PHD Research Bureau
PHD Chamber of Commerce and Industry
PHD CHAMBER OF COMMERCE AND INDUSTRY

RBI increases the Repo Rate by 50bps to 5.4% and sets out developmental and regulatory policy measures

PHD Chamber Viewpoint

50 bps increase in policy repo rate by RBI is in line with the PHD Chamber's expectations as many economies are increasing the policy interest rates, however, it will have a significant impact on the costs of doing business, which are already high.

RBI's decision to raise the repo rate is in response to the headwinds being faced by Indian economy including high inflation, uneasy financial markets, foreign portfolio outflows, majorly caused by distress in the global economic situation.

The volatility in global financial markets is leading to imported inflation in India, however, CPI has eased in the recent two months but still remains uncomfortably high and above the RBI's target level. At this front, RBI has retained the CPI projection at 6.7% for FY2023, with inflation remaining near the upper tolerance of 6% for Q2 and Q3 of this financial year.

However, it is encouraging to note that on the back of India's strong and resilient fundamentals, the economy is expected to be amongst the fastest growing economies in the world, as per the projections of IMF in its recent forecast in July 2022. At this juncture, RBI has retained the GDP growth projections at 7.2% for FY2023, with Indian economy is expected to speedily emerge out of shadows of pandemic and geo-political effects.

Another reassuring message by RBI has been the greater resilience shown by India against the external shocks with significant improvement in the external debt to GDP ratio, net international investment position to GDP ratio, debt servicing ratio and sufficient foreign exchange reserves. This will boost the confidence of businesses and investors on the Indian economy.

It is highly appreciable that RBI strives to remain vigilant on the liquidity front and conduct two-way fine-tuning operations as and when warranted, depending on the evolving liquidity and financial conditions. This will certainly help the Indian financial system to remain on resilient side.

Going forward, any further increase in the repo rate will impact India's economic growth due to impact on demand scenario and consumer and business sentiments. It will further escalate the costs of doing business, which are already high vis-a-vis high raw material costs amid geo-political distress.

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) at its meeting today (August 5, 2022) decided to:

- Increase the policy repo rate under the liquidity adjustment facility (LAF) by 50 basis points to 5.40% with immediate effect.

- Consequently, the standing deposit facility (SDF) rate stands adjusted to 5.1% and the marginal standing facility (MSF) rate and the Bank Rate to 5.65%.

- 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 medium term target for consumer price index (CPI) inflation of 4% within a band of +/- 2%, while supporting growth.

Global Economy

Since the MPC's meeting in June 2022, the global economic and financial environment has deteriorated with the combined impact of monetary policy tightening across the world and the persisting war in Europe heightening risks of recession. Gripped by risk aversion, global financial markets have experienced surges of volatility and large sell-offs. The US dollar index soared to a two-decade high in July. Both advanced economies (AEs) and emerging market economies (EMEs) witnessed weakening of their currencies against the US dollar. EMEs are experiencing capital outflows and reserve losses which are exacerbating risks to their growth and financial stability.

Domestic Economy

Domestic economic activity remains resilient. As on August 4, 2022, the southwest monsoon rainfall was 6 per cent above the long period average (LPA). Kharif sowing is picking up. High frequency indicators of activity in the industrial and services sectors are holding up. Urban demand is strengthening while rural demand is gradually catching up. Merchandise exports recorded a growth of 24.5% during April-June 2022, with some moderation in July. Non-oil non-gold imports were robust, indicating strengthening domestic demand.

CPI inflation eased to 7.0% (year-on-year, y-o-y) during May-June 2022 from 7.8% in April, although it persists above the upper tolerance band. Food inflation has registered some moderation, especially with the softening of edible oil prices, and deepening deflation in pulses and eggs. Fuel inflation moved back to double digits in June primarily due to the rise in LPG and kerosene prices. While core inflation (i.e. CPI excluding food and fuel) moderated in May-June due to the full direct impact of the cut in excise duties on petrol and diesel pump prices, effected on May 22, 2022, it remains at elevated levels.

Outlook

Spillovers from geopolitical shocks are imparting considerable uncertainty to the inflation trajectory. More recently, food and metal prices have come off their peaks. International crude oil prices have eased in recent weeks but remain elevated and volatile on supply concerns even as the global demand outlook is weakening. The appreciation of the US dollar can feed into imported inflation pressures. Rising kharif sowing augurs well for the domestic food price outlook. The shortfall in paddy sowing, however, needs to be watched closely, although stocks of rice are well above the buffer norms.

Firms polled in the Reserve Bank's enterprise surveys expect input cost pressures to soften across sectors in H2. Cost pressures are, however, expected to get increasingly transmitted to output prices across manufacturing and services sectors. Taking into account these factors and on the assumption of a normal monsoon in 2022 and average crude oil price (Indian basket) of US$ 105 per barrel, the inflation projection is retained at 6.7% in 2022-23, with Q2 at 7.1%; Q3 at 6.4%; and Q4 at 5.8%, and risks evenly balanced. CPI inflation for Q1:2023-24 is projected at 5.0%.

On the outlook for growth, rural consumption is expected to benefit from the brightening agricultural prospects. The demand for contact-intensive services and the improvement in business and consumer sentiment should bolster discretionary spending and urban consumption. Investment activity is expected to get support from the government's capex push, improving bank credit and rising capacity utilisation.

Firms polled in the Reserve Bank's industrial outlook survey expect sequential expansion in production volumes and new orders in Q2:2022-23, which is likely to sustain through Q4. On the other hand, elevated risks emanating from protracted geopolitical tensions, the upsurge in global financial market volatility and tightening global financial conditions continue to weigh heavily on the outlook. Taking all these factors into consideration, the real GDP growth projection for 2022-23 is retained at 7.2%, with Q1 at 16.2%; Q2 at 6.2%; Q3 at 4.1%; and Q4 at 4.0%, and risks broadly balanced. Real GDP growth for Q1:2023-24 is projected at 6.7%.

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Please contact for any query related to this mail to Ms Shivani Mehrotra, Research Officer at shivani.mehrotra@phdcci.in, with a cc to Dr S P Sharma, Chief Economist | DSG at spsharma@phdcci.in and Ms Kritika Bhasin, Sr. Research Officer at kritika.bhasin@phdcci.in, PHD Chamber of Commerce & Industry.

Warm Regards,

Dr S P Sharma

Chief Economist | DSG
PHD Chamber of Commerce and Industry
PHD House, 4/2 Siri Institutional Area
August Kranti Marg, New Delhi-110016, India
Tel: +91 49545454
Fax: +91 11 26855450
Email: spsharma@phdcci.in
Website: www.phdcci.in
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PHD House, 4/2 Siri Institutional Area, August Kranti Marg, New Delhi - 110 016 (India) • Tel. : +91-11-2686 3801-04, 49545454, 49545400
Fax : +91-11-2685 5450, 49545451 • E-mail : phdcci@phdcci.in • Website : www.phdcci.in, CIN: U74899DL1951GAP001947

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