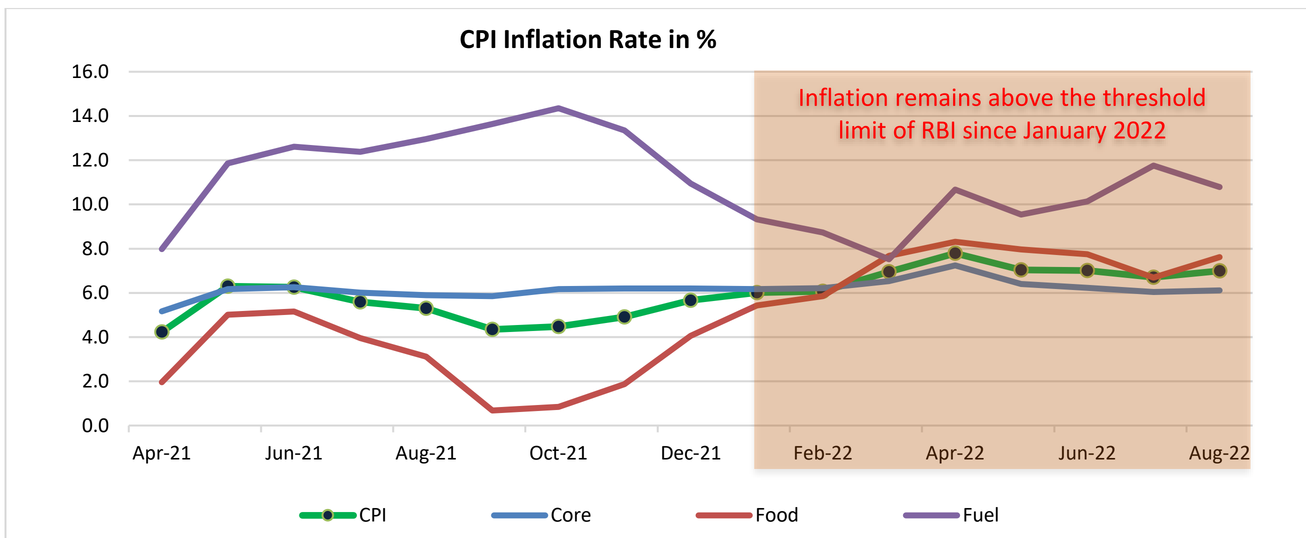
Monetary Tightening Approach to Continue

RBI likely to raise repo rate by 50 bps in September MPC meeting

Brickwork Ratings, Bengaluru, 27 September 2022: With the CPI inflation rate reaching the 7% level again in August 2022, the RBI is likely to continue with its monetary tightening in the upcoming policy meeting. We expect a 50 basis points (bps) increase in the repo rate and appropriate liquidity boosting measures to support growth.

Lingering inflation pressures

CPI inflation has remained above the MPC's upper tolerance level of 6% since January 2022 and averaged 7.1% in the first five months of FY23. After easing slightly in July, most of the major components of the CPI inflation basket increased in August, and food inflation rose to 7.62%. Supply-side constraints and excessive rains and floods in several parts of the country led to an increase in the prices of vegetables, fruits, spices, milk and products, and cereals and products. Although international crude oil prices eased to some extent, high prices at the retail level have continued. Core inflation also continued to increase and remained above the 6% level for 11 straight months. Household goods and services inflation has also been on the rise and remained above the 7% level since January 2022.



Note: Core inflation excluding food and fuel items.
Source: MOSPI, BWR Research

Brickwork Ratings

Inflation outlook

Easing energy and commodity prices globally would help ease inflationary pressures, going forward and also keep imported inflation in check. Food inflation, which accounts for 39% of the overall inflation basket, may ease gradually with the arrival of the kharif foodgrain output, but may take some time. As per the first advance estimates for 2022-23, foodgrain production is expected to be around 149.92 Million Tonnes (MT) in the kharif season, which is likely to fall short of the target set for the year by 13.23 MT. Compared to the previous year's level also, kharif production is likely to be lower by 6.12 MT. This may have a bearing on the food prices, in addition to ongoing supply constraints. Moreover, 8.95% less area had been covered under kharif crops as on 16 September 2022, compared to that in the previous year. Overall, the pressure on food prices is likely to continue for a few more months, and we expect food inflation to continue to remain above 7% in Q3FY23 on the back of low base and may ease slightly in Q4FY23.

Of course, international crude oil prices have eased considerably from USD 113 per barrel on average in March 2022 to USD 97 per barrel in August 2022. The prices have been ruling below USD 90 per barrel in the last few days. However, the domestic prices of oil distillates have not been changed to make up for the past deficit, and until lower crude oil prices translate into lower prices of petroleum products, fuel inflation will remain high. For Q1FY23, the actual CPI inflation stood at 7.28% (monthly average) as against the RBI's estimate of 7.5%, and in Q2 also, the actual inflation rates are likely to be close to the RBI's estimate of 7.1%. ***For the full fiscal, we expect the RBI to retain the inflation outlook at 6.7% projected earlier.***

Estimates of Production of Foodgrains in Kharif Season for 2022-23

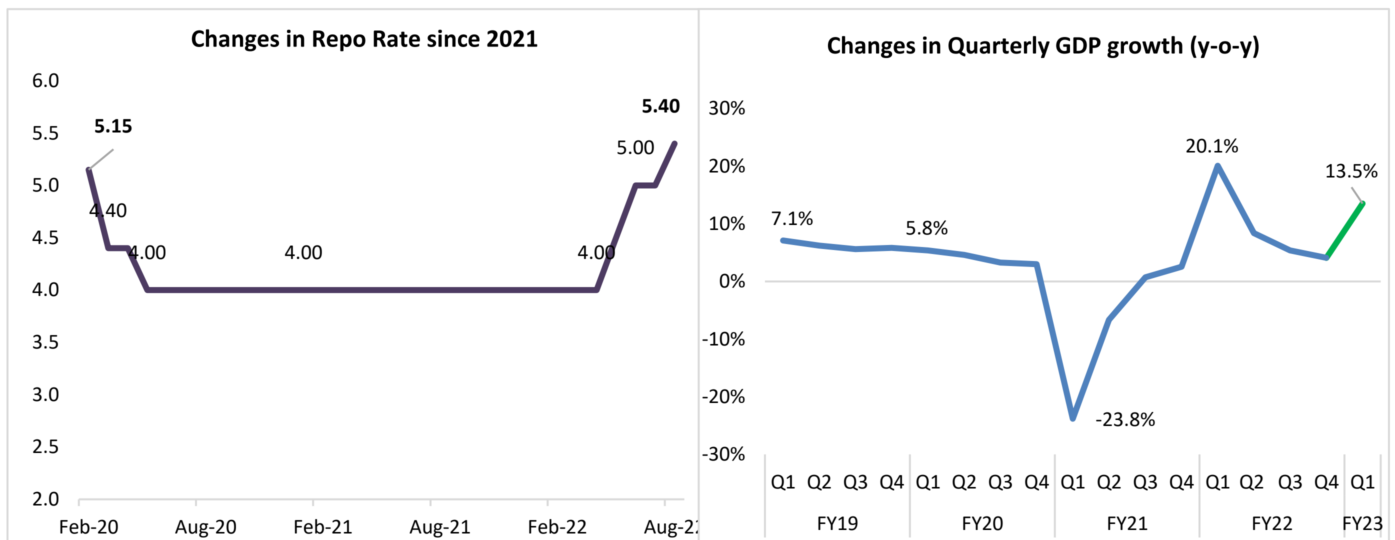
2016-17 to 2020-21 Five Year Average	2021-22 Fourth Advance Estimates	2022-23 Target	**2022-23 First Advance Estimates**
•142.94 MT	•156.04 MT	•163.15 MT	**•149.92 MT**

Source: Ministry of Agriculture and Farmers Welfare, BWR Research

Frontloading of rate hikes to continue with modest revision in growth outlook

Persistent inflationary challenges, prolonged geopolitical crises, a weakening external situation and supply constraints in various sectors have been hindering the domestic growth outlook since the beginning of the current fiscal. The Indian economy continues to grapple with persistent supply-side disruptions, leading to price pressures. There has been a slight respite on the global commodity prices front, which have been falling in the recent months due to weakening global demand; however, domestic inflation still remains above the RBI’s target range.

Globally, the advanced economies’ central banks are raising their respective policy rates in an effort to bring down the record level inflation. The US Federal Reserve raised the policy rate by another 75 bps in its recent FOMC meeting, and the rates reached their highest since early 2008. With the widening interest rate differentials, there is a heightened risk of FPI outflows from India. Despite the continued tightening of global financial conditions, FPIs invested around USD 8.7 bn in Indian markets since July 2022. Yet, the rupee has depreciated sharply and has continued to depreciate, regardless of the RBI’s frequent intervention in the forex market. Given the pressure on the widening current account deficit, coupled with shrinking forex reserves and falling merchandise exports due to the global slowdown, the pressure on the exchange rate is unavoidable. With recession in the UK and expectation of the US economy also entering into a recessionary phase, exports have already taken a hit, and the pressure on the exchange rate has intensified. The rupee-dollar exchange rate has already touched record lows crossing Rs 81 per USD in September, which needs immediate attention.



Source: RBI, MOSPI, BWR Research

Dilemma of managing growth and inflation

There has been severe pressure on the RBI to balance inflation, growth and the exchange rate. The RBI has already started withdrawing the monetary accommodation and has started raising policy rates since May 2022. Of course, inflation management remains a priority, and so is arresting the outflow of foreign portfolio investment. Thus, a sharp increase in the policy rate becomes necessary not only to arrest inflation, but also to narrow the widening interest rate differentials between the advanced countries and India. At the same time, in the current situation, growth also has to be nursed. The Q1 GDP growth estimate released by the MOSPI was much lower, at 13.5%, compared to the RBI's estimate of 16.2%. Although there is some uptick on the high-frequency growth indicators, such as the manufacturing and services PMI, and record GST collections reflect improved recovery and a pick-up in business activity, the IIP and eight core sectors data, showed a moderation in growth in July 2022. Hence, supporting the economy at this stage of recovery also becomes an absolute necessity. Thus, the RBI is faced with a severe dilemma. We expect some moderation in growth outlook by RBI for the current fiscal.

In addition, the banking system is facing a fresh problem of liquidity shortages. After remaining in surplus for more than three years, liquidity in the system slipped into a deficit mode in the third week of September 2022. Pick-up in bank credit and increased market borrowing by the government are weighing on liquidity. Hence, there is a need for increasing money supply for the smooth functioning of the financial system by announcing liquidity enhancing measures such as OMOs. In addition to a rate hike, the September MPC is closely watched for RBI's guidance on liquidity management.

Says Dr M Govinda Rao, Chief Economic Advisor, Brickwork Ratings, "Going by the inflationary pressures and adverse external developments, the MPC may continue with a 50 bps repo rate hike in its upcoming policy meeting. CPI inflation remaining above the 6% level for the last nine months is a major concern, and so is the capital outflows due to the divergence in interest rates. Hence, the primary focus will be to continue to fight to bring down inflation within the MPC's target of 2% to 6%, despite the moderation in growth outlook. We also expect the RBI to lend its support to maintain the smooth functioning of the financial system by augmenting adequate liquidity through appropriate liquidity enhancing measures".

Contacts:

Dr M Govinda Rao
Chief Economic Adviser

Anita Shetty
Senior Research Analyst

Investors & Media Contact
+91 95133 99706
1-860-425-2742
investordesk@brickworkratings.com
media@brickworkratings.com

ABOUT BRICKWORK RATINGS

Brickwork Ratings (BWR) is India's home-grown credit rating agency built with the superior analytical prowess of the industry's most experienced credit analysts, bankers and regulators. Established in 2007, BWR aims to provide reliable credit ratings by creating new standards for assessing risk and by offering accurate and transparent ratings. BWR provides investors and lenders timely and in-depth research across the structured finance, public finance, financial institutions, project finance and corporate sectors. BWR has employed over 339 working professionals including credit analysts and credit market professionals across 8 offices in India. Our experienced analysts have published over 13200 ratings across asset classes. BWR is committed to providing the investment community with products and services needed to make informed investment decisions. BWR is a registered credit rating agency by Securities and Exchange Board of India (SEBI) and a recognised External Credit Assessment Agency (ECAI) by the Reserve Bank of India (RBI) to carry out credit ratings in India. BWR is promoted by Canara Bank, India's leading public sector bank. More information on Canara Bank is available for reference at www.canarabank.com

BWR Rating Criteria are available at https://www.brickworkratings.com/ratingscriteria.aspx

Brickwork Ratings, a SEBI-registered credit rating agency, has also been accredited by the RBI, and it offers rating services for bank loan, NCD, commercial paper, bonds, securitised paper etc. BWR has Canara Bank, a nationalised bank, as its promoter and strategic partner.

BWR has its corporate office in Bengaluru and a country-wide presence, with offices in Ahmedabad, Chandigarh, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi, along with representatives in 150+ locations. BWR has rated debt instruments/bonds/bank loans, securitised paper of over ₹19,02,200Cr. Additionally, fixed deposits and commercial papers, among others, worth over ₹83,555 Cr have been rated.

DISCLAIMER

Copyright ©2022 by Brickwork Ratings India Pvt Ltd., 3rd Floor, Raj Alkaa Park, 29/3 & 32/2, Bannerghatta Main Rd, Kalena Agrahara, Bengaluru, Karnataka 560076.Telephone: +91 80 4040 9940. Fax: +91 80 4040 9941. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings, Brickwork Ratings relies on factual information it receives from issuers and underwriters and from other sources Brickwork Ratings believes to be credible. Brickwork Ratings conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Brickwork Ratings' factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Brickwork Ratings' ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Brickwork Ratings relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Brickwork Ratings and to the market in offering documents and other reports. In issuing its ratings Brickwork Ratings must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

THE INFORMATION IN THIS REPORT IS PROVIDED "AS IS" WITHOUT ANY REPRESENTATION OR WARRANTY OF ANY KIND. A Brickwork Ratings rating is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that Brickwork Ratings is continuously evaluating and updating. Therefore, ratings are the collective work product of Brickwork Ratings and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Brickwork Ratings is not engaged in the offer or sale of any security. All Brickwork Ratings reports have shared authorship. Individuals identified in a Brickwork Ratings report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Brickwork Ratings rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time, for any reason in the sole discretion of Brickwork Ratings. Brickwork Ratings does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Neither Brickwork Ratings nor its affiliates, third party providers, as well as their directors, officers, shareholders, employees or agents (collectively, "BWR Reps") guarantee the accuracy, completeness or adequacy of the Report, and no BWR Reps shall have any liability for any errors, omissions, or interruptions therein, regardless of the cause, or for the results obtained from the use of any part of this publication. In no event shall any BWR Reps be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of any part of the Report even if advised of the possibility of such damages. Brickwork Ratings receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities.