CIO Memo

April 6, 2023

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India: RBI pauses at 6.50%, likely end to hiking cycle

Key takeaways

- The Reserve Bank of India (RBI) paused in its hiking cycle, while keeping the stance of 'withdrawal of accommodation' unchanged.
- Markets reacted positively to this decision across the board with bonds, equities and currency appreciating.
- With rate hikes largely ruled out – other than on any major inflation shocks – accrual yields offer good opportunities for fixed income investments.

1. What happened?

The Reserve Bank of India Governor, Shaktikanta Das surprised economists by pausing repo rate hikes, and staying put at 6.50%. He however mentioned explicitly that the pause was for this decision only, and that the RBI is ready to act if the situation warrants. The Standing Deposit Facility Rate (SFDR) stays at 6.25% and the Bank Rate at 6.75%.

The Monetary Policy Committee (MPC) voted unanimously in favour of the decision. The policy stance though remained unchanged at 'withdrawal of accommodation'. With total repo rate hikes of 250 bps since May 2022, and call money hikes of 300 bps, the RBI is focusing on transmission and the economic impact of these increases.

The GDP growth forecast was broadly unchanged for the financial year ending March 2024 at 6.5% (previous meeting 6.4%), with strong domestic growth trends being cited as the reason. The Consumer Price Inflation (CPI) target for FY23-24 was lowered marginally to 5.2%, down from 5.3% in the previous communication. Quarterly projections were made, all in the range of 5.1%-5.4%.

The MPC kept its cautionary stance on inflation, citing global headwinds (crude oil production cuts) and financial stability concerns. Tighter financial conditions were also mentioned, which could result in weakening external demand and volatile capital flows.

In a major reform, RBI allowed banks to develop an onshore NDF (non-deliverable forward) market in INR, which was hitherto dominated by offshore financial centres. This will allow deepening of the forex market.

Credit limits were allowed on the Unified Payments Interface (UPI), along with linkage to deposit accounts.

2. How did markets react?

Markets reacted positively to this surprise pause from the RBI. Bond yields fell across the curve. The 10-year benchmark yield fell 6 bps to 7.21%, the 5 year fell by 10 bps to 7.04% and the 3 year fell 13 bps to 6.94%.

The INR appreciated slightly to 81.96 vs. the USD, on a day when most Asian currencies were trading weaker.

Equity markets were up as well, with the NIFTY 50 Index up +0.24%, while the financial benchmark Bank NIFTY Index gave up mid-day gains of up to 0.67% towards the close.

3. What does it mean for investors?

The pause declared at this meeting was alluded to concerns on global financial stability by the Governor. While it was not expected by consensus, rate traders in fixed income markets were already betting on this. Thus, the reaction at the short end of the curve was more pronounced than at the longer end, bull-steepening the yield curve.

However, the RBI has kept its options open, and called this pause only for this meeting. This would be contingent on inflation shocks which may occur on geopolitical risks (e.g. crude prices), weather adversities or other major central bank actions.

CPI projections at 5.2% were brought down marginally and seem to be more a result of higher base effects than any significant cooling in prices. Disinflation is expected to be gradual and protracted. But with CPI in the 5.1-5.4% range, real interest rates will be positive by 1.3% and will be an attraction for investors to move into this asset class.

Even though the RBI is prepared to act in the event that inflation rears its ugly head again, the focus seems evenly balanced on growth in this policy. With general elections in India coming up in about 12 months, keeping growth engines running and not hampering their trajectory by excessive rate hikes are also priorities and will be welcomed by the Government.

With rate hikes largely ruled out in this cycle, locking in yields at current levels appears to be an attractive option for investors. We continue to recommend locking in investments with a 3 to 5 year horizon in the government securities space.

Glossary

The Bank rate is the rate at which RBI lends money to banks without any security.

The Bank NIFTY includes the biggest-capitalised and most liquid Indian banking stocks.

The consumer price index (CPI) measures the price of a basket of products and services that is based on the typical consumption of a private household.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

The Indian rupee (INR) is the currency of India.

MPC stands for Monetary Policy Committee.

A non-deliverable forward (NDF) is a currency derivatives contract to exchange cash flows between the NDF and prevailing spot rates.

The NIFTY 50 Index is a benchmark Indian equity index representing the weighted average of 50 stocks over 12 sectors.

When Nominal Interest Rate is adjusted for Inflation, that refers to the Real Interest rate.

The Repo rate is the interest rate at which commercial banks can borrow money from the RBI

The Reserve Bank of India (RBI) is India's central bank and regulatory body under the jurisdiction of the Government of India.

The Standing Deposit Facility Rate (SFDR) is used as a policy tool to encourage overnight deposits by banks at the RBI.

Unified Payments Interface (UPI) is an instant real-time payment system developed by National Payments Corporation of India.

USD is the currency code for the U.S. Dollar.

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