Inflation and growth concerns: RBI likely to raise repo rate by 25 to 35 bps in August MPC

Brickwork Ratings, Bengaluru, 04 August 2022: Despite a slight dip in inflation, the RBI is likely to continue with its monetary tightening and increase the repo rate by 25 to 35 basis points as CPI inflation is still above the MPC's upper tolerance level of 6%.

Slight downward revision in inflation outlook for FY23 likely

The domestic economy continues to grapple with persistent supply-side disruptions, adding to the inflationary challenges, amid fiscal and monetary constraints. Price pressures peaked to record levels in April, but eventually eased with the government announcing measures to bring down the prices and some easing of energy prices on the supply side. The RBI has also gradually started withdrawing the monetary accommodation and has started raising policy rates since May 2022 to control the price situation.

Supply bottlenecks have continued to keep inflation under pressure, while higher global commodity prices have kept the prices of energy and food imports elevated, exerting imported inflationary pressures. Although CPI inflation moderated to 7% in both May and June from a high of 7.8% in April, food inflation has continued to remain above or close to 7 to 8% since March 2022, while core inflation has remained sticky at above 6% since October 2021. The recent fall in global crude oil prices, if sustained, is likely to ease the pressure on fuel inflation and also keep imported inflation in check. Although the Kharif output is expected to be higher, there is still considerable uncertainty on the food front as the area under cultivation is still less compared to that in the previous year. However, with the reservoirs full to their brim, Rabi is likely to yield higher production and to ease food prices in the second half of the fiscal (H2FY23). We expect CPI inflation to remain elevated above the upper band of the target in Q2, but possibly ease below 6% during H2 FY23. **The RBI is likely to revise the inflation outlook downwards for FY23 to 6.5% in its August meeting from 6.7% projected in the June meeting.**

MPC likely to retain GDP growth outlook for FY23 at 7.2%

The Indian economy has started recovering after contracting 6.6% due to the pandemic in FY20, with the tentative recovery at 8.2% in FY21; however, the geopolitical crisis and sanctions, coupled with a sudden spurt in commodity prices, particularly crude oil prices, has disrupted the overall growth progress in FY23. Given the sharp tightening of global financial conditions, coupled with the prolonged war between

Russia and Ukraine, the expectations of a slowdown in global economic recovery have heightened, and this may also constrain the domestic growth outlook in FY23. The negative spillovers of the war, adverse external conditions and continued supply-side crises, in addition to the swift policy tightening and stubborn inflation, may also lead to increased downside risk to growth outlook. The softening oil prices in the recent few days have brought in some optimism. Crude oil prices remained above USD 100 per barrel on most days since March 2022 and averaged around USD 110 per barrel between March and July 2022. The fall in crude oil prices is likely to provide much-needed relief on the fiscal management and foreign exchange reserves, and ease some pressures on the inflation and growth front. There is some uptick on the high-frequency growth indicators, such as the manufacturing PMI, IIP and eight core sector data reflecting improved recovery and a pick-up in business activity. The PMI on the services sector, however, has been the lowest in the last four months.

In the June policy meeting, the RBI maintained the GDP outlook for FY23 at 7.2%, as projected in the April MPC meeting. **We expect the RBI to keep the GDP outlook unchanged for the current fiscal at 7.2%, with some rebalancing in the quarterly and half yearly outlook, assessing the recent domestic and external situation.**

Says Dr M Govinda Rao, Chief Economic Advisor, Brickwork Ratings, "Going by the recent developments on both the domestic and global fronts, the MPC may refrain from a sharp hike in its policy rates. Growth concerns remain, but the primary focus will be to bring down the inflation within the MPC's target of 2% to 6%. Although there was some moderation in price levels in June, CPI inflation remaining above the 6% level for the last six months is a major concern. Continuing war-led supply and trade disruptions, elevated food and energy prices, and sanctions continue to have an adverse impact on both inflation and economic growth, while the recent fall in the international crude oil and other input prices, and reversal in FPI outflows provides some hope. We expect the RBI to revise the inflation outlook slightly downwards and increase the repo rate by 25 to 35 basis points in the August announcement".

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