Overview

The Monetary Policy Committee (MPC) of the Reserve Bank of India voted for maintaining its accommodative stance and policy rates, in contrast to market expectations for a nominal hike in reverse repo and migrating to a neutral stance. Repo and reverse repo rates remain at 4% and 3.35% respectively, at least till Apr'22, when MPC meets again.

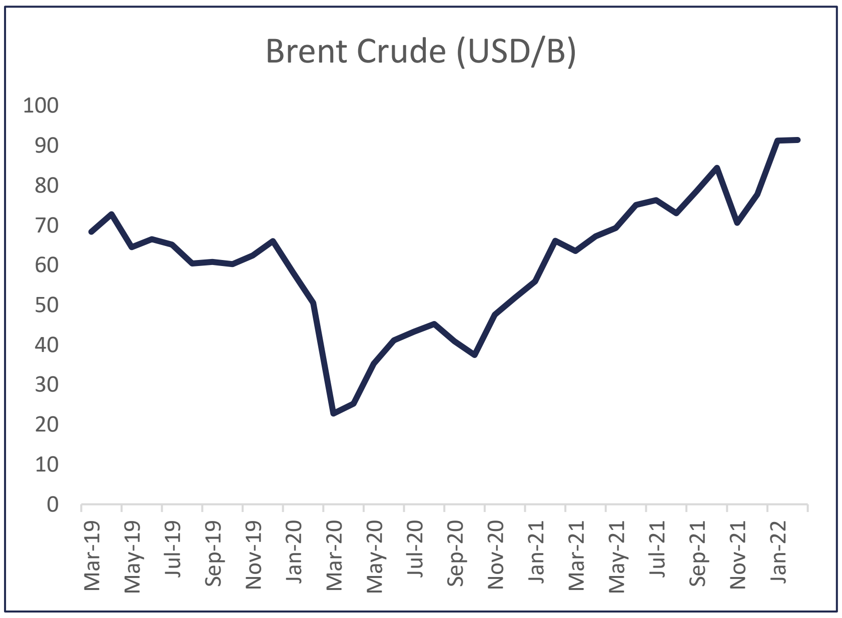
The decision for a status quo in policy rates stem from the larger risks looming over economic revival compared to headwinds from sticky inflation. The decision is pegged largely on a decline in forecasted retail inflation towards the end of FY23. RBI forecasts inflation in FY23 will be 4.5%, down from 5.3% in FY22. This decline will be driven by a sharp moderation in prices in Q3 and Q4 FY23.

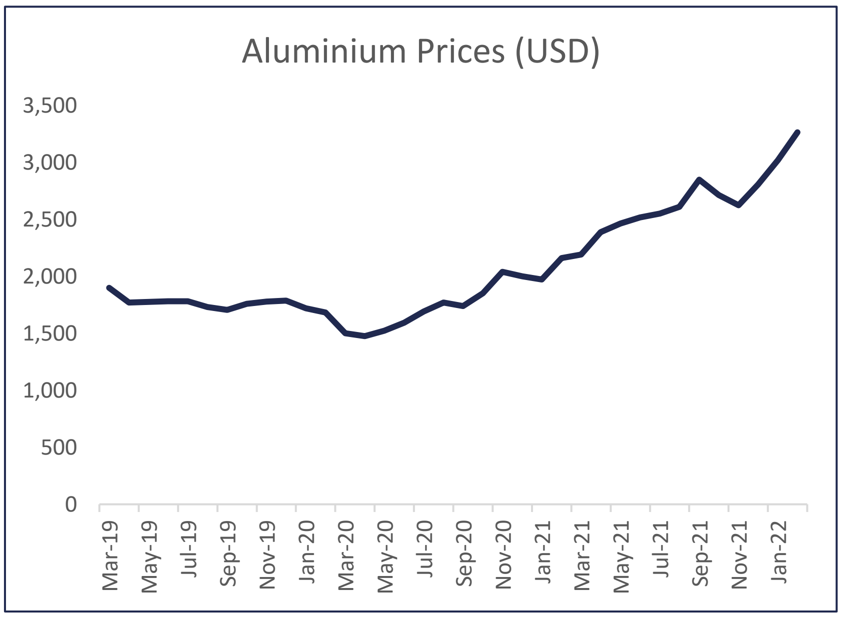
Our Opinion

In our opinion, while the status quo could put RBI behind the curve, but at the same time it can free up some additional headroom (albeit short lived) to support economic revival. This move has potentially reduced the probability of any change in lending or deposit rates in the immediate future. Policy was guided by RBI's inflationary forecast. We feel the forecasts, especially for Q3 and Q4 FY23 are too dovish and are likely to get revised, unless there is a steep fall in crude prices by over USD 20-30, which seems unlikely. RBI expects real GDP growth at 7.8% in FY23. Expected growth in Q3 and Q4 FY23 are 4.3% and 4.5% respectively. Any slippage in inflationary forecasts (on the higher side) will potentially shave away 1-2% from the Q3 and Q4 GDP estimates for FY23.

Some of the major risks that can unfold in FY23 have to do with prices, particularly imported prices. With approximately 50% of the Indian retail inflation basket directly or indirectly influenced by imported inflation, it appears difficult to manage domestic inflation closer to MPC's mandated target of 4% in FY23, more so in Q3 and Q4.

- Oil prices will remain elevated above USD 85 for the most of FY23 as OPEC+ continuously fall short of raising its output to the targeted levels coupled with multiple geopolitical tensions fanning speculative trades in crude derivatives. The only departure from the scenario of high crude prices leading to high domestic inflation can be if Government of India absorbs these hikes and further reduce excise duties.
- At the same time, renewed price pressures in global commodities like aluminum and copper will not mellow down anytime soon, triggered by synchronous economic resumption post the Omicron led wave, across the globe.





Market Reaction

However, domestic markets, both fixed income and equities, have reacted well to the reduced inflationary outlook, for now.

Fixed Income:

The market had been witnessing turbulence since the announcement of Government's borrowing plan for FY23. Lack of any guidance regarding Indian Government Security inclusion in global bond indexes added to the uncertainty within the market. Consequently, the benchmark 10 Year GSec yield rose sharply from ~6.7% on 31st Jan'22 to 6.9% by 1st Feb'22, after the budget announcement. This was followed by a spate of devolvement and cancellations in RBI's government bond auctions to ease market sentiments and communicate RBI's stance.

The market have reacted positively to the announcements made in the Feb'22 monetary policy review. Some of the positive elements announced include:

- Lower inflationary outlook
- Extension in limit of Voluntary Retention Scheme to Rs 2.5 Lakh crores from Apr'22 (rise of Rs 1 lakh crores).
- Introduction of revised norms for Credit Default Swaps to deepen corporate debt market liquidity.

Equity:

Equity markets too seems to have reacted favorably, with the status quo led easy monetary policy auguring well for banking stocks. Also, markets expect a decline in US retail inflation which may soften the steady rise in US yields to some extent, which has been off late triggering a steady selloff of Indian equities and debt by FPIs.

Currency:

Forex market is indicating some correction (INR depreciation) despite RBI's assurances regarding a low current account deficit (to GDP ratio) and sufficient foreign exchange balances to meet any exigencies. Indian Rupee has been declining triggered by the FPI sell down in equity and debt markets over the last few weeks and the mismatch in hawkish intensity between RBI and US Fed. This is expected to prevail well into the new financial year.

	9th Feb'22	10th Feb'22
10 Yr Gsec (%)	6.8	6.7
1 Yr Gsec (%)	4.6	4.4
Nifty 50	17,463.8	17,605.9
USDINR	74.8	75.2

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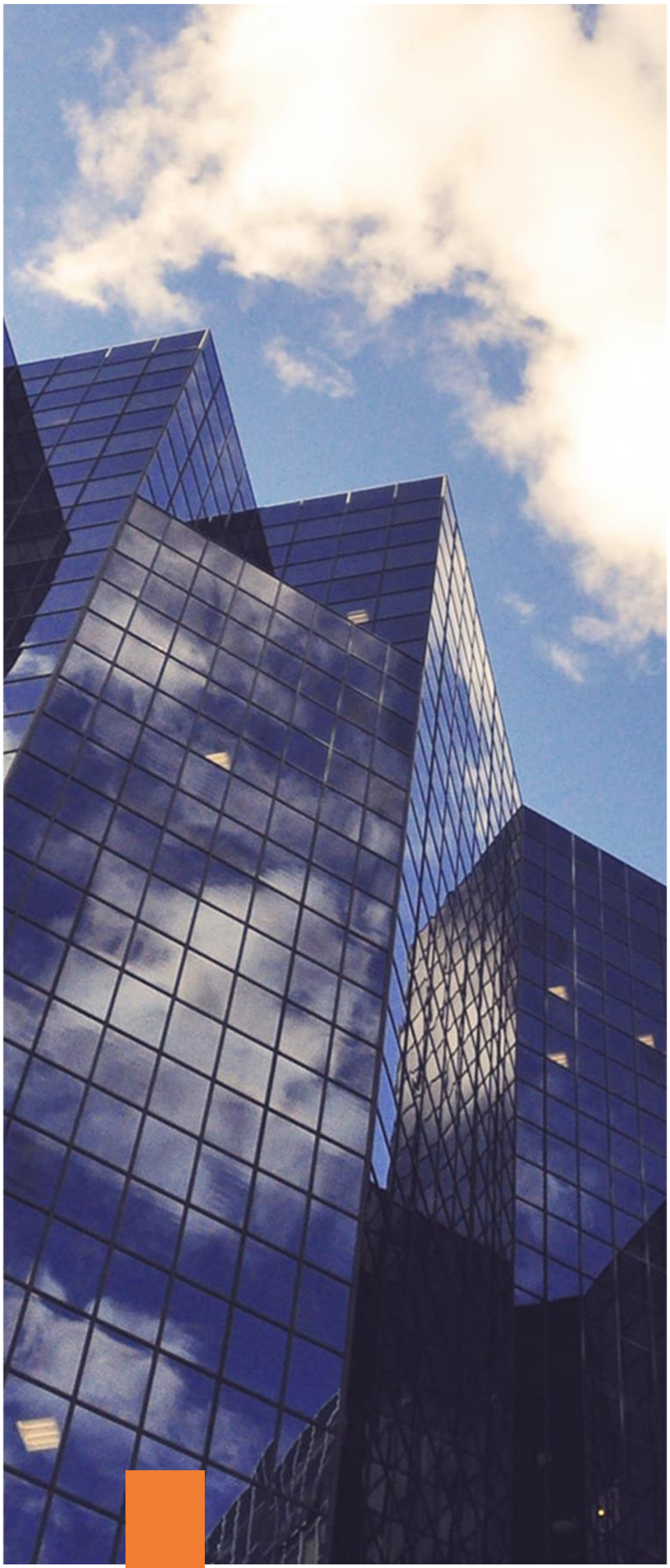

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