Off-Cycle Monetary Policy Statement, 2022-23

May 04, 2022

Policy Actions

The Monetary Policy Committee (MPC) at its meeting today (May 4, 2022) decided to increase the policy repo rate under the liquidity adjustment facility (LAF) by 40 basis points to 4.40 percent with immediate effect.

Consequently, the standing deposit facility (SDF) rate stands adjusted to 4.15 percent and the marginal standing facility (MSF) rate and the Bank Rate to 4.65 percent.

The MPC also decided to remain accommodative while focusing 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 percent within a band of +/- 2 percent, while supporting growth.

Policy Assessment

Since the MPC's meeting in April 2022, disruptions, shortages, and escalating prices induced by the geopolitical tensions and sanctions have persisted and downside risks have increased. The International Monetary Fund (IMF) has revised down its forecast of global output growth for 2022 by 0.8 percentage point to 3.6 percent, in a span of less than three months. The World Trade Organization has scaled down projection of world trade growth for 2022 by 1.7 percentage points to 3.0 percent.

Domestic economic activity stabilised in March-April with the ebbing of the third wave of COVID-19 and the easing of restrictions. Urban demand appears to have maintained expansion but some weakness persists in rural demand. Investment activity seems to be gaining traction. Merchandise exports recorded double digit expansion for the fourteenth consecutive month in April. Non-oil non-gold imports also grew robustly on the back of improving domestic demand.

Overall system liquidity remained in large surplus. Bank credit rose (y-o-y) by 11.1 percent as on April 22, 2022. India's foreign exchange reserves declined by US$ 6.9 billion in 2022-23 (up to April 22) to US$ 600.4 billion.

In March 2022, headline CPI inflation surged to 7.0 percent from 6.1 percent in February, largely reflecting the impact of geopolitical spillovers. Food inflation increased by 154 basis points to 7.5 percent and core inflation rose by 54 bps to 6.4 percent. The rapid rise in inflation is occurring in an environment in which inflationary pressures are broadening across the world. The IMF projects inflation to increase by 2.6 percentage points to 5.7 percent in advanced economies in 2022 and by 2.8 percentage points to 8.7 percent in emerging market and developing economies.

Outlook

Heightened uncertainty surrounds the inflation trajectory, which is heavily contingent upon the evolving geopolitical situation. Global commodity price dynamics are driving the path of food inflation in India, including prices of inflation sensitive items that are impacted by global shortages due to output losses and export restrictions by key producing countries. International crude oil prices remain high but volatile, posing considerable upside risks to the inflation trajectory through both direct and indirect effects. Core inflation is likely to remain elevated in the coming months, reflecting high domestic pump prices and pressures from prices of essential medicines. Renewed lockdowns and supply chain disruptions due to resurgence of COVID-19 infections in major economies could sustain higher logistics costs for longer. All these factors impart significant upside risks to the inflation trajectory set out in the April statement of the MPC.

As regard the outlook for domestic economic activity, the forecast of a normal southwest monsoon brightens the prospects for kharif production. The recovery in contact-intensive services is expected to be sustained, with the ebbing of the third wave and the growing vaccination coverage. Investment activity should get an uplift from robust government capex, improving capacity utilisation, stronger corporate balance sheets and congenial financial conditions. On the other hand, the worsening external environment, elevated commodity prices and persistent supply bottlenecks pose formidable headwinds, along with volatility spillovers from monetary policy normalisation in advanced economies. On balance, the Indian economy appears capable of weathering the deterioration in geopolitical conditions but it is prudent to continuously monitor the balance of risks.

Against this background, the MPC is of the view that while economic activity is navigating the vortex of forces confronting the world with resilience on the strength of underlying fundamentals and buffers, the risks to the near-term inflation outlook are rapidly materialising, as reflected in the inflation print for March and the developments thereafter. In this milieu, the MPC expects inflation to rule at elevated levels, warranting resolute and calibrated steps to anchor inflation expectations and contain second round effects. Accordingly, the MPC decided to increase the policy repo rate by 40 basis points to 4.40 percent. The MPC also decided to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

All members of the MPC unanimously voted to increase the policy repo rate by 40 basis points to 4.4 percent.

All members unanimously voted to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

Our Views & Conclusion:

As per our expectation since the last few months, RBI today finally gave in to the market's expectations of a rate hike. This, however, was announced in an out-of-turn policy scheduled just before the FOMC where it is widely expected that the Fed is going to hike policy rate by 50 bps. It is now clear that RBI will at least hike rates till the policy rates reach 5.15 percent (pre-pandemic level) and then take a view whether inflation and inflation expectations have been anchored or not. Continuing with our strategy, we shall remain invested in the shorter end of the yield curve to avoid volatility typically seen in a rising interest rate scenario.