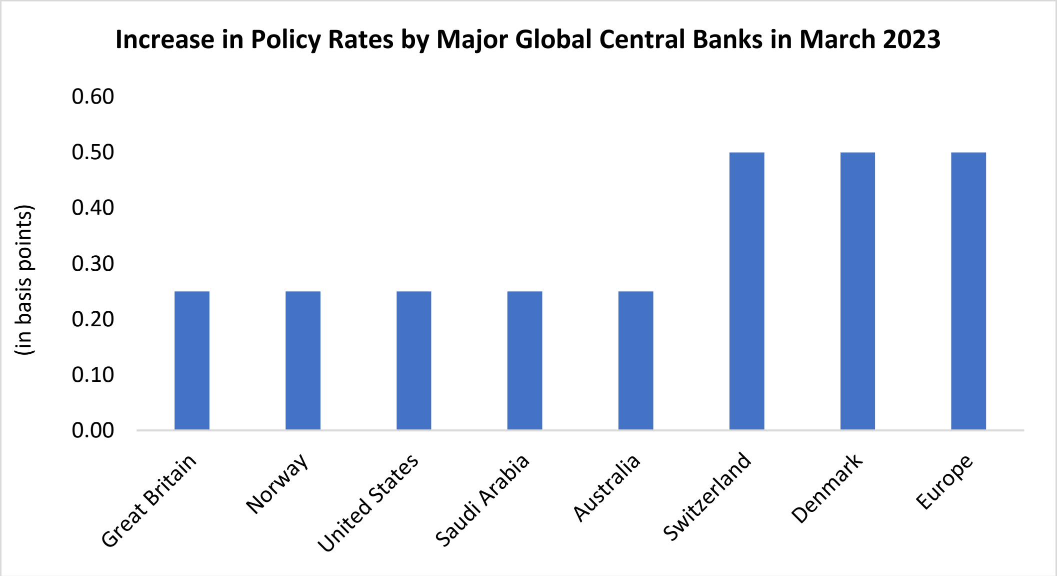
A moderate dose of another rate hike likely in April MPC

Key Expectations from the RBI's MPC meeting

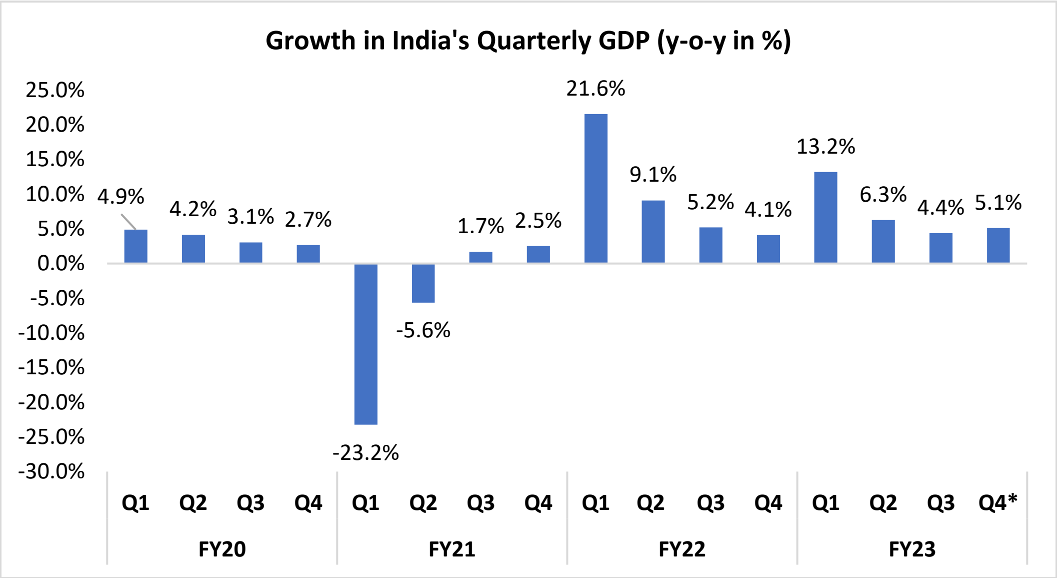
- *25 bps increase in repo rate*
- *No change in policy stance*
- *Announcement of OMOs to manage liquidity*
- *No change in Inflation and growth outlook for FY24*

Since the February Monetary Policy Committee (MPC) meeting, the emergence of global banking crises and their fallout have changed the global economic environment. The financial stresses in addition to the prolonged war between Russia and Ukraine triggered additional 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. Following the uncertain economic environment amid persistent inflationary challenges, major global central banks have continued with the tightening cycle. In the March 2023 meeting, the US Federal Reserve increased the federal funds rate by another 25 basis points (bps), which is the ninth consecutive rate hike in the current tightening cycle. The Fed's policy rate has reached a 16-year high of 4.75%-5.00%. Many other global central banks have also followed suit and raised policy rates in the range of 25 bps to 50 bps.

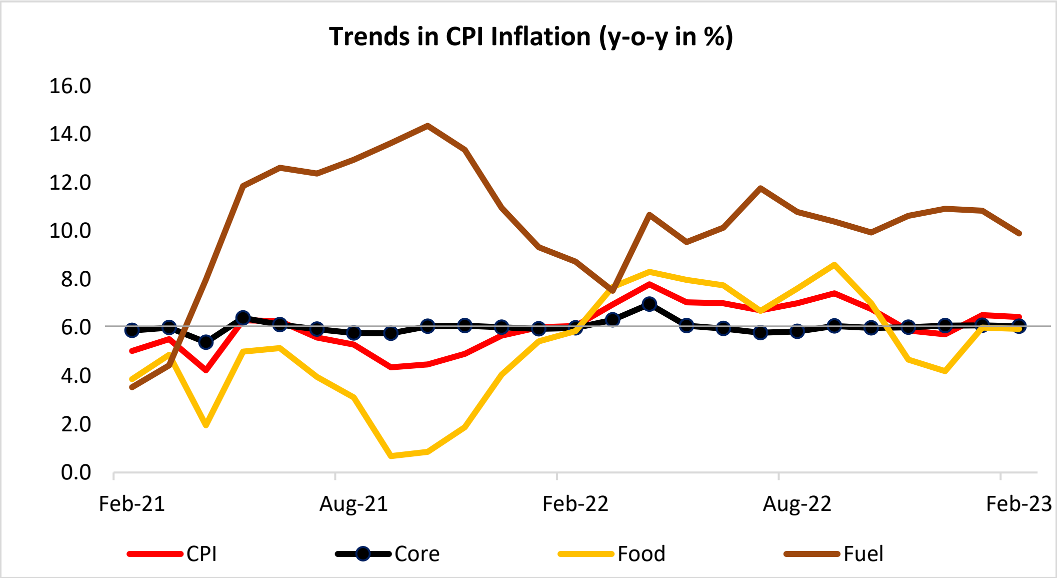


Source: Central bank websites, B2K Analytics

The domestic growth outlook is also likely to follow global cues. Although the high-frequency indicators point towards an improved near-term outlook and global commodity, particularly crude oil prices have moderated to some extent, the growth estimates released by the MOSPI for Q3FY24 show that GDP has grown at the slowest rate since Q4FY22. The revision to last year's growth and the fading of pandemic-induced base effects are partly attributed to the moderation in GDP numbers, but the contraction of 1.1% in the manufacturing sector is a major cause for concern. For the coming fiscal, the RBI has projected GDP growth of 6.4% as compared to the Economic Survey’s projections of 6.5%.



* Data is provisional. Source: MOSPI, B2K Analytics

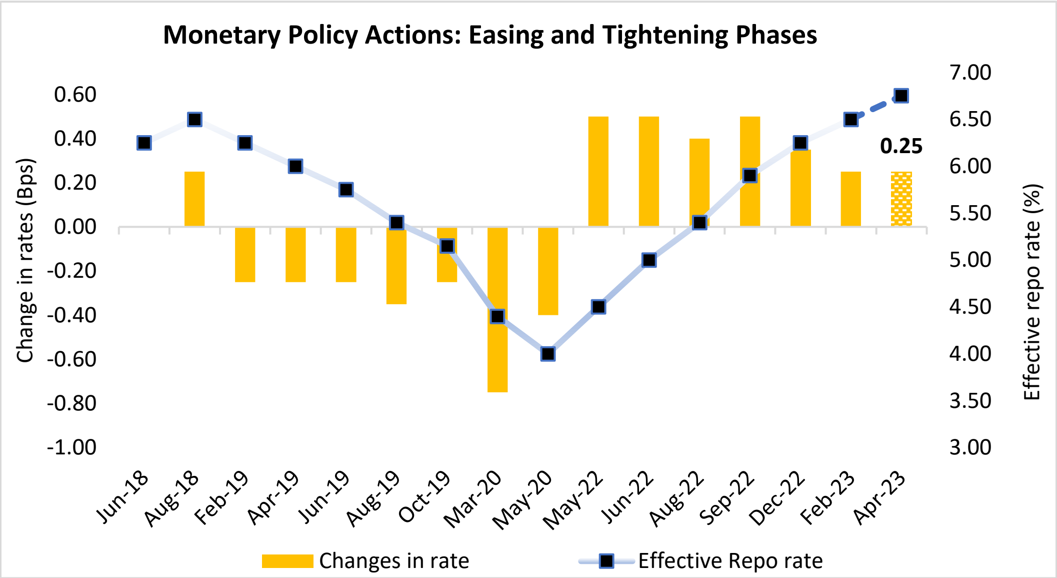


Source: MOSPI, B2K Analytics

On the inflation front, a sharp increase in CPI inflation which remained above 6% levels in the first two months of 2023, heightened the risk of prolonged inflationary challenges. Sticky core inflation which is hovering around 6% for almost two years now is a major cause of worry. The food inflation also inched up to close to 6% in January and February 2023, while fuel inflation has moderately eased, but remained around 10% levels.

The overall outlook on CPI continues to remain uncertain. In the previous MPC, the RBI revised the inflation outlook for FY23 marginally downwards to 6.5% from 6.7% and projected 5.3% average inflation for FY24. However, these estimates are largely based on the assumption of a normal monsoon and an average crude oil price (Indian basket) at ~USD95 per barrel.

Considering the prediction of El Nino this year, which generally results in a poor monsoon in India, the outlook on food inflation remains uncertain. The release of food grains stock (wheat) by the Food Corporation of India (FCI) to bring down prices is likely to cool down food inflation to some extent in the near term. Due to falling commodity prices overseas, the WPI inflation softened notably and fell below the 4% mark in February 2023, after a span of 25 months. The easing in WPI inflation is yet to transmit into reduced CPI, which generally happens with a two to three-month lag. The recent fall in global crude oil prices brings some respite on the fuel inflation front, but movements in oil prices are highly unpredictable, which fluctuate with global developments.



Note: B2K expectations for April 2023

Source: RBI, B2K Analytics

Expectations from MPC

The balancing act of supporting growth and controlling inflation continues to pose challenges to the MPC's policy decisions, amid the ongoing global financial uncertainties. The key policy repo rate has reached August 2018 levels of 6.5% after a 25-bps hike in the February 2023 MPC meeting. Despite the moderation in the growth outlook, the MPC increased the policy rates in its February meeting, though by a smaller dose compared to its earlier increases of 35bps to 50bps between May and December 2022. While the committee did not provide any clear indication regarding its future rate actions or policy stance, geopolitical challenges and inflationary worries continue to persist. There were disagreements between the committee members on both MPC resolutions (the rate hike and policy stance). Out of six members, two had voted against the decision of a 25 bps rate hike and the continuation of the withdrawal of an accommodative policy stance.

There is a likelihood of RBI's MPC taking a pause in its policy action, on the back of growth concerns. However, the expectation of a continuation of interest rate hike in the US to bring down inflation can lead to an increase in the outflow of FII. The pressure on the current account and the exchange depreciation and the consequences on prices could also weigh in the decision of the MPC. More importantly, the focus may shift to bringing down the inflation rate to 4% rather than staying at 6%.

Considering the elevated CPI inflation levels, in addition to the global interest rate scenario, we expect the MPC to increase the key policy rates by another 25 bps in its April meeting and continue with the policy stance of withdrawal of accommodation. The RBI may also announce measures to augment liquidity including Open Market Operations (OMOs), particularly in view of the decision of the Union government to borrow over Rs 8.8 trillion in the first half of FY24. The policy outcome may continue to see some disagreements between the committee members on the policy action front. On the growth and inflation front, the RBI is likely to maintain the outlook projected in the previous MPC meeting.

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