MPC minutes: Emphasis on growth, but inflation risks have mounted now

Much has changed since the last MPC meeting. Oil prices have surged by 10% and US 10Y yield has moved lower by 15bps. Equity markets have seen a sharp correction. Even so, minutes tell us that MPC members continue to emphasize on 1) India's growth and inflation dynamics are very different from AEs, 2) policy support is required to ensure growth is sustained, 3) India's food inflation outlook is benign, 4) demand pull inflation pressure are still muted, and 5) that higher international oil prices pose a risk to inflation outlook. RBI will be communicating its monetary policy glide path in an ever-changing global macro backdrop. Our base case is for RBI to change stance in June policy followed by repo rate hike in August or October. Emerging geo-political situation is a risk to our view.

Growth showing signs of recovery, but momentum is waning: MPC members believe that economic momentum has been impacted by spread of Omicron variant. Indian economy is likely to be only 2% over and above pre-pandemic level in FY22 with consumption continuing to under-perform. Members felt this requires continued policy support. Dr. Bhide pointed out continued weakness in consumer sentiments as reflected in RBI's Consumer Confidence Surveys. Prof. Varma said RBI's fan charts show that pre-pandemic situation of economy growing below potential will re-assert itself in coming quarters. Dr. Patra spoke about divergence in Indian economy as seen in improvement in GST collections, freight movement, real estate sales and a resilient external sector—exports and forex reserves. At the same time, labour force participation has fallen and vehicle registrations are lower as well.

Benign inflation outlook, but a lot has changed: Members believe India's inflation outlook is very different compared with advanced economies, which are witnessing inflation far above target of 2%. Dr. Patra said pandemic inflation surge is not driven by excess demand but by supply constraints. Members were sanguine about India's inflation outlook with Governor Shri Das pointing out that while core inflation is elevated, demand-pull pressures are still muted, given the slack in the economy. However, members added that rising commodity and energy prices need to be monitored. In fact, between the policy and now, oil prices have increased by 10%. During this calendar year, oil prices are higher by 29%. This will put upward pressure on CPI inflation. We expect CPI inflation at 5%, with an upward bias, compared with RBI's estimate of 4.5% in FY23.

Global and Indian conditions are different: Dr. Saggar spoke about rising global yields and monetary policy pivot visible in AE central banks. Inflation levels in these countries are at three-four decade high levels. At the same time, inflation in India is below tolerance band (January was at upper end of tolerance band) and is projected to recede in FY23 allowing RBI to remain accommodative. Rising commodity prices imply a change in inflation outlook depending upon durability of higher international commodity and energy prices at current levels.

What happens next? Prof. Varma spoke about switch to neutral policy stance being long overdue. However, other members spoke about continuing with accommodative stance to support growth. Dr. Saggar spoke about raising policy rate as soon as growth is judged to recover on a durable basis or inflation is seen to be turning endemic. He also spoke about maintaining credibility by keeping inflation on a sustained basis at or near target as soon as real economic conditions normalize. We believe next policy will have to be laid in a context of higher inflationary impulses from global energy and commodity prices. This will also be a drag on growth. Thus, RBI will have to do a fine balancing act and lay out assumptions of its inflation projections which are different from our and consensus estimates. A well-telegraphed message along with absorbing bond issuances of the Centre will give direction to domestic yields.

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