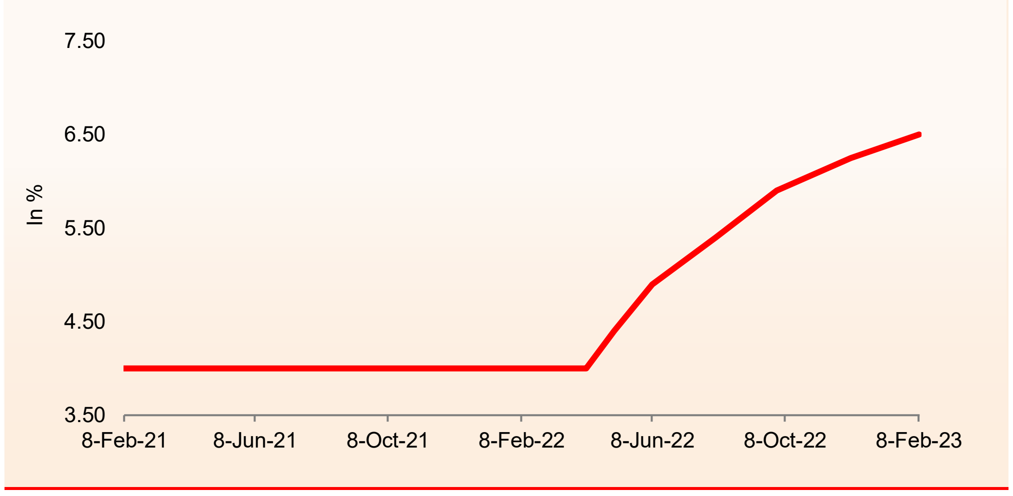
Summary - Stance and Rationale

- The Monetary Policy Committee (MPC) in its bi-monthly monetary policy review raised key policy repo rate by 25 bps to 6.50% with immediate effect. This was the sixth consecutive rate hike by the MPC in this fiscal. Four out of six members voted to increase the policy repo rate by 25 bps. With this rate hike, the repo rate has been raised by 250 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 remains a major risk to the outlook despite easing of inflation in the last two months. Easing of inflation was driven by strong deflation in vegetables, which may dissipate with the summer season uptick. Barring vegetables, headline inflation has been rising well above the upper tolerance band of 6% and may remain elevated, especially with high core inflation pressures. As a result, MPC decided to raise rates as it is necessary to break core inflation persistence and thereby strengthen medium-term growth prospects.

Key policy repo rate hiked by 25 bps to 6.50%

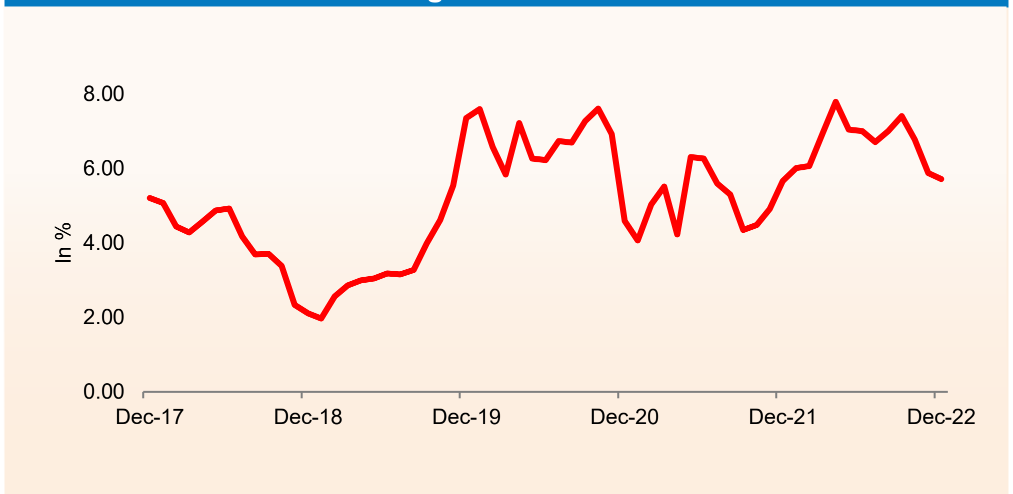


Source: Refinitiv

Inflation Outlook

- According to MPC, the outlook for inflation remained mixed. Although the rabi crop's prospects have improved, particularly for wheat and oilseeds, risks from adverse weather events still exist. The prognosis for global commodity prices, especially the price of crude oil, is impacted by risks associated with supply interruptions brought on by geopolitical tensions as well as concerns regarding demand prospects. Core inflation may continue to be under pressure from the continuous pass-through of input costs to output prices, particularly in the services sector. The enterprise surveys conducted by the Reserve Bank indicate a moderating of input cost and output price pressures in the manufacturing sector.
- MPC projected retail inflation at 6.5% for FY23 with Q4FY23 at 5.7%. On the assumption of a normal monsoon, inflation is projected at 5.3% for FY24, with Q1 at 5.0%, Q2 at 5.4%, Q3 at 5.4% and Q4 at 5.6%.

Inflation eased from its last high

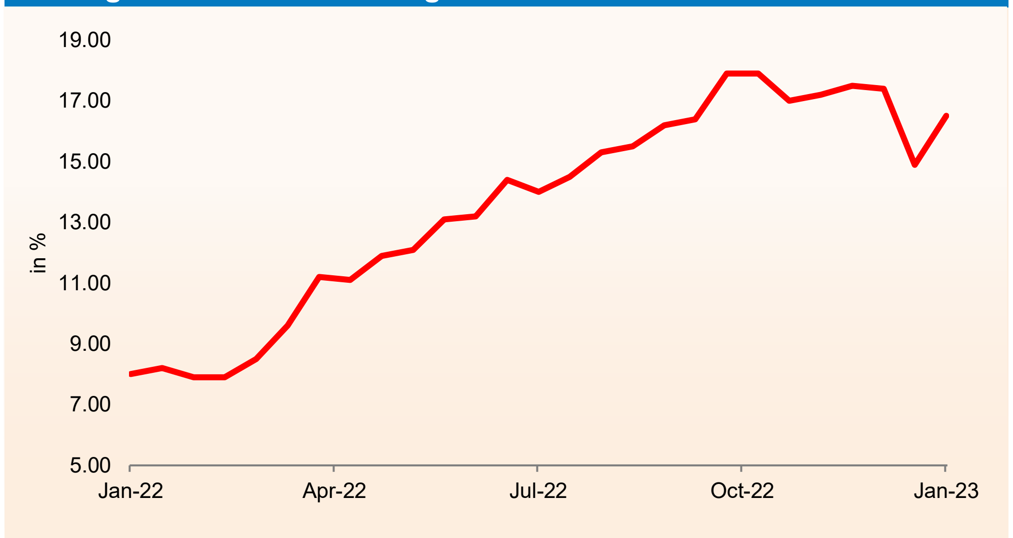


Source: Refinitiv

MPC outlook on Growth and Economy

- According to MPC, demand in rural areas is projected to increase due to the improved prospects for agriculture and related industries. Urban consumption is anticipated to be supported by the recovery in contact-intensive industries and discretionary spending. According to a Reserve Bank survey, individuals and businesses are upbeat about the future. A favourable climate for investment is produced by strong credit growth, stable financial markets, and the government's ongoing emphasis on infrastructure and capital spending. On the other hand, a slowdown in global activity is expected to have a negative impact on exports by denting foreign demand.
- Taking the above-mentioned aspects into consideration, MPC projected the real GDP growth for FY24 at 6.4% with Q1 at 7.8%, Q2 at 6.2%, Q3 at 6.0% and Q4 at 5.8%.

Credit growth remained strong



Source: Refinitiv

Market Reactions

- Indian equity markets rose after the MPC raised key policy repo rate by 25 bps, smaller than the previous rate hike, which was in line with market expectations. Key benchmark indices S&P BSE Sensex and Nifty 50 rose 0.63% and 0.85%, respectively.
- Bond yields rose after the MPC raised key policy repo rate by 25 bps but maintained its policy stance, which dampened sentiments. Yield on the 10-year benchmark paper (7.26% GS 2032) rose 3 bps to close at 7.34% as compared to the previous close of 7.31%.

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