RBI increases the Repo Rate by 50bps to 4.9% and sets out various developmental and regulatory policy measures

PHD Chamber Viewpoint

Hard lending from accommodative policy stance is disappointing as it will have an impact on costs of doing business and production possibilities. In its 3rd Monetary Policy Statement of FY 2023, Reserve Bank of India's MPC has decided to increase the policy repo rate by 50 bps to 4.90% and remain focused on withdrawal of accommodation so that inflation is maintained within the target while supporting growth.

Though RBI's decision to raise the repo rate is in synchrony with its efforts to tackle persistently heightened inflation, however it will impact India's economic growth due to dampened demand scenario and discouraged consumer and business sentiments. Any increase in the interest rate increases the costs of doing business, which are already high vis-a-vis high raw material costs amid geo-political distress.

On the back of lingering geo-political distress, which has made the inflationary pressures broad based, largely driven by supply shocks, RBI has increased the CPI projection to 6.7% for FY2023 as compared to previous projection of 5.7%, with inflation remaining near upper tolerance of 6% for first three quarters of this year.

It is encouraging to note that while the ongoing war is becoming a dampener for global trade and growth, Indian economy remains resilient with strong macroeconomic buffers. RBI has retained the GDP growth projections at 7.2% for FY2023. Giving a big boost to the housing sector, RBI has revised the limits on individual home loans, given by urban and rural co-operative banks, upwards by more than 100% taking into account the rise in housing prices over the last decade.

Accordingly, the limits for Tier I /Tier II Primary (Urban) Co-operative Banks (UCBs) shall stand revised from ₹30 lakh/ ₹70 lakh to ₹60 lakh/ ₹140 lakh, respectively. As regards Rural Cooperative Banks (RCBs), the limits shall increase from ₹20 lakh to ₹50 lakh for RCBs with assessed net worth less than ₹100 crore; and from ₹30 lakh to ₹75 lakh for other RCBs.

It is highly appreciable that the RBI has permitted State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs) to extend finance to Commercial Real Estate – Residential Housing (CRE-RH) within the existing aggregate housing finance limit of 5% of their total assets. These measures will enhance the flow of credit to the housing sectors and cater to the growing needs of affordable housing.

- On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) at its meeting today (June 8, 2022) decided to:

- Increase the policy repo rate under the liquidity adjustment facility (LAF) by 50 basis points to 4.90 per cent with immediate effect. Consequently, the standing deposit facility (SDF) rate stands adjusted to 4.65 per cent and the marginal standing facility (MSF) rate and the Bank Rate to 5.15 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 mediumterm target for consumer price index (CPI) inflation of 4 per cent within a band of +/- 2 per cent, while supporting growth.

- According to the provisional estimates released by the National Statistical Office (NSO) on May 31, 2022, India's real gross domestic product (GDP) growth in 2021-22 was 8.7 per cent. This works out to 1.5 per cent above the pre-pandemic level (2019-20). In Q4:2021-22, real GDP growth decelerated to 4.1 per cent from 5.4 per cent in Q3, dragged down mainly by weakness in private consumption on the back of the Omicron wave.

- The recovery in domestic economic activity is gathering strength. Rural consumption should benefit from the likely normal south-west monsoon and the expected improvement in agricultural prospects. A rebound in contact-intensive services is likely to bolster urban consumption, going forward. Investment activity is expected to be supported by improving capacity utilisation, the government's capex push, and strengthening bank credit. Growth of merchandise and services exports is set to sustain the recent buoyancy. Spillovers from prolonged geopolitical tensions, elevated commodity prices, continued supply bottlenecks and tightening global financial conditions nevertheless weigh on the outlook. Taking all these factors into consideration, the real GDP growth projection for 2022-23 is retained at 7.2 per cent, with Q1 at 16.2 per cent; Q2 at 6.2 per cent; Q3 at 4.1 per cent; and Q4 at 4.0 per cent, with risks broadly balanced.

- Inflation risks flagged in the April and May resolutions of the MPC have materialised. The projections indicate that inflation is likely to remain above the upper tolerance level of 6 per cent through the first three quarters of 2022-23. Considerable uncertainty surrounds the inflation trajectory due to global growth risks and geopolitical tensions. The supply side measures taken by the government would help to alleviate some cost-push pressures. At the same time, however, the MPC notes that continuing shocks to food inflation could sustain pressures on headline inflation. Persisting inflationary pressures could set in motion second round effects on headline CPI. Hence, there is a need for calibrated monetary policy action to keep inflation expectations anchored and restrain the broadening of price pressures. Accordingly, the MPC decided to increase the policy repo rate by 50 basis points to 4.90 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.

Please find the attached documents on the same for your kind reference. Also, the detailed Report on Monetary Policy, June 2022 can be accessed at:
https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR3336416D60D22514022BC8C197A992D837C.PDF

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Warm Regards,

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