5 August 2022

RBI hikes repo rate for third time in a row, to fight inflation

RBI's Stance → Withdrawal of Accommodation

Key Highlights

- **Unanimously hiked Repo Rate by 50 bps to 5.40%.**
- Cash reserve ratio **(CRR) kept unchanged at 4.50%.**
- The MPC voted on **"withdrawal of accommodation"** to ensure that inflation remains within the target going forward, while supporting growth; however, this decision was not unanimously.
- **Inflation** projection for FY23 retained at **6.7%.**
- **Growth** projection maintained at **7.2%** for FY23.
- While the **bond market** reacted negatively on a rather hawkish stance by MPC; the **equity markets** remained flat.

Policy Rates / Reserve Ratio	8 Jun '22	5 Aug '22	Status
CRR	4.50%	4.50%	↔
SLR	18.00%	18.00%	↔
SDF	4.65%	5.15%	↑
Repo Rate	4.90%	5.40%	↑
MSF	5.15%	5.65%	↑
Bank rate	5.15%	5.65%	↑
Fixed Reverse Repo Rate	3.35%	3.35%	↔

In a scheduled policy meeting held from **August 3 to 5** amid inflation peaking out, the MPC **unanimously announced a repo rate hike of 50 bps to 5.40%**. Consequently, the standing deposit facility (SDF) rate stands adjusted to 5.15%; and the marginal standing facility (MSF) rate and the Bank Rate to 5.65%. The MPC **voted** on **"withdrawal of accommodation"** to ensure that inflation remains within the target going forward, while supporting growth; however, this decision was not unanimously.

The background

Repo Rate hike & Stance: When the pandemic struck the world in March 2020, the monetary policy had shifted gears to an **ultra-accommodative mode**, with a large reduction of **75 bps** in the policy repo rate on **March 27, 2020** followed by another reduction of **40 bps on May 22, 2020**. Accordingly, the decision of the MPC to raise the policy repo rate by 40 bps in the off-cycle policy meet on 4 May and by 50 bps each in June and August, **keeping in line with the announced stance of withdrawal of accommodation set out in April 2022 is now above the pre-pandemic level of 5.15%.**

Liquidity: In April the RBI introduced the **Standing Deposit Facility (SDF)** as the floor of the **liquidity adjustment facility (LAF)** corridor thus raising the LAF by 40 bps; along with the policy repo rate hikes in May and June, have effectively resulted in withdrawal of accommodation by 130 bps.

Surplus liquidity in the banking system, as reflected in average daily absorptions under the LAF (both SDF and variable rate reverse repo auctions), **moderated to Rs. 3.8 lakh crore during June-July 2022** from Rs. 6.7 lakh crore during April-May.

Growth Outlook

- The **south-west monsoon rainfall and reservoir levels are above normal**; kharif sowing is progressing well, although it is marginally below last year's level due to uneven rainfall distribution.
- **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.

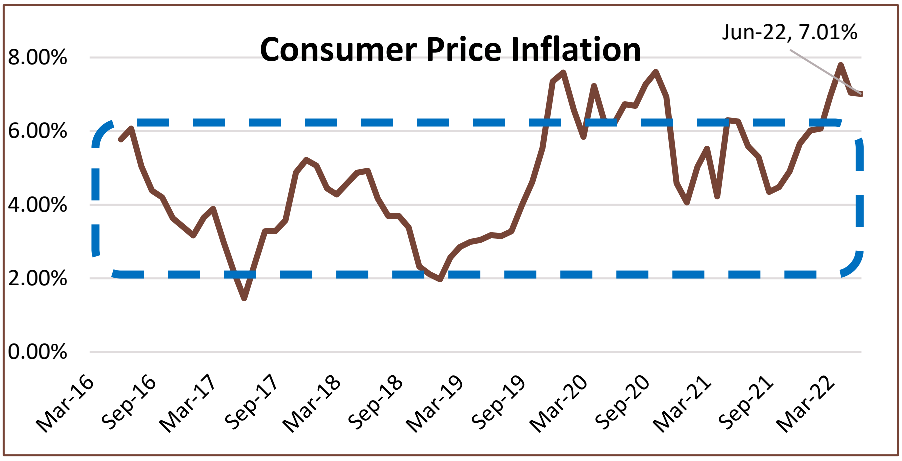
- **High frequency indicators of the services sector** like railway freight traffic, port freight traffic, e-way bills, toll collections and commercial vehicle sales remained robust in June and July. **PMI** manufacturing rose to an 8-month high in July and PMI services indicated continued expansion in July. **Capacity utilisation** in the manufacturing sector is now above its long-run average, signalling the need for fresh investment activity in additional capacity creation. **Bank credit** growth has accelerated to 14.0% (y-o-y) as on July 15, 2022 from 5.4% a year ago.

Period	FY23	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24
Growth Projection	**7.2%**	16.2%	6.2%	4.1%	4.0%	6.7%

Inflation Outlook

- The CPI headline inflation in June cooled down to 7.0%. It was the **sixth consecutive month when inflation touched or was above the upper tolerance level of 6.0%.**

- The **global geopolitical situation remains fluid** and however now commodity markets has softened particularly in prices of industrial metals and some softening in global food prices; thus, now **inflation trajectory is now poised at a decisive point.**



Source: RBI DBIE

- The below data assumes a **normal monsoon in 2022** and average **crude oil price (Indian basket) of US$ 105 per barrel.**

Period	FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24
Inflation Projection	**6.7%**	7.1%	6.4%	5.8%	5.0%

Conclusion

While the bond market reacted negatively on a rather hawkish stance by MPC; the equity markets remained flat. The 10-year India Government bond yields rose from 7.16.% close of 4 Aug 2022 to a day high of 7.32% when the policy was announced and to close at 7.30%, while the Nifty 50 closed marginally higher by 0.09% from a day's high of 17,469 when the policy was announced.

With the RBI stance of **taking out excess liquidity from the system directly through CRR hike and interest rate hike initiated in the economy** we continue to maintain our stance of **investing in shorter end of the curve through mutual fund** categories like **Low Duration / Floating Rate Funds** till the time rates stabilize.

For **longer term investments Short Term Funds / Corporate Bond Funds** & **Target Maturity Funds** continue to be our preferred categories. Along with MF good quality **Corporate Fixed Deposits and Bonds** can be looked at allocation in the debt portfolio for diversification and enhancing overall return.

5 August 2022

Disclaimer

Tata Capital Financial Services Limited ("TCFSL") is registered with The Association of Mutual Funds in India as a Mutual Fund Distributor bearing ARN No.84894 and Tata Capital Wealth is a service offering by TCFSL.

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. TCFSL is not soliciting any action based upon it. Nothing in this report shall be construed as a solicitation to buy or sell any security or product, or to engage in or refrain from engaging in any such transaction. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of the reader.

This report has been prepared for the general use of the clients of the TCFSL and must not be copied, either in whole or in part, or distributed or redistributed to any other person in any form. If you are not the intended recipient, you must not use or disclose the information in this report in any way. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. TCFSL will not treat recipients as customers by virtue of their receiving this report. Neither this document nor any copy of it may be taken or transmitted into the United States (to US Persons), Canada or Japan or distributed, directly or indirectly, in the United States or Canada or distributed, or redistributed in Japan to any residents thereof. The distribution of this document in other jurisdictions may be restricted by the law applicable in the relevant jurisdictions and persons into whose possession this document comes should inform themselves about, and observe any such restrictions.

It is confirmed that, the author of this report has not received any compensation from the companies mentioned in the report in the preceding 12 months. No part of the compensation of the report creator was, is, or will be directly or indirectly related to the inclusion of specific recommendations or views in this report The author, principally responsible for the preparation of this report, receives compensation based on overall revenues of TCFSL and TCFSL has taken reasonable care to achieve and maintain independence and objectivity in making any recommendations.

Neither TCFSL nor its directors, employees, agents, representatives shall be liable for any damages whether direct or indirect, incidental, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information contained in this report. The report is based upon information obtained from sources believed to be reliable, but TCFSL does not make any representation or warranty that it is accurate, complete or up to date and it should not be relied upon as such. It does not have any obligation to correct or update the information or opinions in it. TCFSL or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. TCFSL or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations. This information is subject to change without any prior notice. TCFSL reserves at its absolute discretion the right to make or refrain from making modifications and alterations to this statement from time to time. Nevertheless, TCFSL is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.

Certain products -including those involving futures, options and other derivatives as well as non-investment grade securities - involve substantial risk and are not suitable for all investors. Reports based on technical analysis centers on studying charts of a stock's price movement and trading volume, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals.

Before making an investment decision on the basis of this report, the reader needs to consider, with or without the assistance of an adviser, whether the advice is appropriate in light of their particular investment needs, objectives and financial circumstances. There are risks involved in securities trading. The price of securities can and does fluctuate, and an individual security may even become valueless. International investors are reminded of the additional risks inherent in international investments, such as currency fluctuations and international stock market or economic conditions, which may adversely affect the value of the investment. Neither TCFSL nor the director or the employee of TCFSL accepts any liability whatsoever for any direct, indirect, consequential or other loss arising from any use of this report and/or further communication in relation to this report.

We and our affiliates, officers, directors, and employees worldwide may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions.

Investments in securities are subject to market risk; please read the SEBI prescribed Combined Risk Disclosure Document prior to investing. Derivatives are a sophisticated investment device. The investor is requested to take into consideration all the risk factors before actually trading in derivative contracts. Our report should not be considered as an advertisement or advice, professional or otherwise.

General Disclosure

Tata Capital Financial Services Limited ("TCFSL") is registered with the Reserve Bank of India as a Non Deposit Accepting Systemically Important Non-Banking Finance Company ("NBFC-ND-SI").

Tata Capital Financial Services Limited ("TCFSL") bearing License no. CA0076 valid till 31st Mar 2022, acts as a composite Corporate Agent for TATA AIA Life Insurance Company Limited, HDFC Life Insurance Company Limited, TATA AIG General Insurance Company Limited and New India Assurance Company Limited. Please note that, TCFSL does not underwrite the risk or act as an insurer. For more details on the risk factors, terms & conditions please read sales brochure carefully of the Insurance Company before concluding the sale. Participation to buy insurance is purely voluntary.

TCFSL is also engaged in Mutual Fund Distribution business and is registered with The Association of Mutual Funds in India ("AMFI") bearing ARN No. 84894 and Tata Capital Wealth is a service offering by TCFSL. Please note that all Mutual Fund Investments are subject to market risks, read all scheme related documents carefully before investing for full understanding and details.

TCFSL distributes:

(a) Mutual Fund Schemes of TATA Mutual Fund
(b) Life Insurance Policies of Tata AIA Life Insurance Company Limited
(c) General Insurance Policies of TATA AIG General Insurance Company Limited

TCFSL receives commission ranging from 0.00% to 2.00% p.a. from the Asset Management Companies ("AMC") towards investments in mutual funds made through TCFSL. TCFSL receives commission ranging from 0.00% to 40.00% as First year commission and renewal commission ranging from 0.00% to 5.00% on Life Insurance Policies bought through TCFSL. TCFSL receives commission ranging from 0.00% to 25.00% on General Insurance Policies bought through TCFSL. TCFSL receives commission ranging from 0.00% to 2.00% on Corporate Fixed deposit made through TCFSL.

Please note that the above commission may change from time to time and are exclusive of statutory levies like GST, Security Transaction tax, Stamp Duty, Exchange transaction charges, SEBI turnover fee etc. TCFSL does not recommend any transaction which is required to be dealt with on a Principal to Principal basis.

Registered office: 11th Floor, Tower A, Peninsula Business Park, Ganpatrao Kadam Marg, Lower Parel, Mumbai 400 013, India.