ICICI direct Research

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# Rate hike in line with expectation; inflation projection retained…

**Repo rate…………………………………………………………Increased to 5.9%**

**CRR……………………………………………………………Unchanged at 4.5%**

The Reserve Bank of India (RBI) increased its repo rate by 50 bps to 5.9% with immediate effect. Accordingly, the SDF and MSF rate were adjusted to 5.65% and 6.15%, respectively. Five out of six members of the MPC voted to increase the repo rate by 50 bps while one member voted to increase the repo rate by 35 bps. Similarly, five out of six members voted to remain focused on withdrawal of accommodation to ensure that inflation remains within the target while supporting growth.

According to the RBI, inflation is likely to be above the upper tolerance level of 6% through the first three quarters of FY23, with core inflation remaining high. The outlook is tense with considerable uncertainty, given the volatile geopolitical situation, global financial market volatility and supply disruptions. Meanwhile, domestic economic activity is holding up well and is expected to be buoyant in H2FY23, supported by festive season demand amid consumer and business optimism. The MPC is of the view that further calibrated monetary policy action is warranted to keep inflation expectations anchored, restrain the broadening of price pressures and pre-empt second round effects. The RBI feels that the action will support medium-term growth prospects. Taking into account these factors and an average crude oil price (Indian basket) of US$100/barrel, inflation is projected at 6.7% in FY23, with Q2FY23 at 7.1%; Q3FY23 at 6.5%; and Q4FY23 at 5.8% and risks evenly balanced. CPI inflation for Q1FY24 is projected at 5.0%.

## View

The rate hike by the RBI by 50 bps was on expected lines and even the borrowing calendar was largely as per market expectations. Bond yields moved higher by around 5 bps as an initial market reaction but the overall movement was largely well behaved.

Globally, the epicentre of the recent sharp fall in equity markets, including India, is the global bond market. During the week, US 10-year bond yield crossed the 4.0% mark for the first time in 12 years reacting to previous week's rate hike and hawkish commentary by US Federal Reserve. Rising expectations of higher terminal rate in the US from less than 4.0% to 4.5-4.75% in the last one week has led to a current further sell-off in bonds. US 10-year yield had risen sharply from 3.5% at the start of the week but saw some moderation in the later part of the week towards 3.85% as BoE announced emergency measures to buy government bonds. Yields have now moved up around 1.5% in the last two months from 2.5% in the first week of August 2022 to 4.0% this week. Bond buying measures by a few other central bankers/governments similar to BoE may not be ruled out as implications of a sharp rise in yields are grave, ranging from general investment losses to systematic risk for select sectors (insurance companies) to higher cost of funds leading to unsustainable business, etc.

Indian bond yields have also seen some pressure with 10-year bond yield moving up from 7.1% (second week of September) to 7.35% currently. However, news flows surrounding inclusion of Indian G-Secs in global bond indices dominated the yield movement. While the global bond index inclusion has been deferred to early next year, investors seem confident that it is a matter of when and not whether the same will happen or not. Overall, just like equities, Indian bond markets have also outperformed global bond markets in terms of stemming the sell-off.

RBI Action

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## RBI development, regulatory measures – Key points

### Discussion paper on expected loss (EL) based approach for loan loss provisioning

Banks currently follow the incurred loss approach for provisioning on their loan assets whereby provisions on loan assets are made after the stress has materialised. A more prudent and forward looking approach is the expected loss based approach, which requires banks to make provisions based on an assessment of probable losses. As a step towards converging with globally accepted prudential norms, RBI will issue a discussion paper on the proposed transition for stakeholder comments.

### Discussion paper on Securitisation of Stressed Assets Framework (SSAF)

The revised framework for securitisation of standard assets was issued by the RBI in September 2021. It has now been decided to introduce a framework for securitisation of stressed assets. This will provide an alternative mechanism for securitisation of NPAs in addition to the existing ARC route. A discussion paper (DP) on the proposed framework is being issued for feedback from stakeholders.

### Regulating offline payment aggregators

Online payment aggregators (PAs) have been brought under the purview of RBI regulations since March 2020. It is now proposed to extend these regulations to offline PAs, who handle proximity/face-to-face transactions. This measure is expected to bring in regulatory synergy and convergence on data standards.

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