

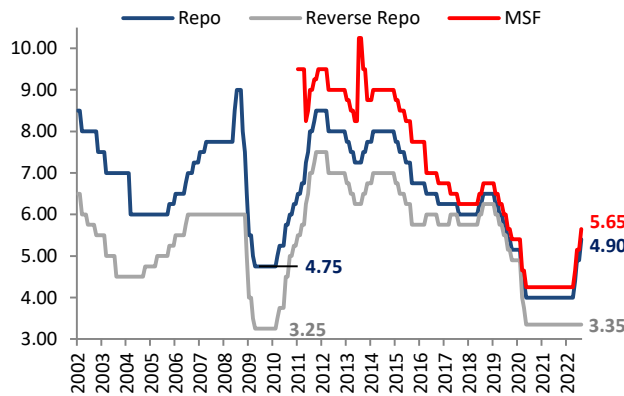
RBI hiked its policy rates by 50 bps (third hike since May-22 aggregating 140 bps) through a unanimous vote of the Monetary Policy Committee (MPC). Thus Repo, SDF & MSF rates stand at 5.40%, 5.15% and 5.65%, respectively. The MPC maintained its stance “remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth”. However, the stance was not unanimous as Prof. Jayanth R. Varma expressed his reservations. The fourth iteration of the projection of FY23 real GDP growth has left it unchanged at 7.2% (after Apr-22 downgrade of 60 bps) while inflation estimate too has been kept unchanged at 6.7% (with little alteration in the quarterly estimates). RBI also put out, Q1 FY24 GDP growth and inflation estimate at 6.7% and 5%, respectively. MPC also noted that “inflation is projected to remain above the upper tolerance level of 6 per cent through the first three quarters of 2022-23, entailing the risk of destabilising inflation expectations and triggering second round effects”.

Other measures:

- **CICs under Ombudsman:** It has been decided to bring Credit Information Companies (CICs) also under the ambit of the Reserve Bank-Integrated Ombudsman Scheme (RB-IOS) 2021. This will provide a cost free alternate redress mechanism to customers of REs for grievances against CICs. Further, with a view to strengthen the internal grievance redress of the CICs and to make it more efficient, it has also been decided to bring the CICs under the Internal Ombudsman (IO) framework.
- **Standalone PDs business scope:** The Standalone Primary Dealers (SPDs) have been permitted to undertake Foreign Currency Settled Overnight Indexed Swap (FCS-OIS) transactions directly with non-residents and other market-makers. Necessary directions will be issued shortly.
- **Committee on MIBOR Benchmark:** The Mumbai Interbank Outright Rate (MIBOR) based overnight indexed swap (OIS) contracts are the most widely used interest rate derivatives (IRDs) in the onshore market. The MIBOR benchmark rate, calculated based on call money deals executed on the NDS-call platform in the first hour after market opening, is based on a narrow window of transactions. Internationally, there has been a shift to alternate benchmark rates with wider participant bases (beyond banks) and higher liquidity. Amidst these developments, it is proposed to set up a committee to undertake an in-depth examination of the issues, including the need for transition to an alternate benchmark, and suggest the most appropriate way forwards.
- **Enabling BBPS to Process Cross-Border Inbound Bill Payments:** Bharat Bill Payment System (BBPS), owned and operated by NPCI Bharat BillPay Ltd. (NBBL), has transformed the bill payment experience in the country. BBPS offers an interoperable platform for standardised bill payment experience, centralised customer grievance redress mechanism, uniform customer convenience fee, etc. Over 20,000 billers have been onboarded on the system and more than eight crore transactions are processed on a monthly basis. BBPS is currently accessible only for residents in India. To facilitate Non-Resident Indians (NRIs) undertake utility, education and other bill payments on behalf of their families in India, it is proposed to enable BBPS to accept cross-border inward payments. This will also benefit payment of bills of any biller onboarded on the BBPS platform in an interoperable manner.

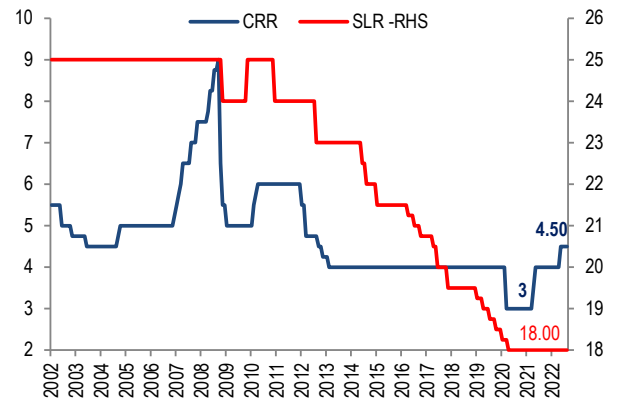
RBI raises rates second time by 50 bps with cumulative hike of 140 bps since May-22

Exhibit 1: RBI raised rates by 50 bps in Aug-22 policy



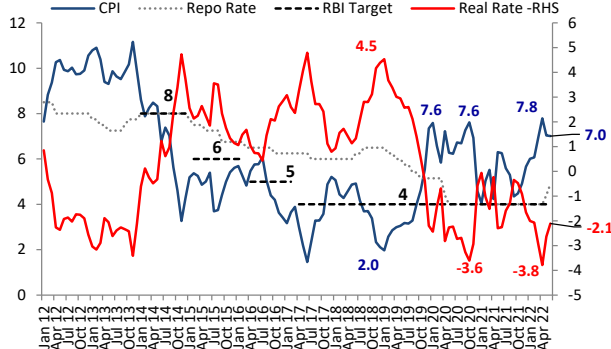
Source: RBI, ASKWA Research

Exhibit 2: No hike in CRR, SLR stable now



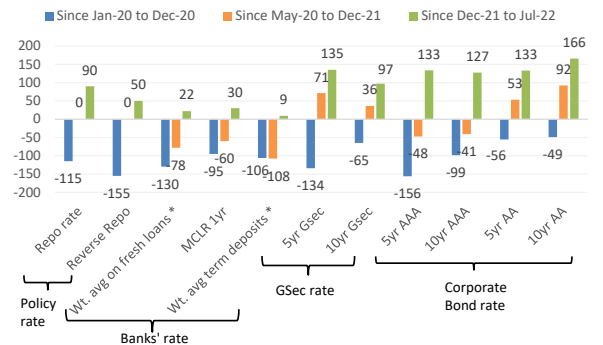
Real policy rate would still be negative; transmission of rate hikes typically slow in credit market

Exhibit 3: Inflation volatile; real Repo rate still stays deeply negative and is expected to stay so



Source: CMIE, RBI, ASKWA Research

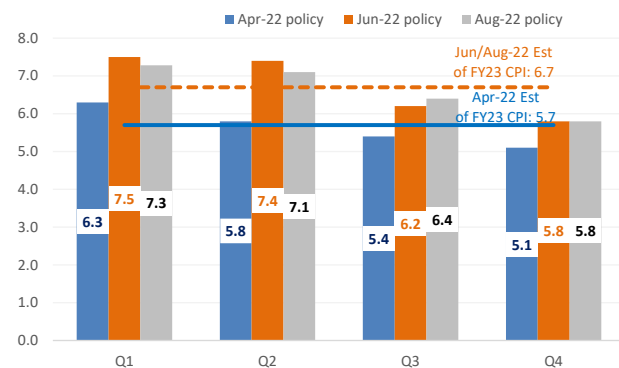
Exhibit 4: Credit market rates have started moving up slowly while G-sec reversed in 2021 itself



Source: CMIE, RBI, ASKWA Research

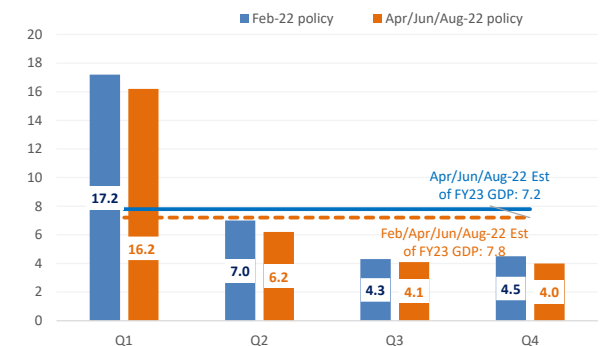
RBI growth-inflation estimates for FY23 stays broadly unchanged from the Jun-22 projections

Exhibit 5: FY23 CPI inflation forecast stays unchanged with some variation for quarterly estimates



Source: RBI, ASKWA Research

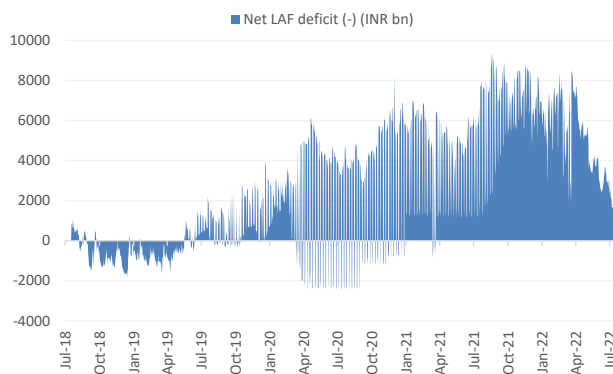
Exhibit 6: FY23 GDP growth forecast has been retained at the Feb-22 levels



Source: RBI, ASKWA Research

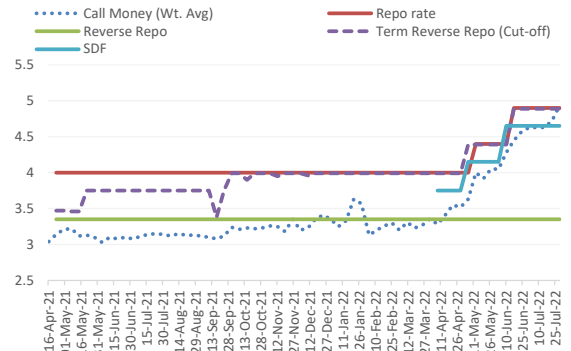
System liquidity moves towards neutral zone; money market rates have hit the upper end of the corridor

Exhibit 7: Liquidity surplus has come down to INR1-2 tn



Source: CMIE, RBI, ASKWA Research

Exhibit 8: Money market rates have hit upper corridor



Source: CMIE, RBI, ASKWA Research

A few considerations of RBI:

A few considerations seem to have guided RBI for the third rate hike amidst unchanged stance. Following are the highlights from the speech of RBI Governor.

Inflation: Consumer price inflation has eased from its surge in April but remains uncomfortably high and above the upper threshold of the target. Inflationary pressures are broad-based and core inflation remains at elevated levels. The volatility in global financial markets is impinging upon domestic financial markets, including the currency market, thereby leading to imported inflation. June 2022 was the sixth consecutive month when headline CPI inflation remained at or above the upper tolerance level of 6 per cent. Looking ahead, the inflation trajectory continues to be heavily contingent upon the evolving geopolitical developments, international commodity market dynamics, global financial market developments and the spatial and temporal distribution of the south-west monsoon. Household inflation expectations have eased, but they still remain elevated...The inflation trajectory is now poised at a decisive point. While there are incipient signs of a confluence of factors that could lead to further softening of domestic inflationary pressures, there remain significant uncertainties.

Growth: Domestic economic activity is exhibiting signs of broadening. On the demand side, indicators such as production of consumer durables, domestic air passenger traffic and sale of passenger vehicles suggest improvement in urban demand. Rural demand indicators, however, exhibited mixed signals – while two-wheeler sales increased, tractor sales contracted in June over a high base though. High frequency indicators of the services sector like railway freight traffic, port freight traffic, e-way bills, toll collections and commercial vehicle sales remained robust in June and July. Investment activity is also picking up – the production of capital goods recorded double-digit growth for the second month in a row in May and import of capital goods also witnessed robust growth in June. Capacity utilisation in the manufacturing sector is now above its long-run average, signalling the need for fresh investment activity in additional capacity creation.

Rationale for the decision:

With inflation expected to remain above the upper threshold in Q2 and Q3, the MPC stressed that sustained high inflation could destabilise inflation expectations and harm growth in the medium term. The MPC, therefore, judged that further calibrated withdrawal of monetary accommodation is warranted to keep inflation expectations anchored and contain the second-round effects. Accordingly, the MPC decided to increase the policy repo rate by 50 basis points to 5.4 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...In such a milieu, *with growth momentum expected to be resilient* despite headwinds from the external sector, monetary policy should persevere further in its stance of withdrawal of accommodation to ensure that inflation moves close to the target of 4.0 per cent over the medium term, while supporting growth (italics added).

Implication and outlook: The peak – So near yet so far

With inflation slated to stay above the upper threshold of 6% for three consecutive quarters as per the inflation targeting framework; MPC would be 'accountable for failure to establish and achieve the nominal anchor'. 'Failure' is defined as the inability to achieve the inflation target of 4% (+/-2%) for three successive quarters. 'Such failure will require the MPC to issue a public statement, signed by each member, stating the reason(s) for failure, remedial actions proposed, and the likely period of time over which inflation will return to the centre of the inflation target zone'. Thus RBI needed to act in view of the inflation staying stubbornly above its tolerance limit for more than the tolerable period as prescribe by the Inflation Targetting framework. RBI also needed to match steps with US FED to maintain the interest rate parity especially at a time when capital inflows has been weak. Thus, rate hike was an imperative both from domestic and external considerations.

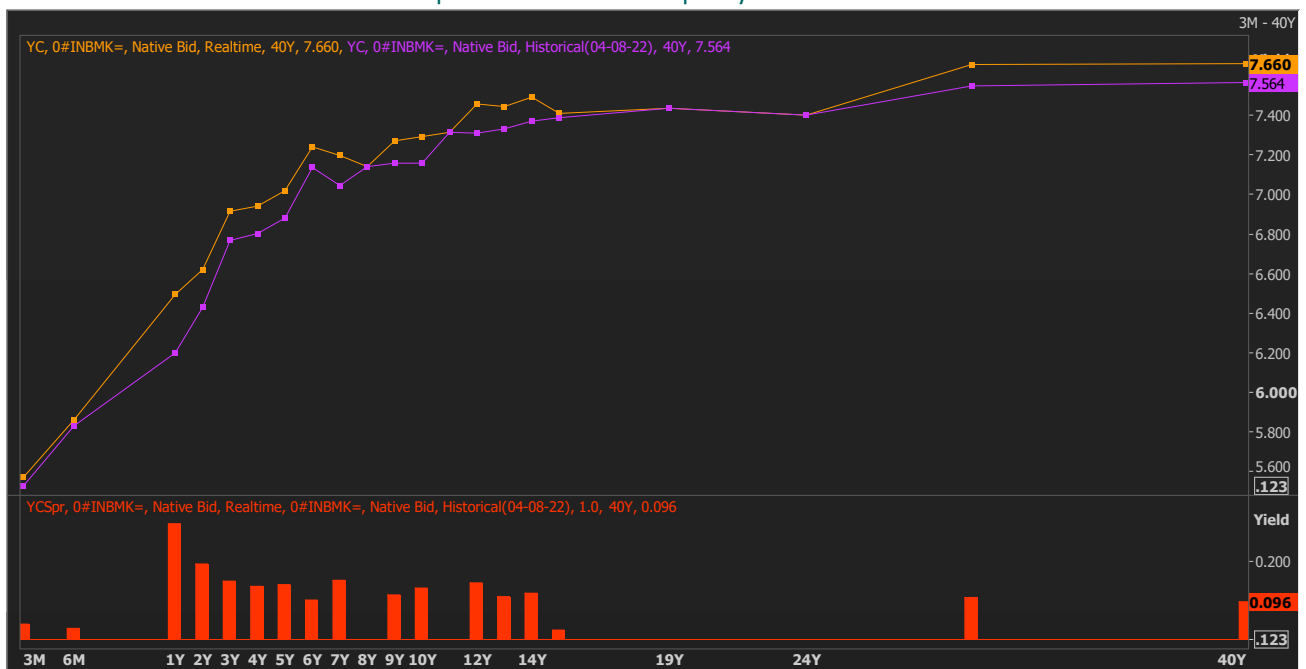
Bond market that has seen a surprise rally recently, witnessed a spike in yields (15 bps for 10yr benchmark) today as the magnitude of rate hike was broadly expected to be of 35 bps than the 50 bps effected while the general tone of the policy too were found more hawkish than expected. US bond yields too witnessed a spike today of similar magnitude on better than expected jobs data. Thus, it is possible that the recent bond market rally seen in the two geographies would be unwounded and look for new direction from this month's inflation print.

With credit growth picking up (14% as reported in the current policy), heavy borrowing programme yet on the pipeline, a more investment oriented growth process and weakened balance of payments position - its only a matter of time that the liquidity window turns into deficit mode. This would put an upward thrust to the bond yields providing more policy space for RBI to hike rates without impinging market expectations. In short while we have covered quite a distance, we are not near the end of the rate hike cycle yet. These boundaries set the peak rate expectations close to 6 – 6.25% for RBI Repo rate and 8 – 8.25% for 10yr benchmark rate in the current cycle on a ceteris paribus assumption.

In terms of fixed income strategy, we continue to see enormous value accruing in the 4-6 year tenor. Investors with a 3-year horizon should be looking at this tenor to make investments in the hi grade space. Yields with potential of MTM gains as rates are expected to be in a down-cycle from these levels at least once in the next 3 years.

Clearly the RBI policy was NOT in the price for bond market

Exhibit 9: Yield curve shifted further up as a reaction to RBI policy



Source: Refinitiv, ASKWA Research

Ends

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