Expectations from the RBI's December 2022 Monetary Policy

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Introduction

The recent softer tone of the Fed regarding future policy rate has calmed the market to some extent, but there are many red flags. The Fed has currently estimated that 12-month personal consumption expenditures (PCE) inflation through October ran at 6.0 percent. The Core PCE inflation, (that excludes the food and energy inflation components), has shown a downward trend recently but still is quite volatile. Of course, food and energy prices matter a great deal for household budgets, but core inflation often gives a more accurate indicator of where overall inflation is headed. Fed has raised its target range for the federal funds rate by 3.75 percentage points since March'22.

For the sake of better analysis, Core inflation can be categorized in the following categories:

(a) Core Goods Inflation.

(b) Housing Services Inflation.

(c) Inflation in core services other than houses.

Core good inflations have shown a declining trend; *or at least may be relatively in better situation compared to the other two categories* (Fed is relatively more optimistic it will reduce in future). On the other hand, *Housing services inflation has increased* (overall housing services inflation has continued to rise as existing leases turn over and jump in price to catch up with the higher level of rents for new leases. Further, housing services inflation will probably keep rising well into next year, but if inflation on new leases continues to fall, we will likely see housing services inflation begin to fall later next year. *Inflation in core excluding housing does not show any clear trend*. This spending category covers a wide range of services from health care and education to haircuts and hospitality. This is the largest of the above three categories, constituting more than half of the core PCE index. Thus, this may be the most important category for understanding the future evolution of core inflation. Because wages make up the largest cost in delivering these services, the labor market holds the key to understanding inflation in this category.

Among other Advanced Economies (AEs), ECB and Bank of Canada also frontloaded their monetary policy with a 75 bps and 50 bps rate hike in October'22. UK and Australia raised their policy rates by 75 bps and 25 bps, respectively in Nov'22. Norway increased its policy rate by 25 bps in Nov'22. Japan, however, continued to diverge by maintaining an accommodative stance.

Among the Emerging Market Economies (EMEs), Colombia and Indonesia increased their policy rates by 100 bps and 50 bps, respectively, in Oct'22. While Malaysia increased its policy rate by 25 bps in Nov'22, Brazil went for a wait mode in its Oct'22 meeting. Turkey had cut its rate by 150 bps in Oct'22 (as President Erdogan believes rate cut would be conducive for incentivizing business sentiments and investments, and rate hike will not help in containing inflation). On the other hand, China remained accommodative.

IMF GDP growth projection for China 3.2% in 2022 and 4.4% in 2023-24 based on assumption current zero covid policy will be gradually lifted in the second half of 2023. Certain plants like in Zhengzhou are suffering from strict COVID-19 restrictions. China has relaxed the testing and quarantine rules amid nationwide protests calling for an end to lockdowns and greater political freedoms.

OPEC+alliance has decided to stick to its oil output target as oil market is struggling to assess the impact of a slowing Chinese economy on demand and a G7 price cap on Russian oil on supply.

Table 1: GDP growth projections of AEs and EMEs (%)

	Growth Projections (%)		Change from WEO Update (July 2022) (%)	
	2022	**2023**	**2022**	**2023**
World	3.2	2.7	0	–0.2
Advanced Economies	2.4	1.1	–0.1	–0.3
United States	1.6	1	–0.7	0
Euro Area	3.1	0.5	0.5	–0.7
UK	3.6	0.3	0.4	–0.2
Japan	1.7	1.6	0	–0.1
Emerging Market Economies	3.7	3.7	0.1	–0.2
China	3.2	4.4	–0.1	–0.2
India*	6.8	6.1	–0.6	No change
Source: IMF ***Projection for India is for its fiscal year (Apr-Mar) while for the other economies, it is from Jan-Dec.**				

Source: Ministry of Finance, Monthly Report, October 2022.

Developments in the Indian Economy

India's foreign exchange reserves rose for the third straight week, to $550.14 billion in the week through November 25, 2022. Demand for work under the Mahatma Gandhi National Rural Employment Guarantee Scheme increased to a four-month high of 22.5 million in Nov'22. Gross Domestic Product (GDP) posted a growth of 6.3 per cent year-on-year for the July-September 2022 quarter of the current financial year. The manufacturing sector witnessed a slowdown owing to fall in profits, a key component of the Gross Value Added (GVA). Profits were adversely affected by higher costs of raw materials, energy prices and rise in interest rates. On the other hand, the services sector has done relatively well. Government consumption expenditure registered a contraction (the first contraction in five quarters). The government is keeping its revenue expenditure under check, possibly to achieve fiscal consolidation.

Table 2: Quarterly Estimates of GVA at Basic Prices for Q2 (July-September) 2022-23 (at 2011-12 Prices) (₹ Crore)

Industry	GVA at Basic Price									
	2020-21		2021-22		2022-23		Percentage Change Over Previous Year			
							2021-22		2022-23	
	Q1	Q2	Q1	Q2	Q1	Q2	Q1	Q2	Q1	Q2
1. Agriculture, Forestry & Fishing	462,006	393,424	472,258	405,870	493,325	424,386	2.2	3.2	4.5	4.6
2. Mining & Quarrying	68,000	59,916	80,243	68,626	85,423	66,696	18.0	14.5	6.5	-2.8
3. Manufacturing	387,448	591,929	577,249	624,891	605,104	598,011	49.0	5.6	4.8	-4.3
4. Electricity, Gas, Water Supply & Other Utility Services	67,901	74,997	77,297	81,385	88,640	85,971	13.8	8.5	14.7	5.6
5. Construction	131,437	224,897	225,166	243,071	262,918	259,098	71.3	8.1	16.8	6.6
6. Trade, Hotels, Transport, Communication & Services related to Broadcasting	331,582	516,278	445,454	565,940	559,723	649,354	34.3	9.6	25.7	14.7
7. Financial, Real Estate & Professional Services	787,925	812,108	805,847	861,973	880,313	924,137	2.3	6.1	9.2	7.2
8. Public Administration, Defence & Other Services*	347,501	391,371	369,150	467,491	466,380	497,946	6.2	19.4	26.3	6.5
GVA at Basic Prices	**2,583,801**	**3,064,920**	**3,052,664**	**3,319,248**	**3,441,826**	**3,505,599**	**18.1**	**8.3**	**12.7**	**5.6**

Public Administration, Defence & Other Services category includes the Other Services sector i.e. Education, Health, Recreation, and other personal services

The Goods and Services Tax (GST) collections topped INR 1.40 lakh crore in November. The GoI settled INR 33,997 crore to CGST and INR 28,538 crore to SGST. The total revenue of the Centre and the States after the regular settlements in Nov'22 was INR 59,678 crore for CGST and INR 61,189 crore for SGST.

The government's fiscal deficit in end-October 2022 touches 45.6% of the full year Budget Estimate (BE). The fiscal deficit remains at INR 7,58,137 crore during the Apr-Oct' period of 2022-23. In the year-ago period, the deficit was 36.3% of the estimate of 2021-22.

Fiscal Deficit As A Percentage of GDP (%)

Year	Fiscal Deficit (%GDP)
2015-16	3.9
2016-17	3.5
2017-18	3.5
2018-19	3.4
2019-20	4.6
2020-21	9.2
2021-22	6.9
2022-23	6.4

Source: Union Budget Documents.

GOVERNMENT OF INDIA UNION GOVERNMENT ACCOUNTS

(AS AT THE END OF OCTOBER 2022) (Rs. in Crore)

			Budget Estimates 2022-2023*	Actuals@ upto October 2022	Percentage of Actuals to Budget Estimates	
			Rs.	Rs.	Current	COPPY**
1	**Revenue Receipts**		**2204422**	**1349882**	**61.2%**	**(70.5%)**
2	Tax Revenue (Net)	***(Details)***	1934771	1171103	60.5%	(68.1%)
3	Non-Tax Revenue	***(Details)***	269651	178779	66.3%	(85.1%)
4	**Non-Debt Capital Receipts**	***(Details)***	**79291**	**35692**	**45.0%**	**(10.5%)**
5	Recovery of Loans		14291	11102	77.7%	(79.7%)
6	Other Receipts		65000	24590	37.8%	(5.4%)
7	**Total Receipts (1+4)**		**2283713**	**1385574**	**60.7%**	**(64.7%)**
8	**Revenue Expenditure**		**3195257**	**1734697**	**54.3%**	**(53.7%)**
9	*of which* Interest Payments		940651	481172	51.2%	(49.5%)

10	**Capital Expenditure**		**749652**	**409014**	**54.6%**	**(45.7%)**
11	*of which* Loans disbursed		140057	44307	31.6%	(50.9%)
12	**Total Expenditure (8+10)**	***(Details)***	**3944909**	**2143711**	**54.3%**	**(52.4%)**
13	**Fiscal Deficit (12-7)**		**1661196**	**758137**	**45.6%**	**(36.3%)**
14	**Revenue Deficit (8-1)**		**990835**	**384815**	**38.8%**	**(27.5%)**
15	**Primary Deficit (13-9)**		**720545**	**276965**	**38.4%**	**(20.9%)**

Source: CGA.

Growth in the country's eight key infrastructure sectors slowed to a 20-month low in October'2022 dragged down by a contraction in four major sectors-crude oil, natural gas, refinery products, cement. The combined Index of Eight Core Industries increased by 0.1 per cent (provisional) in October 2022 as compared to the Index of October 2021.The fertilser sector which grew by 5.4% and the steel with 4% expansion were the only two sectors showed some robust growth.

According to the Oct'22 report by the Ministry of Finance, GoI, "*During Jan-Oct 2022, CPI inflation was largely driven by food inflation (48.3 per cent contribution) with major contributors being imported food items like oil and fats during the first five months of 2022. Since June 2022 however, domestic seasonal factors have increased the inflation of vegetables, cereals and their products, which have contributed to elevating food inflation. Fuel and light inflation has, on average, remained a moderate contributor at 9.7 per cent. On the other hand, the contribution to inflation by miscellaneous components, including transport and communication, health and others, decreased from 30 per cent in January 2022 to 24 per cent in October 2022*."

RBI's households' inflation expectation survey for September 2022 revealed that the three-month and one-year ahead expected inflation rates increased to 10.8 per cent and 11.0 percent, respectively compared to 10.3 per cent and 10.5 per cent in the July 2022 survey. While inflation expectations have increased, they tend to be influenced more by the present conditions than the decline in international commodity prices. Hence, the elevated inflation in the current period has led to an increase in household inflation expectations.

Concluding Remarks

The world is facing a daunting future. In its latest Global Financial Stability Report (GFSR), the IMF has highlighted two major risks to global financial stability: disorderly tightening of financial conditions; and debt distress among emerging and frontier economies. The global composite PMI output index dropped for the second consecutive month in Sept'22, led by fragility in advanced economies (particularly in the euro area), as high uncertainty and soaring energy prices undermined confidence.

The global macroeconomic outlook remains highly uncertain. Russia and Ukraine being major suppliers of agricultural commodities, their war has stifled the supply and increased food inflation, impacting overall global food security. International sanctions, including trade restrictions imposed on Russia, have also contributed to the collapse of global supply chains.

India's food system has also been adversely impacted by the conflict and vagaries of nature. Domestic prices of some food items have risen in the wake of the rise in international prices. India's grain availability was affected by the untimely heatwaves and deficiency of the southwest monsoon in the current year.

In this uncertain backdrop, the RBI has raised its policy repo rate by 190 bps from 4 per cent to 5.9 per cent. In each monetary policy, RBI's stance remains relatively softer towards stance, in most of the policies it remains at accommodative, while even at tightening phases, the stance remains largely withdrawal of accommodation while supporting growth, which clearly shows, that the RBI's concern for growth is no less than the inflation. One of the favorable factors for the RBI is the assumption on crude oil; while it has been hovering around $87 per barrel, while the RBI's projections on future inflation and subsequent increase of repo rate is largely conditioned upon its assumption that crude oil price will remain at $100/barrel.

Barring the recent external balance stress, subdued oil price, increased forex reserves and possible Fed rate softened stance may prompt RBI for a relatively softer stance of repo rate hike by 25-35 bps points. If the terminal rate remains at 6.50%, then a 25-bps hike in Dec’22 means RBI will be left with some leeway in the forthcoming monetary policy. Given the current repo rate at 5.90%, a 25 bps hike will lead to the policy repo rate at 6.15%, thus providing leeway for 35 bps hike in the next policy, if inflation increases meanwhile. Given that, it is more likely that RBI would increase the repo rate by 25 bps in Dec’22 policy, however, overall, the subsequent monetary policy would be seeing a rate hike in the range of 25-35 bps.