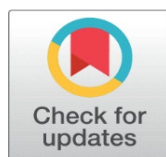# RBI'S INTEREST RATE HIKES AND INFLATION CONTROL: ANALYZING THE REPO RATE MOVEMENTS FROM 2022 TO 2023

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ABSTRACT

Unlike the usual, this April 2023, The Reserve Bank of India kept its repo rate at 6.5 %, this was right after making six hikes at a stretch, resisting market projections for a 25-basis point rate hike. The effect of the recent financial turbulence was closely monitored by the body.

It was stated by policymakers that they were still focused on accommodation withdrawal, thus more tightening was possible.

Rate increases were put on hold only for this conference. From May 2022, the RBI increased rates by a total of 250 basis points, bringing borrowing costs up to levels seen in January 2019. The board also reduced its inflation forecast to 5.2% from 5.3% and increased its growth estimate to 6.5% from 6.4% for the fiscal year that begins in April. This article examines the Reserve Bank of India's recent interest rate increases in the perspective of reducing inflation.

Keywords: RBI, Repo Rate, Inflation Control, Monetary Policy, Borrowing Costs, Economic Growth, Central Bank Policy, Inflation Forecast

1. INTRODUCTION

The Reserve Bank of India in April 2023 kept the repo rate steady, keeping the key benchmark interest rate at 6.5 percent, adding that it would not hesitate to act in the future if the situation warranted. The central bank has raised rates by 250 basis points since May last year. RBI Governor Shaktikanta Das said the central bank's policy remained focused on "accommodative withdrawal", signaling it could consider further rate hikes if necessary. The pause in rate hikes is "only for this meeting", Shaktikanta Das said. "If I have to characterize today's monetary policy in just one line ... it's a pause, not a pivot," he told a news conference after announcing the policy review. Real gross domestic product (GDP) growth for 2023-24 is projected at 6.5%, with 7.8% in Q1 (Q1), 6.2% in Q2, 3. Q4 6.1% and Q4 5.9%, the RBI governor

said, adding that economic activity remains resilient and headline inflation is expected to ease in the financial year (FY) 2023-24. In a tightening cycle, a premature pause in monetary policy measures would be a costly policy mistake, Governor Shaktikanta Das had said earlier. The governor also said that in a world of high uncertainty, providing explicit guidance on the future course of monetary policy would be counterproductive. Retail inflation rose 6.44 percent year-on-year in February, down from 6.52 percent in January, but remained stubbornly above the RBI's set target of 2 percent to 6 percent. Unseasonal rains could push food prices high, and OPEC's recent move to cut production has also pushed up oil prices, which could further add to imported inflation. India's manufacturing segment grew at its fastest pace in three months in March, while growth in the services sector slowed slightly from a 12-year high in February, private business surveys by S&P Global showed. Some economists were of the view that signs of trouble in the US and European banking sectors could lead to tighter financial conditions and a steeper global slowdown. The first signs of a slowdown in India are also visible in the easing of imports and stagnant demand for loans from banks. The liquidity of the banking system has recently improved after being in deficit at the end of March.

2. LITERATURE REVIEW

Patra et al. (2016) to study the first branch relationship between the base interest rate (repo) and the weighted average call money rate (operating target), divided the period from April 2008 to September 2015 into three segments based on the main changes in monetary policy. Their distributed lag autoregressive approach finds that the call rate is closely aligned with the monetary policy rate in the entire sample and across regimes. After monetary policy reforms in 2014, the speed of adjustment increased compared to earlier periods. The authors attribute this to intraday fine-tuning operations, better liquidity management by banks and increasing efficiency in the money market. Fine-tuning is mainly done through variable rate term repo auctions as recommended by RBI (2014). Volatility in the operating target would affect the second branch of transmission—its impact on the intermediate target. Volatility in WACR is defined in terms of SD. Higher volatility in the WACR can create uncertainty about longer-term rates. The standard deviations of the rolling period of the 7–90-day call rate declined to 0.2% in 2015-2016 from 4.6% in 2006-2007 (Patra et al., 2016), indicating better effectiveness of monetary policy. Kavediya and Pattanaik (2016) find that WACR volatility has a modest but statistically significant effect on the volatility of daily changes in other interest rates. In the credit market, it is estimated that a one percentage point increase in WACR volatility will cause bank lending rates to increase by around 26 basis points. Prabu and Ray (2019) continued the study of the second branch of currency transmission and estimated the model of currency transmission to financial markets in three different periods of regime change using SVAR models. Variables such as call money rate, 10-year g-s rate, corporate deposit rate, rupee-dollar exchange yields and smart returns were used to examine the transfer in money, g-s, corporate debt, FX and equity segments of the Indian financial market, respectively. The impact has been found to vary across different segments of financial markets as well as with different operational procedures of monetary policy. Transmission was faster in the call money and bond markets, but slower in the FX and equity markets. They also observed that the transmission of monetary policy in the financial sector improved significantly after the fine-tuning of the liquidity framework and the introduction of the FIT regime. In another first-stage and second-stage analysis, Goyal and Agarwal (2019) compared the strength and effectiveness of base rate transmission and liquidity provision to market rates in India using event window regression analysis. They found that the interest rate transmission channel was dominant, but the quantitative channel had an indirect effect, increasing the size of the interest rate transmission. They also compared transmission during periods when LAF was in surplus and deficit but found little support for asymmetry in adjustments during tightening. However, transmission was faster when liquidity variables and rates were matched. Moving to the third part of monetary transmission to the real sector, Khundrakpam and Jain (2012) used quarterly data for the period 1996–1997:1 to 2011–2012:1 in SVAR models to estimate the relative importance of different monetary policy transmission channels for GDP growth and inflation in India. They find that external exogenous factors delay the impact of monetary policy transmission on GDP growth and inflation. Among the various transmission channels, the interest rate channel, the credit channel and the asset price channel were important, with the interest rate dominating while the exchange rate channel was weak. A positive shock to the monetary policy rate led to a slowdown in credit growth with a lag of two quarters and subsequently negatively affected first GDP growth and then inflation. The monetary policy shock depressed asset prices from the third quarter onwards. Mishra and Mishra (2011) used a SVAR approach where the monetary policy instrument was set after assessing current inflation values to build a hypothetical case for inflation targeting in India. The results indicated that the demand effects of interest rates were stronger than those of exchange rates and supported the transition to the FIT framework.

3. METHODOLOGY

To draw meaningful inferences and conclusions, a minimum sample size of 100 is recommended (Alreck and Settle, 2003). Accordingly, 120 Bank Managers from Pune were surveyed through a questionnaire containing agreement accorded to the 5 statements pertaining to the rate rise:

1) The quantum of increase is justified
2) Supply of money has been checked due to rate increase
3) There has been positive impact on inflation
4) Timings of the increases were correct
5) The rate increase by RBI is also reflected in interest rate rise of commercial banks

Likert scales were used for response options. The response options were - 0 - Can't Say, 1 - Somewhat agree, 2 - Completely agree, 3 - Somewhat Disagree, 4 - Completely Disagree.

Responses were received from 120 Bank Managers. The questionnaire was tested for reliability, and it returned a Cronbach Alpha score of 0.87 and hence was considered reliable. Following hypotheses were formulated:

Ho: The recent rate increase by RBI is not well-directed

Ha: The recent rate increase by RBI is well-directed

The hypothesis was tested based on the average agreement/disagreement responses to the five statements of the questionnaire. The average agreement/disagreement response of the 100 respondents for all the five statements was taken as the sample mean and it was compared with a hypothesized population mean of 50% agreement/disagreement connoting an event by chance and not due to any statistical significance. A t-test was applied at 95% confidence level and based on the p-value the null hypothesis was tested for rejection or non-rejection.

4. DATA ANALYSIS AND INTERPRETATION

30 respondents were from the Northern region of Pune, 35 were from the Eastern region, 30 were from the Western region, and 25 were from the Southern region. 47 respondents were from the age-group of <30 years, 43 were from the age-group 30-40 years, and 30 were from the age-group of >40 years.

Table 1 gives the five statements items and their agreement ratings by the 120 respondents:

Table 1: Average ratings for the five statements

Sr. No.	Item	Agreement %
1	The quantum of increase is justified	84%
2	Supply of money has been checked due to rate increase	88%
3	There has been positive impact on inflation	85%
4	Timings of the increases were correct	77%
5	The rate increase by RBI is also reflected in interest rate rise of commercial banks	86%
	Average	84%

The average agreement for the five statements was 84% and this was compared with the hypothesized population mean of 50%. Results were as under:

Table 2: Summary statistics

Parameter	Value

Sample mean	84%
SD of sample	0.92654
Hypothesized population mean	50%
N	120
t-value	3.90158
p-value	0.00008
Alpha	0.050

As the computed p-value is lower than the significance level alpha=0.05, one should reject the null hypothesis H0, and accept the alternative hypothesis, Ha.

Thus, the null hypothesis the recent rate increase by RBI is not well-directed was rejected in favor of the alternate the recent rate increase by RBI is well-directed.

5. CONCLUSION

India's economy remains stable and is doing better than most economies despite global uncertainty, a Nuvamy report said. The country's growth momentum is supported by high-frequency indicators such as GST collection, auto sales, fuel consumption, manufacturing and services PMIs, which have seen higher annual growth rates and sequential improvements. However, domestic brokerages saw cause for concern for a jump in India's overall CPI inflation in January 2023 and its persistence in February 2023. The 6.4-6.5% y-o-y inflation rate not only reversed the moderation in retail inflation in the previous months but also breached the RBI's upper tolerance in inflation targeting band. Despite the rise in interest rates, bank loan offtake showed a strong recovery in FY23. The improvements were broad across segments and reflected the economy's resilience and consumers' ability to withstand higher rates, according to Nuvama. The incremental growth of loan withdrawals for the period from April 1, 2022, to March 10, 2023 was 13.9%, while the comparable growth of deposits was 8%. The report also noted a sharp turnaround in the liquidity of the domestic banking system. After experiencing a liquidity surplus for more than three years, the liquidity surplus has seen a significant decline, from an average of 6.5 million rupees in April 2022 to a deficit of 0.4 million rupees in March 2023. While the Indian economy continues to remain stable amid global uncertainty, the persistently high inflation and a decline in excess liquidity in the banking system pose significant challenges.

CONFLICT OF INTERESTS

None.

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