Monetary Policy Review

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Summary - Stance and Rationale

- The Monetary Policy Committee (MPC) in its bi-monthly monetary policy review raised key policy repo rate by 35 bps to 6.25% with immediate effect. This was the fifth consecutive rate hike by the MPC in this fiscal. Five out of six members voted to increase the policy repo rate by 35 bps. With this rate hike, the repo rate has been raised by 225 bps since May 2022. The MPC also remained focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth. Four out of six members voted in favour of the same.
- According to MPC, inflation remained above the upper tolerance band of 6% since Jan 2022 while core inflation remained sticky at around 6%. Meanwhile, domestic economic activity remained upbeat and is expected to be resilient moving ahead on the back of domestic demand. Thus, MPC decided to raise the key policy repo rate by 35 bps as it was of the view that calibrated monetary policy action was required to break the stickiness of core inflation, contain second round effects and keep inflation expectations anchored which will boost the medium-term growth prospects of the domestic economy.

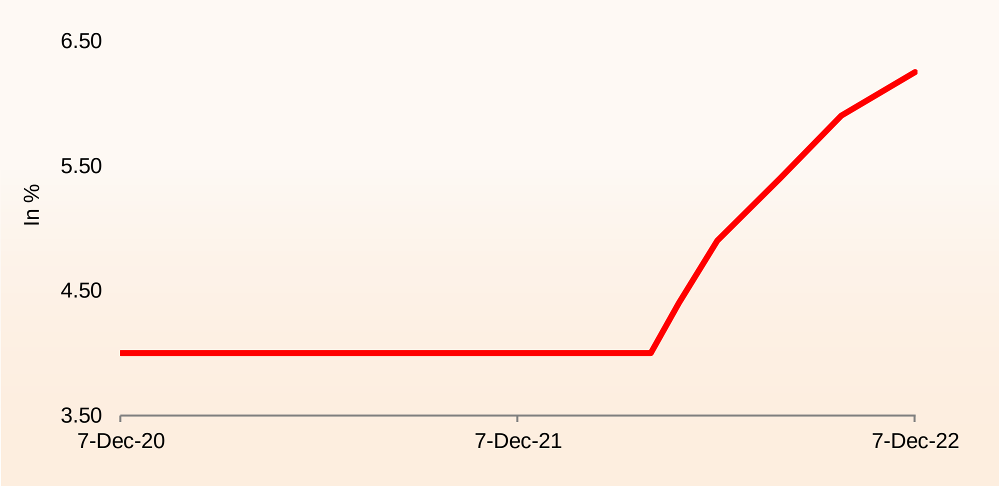
Inflation Outlook

- According to MPC, retail inflation moving ahead will be dictated by both domestic and global factors. Prices of vegetables may witness seasonal winter correction while prices of cereals and spices may remain elevated in the near-term on supply concerns. Milk price may also remain high due to high feed cost. Also, food prices may go up due to adverse climate events. On the global front, the food and energy prices outlook remain clouded with uncertainty due to weakening global demand, lingering geopolitical tensions and imported inflation risks emanating from the movement of the greenback. Core inflation may also remain sticky due to delayed pass-through of input costs despite correction in industrial input prices and supply chain pressures.
- MPC projected retail inflation at 6.7% for FY23. Retail inflation for Q3FY23 was projected at 6.6%, for Q4FY23 at 5.9%, for Q1FY24 at 5.0% and for Q2FY24 at 5.4%.

MPC outlook on Growth and Economy

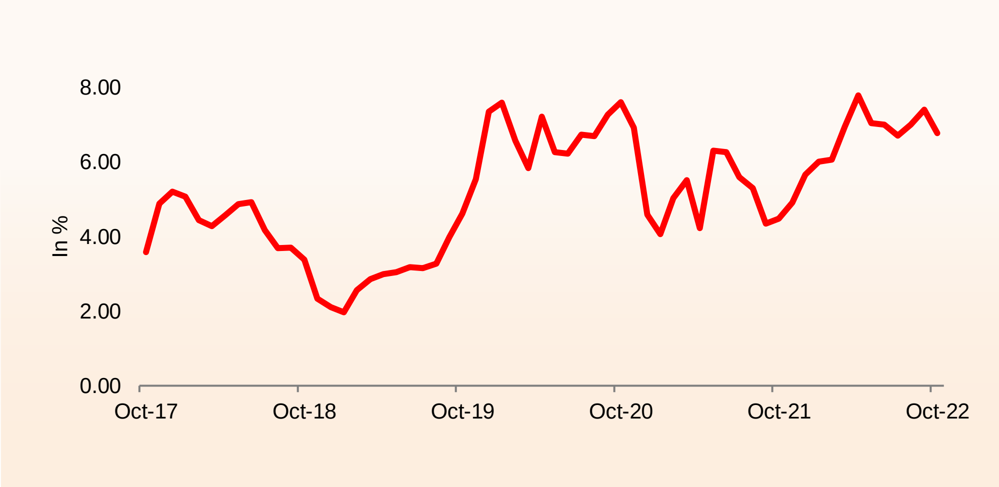
- According to MPC, the growth outlook for the agriculture sector has improved which can be attributed to a good rabi harvest. Economic activity rebounded sharply in contact-intensive sectors which in turn boosted urban consumption. The government's focus on infrastructure and capital spending coupled with a pickup in credit growth is expected to spur investment activity. Also, there are signs of improving consumer confidence. However, MPC warned that persisting geopolitical tensions, weakening global demand, and tightening global financial conditions may adversely impact the growth prospects of the domestic economy.
- Taking the above-mentioned aspects into consideration, MPC projected the real GDP growth for FY23 at 6.8%. Real GDP growth for Q3FY23 was projected at 4.4%, for Q4FY23 at 4.2%, for Q1FY24 at 7.1% and for Q2FY24 at 5.9%.

Key policy repo rate hiked by 35 bps to 6.25%



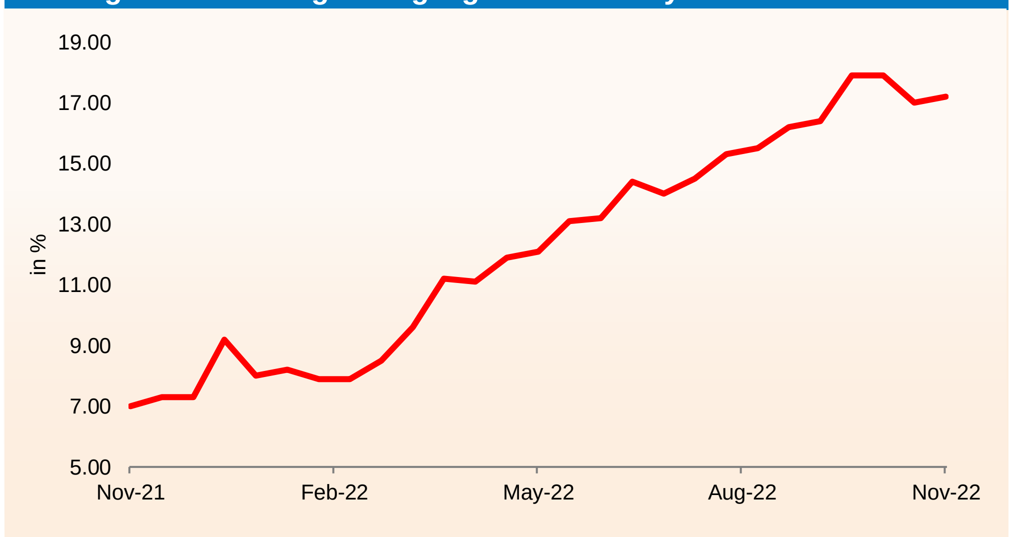
Source: Refinitiv

Retail inflation remained at elevated levels



Source: Refinitiv

Credit growth showing strong signs of recovery



Source: Refinitiv

Market Reactions

- Indian equity markets fell after the MPC raised key policy repo rate by 35 bps and lowered the domestic economic growth projection to 6.8% from the earlier estimate of 7% for the current fiscal. Key benchmark indices S&P BSE Sensex and Nifty 50 fell 0.34% and 0.44%, respectively.
- Bond yields rose for the fourth consecutive session after the MPC raised key policy repo rate by 35 bps and highlighted concerns over domestic inflationary pressures. Yield on the 10-year benchmark paper (7.26% GS 2032) rose 2 bps to close at 7.27% as compared to the previous close of 7.25%.

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