

## Reassessing inflation and growth

- **MPC to hike repo rate by 50bps but leave CRR unchanged given the large reduction in system liquidity since the last policy meet**
- **MPC to revise the inflation projection to 6.2-6.5% from 5.7%, on the back persistent and broad-based momentum**
- **Growth forecast may be revised lower to 7% on the back of lower global growth. Recent indicators show dip in exports but pick-up in credit growth**
- **We continue to see terminal rate at 6%. However, rising oil prices are a risk to our view. Another greater than 25bps rate hike in August not ruled out given inflation momentum**

**Reassessing inflation trajectory:** Since the off-cycle hike by RBI in May 2022, inflation backdrop has seen signs of moderation led by supply side measures taken by government: 1) reduction in taxes on petrol and diesel by Centre and States, 2) imposition of export duties on iron ore and steel, 3) reduction in customs duty or agriculture infra cess on a number of inputs ([Supply side measures to moderate inflationary pressures](#)). However, crude oil prices have continued their upward march with EU imposing a ban on Russian oil imports despite OPEC+ agreeing to ramp up output. Oil prices have averaged USD 114/bbl since the last off-cycle hike compared with USD 106/bbl in April 2022. Global food prices too have continued the upward momentum. Only metal prices have seen some easing. Notably, RBI did revise its inflation trajectory upwards to 5.7% in April from 4.5% in February 2022. However, given the inflation backdrop, we believe RBI's new inflation forecast could be anywhere between 6.2-6.5% (our estimate: 6.5%).

**Growth to moderate:** Global economic momentum is likely to slowdown in the wake of global monetary tightening, supply side constraints and inflationary pressures. The impact on growth will be visible through decline in real incomes and negative wealth effect. As of now, in the current financial year, equity markets have seen a correction (Nasdaq: -16%, S&P 500: -9%). New home sales in US are also seeing some moderation given the elevated mortgage rates. Consumer confidence is drifting lower. However, US non-farm payroll additions and housing prices tell a different tale. Global monetary tightening will have an impact on asset prices in the coming months. India's growth will also moderate with inflation impacting discretionary consumption, moderation in exports with lower global growth (already visible), negative terms of trade and dip in foreign inflows. We have revised our GDP growth lower to 7% from 7.4% earlier. RBI may also look at revising growth lower to around 7%.

**Liquidity moving towards lower levels:** Systemic liquidity as on 3 June stood at INR 3.8tn (~2.3% of NDTL). It was at INR 7.1tn as on 31 March 2022 and INR 5.4tn at the time of off-cycle hike. The decline in liquidity is driven by higher demand for currency, FX interventions, CRR build-up and OMO sales. With such a large scale back in liquidity and estimated INR 3.9tn decline in liquidity from now till end of the financial year, we believe system liquidity will be around INR 1.5-2tn range in end-March 2023. This is well within RBI's non-inflationary band of 1.5% of NDTL. Thus, we don't see RBI raising CRR in the upcoming meet.

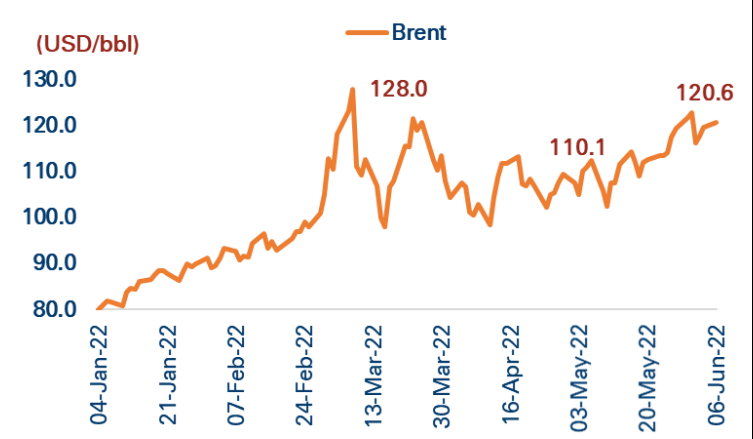
**A 50bps hike in the offing:** In the off-cycle hike, MPC raised repo rate by 40bps along with CRR hike of 50bps. MPC member, Dr Goyal spoke on the fact that rate hike would have been higher if not for CRR hike (Business Standard: [RBI rate hike was moderate as CRR was also raised](#)). While April print of 7.8% did surprise us (our est: 7.4%), we don't know the extent of surprise to RBI's estimate. Even May inflation will be just short of 7%. With no immediate need for a CRR hike, the inflation and growth assessment calls for 50bps increase in repo rate. We continue to see terminal repo rate at 6% with back-to-back rate hikes unless inflation trajectory surprises on the positive side. We do not rule out another greater than 25bps rate hike in the August policy. Our terminal repo rate view is contingent on oil prices. If oil prices do increase further, we believe terminal repo rate would have to be higher. Bond yields will move depending upon indication from RBI on terminal rate and the pace of the rate hikes. Fundamentals point towards higher yields given elevated supply of government bonds when Centre is spending more and more on subsidies and reducing duties (lower revenues). We see near-term range between 7.5% and 7.75%.

**Chart 1: Vegetable prices accelerated in May**



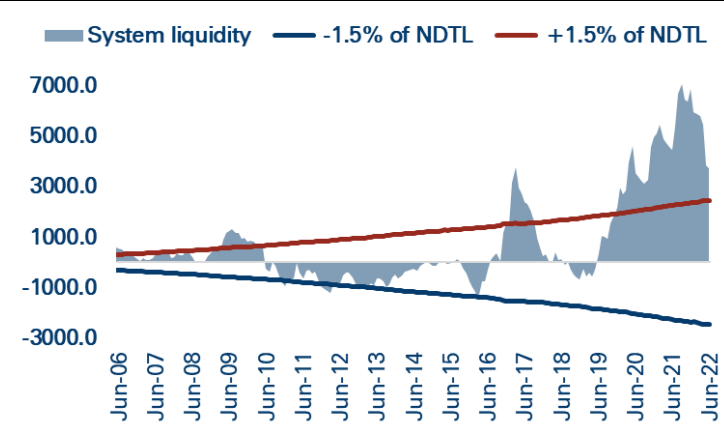
Source: CEIC, Reuters, ICICI bank Research

**Chart 2: Crude inched up 9.5% since last policy meet**



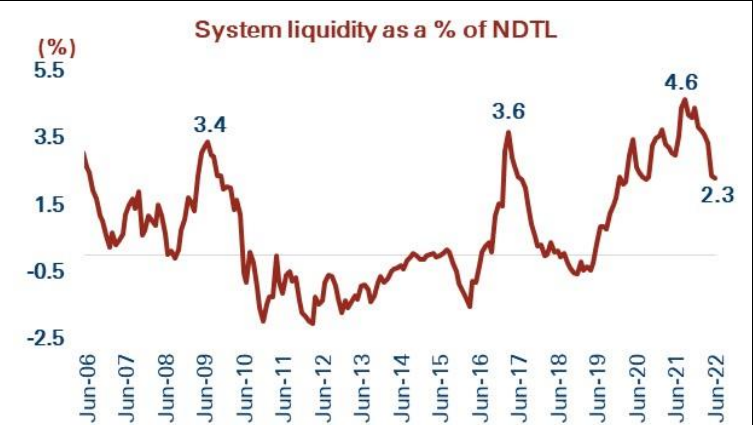
Source: Bloomberg, ICICI Bank Research

**Chart 3: Systemic liquidity coming down recently on account of leakage through the durable liquidity drivers**



Source: CEIC, ICICI Bank Research

**Chart 4: System liquidity as % of NDTL as come down to 2.3% of NDTL from the highs on 4.6% in September 2021**



Source: CEIC, ICICI Bank Research

**Growth Estimates**

Yearly Growth estimates (% YoY)	FY19	FY20	FY21	FY22	FY23 (F)
Agriculture	2.1	5.5	3.3	3.0	3.0
Industry	5.3	-1.4	-3.3	10.3	4.9
Services	7.2	6.3	-7.8	8.4	9.2
GVA	5.8	3.8	-4.8	8.1	6.8
GDP	6.5	3.7	-6.6	8.7	7.0

Source: MoSPI, ICICI Bank Research

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