1. The latest 50 bps hike in Aug’22 was the third consecutive hike in the current cycle since May’22. At 5.4%, repo rate rose by 140 bps in a span of 4 months. In our view, another 80-100 bps rise is expected in the next 4-6 months.

2. The Liquidity Adjustment Facility corridor now ranges from 5.15% (SDF) to 5.65% (MSF).

3. Surplus liquidity is declining steadily. Fell by ~Rs 2.9 Lakh crores between May’22 and July’22. This is a function of higher rates and steady rise in lending activity by banks.

4. Unlike developed market central banks like Fed and BoE which are also facing strong recessionary headwinds, RBI does not seem to be forecasting an economic contraction or slowdown in the next 12 months. That gives it a larger headroom to roll back its accommodative stance and rein in the demand led part of inflation.

5. Real policy rates in UK, US, Eurozone range between (-) 7%-8% while after today’s hike, Indian real policy rate is at (-) 1.5%. India can expect to generate positive rates sooner, attracting foreign investors by offering better carry opportunities.

6. Recession in developed markets may prove to help the supply led inflation in India through softening global prices, especially that of commodities and energy.

7. With the INR performing better than major currencies, impact of a higher current account deficit (CAD) can be efficiently managed with the strong pile up of forex reserves. India continues to have the 4th largest foreign reserves in the world.

8. RBI expects CPI to fall below the upper tolerance of 6% by Q4 FY23, backed by good monsoons expectations, declining global metal prices and softening international food prices. This appears somewhat overambitious in our opinion. Kharif acreage has been low due to errant monsoon conditions. Rice with 10% weight in CPI basket is a kharif crop.

9. We have been forecasting a frontloading of Repo rates till 6% by Apr’23. The current rate hike of 50bps is in sync with our expectations. However, majority of the market participants did not expect RBI to appear as hawkish as it did today, with perhaps limiting to a 35 bps hike. This surprised the Indian GSEC market, with the benchmark 10 year yields rising to 7.25% immediately after the announcement, compared to a close of 7.15% on 4th Aug.

10. With 44% of bank loans linked to external benchmarks (mostly repo), lending rates will increase sharply in the rest of FY23 and H1 FY24. However, bank deposit rates may not witness a similar trajectory, improving net interest margins of lenders.

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Market reaction

	Yesterday Close	Post Policy (11 AM)
10 Year GSEC	7.16%	7.26%
Wtd Call Rate	4.59%	5.24%
USDINR	79.4	79.02
Nifty 50	17,382	17,467

Policy rate changes across key markets in 2022:

	Country	Trajectory of Policy Rates in 2022							
Emerging		Jan	Feb	March	April	May	June	July	August
	China	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70
	India	4.00	4.00	4.00	4.00	4.40	4.90	4.90	5.40
	South Africa	4.00	4.00	4.25	4.25	4.75	4.75	5.50	5.50
	Brazil	9.25	10.75	11.75	11.75	12.75	13.25	13.25	13.75
Developed	U.S	0.25	0.25	0.50	0.50	1.00	1.75	2.50	2.50
	U.K	0.25	0.50	0.75	0.75	1.00	1.25	1.25	1.75
	EuroZone	0.00	0.00	0.00	0.00	0.00	0.00	0.50	0.50

MPC's rationale for hike in Repo:

1) Resilience in domestic economic activity
2) CPI breaching the upper tolerance limit of 6%
3) Global financial markets volatility affecting domestic markets
4) Currency depreciation
5) Sustained high inflation destabilizing expected inflation and harming growth prospects.

MPC's view on what is supporting growth:

1) Kharif sowing well (marginally lower than last year).

2) Demand side : Production of consumer durables and sale of passenger vehicles suggest improvement.

3) Rural vs Urban growth : Tractor sales contracted in rural markets though 2 wheeler sales are up. Growth in urban sector on account of revival of contact sensitive industries.

4) Services sector growth : Railways, ports, toll collection and commercial vehicle sales remained robust. Import of capital goods robust.

5) PMI at an 8-month high.

6) Capacity utilization in manufacturing sector in Q4 at 75.3% relative to its long-term average of 73.7%.

7) Bank credit growth accelerated to 14% from 5.4% same time last year.

8) Private sector manufacturing sector profitability remained buoyant.

9) Urban sector: contact sensitive industries revival.

10) Expansion in bank credit to improve further due to rising demand for Capex. This will lead to higher capacity utilization.

Some projected headwinds:

1) Geographical tensions

2) Global tightening

3) Global recession risks

4) Volatility in financial markets globally.

TruQuest

TruQuest is a knowledge series launched by TruBoard Partners providing succinct updates and views on:

- Liquidity outlook
- India's macro-economic view
- Trends within the Infrastructure, Real Estate and Renewable Energy sectors
- Impact analysis of new regulations and policies on lending and capital flow

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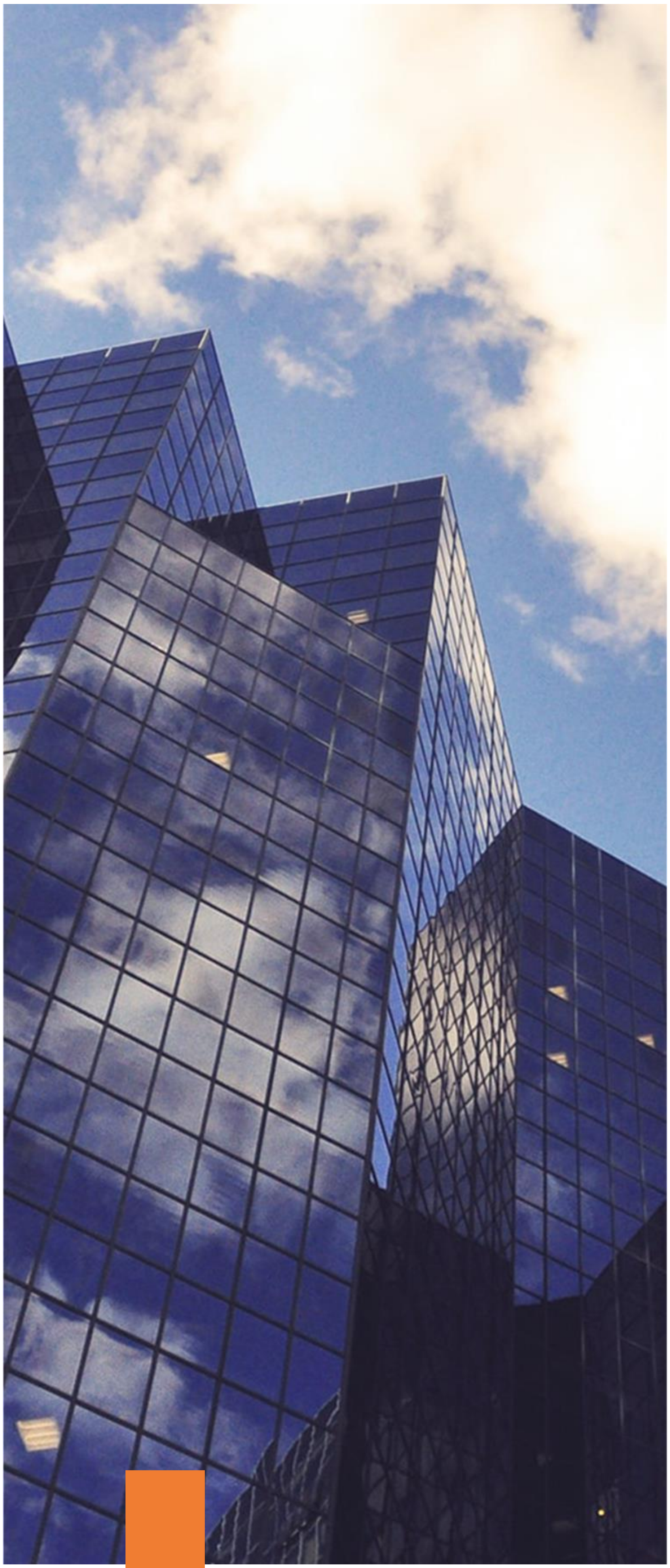

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