

## MPC minutes: Inflation concerns led to off-cycle hike; MPC to front-load hikes

**A broad-based and persistent inflation outlook led MPC members to do an off-cycle hike to ensure inflation expectations are not un-anchored. Members believe growth is holding up, even as there are risks to growth emanating from global factors—higher commodity prices and monetary tightening. CRR hike was on the back of persistent liquidity overhang. While system liquidity will come down to INR 4.5tn after CRR hike taking effect, it is still higher than RBI's framework of non-inflationary level of 1.5% of NDTL. Thus we see room for another 50bps of CRR hike. Also, with inflation continuing to remain elevated, we believe MPC will front-load rate hikes with a 50bps rate hike in June policy.**

**Tackling supply driven inflation:** Members agreed that inflation is getting broad based and persistent even if it is supply driven. Dr Ranjan said the upside risks materialized earlier than anticipated. Also, the drivers of inflation now are different compared with what it was during pandemic. Dr. Patra, Dr Ranjan and Governor, Shri Das, pointed out that inflation outlook can un-anchor inflation expectations. More importantly, Governor enumerated five factors since April meeting that have caused concern: higher than expected inflation in March, higher global commodity and food prices, elevated core inflation, increase in electricity tariffs and medicine prices and war in Europe. In our view, inflation is more persistent and broad based with 60% of CPI items now increasing in excess of 6%. Price data available for May 2022 also shows momentum continuing in pockets of food inflation. We believe there is upside risk to our CPI inflation projection of 6.5% for FY23.

**Growth outlook improving:** Members acknowledged that growth outlook is improving. Contact intensive services are rebounding and so is urban consumption. Rural consumption should pick-up with a normal monsoon. Investment activity should see an uptick with higher capacity utilization. Exports are resilient. However, high global commodity prices and tightening by global central banks poses a downside risk to growth. Dr. Goyal believes growth outlook remains robust despite a global slowdown since likelihood of a fourth wave is remote. Dr. Bhide pointed out that high frequency indicators are suggesting recovery is gaining traction as evident in improved bank credit, higher GST collections, manufacturing and services PMI and improved capacity utilisation. We believe there is downside risk to our growth estimate of 7.4% for FY23 on the back of lower global growth and slowdown in spending on the back of higher inflation.

**Real rates, liquidity and repo hikes:** Dr Goyal spoke on real rates and the need to prevent large deviations in real rates as was seen in post GFC when real rates were too negative and in 2010s when they were too high. Prof Varma too said real rates are sharply negative when evaluated at today's inflation or 3-4 quarters ahead inflation. On CRR hike, Dr Ranjan said it is in consonance with objective of withdrawing surplus liquidity. Governor, Shri Das said that hike should be seen in the backdrop of persistent liquidity overhang. Notably, Prof Varma spoke on the need for 50bps hike in May policy itself and raising rates by more than 100bps soon enough. Dr Goyal also believes that markets are pricing-in excessive rate hikes. Since, consumer demand is soft, such rate hikes may not be required. She also said that excessive yield spread can be reduced by OMOs apart from credible inflation targeting.

**Rate and liquidity trajectory:** Liquidity overhang continues with system liquidity at INR 5.3tn now vs. INR 5.7tn as on 4 May 2022. While it may reduce to INR 4.5tn after CRR hike taking effect on 21 May, it still seem to be far higher than normal levels and RBI's preferred framework of 1.5% of NDTL. Hence, we see another CRR hike to reduce liquidity. On repo rate, we believe a 50bps rate hike is on the cards in June meeting to ensure front-loading of monetary policy to restrain inflationary pressures. This will be followed by smaller 25bps rate hikes to take the terminal rate to 6% in back-to-back hikes. Higher oil prices are a risk to our terminal rate view.

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