

RBI Monetary Policy and Market Outlook

Policy Action

- Monetary Policy Committee (MPC) increased the policy repo rate by 35 basis points to 6.25%.
- The MPC also decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

Global Economy

December 2022

According to RBI, the global economic outlook has been deteriorating. Due to interest rate hikes by major countries global growth is set to weaken. Inflation remains elevated and persistent across countries as they grapple with food and energy price shocks and shortages.

However, there are some signs of moderation in food and commodity prices, which have raised expectations of an easing in the pace of interest rate hikes. Alongside easing in sovereign bond yields, the US dollar has come off its highs. Capital flows to emerging market economies remain volatile and global fund flows pose risks to growth prospects.



Gajendra M,
Fund Manager,
Portfolio Management Services.

Indian Economy: Indian economic activity is exhibiting resilience. In the agricultural sector, a pick-up in rabi crop is supported by the good progress of the north-east monsoon and above average reservoir levels. Activity in the industry and services sectors is in expansion mode.

Aggregate demand conditions have been supported by pent-up spending and discretionary expenditures during the festival season. Urban demand has remained buoyant, and rural demand is recovering.

Inflation: CPI inflation moderated to 6.8% in October 2022 from 7.4% in September. Food and Fuel registered some easing in October.

Market Outlook

MPC has assumed an average crude oil price of US\$ 100 per barrel. Inflation is projected at 6.7% in 2022-23. CPI inflation for Q1:2023-24 is projected at 5.0% and for Q2 at 5.4% on the assumption of a normal monsoon. Inflation has ruled at or above the upper tolerance band of 6% since January 2022 and core inflation is persisting around 6%. CPI is expected to moderate going forward but remain above 5% for some time.

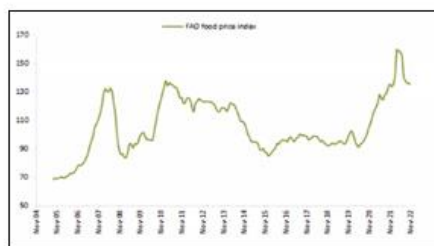
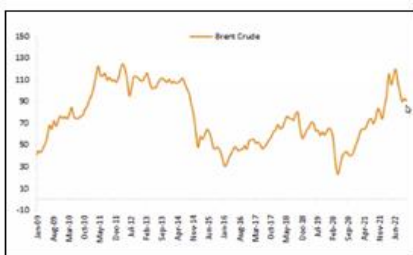
The agricultural outlook has brightened. Banking sectors robust and broad-based credit growth and government's thrust on capital spending and infrastructure should bolster investment activity. According to the RBI's survey, consumer confidence is improving. The economy, however, faces headwinds from geopolitical tensions, tightening global financial conditions (fund flows) and slowing external demand.

Taking all these factors into consideration, GDP growth for 2022-23 is projected at 6.8%. GDP growth is projected at 7.1% for Q1:2023-24 and at 5.9% for Q2.

RBI Guidance: MPC is of the view that, further rate hike is warranted to keep inflation expectations anchored, so as to strengthen medium-term growth prospects.

What should investors do?

RBI has hiked interest rate by 225 basis points (2.25%) in 2023. Our view is that RBI will hike by another 25 bps in the next policy, only if commodity prices especially crude oil prices is elevated. But with food and commodity prices cooling off (see charts below) recently, RBI may consider to pause interest rates as data would be supportive going forward.



I believe 10-year G-sec would trade between 7.00%-7.50% until the budget scheduled on 1st Feb 2023. Investors are advised to gradually add duration assets or long term G-sec / State Government Securities (SGS/SDL) in the next 2-4 months.

As the global economy is entering into a slow or anaemic growth going forward, India's GDP would also slow down as we are integrated with the global markets. Very soon, major central banks including India would shift focus towards growth once the inflation comes under control. However, rising US bond yields, stubborn core inflation and India's trade imbalances could pose as significant risk factors to bond investors going forward.
