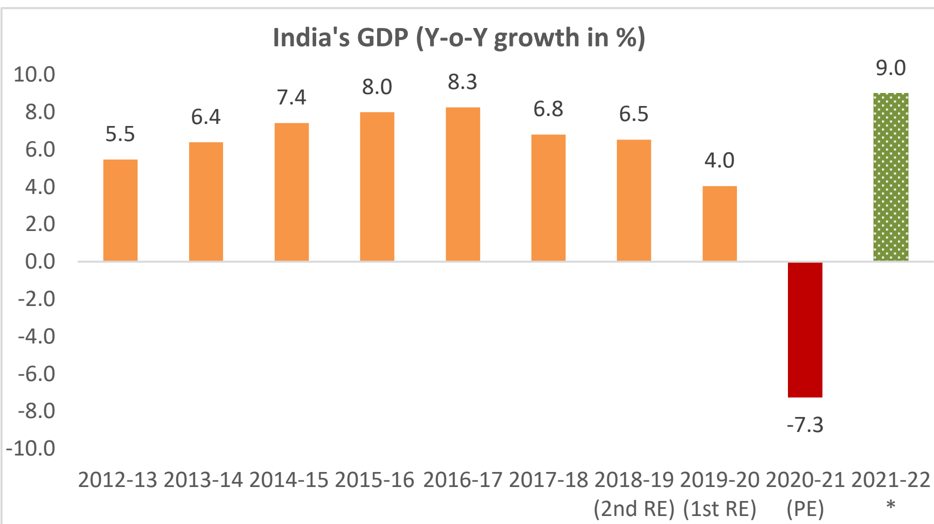
Brickwork Ratings expects RBI's MPC to maintain status quo on rate cuts in June MPC meeting in view of optimistic Q4 GDP growth

The better-than-expected GDP numbers provide the much-needed comfort to the MPC on the growth outlook. However, with the imposition of partial lockdown-like restrictions to contain the virus spread in several parts of the country, the downside risk on growth recovery has intensified. Hence, the RBI is likely to continue with its accommodative monetary policy stance in the decision of the MPC meeting to be announced on 4 June 2021. Considering the risk of inflation emanating from the rising commodity prices and input costs, BWR expects the RBI MPC to adopt a cautious approach and hold the repo rate at 4%.

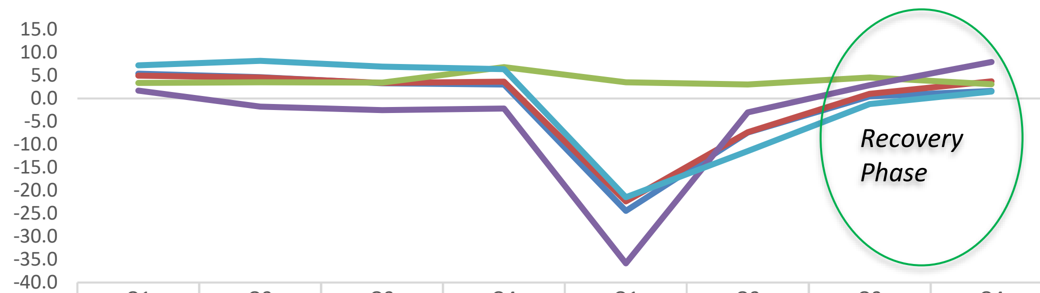
Growth Outlook: The revised estimates of GDP for FY21 released by the Ministry of Statistics and Programme Implementation (MOSPI) on 31 May 2021 are more optimistic than what the market had expected. In FY21, the GDP contracted by 7.3% (year-on-year) as against the BWR estimates of a 7.5% contraction. Agriculture activities as usual continued to show positive growth of 3.6%, while industry and services sectors contracted by 7% and 8.4%, respectively, in FY21.



RE: Revised estimates, PE: Provisional estimates, *: BWR estimates.
Source: MOSPI, BWR Research.

The Q4 FY21 growth estimate on the GDP and GVA at 1.6% and 3.7%, respectively, brings some hope on the recovery front. Although Q4 growth is largely due to the low base, it also reflects an improvement in economic activities before the economy was hit by the second wave of Covid-19 infections. During Q4, all the major sectors reported positive growth, except the trade, hotels, transport, storage and communication segment, and the mining and quarrying segment. Construction and manufacturing activities seemed to have picked up faster in the Q4 FY21, while sectors that require social distancing continued to suffer. Muted growth (2.3%) in public administration in Q4 reflects limited government spending, which may delay the recovery progress.

Growth in Agriculture continued, indusrtrial sectors recovered the most, while the services sector recovery remains muted

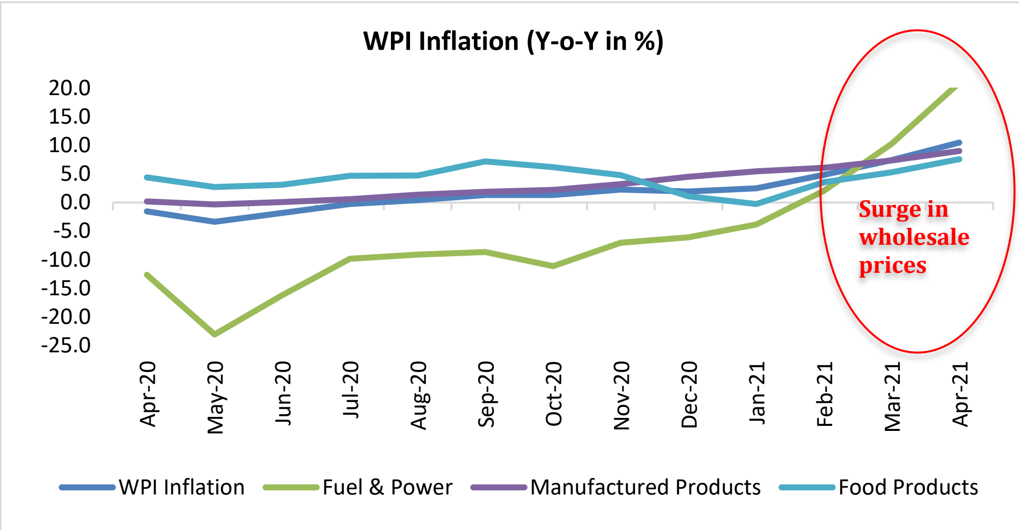


	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21
GDP	5.4	4.6	3.3	3.0	-24.4	-7.4	0.5	1.6
GVA	5.0	4.6	3.4	3.7	-22.4	-7.3	1.0	3.7
Agri	3.3	3.5	3.4	6.8	3.5	3.0	4.5	3.1
Industry	1.7	-1.8	-2.6	-2.2	-35.8	-3.0	2.9	7.9
Services	7.2	8.2	7.0	6.4	-21.5	-11.4	-1.2	1.5

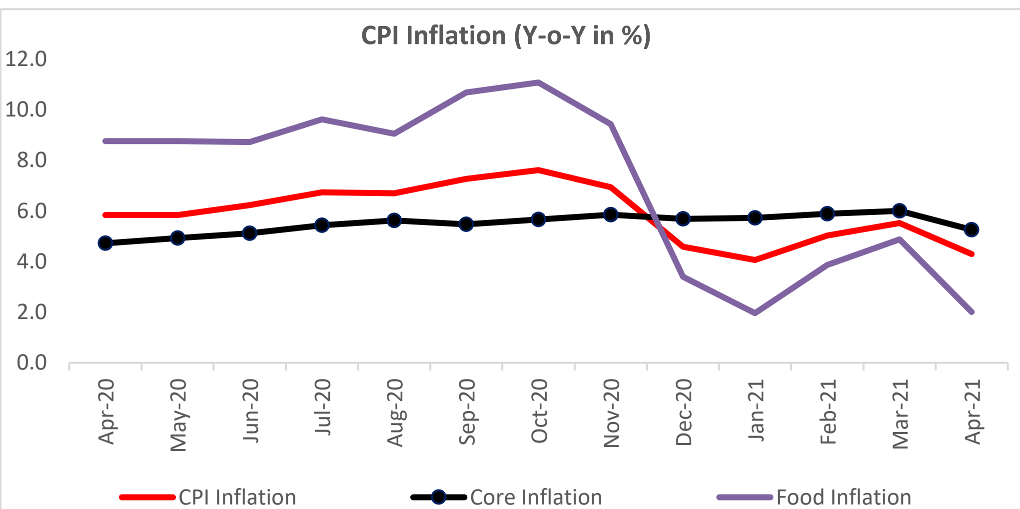
Note: GDP numbers are year-on-year changes in %. Data is provisional.
Source: MOSPI, BWR Research.

The second wave of Covid-19 has caused disruptions in economic activities, interrupting the recovery process. It is assumed that the second wave of Covid-19 in India is more severe than the first wave, and the problem has been intensified due to poor healthcare facilities. The sudden surge in Covid-19 cases prompted many states to impose lockdown-like restrictions of varying magnitude to contain the virus spread. However, most of the essential activities have been kept out of these restrictions, thereby limiting the losses. On the global front, economies are recovering from the pandemic, supported by improved vaccination and government spending. The declining Covid-19 positivity rates in countries such as the US and Europe and pick-up in economic activities, particularly in manufacturing, are creating considerable demand for certain commodities. Oil prices surged nearly to USD 70 per barrel in May, and metal prices rose sharply as well. On the domestic front also, supply constraints and global demand have intensified upside pressures on prices, as reflected by the sharp rise in WPI inflation recently. In April 2021, WPI inflation hit double-digit levels of 10.49%, with a sharp uptick in fuel and manufacturing inflation. Moreover, the food price index also reported 7.58% inflation in April.

Inflation Scenario: Since the last MPC meeting, core, food and fuel inflation in the CPI index have eased despite supply constraints. CPI inflation eased to 4.29% in April 2021, largely due to a favourable base and softening food prices. The core inflation was at 5.25%, which continued to remain above 5% since June 2020, and that is a concern. An upsurge in crude oil prices is also posing fuel inflationary threats, in addition to a rise in the prices of some items of food segments. The transient effect of the input cost pressure emanating from rising commodities and supply constraints was already reflected in the WPI and is likely to be felt in CPI inflation in the next 2 to 3 months. In addition, excess liquidity, combined with volatility in crude oil prices, can pose an upward risk to inflation.



Note: Data is provisional. Source: eaindustry.nic.in, BWR Research



Note: Data is provisional. Source: MOSPI, BWR Research

RBI's recent measures to support the economy

With surplus liquidity already in the market and continued regulatory forbearance, the chances of the RBI going for a rate cut are nil, like it did last year, when the first wave of the pandemic had hit in March 2020. As a timely response to the second wave, the RBI has already announced the Covid-19 package on 5 May 2021, comprising Rs 50,000 crore emergency health services loans to vaccine makers, medical equipment suppliers, hospitals and even patients in need of funds. In addition, the RBI was to conduct a special long-term repo operation worth Rs 10,000 crore at the repo rate for small finance banks to enable them to undertake fresh lending up to Rs 10 lakh per borrower. The Central Bank has also eased norms regarding the overdraft facility for state governments.

Expectations from the RBI MPC

Monetary measures are important, but the RBI is unlikely to undertake the heavy lifting that it did last year by further expanding liquidity, for the fear of other adverse macroeconomic consequences. There is not much more the RBI can do to revive the economy, and the heavy lifting has to be done by fiscal policy. Under the prevailing circumstances, maintaining retail inflation at 4% with a margin of 2% on either side may pose challenges. The RBI will have to be vigilant as the current ease in CPI inflation is largely due to a favourable base and weak demand.

Positive GDP growth for the second quarter in a row provides some support on the growth front. Economic recovery will gain momentum if vaccination is carried out at an accelerated pace. However, the spike in Covid-19 cases and shortage of vaccines create considerable uncertainty regarding the recovery in the near-term growth outlook. We hopefully expect the economy to register 9% growth in the FY22, while the rising Covid-19 infections, particularly in rural areas, pose a downside risk to these growth estimates.

In the current situation, we expect that the RBI may likely maintain the status quo and may continue with G-sap auctions to keep the yields on government securities in check. We expect the inflation rate to remain close to the upper bound target of 6% in the near term, and therefore, the MPC may continue to pause on the interest rates by maintaining the accommodative stance to support growth as long as inflation remains within the target range of the monetary policy framework.

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