crore in August 2022 end). We expect average liquidity in the system to remain in surplus in Q3, supported by RBI's fine-tuning operations. That said, the level of systemic liquidity as seen by the balances under the LAF window are likely to average lower than what has been recorded in Q2 FY23 (average: INR 2.16 lakh crore in Q2).*

External resilience and the rupee: *The central bank re-iterated the resilience of India's external balances compared to our peers in today's policy announcement. On the rupee, as we have argued before, the RBI emphasized that their strategy would be focussed on maintaining investor confidence and anchoring expectations -- signalling that FX interventions are likely to continue and be focussed towards defending any extreme volatility in the rupee. The absence of any additional measures in order to shore up reserves and attract capital (like was done in 2013)*

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signals RBI's comfort with the current level of foreign exchange reserves as well as the level of the rupee. Given the continued dollar rally and elevated global risks, the USD/INR pair is likely to witness continued depreciation pressures and we expect a range of 81-82 in the near-term. In extreme risk-off, we continue to expect the central bank to provide support and curtail the quantum of fall in the currency.

Policy outlook: *The central bank refrained from providing a forward guidance on terminal rates and kept the window open for the quantum and pace of rate action in response to the evolving global and domestic conditions. We expect the RBI to continue with its rate hikes in the upcoming policies taking rates up to 6.5% (terminal rate) by the end of the fiscal year.*

Bond yields & FX update: *The 10-year yield was largely flattish at 7.343% (post the policy announcement) vs. yesterday's closing level of 7.34% as the policy was on expected lines. The 10-year yield is trading at 7.355% at the time of writing. We expect the 10-year paper to trade closer to 7.3-7.4% by the end of the quarter. On the FX front, the USD/INR strengthened post the policy announcement to 81.55 vs. yesterday's closing level of 81.86.*

The Specifics:

Inflation: The RBI retained its CPI inflation forecast at 6.7% for FY23 assuming average crude oil price (Indian basket) at USD 100 pbl in H2 FY23. On a quarterly basis, inflation was revised up by 10 bps for Q3 FY23. The RBI expects CPI inflation to average at 5% in Q1 FY24.

Our View: We expect CPI inflation to rise further to 7.3-7.4% in September 2022 amid a low base from last year and higher food prices. We expect inflation to remain above the RBI's upper band of 6% until Feb-22. For FY23, we expect CPI to average at 6.7%, with upside risks emanating from higher than expected food prices.

Inflation Projections

%YoY	Q2 FY23	Q3 FY23	Q4 FY23	FY23	Q1 FY24
RBI (August forecast)	**7.1**	**6.4**	**5.8**	**6.7**	**5**
RBI (September forecast)	**7.1**	**6.5**	**5.8**	**6.7**	**5.0**
HDFC Bank (Forecast)	**7.05**	**6.4**	**5.9**	**6.7**	**5.0**

Source: RBI and HDFC Bank

Growth Outlook: The RBI revised down its GDP growth forecast by 20 bps to 7.0% for FY23. The RBI expects investment to pick up on account of an improvement in capacity utilisation, Government's capex plan and strengthening bank credit. On the consumption side, urban demand is expected to strengthen further in the second half and rural demand to catch up with the onset of festive season.

That said, the RBI continues to see spill overs from prolonged geo-political tensions, tightening global financial conditions and the slowing external demand as key risks to growth.

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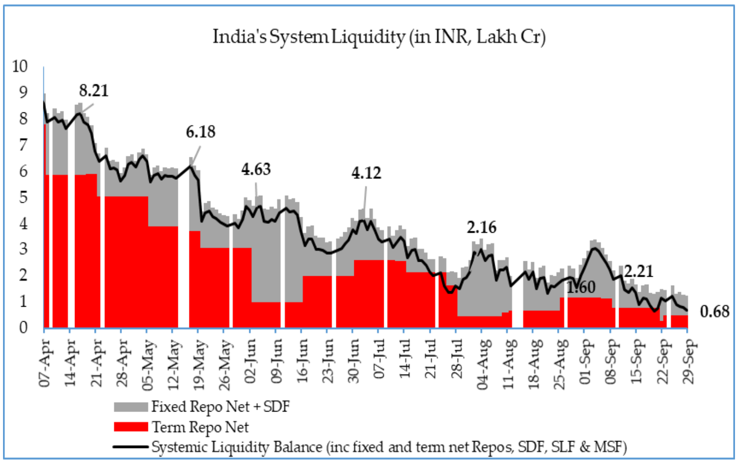
Our view: We expect GDP growth at 7% in FY23 vs. 8.7% in FY22. While there are risks stemming from the possibility of global slowdown, high inflation, and an uneven monsoon, we believe that continued recovery in domestic demand and higher government capex are likely to provide support to the economy.

Growth forecast

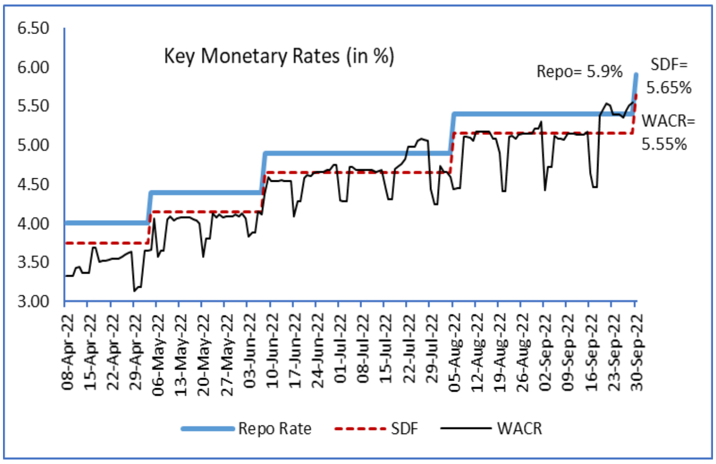
%YoY	Q2 FY23	Q3 FY23	Q4 FY23	FY23	Q1 FY24
RBI (August forecast)	**6.2**	**4.1**	**4.0**	**7.2**	**6.7**
RBI (September forecast)	**6.3**	**4.6**	**4.6**	**7.0**	**7.2**
HDFC Bank (forecast)	**6.8**	**4.3**	**4.4**	**7.0**	**7.0**

Source: RBI and HDFC Bank

System liquidity surplus eased below INR 1 lakh Cr recently on account of advance tax payments, GST related outflows



With low liquidity, WACR rate had moved above the policy rate as of 29 Sep.



Source: CEIC, RBI, HDFC Bank. Note: WACR data as of 29th September

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Bond Yields: Short-term rates continue to move up, some respite at the long end

	Mid September	Post Fed meeting (23rd September)	Latest (Post RBI Meeting)	Cumulative Change (in bps)
Money Market				
WACR	5.13	5.4▲	5.55▲	42
G-Secs				
3M	5.66	5.9▲	6.08▲	42
6M	6.10	6.45▲	6.58▲	48
1Y	6.25	6.71▲	7.07▲	82
5Y	6.97	7.37▲	7.27▼	30
10Y	7.11	7.39▲	7.35▼	24
30Y	7.28	7.53▲	7.53	25
Corporate bonds				
3M-CP	6.05	6.4▲	6.5▲	45
6M-CP	6.38	6.75▲	6.95▲	57
10Y-AAA	8.92	8.67▼	8.59▼	-33
10Y-AA	9.36	9.1▼	8.71▼	-66
OIS				
1M	5.51	5.86▲	6.05▲	54
3M	5.74	6.06▲	6.21▲	47
6M	6.01	6.47▲	6.53▲	52
1Y	6.30	6.92▲	6.8▼	50

Source: CEIC, Reuters, HDFC Bank. Note: WACR data as of 29th September

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