Our Views

Interest rate increase – growth will not be compromised

Earlier this week, the Reserve Bank of India (RBI/ Central Bank) increased the interest rate by 50 basis points. An increase of around 35 bps was largely expected by the market given the recent data on inflation. Market was therefore a bit disappointed with the large upfronting of the rate hike. As a result, we saw the bond yields spike by 10-15bps post the policy announcement. In my view, RBI has front loaded the increase to aggressively target inflation and to manage the currency. With this increase, the rates are back around the pre-pandemic levels. Post this announcement, as expected, the currency has reacted positively. Surely, some of the RBI objectives are fulfilled.

The key question now is whether the consistent increase in the interest rate will have a significant impact on the growth rate of the economy. Higher interest rates essentially compress the demand, thereby containing inflation. From a growth perspective, it is important to note that the interest cost of a corporate on an average is around 7% of its total cost. Therefore, given that interest is not a very significant component of the total cost of a corporate, a marginal increase in the overall cost can be absorbed by them without much pain. If that is so, this will not increase the cost pressures or suppress growth. In my opinion, this could be one of the factors why the RBI has kept their growth projections for FY 23 unchanged at 7.2%.

Another important announcement in the policy was the proposal to allow Standalone Primary Dealers ("SPDs") to offer all forex market-making facilities and also enable Bharat Bill Payment System ("BBPS") to accept cross-border inward bill payments from NRIs.

This new development will bring SPDs on par with the Category-1 authorized dealers in the space of forex market-making products. The central bank has also permitted them to deal in offshore rupee overnight index swap market directly with non-residents and other market-makers. The space, which was pre-dominantly dominated by the banks, will now also feature these SPDs providing the customers with a wider set of market makers for currency risk management. This move will also improve the ability of SPDs to provide support to the primary issuance and secondary market activities in government securities.

BBPS, which is currently only accessible to Indian residents, is catering to almost 20,000 billers and processes around 80 million transactions in a month. After being enabled for accepting cross-border inward payments, the NRIs can use this platform to pay utility bills like electricity, water, and education on behalf of their families living in India. The rules and instructions in this regard is yet to be notified, but the impact on the bill payment experience for NRIs will surely be positive. This will drastically increase the user base and transaction volumes. This is also likely to increase the forex inflows for the country. In addition, this will also solve the problems of old parents who financially depend on their children based out of India.

Overall, I think the market has taken this policy in its stride without any significant sharp reaction. There is a recognition of the positive implications of the rate hike and the other proposed changes.

Sunil Sanghai
Founder & CEO
NovaDhruva Capital Pvt. Ltd