MPC Preview – Communicating monetary policy amidst status quo

- **RBI to lay out path ahead for monetary policy with well telegraphed message on liquidity, growth and interest rates including policy normalization**
- **We expect RBI to guide markets towards a stance change in June policy which will also lay out condition for narrowing the corridor between repo and reverse repo rate**
- **First repo rate hike expected only in August or October depending upon inflation and growth**
- **Significant upward revision expected in CPI inflation and downward revision to growth estimate for FY23**
- **RBI to signal OMO purchases to be need based to ensure government borrowing sails through in a non-disruptive manner**

Inflation, inflation and inflation: Global Central Banks have had to contend with inflationary pressures emanating from supply bottlenecks emanating from the pandemic even as consumer behaviour changed towards consuming more goods. Apart from China, pandemic seems to have eased. However, Russia – Ukraine war and underinvestment in energy supplies has led to change in inflationary outlook. Apart from direct and indirect impact of higher oil and energy prices, even food inflation is rising globally led by supply side disruptions from the war. In the above backdrop, inflation is likely to be closer to 6% in FY23. Even in Q4, inflation is tracking above 6% (RBI's estimate of 5.7%). This is in sharp contrast to RBI's forecast of 4.5% with inflation ranging between 4% and 4.2% in H2FY23.

Growth to be lower: Oil and industrial metal prices have increased by 35% and 25% respectively during CYTD22. Food prices have gone up 37% YoY. Consumer budgets will be under stretch and will lead to decline in demand. Manufacturing margins were already under pressure during Q3FY22 will be under even more significant pressure now. At the same time, rural demand is likely to see an uptick with better terms of trade for farmers (wheat exports and higher realisations) and opening up of the economy with removal of restrictions. On balance, we have reduced our growth estimate from 8.2% earlier to 7.4% in FY23 (average of USD 95/bbl). We expect RBI to also revise its growth estimate lower from 7.8% earlier since our research shows that every USD 10/bbl change impact GDP growth by 0.2%. RBI's 7.8% estimate was predicated on average oil price at USD 75/bbl.

Managing government borrowing: Overall government borrowing by Centre and States combined is estimated at INR 23.4tn in FY23 compared with INR 18.3tn in FY22. The sharp increase in borrowing comes amidst an elevated CAD projection of 2.6% of GDP in FY23. Domestic resource mobilisation with the banking system has also been lower at INR 11.6tn in FYTD22 compared with INR 13.8tn in same period last year. Credit growth is also showing signs of uptick as economy emerges from the pandemic at 8.5% now versus 5.6% in March 2021. Thus, RBI's most important task at hand will be to manage government borrowing in the upcoming fiscal. While in April 2021, RBI did announce a purchase calendar (GSAP), in this policy we see RBI nudging the markets and undertaking bond purchases depending upon decline in FX reserves and demand for currency. Nevertheless, yields are headed higher.

What to expect in April policy?: In the April policy, we expect RBI to telegraph and communicate its monetary policy framework or roadmap as we exit the pandemic. We see RBI changing stance in June and normalising policy rates beginning in June. A repo rate hike will follow somewhere in August or October depending upon inflation and growth. Financial markets reaction to US Fed balance sheet tightening and half-a-point increase in rates will also be an important factor in achieving a balance between liquidity, growth and inflation. As of now, we see RBI raising repo rate by 75bps in FY23. However, the current tightening cycle may encompass far lower peak rate than what we have seen in the previous cycles.

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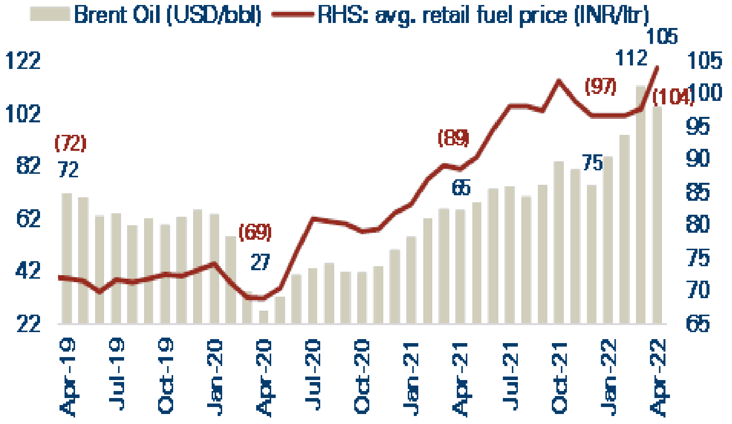
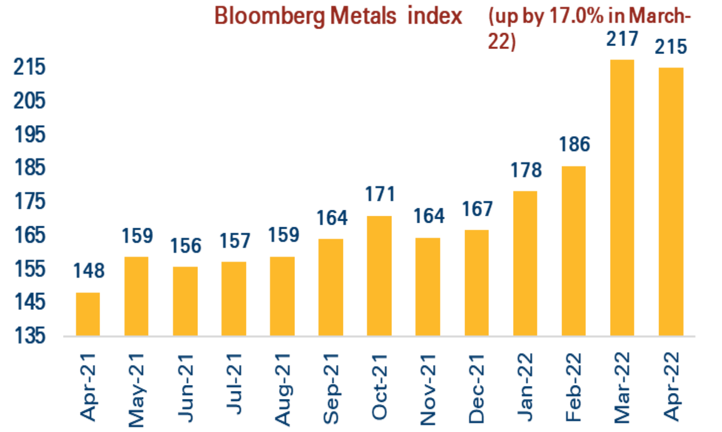
Retail prices have increased tracking global crude oil	Metal prices are also on the rise



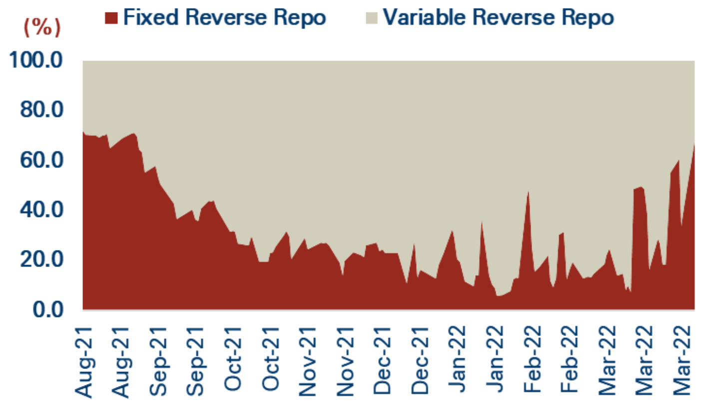
Source: CEIC, Reuters, ICICI bank Research



Source: Bloomberg, ICICI Bank Research

VRRR inching towards Repo	Absorption through VRRR has increased

Source: CEIC, ICICI Bank Research



Source: RBI, ICICI Bank Research

Growth Estimates

Yearly Growth estimates (% YoY)	FY19	FY20	FY21	FY22 SAE	FY22 (F)	FY23 (F)
Agriculture	2.1	5.5	3.3	3.3	3.3	3.2
Industry	5.3	-1.4	-3.3	10.3	8.4	5.4
Services	7.2	6.3	-7.8	8.6	8.9	9.2
GVA	5.8	3.8	-4.8	8.3	7.8	7.0
GDP	6.5	3.7	-6.6	8.9	8.5	7.4

Source: MoSPI, ICICI Bank Research

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