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Press Release

So here comes the rate hike!

MPC hikes repo rate by 40 bps, CRR by 50 bps in an unscheduled meeting

04 May 2022

In an unscheduled but not entirely unexpected announcement, the MPC of RBI has announced a hike in repo rate and in all other benchmark rates by 40 bps. Further, the CRR has also been increased by 50 bps to indicate a reversal of the easy liquidity scenario. Virtually, RBI has exited from the accommodative policy stance through these measures. Acuité had indicated in its publications over the last 1-2 months that a rate hike is imminent given the exceptionally strong inflationary pressures across the globe as well as in India, triggered by the Ukraine crisis. The headline CPI inflation had already moved up to 6.95% in Mar-22 and a further rise in the print over the next 2-3 months is on the cards which will reflect the impact of higher retail fuel prices and also the increase in food inflation from categories such as edible oil. RBI's action implies a rise in banks' lending and deposit rates in the near term, translating into higher interest rates for home and consumer loans and adversely impacting consumer sentiments. Corporates whose borrowings are directly linked to the benchmark interest rates will see an immediate impact in their interest costs.

Says Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research "Given the tone of urgency in RBI's statement to signal the altered inflation-growth dynamics, we expect another 60 bps hike in the repo rate in the rest of FY23 that could be delivered between June and March FY23. Further acceleration in global commodity prices could potentially tilt the balance in favour of additional repo rate hikes thereby taking the repo rates to the pre-pandemic level of 5.15% or higher. The 10Y g-sec yields have already hardened by more than 20 bps post the unscheduled policy announcement and we expect it to move faster now towards 7.50% with significant upside risks before the end of FY23."

Global as well as domestic economic recovery which was underway facilitated by abating risks from the pandemic and robust vaccination coverage, has been facing significant headwinds from intensifying Russia-Ukraine crisis, persistent supply chain bottlenecks and hardening commodity prices. With risks from geopolitical conflicts and retaliatory sanctions amplifying the existing inflationary pressures, policy makers across the globe have started scaling back their pandemic era accommodative policies and have started increasing interest rates (Chart 2). Among developed countries, the US Fed (with 25 bps hike) and the BoE (with 65 bps hike) are major central banks who have initiated their monetary policy normalization with an aim to start refocusing on inflation management and importantly, indicated that further rate hikes are around the corner.

From domestic standpoint, the weakening economic impact of the pandemic, progressive normalization of growth impulses, sharp upside risks to inflation and the need to be in sync with global interest rate cycle – are all conditions that warranted the commencement of withdrawal of the pandemic era monetary policy accommodation. While the RBI had already taken steps towards policy normalization in the form of reinstating the width of the policy corridor to the pre-pandemic levels by introducing the standing deposit facility (SDF) as the lower bound of the policy corridor in its Apr-22 meeting, it refrained from a repo rate hike at that juncture. But in an unscheduled meeting today, MPC unanimously decided to increase the repo rate hike by 40 bps to 4.40% for the first time since Aug-18. Consequently, the standing deposit facility (SDF) rate stands adjusted to 4.15% and the marginal standing facility (MSF) rate and the Bank Rate to 4.65% (Chart 1) which will eventually lead lending and deposit rates to go up.

While we were anticipating the RBI to initiate the repo rate hikes in the Jun-2022 policy meeting through a 25 bps increase, RBI surprised us as well as markets by frontloading the same while increasing its quantum. Interestingly, the committee also decided to continue with its accommodative stance while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth. In our opinion, RBI has virtually exited from its accommodative policy stance through the latest measures, although its actions may be calibrated going forward.

In a further move to modulate liquidity conditions in line with the policy actions and stance, the RBI decided to increase the CRR rate by 50 bps to 4.5% beginning May 21,2022 which would approximately lead to a liquidity withdrawal of Rs. 870 bn from the financial system.

With respect to RBI's economic outlook for FY23, the assessment on growth and inflation were kept unchanged at 7.2% and 5.7% respectively. However, the RBI has highlighted significant upside risk to the inflation forecast due to mounting pressures on food as well as fuel inflation. This indicates a strong possibility of the RBI revising its inflation forecast upwards from the current 5.7% for FY23 in the upcoming Jun-22 policy meeting.

Annexure

Chart 1: RBI hikes MSF, Repo and SDF rates by 40 bps each, maintaining the width of the policy corridor at 50 bps

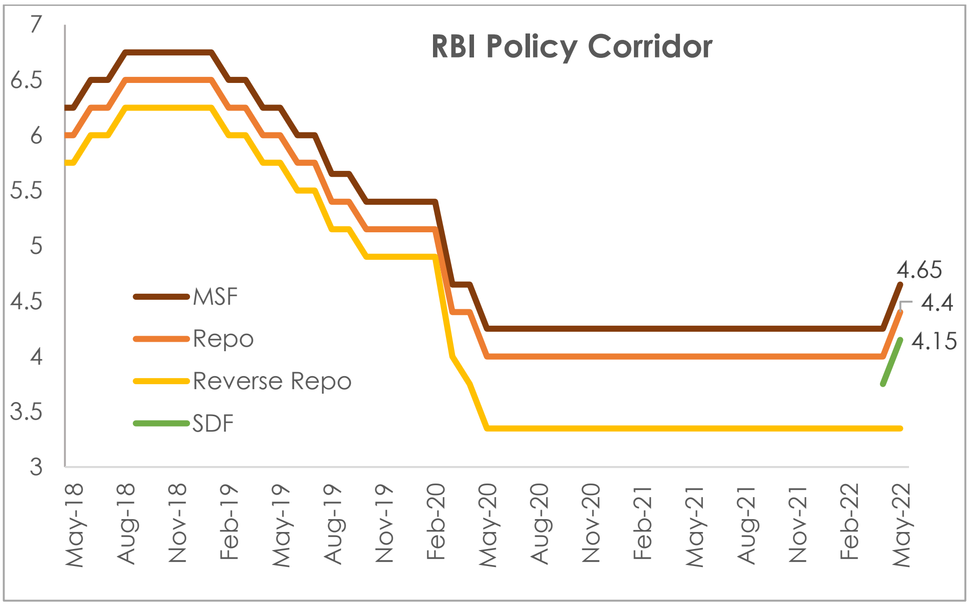
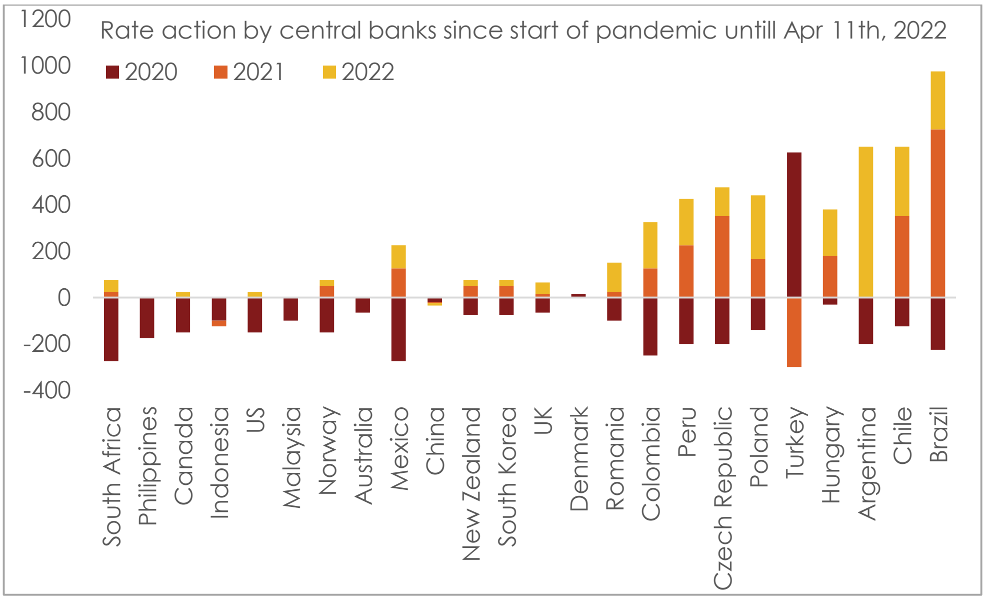


Chart 2: Currently 4 central banks have their monetary policy rate at their pre pandemic level while 12 above their pre pandemic levels.



About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 9,000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Kanjurmarg, Mumbai.

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