

MNI RBI Preview - February 2023

Meeting Date: Wednesday 8th February 2023

Link To Statement: [Reserve Bank of India - Monetary Policy \(rbi.org.in\)](https://www.rbi.org.in/monetary-policy)

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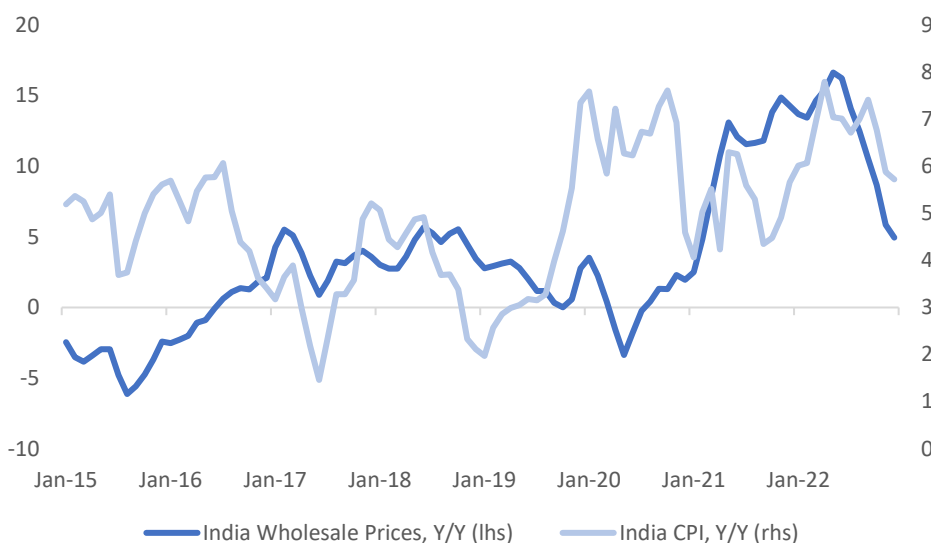
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MNI POV (Point Of View): +25bps Expected, But Will Stance Be Shifted To Neutral?

The RBI is expected to deliver a 25bps hike at tomorrow's policy meeting. This is the consensus from economists surveyed by Bloomberg, although a small number of forecasters expect the RBI to remain on hold. If a 25bps hike is delivered, which is also our expectation, then this would take the policy rate to 6.50%.

This would be a down step from the previous meeting (where a 35bps hike was delivered). It would be in line with headline inflation generally surprising on the downside, albeit modestly in recent months, and the level of the policy rate. A policy rate at 6.50% is back to 2018 highs. Headline y/y CPI is back to 5.72% y/y, which is sub the upper end of the RBI's 2-6% target range, while lower upstream price pressures also bodes well for the outlook, all else equal, see the first chart below.

Fig 1: India Headline & Wholesale Inflation



Source: MNI – Market News/Bloomberg

A case could be made for no change, given the likely headline CPI trajectory and the potential for the RBI to revise down its inflation outlook (6.7% is the projection for the current financial year, ending March 31). Still, an important offset comes from sticky core inflation pressures. For instance, a Bloomberg measure of core India inflation came in at 6.43% y/y in December, barely off recent highs near 6.50%. So, whilst the real policy rate, against headline inflation is trending back into positive territory, against core inflation, it will only just be in positive territory.

The RBI is unlikely to be too concerned around the risks of derailing the growth outlook with a further 25bps in tightening. Domestic growth still looks to be holding up ok, based off PMI survey measures. The latest readings for manufacturing (55.4) and services (57.2), while off recent highs, remain comfortably in expansion territory. IP growth also rebounded in November, back to +7% y/y, although the December print may be weaker owing to softer commodity related production.

Last week's budget should also give the RBI some confidence in the medium term growth outlook, given the government's commitment to boosting investment spending over the coming 3 years.

The other focus point from the meeting is likely to be RBI's policy stance. There are some forecasters that expect 'withdrawal of accommodation' will be replaced with something more akin to 'neutral'. There is also scope for some RBI board members, most likely external members, to vote against a rate hike. A shift to neutral language around the stance of policy would leave the market expecting a pause in the tightening cycle and the RBI becoming more data dependent around future shifts. At this stage, market pricing (using the MIPR function on Bloomberg) looks for close to 2 more hikes in the next 6 months, before rates come down year end and into 2024.

We would note the shift to neutral view in terms of the RBI language is not a uniform consensus across the sell-side (see the previews below). Some expect the RBI to maintain language around continuing to withdraw stimulus. The key rationale for this is that core inflation pressures remain sticky and that the move down in headline inflation pressures could ultimately prove temporary.

RBI December 7th 2022 Monetary Policy Statement

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) at its meeting today (December 7, 2022) decided to:

- Increase the policy repo rate under the liquidity adjustment facility (LAF) by 35 basis points to 6.25 per cent with immediate effect.

Consequently, the standing deposit facility (SDF) rate stands adjusted to 6.00 per cent and the marginal standing facility (MSF) rate and the Bank Rate to 6.50 per cent.

- The MPC also decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 per cent within a band of +/- 2 per cent, while supporting growth.

The main considerations underlying the decision are set out in the statement below.

Assessment

Global Economy

2. The global economic outlook is skewed to the downside. Global growth is set to lose momentum as monetary policy actions tighten financial conditions and as consumer confidence weakens with the rising cost of livelihood. Inflation remains elevated and persistent across countries as they grapple with food and energy price shocks and shortages. More recently, however, there are some signs of moderation in price pressures, which have raised expectations of an easing in the pace of monetary tightening. Alongside easing in sovereign bond yields, the US dollar has come off its highs. Capital flows to emerging market economies (EMEs) remain volatile and global spillovers pose risks to growth prospects.

Domestic Economy

3. On the domestic front, real gross domestic product (GDP) increased by 6.3 per cent year-on-year (y-o-y) in Q2:2022-23 after an increase of 13.5 per cent in Q1. On the supply side, gross value added (GVA) rose by 5.6 per cent in Q2.

4. In Q3, economic activity is exhibiting resilience. In the agricultural sector, a pick-up in rabi sowing (6.4 per cent higher than a year ago on December 2) is supported by the good progress of the north-east monsoon and above average reservoir levels. Activity in the industry and services sectors is in expansion mode, as reflected in purchasing managers' indices (PMIs) and other high frequency indicators.

5. Aggregate demand conditions have been supported by pent-up spending and discretionary expenditures during the festival season, although their evolution is somewhat uneven across sectors. Urban demand has remained buoyant, and rural demand is recovering. Investment activity is in modest expansion. Merchandise exports contracted in October after an expansion for 19 consecutive months. Growth in non-oil non-gold imports decelerated.

6. CPI inflation moderated to 6.8 per cent (y-o-y) in October 2022 from 7.4 per cent in September, with favourable base effects mitigating the impact of pick-up in price momentum in October. Food inflation softened, aided by easing inflation in vegetables and edible oils, despite sustained pressures from prices of cereals, milk and spices. Fuel inflation registered some easing in October, driven by softening of price inflation in LPG, kerosene (PDS) and firewood and chips. Core CPI (i.e., CPI excluding food and fuel) inflation persisted at elevated levels at 6 per cent, with price pressures across most of its constituent sub-groups.

7. The overall liquidity remains in surplus, with average daily absorption under the liquidity adjustment facility (LAF) at ₹1.4 lakh crore during October-November as compared with ₹2.2 lakh crore in August-September. On a y-o-y basis, money supply (M3) expanded by 8.9 per cent as on November 18, 2022 while bank credit rose by 17.2 per cent. India's foreign exchange reserves were placed at US\$ 561.2 billion as on December 2, 2022.

Outlook

8. The inflation trajectory going ahead would be shaped by both global and domestic factors. In case of food, while vegetable prices are likely to see seasonal winter correction, prices of cereals and spices may stay elevated in the near-term on supply concerns. High feed costs could also keep inflation elevated in respect of milk. Adverse climate events – both domestic and global – are increasingly becoming a significant source of upside risk to food prices. Global demand is weakening. Unabating geopolitical tensions continue to impart uncertainty to the food and energy prices outlook. The correction in industrial input prices and supply chain pressures, if sustained, could help ease pressures on output prices; but the pending pass-through of input costs could keep core inflation firm. Imported inflation risks from the US dollar movements need to be watched closely. Taking into account these factors and assuming an average crude oil price (Indian basket) of US\$ 100 per barrel, inflation is projected at 6.7 per cent in 2022-23, with Q3 at 6.6 per cent and Q4 at 5.9 per cent, and risks evenly balanced. CPI inflation for Q1:2023-24 is projected at 5.0 per cent and for Q2 at 5.4 per cent, on the assumption of a normal monsoon.

9. On growth, the agricultural outlook has brightened, with the prospects of a good rabi harvest. The sustained rebound in contact-intensive sectors is supporting urban consumption. Robust and broad-based credit growth and government's thrust on capital spending and infrastructure should bolster investment activity. According to the RBI's survey, consumer confidence is improving. The economy, however, faces accentuated headwinds from protracted geopolitical tensions, tightening global financial conditions and slowing external demand. Taking all these factors into consideration, the real GDP growth for 2022-23 is projected at 6.8 per cent with Q3 at 4.4 per cent and Q4 at 4.2 per cent, with risks evenly balanced. Real GDP growth is projected at 7.1 per cent for Q1:2023-24 and at 5.9 per cent for Q2.

10. Inflation has ruled at or above the upper tolerance band since January 2022 and core inflation is persisting around 6 per cent. Headline inflation is expected to remain above or close to the upper threshold in Q3 and Q4:2022-23. It is likely to moderate in H1:2023-24 but will still remain well above the target. Meanwhile, economic activity has held up well and is expected to be resilient, supported by domestic demand. Net exports would remain subdued due to the drag from evolving external demand conditions. Further, the impact of monetary policy measures undertaken needs to be watched. On balance, the MPC is of the view that, further calibrated monetary policy action is warranted to keep inflation expectations anchored, break the core inflation persistence and contain second round effects, so as to strengthen medium-term growth prospects. Accordingly, the MPC decided to increase the policy repo rate by 35 basis points to 6.25 per cent. The MPC also decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

11. Dr. Shashanka Bhide, Dr. Ashima Goyal, Dr. Rajiv Ranjan, Dr. Michael Debabrata Patra and Shri Shaktikanta Das voted to increase the policy repo rate by 35 basis points. Prof. Jayanth R. Varma voted against the repo rate hike.

12. Dr. Shashanka Bhide, Dr. Rajiv Ranjan, Dr. Michael Debabrata Patra and Shri Shaktikanta Das voted to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth. Dr. Ashima Goyal and Prof. Jayanth R. Varma voted against this part of the resolution.

13. The minutes of the MPC's meeting will be published on December 21, 2022.

14. The next meeting of the MPC is scheduled during February 6-8, 2023.

Sell-Side Analyst Views

ANZ: We expect the Reserve Bank of India (RBI) to deliver its final 25bp rate hike on 8 February (12:30 SGT), taking the terminal repo rate in the current hiking cycle to 6.50%. The Union budget unveiled this week was growth-supportive, with few direct implications for inflation. Hence, it is unlikely to have a bearing on the RBI's response function, which is aimed at taming inflation. While headline CPI inflation has been trending below expectations in recent months, the disinflation was largely limited to food items such as vegetables. Core inflation, about which the RBI has expressed concerns, remains sticky at around 6%, and its persistence needs to be broken. Apart from the hike, we also expect a change in stance to 'neutral' from 'withdrawal of accommodation', and potentially a cut in inflation projections.

Barclays: We expect the MPC to deliver another 25bp rate hike at its 8 February meeting, bringing the repo rate to 6.50%, with the need for larger hikes fading rapidly amid falling inflation and moderating imported price headwinds. Headline inflation coming back to the target range – and below the RBI's projections – is increasing the room for dissent in the MPC, with at least two members likely to vote to keep rates on hold, in our view. This means the possibility of an on hold decision is non-negligible, but given elevated core CPI and recent comments by Governor Shaktikanta Das, we still believe a 25bp hike is the most likely step in February. We also think it is likely that the policy stance will be changed to neutral, where it was last in December 2018, when the repo rate was 6.50%. Furthermore, inflation has begun to moderate and appears set to drop further in coming months. With growth resilient and inflation declining, India's macroeconomic backdrop is improving, and the RBI may feel it needs to wait and see regarding the need for further policy tightening, based on incoming data. We thus expect the February rate hike to be the last in this cycle, but we also believe it is too early for the RBI to cut rates, as inflation is likely to be hovering around 5.0-5.5% by end of 2023, which may prevent an early reversal in rates.

Bank Of America: We see RBI MPC downshifting rate hikes as inflation has eased in recent months. We expect a 25bp hike in the Feb policy, with a split voting pattern with external members likely voting for a pause. A likely shift in stance from 'withdrawal of accommodation' to 'neutral' may indicate the MPC's intention to pause on the rates front to assess the full impact of the hikes to date. We expect CRR to be kept unchanged even as system liquidity has declined.

Citi: Citi Economics expects 25bps hike in the RBI repurchase rate to 6.50%, as well as a 25bps hike in SDF to 6.25%. We remind that there continues to be some concern around sticky inflation, though we think language could tilt a little dovish on the margin.

DBS: The Reserve Bank of India monetary policy committee meets this week. Since the last rate review, the inflation print for Dec eased further to 5.7% yoy owing to lower food prices, even as core reading was sticky around 6%. Wholesale inflation fell to nearly a two-year low below 5% in Dec 22, on weaker imported forces. The recent FY24 Budget was neutral for monetary policy, in terms of near-term inflation and macro stability. We continue to expect the last 25bp hike this week to 6.5% before slipping into a prolonged pause. The commentary might be more balanced to retain the flexibility to act if global conditions unexpectedly deteriorate or inflation risks rise anew. Domestic bonds reacted positively to the borrowing program that was largely along expectations. The official stance on liquidity is also under watch, given the banks' credit-deposit yawn and upcoming TLTRO maturities this quarter.

Goldman Sachs: We forecast the RBI to slow down the pace of policy repo rate hikes to 25bp at the February 2023 meeting next week (from 35bp in the December 2022 meeting), and retain the stance of "withdrawal of accommodation". Two external MPC members (Prof. Varma and Prof. Goyal), who advocated a pause or tapering of hikes in the minutes of the December meeting, are likely to vote for a pause, in our view. Since the last policy meeting on December 7, 2022: a) headline inflation has come in below consensus estimates, purely driven by a steep decline in vegetable (-8.3%/-4.5% mom sa in Nov/Dec) prices, some of which we expect to revert over the next two months; b) core inflation (headline inflation excluding food and fuel inflation) has stayed elevated and sticky at around 6.0% yoy, mainly driven by rising services inflation; c) activity indicators have been mixed – while services indicators such as domestic air passenger traffic improved, and soft data like manufacturing and services PMIs remained in expansion, steel and coal production was weak in December, and d) on the external balances

front, India's goods trade deficit remains elevated driven mainly by an increase in imports, as domestic demand remains resilient. However, strong services export has helped somewhat offset the expansion in goods trade deficit.

ING: We can expect to see further central bank action from the Reserve Bank of India (RBI) on 8 February, and the outcome is much less certain than the RBA. The current repo rate is at 6.25%, which is 55bp higher than the prevailing rate of inflation, which has since fallen back into the top end of RBI's 2-6% tolerance range. Our contention has been that the RBI is at or close to the peak, and we believe that the RBI will put a pause on the hikes to give growth a chance.

J.P.Morgan: Those arguing that the RBI should hike this week, such as us, remain concerned that even as headline inflation has come off, underlying inflation remains very sticky. Core-core inflation has averaged 5.6% for 33 months since the start of the pandemic and accelerated to average 6.1% in 2022. Furthermore, even as commodity prices have cooled off in recent months and supply chains have normalized, the monthly momentum of core has not budged from a 0.5% average (an annualized rate of 6%) in recent months.

Morgan Stanley: We expect the RBI to put a lid on rates with a final rate hike of 25bps, taking the terminal policy rate to 6.5% in the February meeting. Further, we expect the RBI to change its stance from accommodative to neutral as the rate hike cycle comes to an end. In our view, this is likely to drive decelerating domestic inflation due to base effect and moderating global commodity prices. On the growth front, recovery continues to remain resilient with strength in domestic demand providing a partial offset to slowing external demand. Risks of further increase in policy rates will be contingent on expectations of inflation trajectory and external factors such as movement in oil prices, and/or capital market environment. Additionally, we believe that normalization in real rates should help preserve macro stability and provide a basis for durable growth recovery.

Scotiabank: Most economists expect another 25bps hike from the RBI into Thursday. That would take the repo rate up to 6 ½% for a cumulative increase of 225bps since policy tightening began last April. OIS markets are priced for most of a quarter-point hike. Key is whether the Monetary Policy Committee will continue to vote in favour of further withdrawal of policy accommodation after a 4–2 vote in favour of doing so in December, or whether it may signal a hard pause. While headline inflation subsequently ebbed, core inflation remains resilient

Societe Generale: With the Fed expected to slow down the pace of its rate hikes and the Indian economy moving into the slower lane, we retain our view that the RBI is in the final leg of its rate hike cycle. The major festival period over and the technical bounce-back from the depths of the pandemic low triggered by pent-up demand is expected to run its course. Against this backdrop, the RBI expects growth to slow down next year. While a slowing economy is indeed a worry for the central bank, especially as the labour market remains visibly weak, prices have yet to exhibit a decisive disinflationary trend. The lower December inflation print (5.7% yoy vs 5.8% in September) may inch up again before it embarks on a sustained disinflationary trend. Yet, we do expect headline inflation to remain elevated albeit lower than RBI's upper comfort level of 6.0%. We now expect the central bank to opt for a final rate hike of 25bp, taking the terminal policy rate to 6.5%. We also believe that sustained disinflation would be visible from 2Q23 onward, which would result in India's real policy rate eventually turning positive after a rather prolonged period in negative territory.

TD Securities: We expect the RBI to go with a final 25bps hike and further signal that it is done with hikes by switching its stance to neutral from the stance of withdrawal of accommodation. Progress on inflation been encouraging, and the RBI may revise its quarterly CPI forecasts lower for this year and Governor Das may sound less hawkish on inflation compared to the previous meeting.

UOB: Market expectation, in line with our forecast, is that the RBI will deliver one last rate hike in the current cycle in Feb. The RBI's stance of accommodation withdrawal, its focus on bringing down core inflation, and an economic recovery that's not caving to monetary tightening or the external slowdown all point to a rate increase. We expect the monetary policy committee to vote 4-2 in favor of raising the repo rate by 25bps to 6.50%.