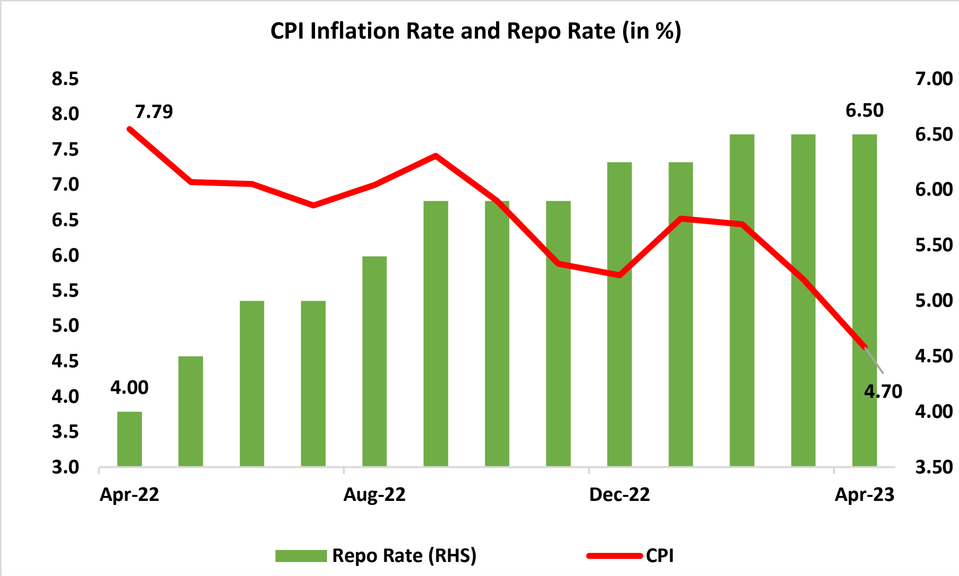
MPC likely to pause in the June Meeting

Key Expectations from the RBI's MPC meeting

- *No change in repo rate*
- *No change in policy stance*
- *Measures to manage liquidity*

A better-than-expected FY23 GDP data released by the government on 31 May 2023 has renewed the optimism about India's promising growth recovery. Since the April Monetary Policy Committee (MPC) meeting, the domestic economic conditions have continued to remain resilient, despite the global banking crises and their fallout on global economic environment. Sustaining the quickening of momentum seen in the last few months in FY23, the PMIs in both manufacturing and services have shown creditable expansion in the first two months of FY24. Added to this, CPI inflation eased below 5% in April 2023, for the first time since November 2021. Corporate earnings are beating consensus expectations, with banking and financial sectors posting strong revenue performance, aided by robust credit growth. In the first quarter of FY24, growth is expected to be driven by private consumption, supported by reviving rural demand, and renewed buoyancy in manufacturing on easing of input cost pressures.

On the global front, despite the steepest global interest-rate hiking cycle in four decades, inflation remains high. According to World Bank's Global Economic Prospects June 2023 edition, even by end-2024, inflation will remain above the target range of most inflation-targeting central banks. The financial stresses in addition to the prolonged war between Russia and Ukraine continued to add concerns about the global recovery and outlook, which was otherwise termed as *less gloomy* by the IMF in its January 2023 World Economic Outlook report. In the April 2023 edition, the IMF has termed the growth as a *rocky recovery* and has cautioned an uncertain outlook. Following the uncertain economic environment amid persistent inflationary challenges, major global central banks have continued with the tightening cycle. In the May 2023 meeting, the US Federal Reserve increased the federal funds rate by another 25 basis points (bps), which is the tenth consecutive rate hike in the current tightening cycle. The Fed's policy rate has reached 5.00%to 5.25%. Although the pace of rate hikes has slowed down since March 2023, many global central banks have continued to raise policy rates in the range of 25 bps to 50 bps, with a cautious approach following the sticky inflation. On the contrary, RBI in its April policy meeting, paused the rate tightening cycle and maintained the repo rate at 6.5%. Since May 2022, the policy rate has been increased by a cumulative 250 basis points to contain the high retail inflation levels. In the April meeting, RBI stated that past rate hikes are still working through the system, and wants to wait for its effect to work before raising the rate further.



Source: MOSPI, RBI, B2K Analytics

Since the last meeting, the CPI inflation rate softened significantly and fell below 6% in March and further eased to 4.7% in April 2023. In addition, domestic growth outlook has also improved. The growth estimates released by the MOSPI for FY24 shows that Q4FY23 GDP has accelerated to 6.1% and this marks a strong rebound and holds the promise of continued buoyancy in the economy in the coming quarters. High-frequency indicators already point towards an improved near-term outlook. Considering these factors, it should be possible to achieve the 6.5% growth estimated by the RBI in FY24, barring unforeseen circumstances. Inflation is expected to remain below 5%, largely supported by high base and easing global commodity, particularly crude oil prices which have moderated from their April levels. However, considering the prediction of El Nino this year, which generally results in a poor monsoon in India, the outlook on food inflation remains uncertain.

We expect the RBI to follow a cautious approach and maintain a pause in the June policy meeting and keep the repo rate unchanged at 6.5%. If the prices continue to show a downward trend, MPC may lower the rates in the August meeting.

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