Mounting challenges on growth; RBI expected to keep policy rates unchanged in April 2022 MPC meeting

Despite surging inflationary expectations, supporting broad-based economic recovery remains a priority. The economy has still not fully recovered from the pandemic shock and adverse geopolitical developments impeding the recovery process.

Brickwork Ratings, Bengaluru, 04 April 2022: Supporting broad-based economic recovery has remained a priority for the RBI's Monetary Policy Committee (MPC) since the outbreak of Covid-19, which began in March 2020. The RBI has maintained the key policy repo rate at record low levels of 4% since May 2020 and has continued with supportive liquidity measures to support growth revival in the pandemic-hit economy. With the lifting of the lockdown restrictions, the economy has been progressing well, even in the wake of a shortage in critical items, such as semiconductor chips, which are essential for manufacturing. However, Russia's war with Ukraine, which began on 24 February 2022, has suddenly changed the economic outlook. Continuing war-led supply and trade disruptions, and sanctions and a sharp rise in the international crude oil and other input prices are likely to have a significant adverse impact on economic growth. Rating agencies have already lowered India's GDP growth projections for FY23, and Brickwork Ratings projects 7.5% growth in FY23. Not only growth, inflationary expectations also heightened due to supply disruptions, along with high cost-push factors such as rising crude oil prices. The rise in edible oils is also likely to increase inflationary pressures as India imports nearly 90% of its sunflower oil from Russia and Ukraine together. In addition, with the elevated level of borrowing shown in the budget for FY23, amid excess liquidity in the system, the pressure on inflation intensifies. CPI inflation has already crossed the MPC's upper tolerance level of 6% for two consecutive months since January 2022, and continued supply disruptions caused by the ongoing geopolitical developments may further increase inflation in the coming months. We expect the RBI to revise its inflation forecast upwards to 5% for FY23 from 4.5% estimated in the February policy meeting.

Going by the price pressures, the MPC has been left with little scope to continue with an accommodative stance. The economy is still in the recovery mode with persistent supply chain disruptions and rising crude oil prices, which may pose a serious threat to sustaining the recovery. Despite this, the RBI may go slow with interest rate hikes and continue to support growth revival. The MPC may postpone its decision to hike policy rates in the ensuing MPC meeting and continue with the variable repo rate auctions. It may provide some hints on a calibrated normalisation of policy and may continue with unwinding measures.

We expect the RBI to keep the policy rates unchanged in the upcoming MPC meeting. Again, the statement is keenly awaited for its forward guidance on inflation and the GDP for FY23.

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