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RBI MONETARY POLICY EXPECTATIONS

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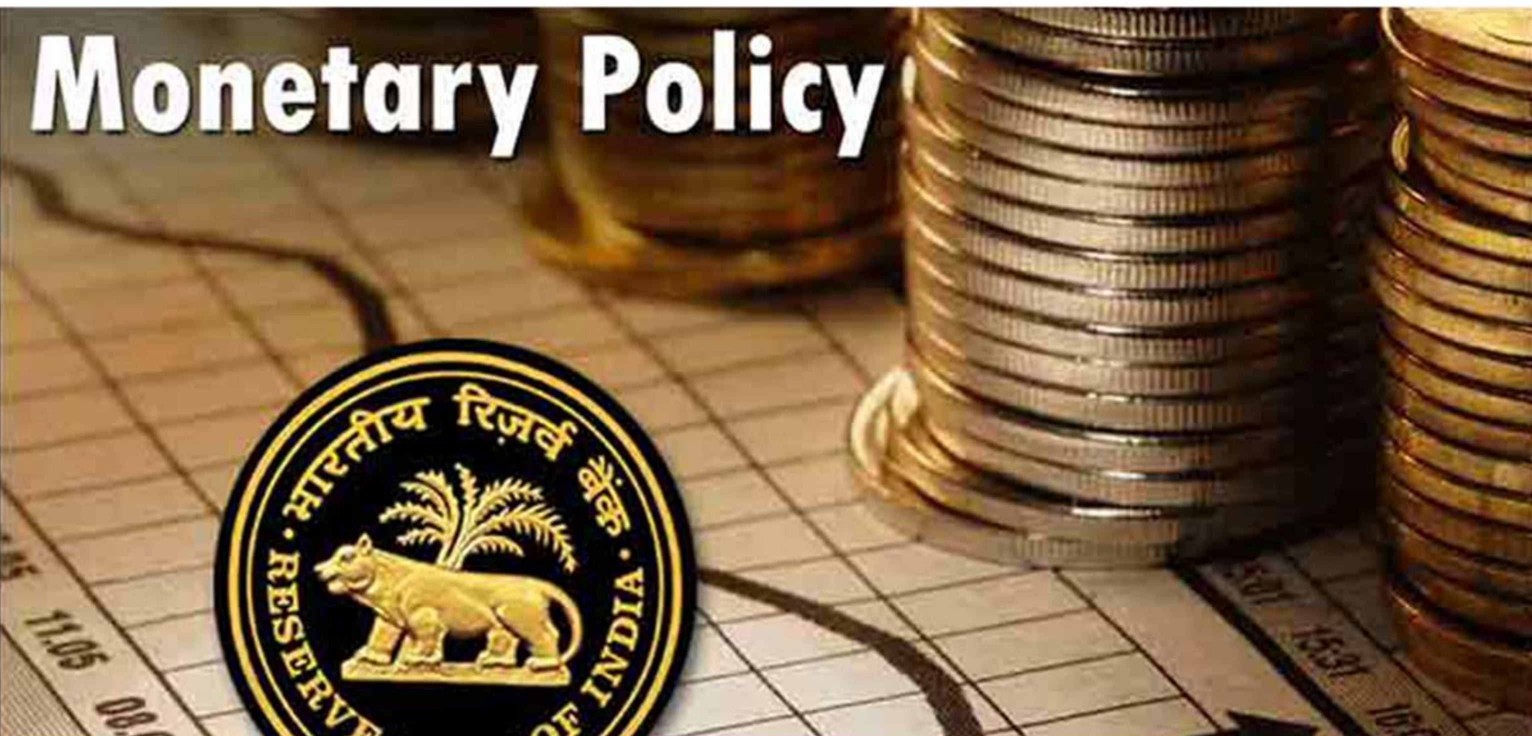
RBI'S APRIL 2022 POLICY EXPECTATIONS - STATUS QUO ON KEY RATES TO SUPPORT GROWTH

GLOBAL PERSPECTIVE

The RBI's April Policy would be formulated against challenging global and domestic conditions. The global recovery has been jolted by the Russia Ukraine war because of surging energy prices, supply side disruptions and spiking inflation. This war has global ramifications. It needs no clairvoyance to realize that eventually there are no winners in a war.

Global growth and inflation are imperilled by surging commodity prices post Ukraine war, fragile real incomes, disrupted trade and energy lines. Muted European growth, scarce wheat, vegetable oils, some metals and electronic components and evolving Chinese Covid situation weaken global growth. The global economy is in a spin. The global economy has been severely impacted by decelerating growth and accelerating inflation. The IMF shows economic impact of Ukraine war to flow through 3 main channels: 1. Higher prices for commodities, viz., energy, grains and metals, accelerating inflation. 2. Disrupted trade, supply chains and remittances in neighbouring countries, surge in refugees. 3. Reduced business confidence and higher investor uncertainty to impact asset prices.



There is, then, the dread of recession and stagflation. Legendary Pimco cofounder Bill Gross maintains recession is imminent because of slowdown preceding Russia Ukraine war, spike in oil prices, Fed hike in March. The period ahead is petrifying and extensiuve uncertainty. These testing times bring out the need for all round care and caution.

The global scenario is characterized by ongoing geopolitical crisis (Russia-Ukraine war), which has roiled global markets for stocks and commodities with prices of wheat, aluminum, and even coal surging, wide-ranging impact on the U.S. and global economies and isolation of the Russian economy. The Russian isolation, as stressed by Bloomberg, is "choking off a major source of energy, metals, and crops — sparking fears of prolonged shortages and accelerating global inflation". Some indications of the real and worrisome scenario is manifested in the fact SandP Dow Jones Indices said it will strip stocks listed or domiciled in Russia from its benchmarks and, "given the deterioration in the level of accessibility of the Russian market", declassify the country as an emerging market. Apart from the financial sanctions imposed by the West, including blocking Russia's central bank from international operations, the U.S., UK, Canada, and EU have blocked Russian banks from the Swift payment transactions system to "harm their ability to operate globally".

The rapidly unfolding worsening scenario in a post-pandemic world, where growth was gaining traction, has forced the U.S., allies to draw on emergency crude (the fourth such synchronized downsizing in 47 years with the clear and ostensible aim of debilitating Russia's energy industry. There has, however, been a robust growth in U.S. job growth with the unemployment rate reducing from 4% to 3.8% because of an increment of 678,000 jobs in March 2022— the most since July 2021. It has, therefore, sometimes been suggested that the US economy could weather surging inflation, geopolitical tensions, and higher interest rates.

Spiralling inflation; rising policy rate in UK.With UK facing worst squeeze in real disposable income in 30 years, The Bank of England (BoE) raised Bank rate from 0.25 % to 0.50 %- first such hike post 2004 in 2 successive meetings. Inflation could reach 7.25 % in April. The Bank of Canada raised its benchmark interest rate to 0.5% for the first time since 2018 in a succession of rate hikes intended to tame inflation, which is at its highest point in decades.

Raising interest rate by the US Fed for the first time post 2018 is contextually significant. With Fed hiking interest rates by 25 bps and peoviding guidance showing hike in all remaining 6 meetings (market factoring in further 180 bps hike), the fears of recession are surfacing. The US Fed's action is aimed at cooling 8 % inflation, which is the highest in 4 decades, despite upside growth risks. Emergingmarkets must prepare effectively to ward off capital outflows and currency depreciation. This causes a difficult policy trade off between rising debt and inflation or fostering recovery; response to be based on circumstances and vulnerabilities in worrisome.

The IMF shows "spillovers" caused by tightening monetary policy could be benign. But fast Fed moves to check inflation and taper asset purchases could shake financial markets and tighten financial conditions globally. The IMF shows economic policies in Euro zone supported household incomes and protected corporate balancesheets with greater vaccination and adaptation to pandemic. With higher uncertainties and inflation, some Euro countries could tighten their macro-prudential stance, facilitate labor reallocation and protect the vulnerable. Repressed economic growth, which customarily goes along such shocks in commodity prices, makes the monetary policy formulation uneasy and complex. The cognizable predicament is reflected in thr fact that hiking interest rates in the wake of surging oil and gas prices and distressed financial market conditions could check the inflationary spiral but also hamper growth while leaving rates low could shoot prices even higher. In sum, the Russia Ukraine war, volatility in prices of oil and gold have led to unbounded global uncertainty. Wide ranging sanctions by US, UK and EU on persons connected to the war, greatly restricted access to global markets and use of foreign assets, stopped access to dual purpose imports of goods and components to weaken Russian economy and also hamper the global economy. There is stressed geopolitical dynamics.

Global economic prospects are marred by unequal vaccination across countries; ubiquitous rising inequality; 3rd pandemic wave; inflationary spiral; GDP growth headwinds for US, Germany and China; higher goods prices because of pandemic deficits and the completely disruptive Russia Ukraine war. Against this backdrop, Central banks have been forced to straddle growth inflation tradeoff because of supply-side disruptions and cascading prices. Divergent currency movement- ascendant $ and feeble 夫 complicate policy making in emerging economies. These are indeed difficult times.

The emerging contours of the global economy imply significant downside risks for countries across the development spectrum because of the contagion effects. The overarching global scenario together with the emerging domestic macro-economic landscape could lead some Southeast Asian countries to raise their benchmark interest rates earlier. Indonesia is expected to increase its seven-day reverse repurchase rate in the third quarter. Meanwhile, Malaysia may raise its benchmark rates by 25 basis points in both the third and fourth quarters. Singapore tightened its monetary policy unexpectedly in January, with further monetary action likely in April. Singapore recorded the fastest rise in core CPI in a decade in January.

About 100 countries globally are exploring central bank digital currency (CBDC). IMF paper argues the new currencies could boost financialinclusion in places where private financial institutions find it unprofitable to operate and generate more resilience in regions prone to natural disasters. The IMF’s MD stressed 3 lessons: 1. no universal case for CBDCs because of economy-wise peculiarities; 2. financial stability and privacy concerns; 3. balancing design and policy.

Geopolitical tensions post Russia Ukraine war, sweeping financial sanctions, supply chain disruptions leading to snowballing prices across the development spectrum from wheat and corn, to metals, including aluminium and nickel and oil and gas. These aspects are not just worrisome both for domestic and global economy but also heighten stagflation concerns.

The CPI inflation is likely to breach 8 % in March in US. With surging inflation, CPI inflation in US reached a 40 year high of 7.9 % in Feb. Geopolitical dynamics would cause it to breach 8 % in March. Later with drop in energy prices, restored supply chains and base effects, the CPI level is likely to dip post March. Gazing into the crystal ball- collapse of financial markets?The Economist, London demonstrates elements of continuity and change of USA’s present financial system vis-a-vis 2001 and 2008. Given high asset prices and rising interest rates, it’s unclear whether the system will absorb or amplify them.

Today banks are safer but less pivotal, risks shifted to shadow banks and investment funds, reliance of more decentralised financial system through few nodes injects systemic volatility because of regulation and technological innovation. Testing times ahead. Future of Money- Digital Revolution. Cornell Prof. Eswar Prasad shows profound influence of digital currencies and other financial technologies on all aspects from consumer banking to monetary policy and international payments. Cash could wither away- tectonic times ahead.

INDIAN SCENARIO

GDP GROWTH

The IMF’s MD said India has been very good at managing its finances but the surge in global energyprices will hurt it. Hence she stressed focus on vulnerable sections and appropoiate fiscal and monetary policies. Despite a difficult macroeconomic environment, viz., Covid19 concerns, severe resource constraint and required thrust on spending, there is a distinct likelihood of the Indian economy recording 7.5 per cent growth in the current financial year and 8 per cent in 2023-24.

As brought out by the Asian Development Bank (ADB), the future economic growth would be fostered "by increased public investment in infrastructure and a pickup in private investment". This forecast is, however, contingent on sustained progress in COVID-19 vaccinations, limited severity of any new variants of the virus, the impact of Russia's invasion of Ukraine, primarily higher global oil and commodity prices and sharp rises in commodity prices.

Tailwinds for sustained growth relate to large public infrastructure investments planned over the next two years, the PM Gati Shakti initiative to improve India's logistics infrastructure, increased financial and technical support to states to expand capital investment, the government's production-linked incentive scheme providing an impetus to the manufacturing sector in and higher private consumption with improving labour market conditions. There are also expectations of a normal Monsoon, which coupled with rising wheat prices with salubrious impact on agriculture output and farmers' income.

India is on the cusp of a revolution in digital payments. Digital payments have zoomed 160 times in last 2 decades in India. Nasscom shows India's sprint to a world-leading digital payments ecosystem by 2025 to create Rs. 2.8 lakh crores in economic value and upto 26 lakh jobs. Truly stupendous!

Despite the ravages of Covid19 and global uncertainties post Ukraine war, India's exports breached $ 400 billion led by exports of engineering goods, apparels and garments, gems and jewellery, agricultural and petroleum products. Way to go! But India's rising trade deficit causes concern. Imports rose by 36.1 % yoy (6.8 % sequentially to $ 55.45 billion) and exports by 25.1 % yoy (0.2 % sequentially to $ 34.57 billion). Despite this uptick in export growth, the trade deficit rose from $ 17.42 billion in Jan. to $ 20.88 billion in Feb. because of higher growth in imports. FY 23 Current Account Deficit (CAD) could be 2.8 % of GDP.

Rising trade deficit is a cause for concern. India's current account deficit rose from $9.9 billion/ 1.3% of GDP in Q2 to $23 billion/ 2.7 % (close to perilous 3%- 1.8 % in FY 22); trade deficit surged to $ 60.4 billion because of rising imports.FY 23 current account deficit could be 2.8-3 % of GDP.

Heightened geopolitical tensions impact India. Heightened geopolitical tension-Russia-Ukraine war could cause ₹ to slide, rise in inflation, supply chain disruptions and flight of capital. India's current account deficit to change from surplus of 0.9 % of GDP in FY 21 to deficit of 2.8% in FY 23 necessitating a close and careful monitoring.

There is a repercussion of Russia-Ukraine war on Indian companies. RussiaUkrainewar and consequent economic sanctions on Russia could reduce creditworthiness of Indian companies; necessitate rating revisions in defense, tea exports, steel, coal, pharma, fertiliser, oil and gas sectors. Challenging times. Spiralling WPI inflation, capital market valuations, supply-chain issues and labour shortages, private capex and housing could cloud macro-economy necessitating urgent coordinated and concerted action.

Omicron struck a discordant note in India's growth story. Despite Omicron concerns and supply disruptions, positivity in consumer-led recovery, rising coal production, car sales. FY 22 GDP likely to be 8.3%. Macroeconomic risks include inflation, glidedown of accommodative monetary policy and fiscal crunch. Reconciling policy objectives is needed.

India's foreign exchangereserves at $ 634 billion exceed foreign debt of $600 billion. These forex reserves enough to cover 1 year of imports reflecting India's macro-economicstability and resilience. Despite stagflationary concerns, India is likely to remain the fastest growing economy. Enhancing broad-based growth, fiscal consolidation, accent on lives and livelihood is crucial.

Rising vaccination facilitated demand transmission from goods to contact intensive services and real estates. But accentuating skew in income and wealth causes concern. Growth to be powered by ITservices, autos, pharma, mobile phones and tech startup with huge financial inflows.

Sustainable growth over the long haul requires, as Pranjul Bhaduri shows, focus on health of corporate balance-sheets, worldgrowth, policy certainty and domestic growth. Tough times necessitate an equally tough response.

The fiscal policy conundrum in India is baffling. Prudent fiscal reforms are needed to raise the resilience of the Indian economy post Covid and sustainable public finance- both on revenue and expenditure sides. Success depends on design, management and effective response to stakeholder concerns. This has led to the Shakespearean dilemma of reducing revenues by slashing fuel taxes or risking both higher inflationary price spiral and decelerated growth. To be or not to be!

CBDT Chairman maintains 30 % tax on digital assets will cause a surge in tax collections as the turnover of top 10 crypto exchanges in India is around ₹1 trillion. This is a measure of considerable contemporary significance. India's public debt at 90 % of GDP is one of the highest in emerging markets (EMs). While debt is still sustainable, nominal GDP rates and interest rate impact macroeconomic situation. Adroit public debt management is needed.

AGRICULTURE

The steep decline in contribution of Indian agriculture from 55 % of GDP in 1951 to 20 % now evokes discussions. But transforming consumption patterns, diversifying agriculture from foodgrains to high value items, viz., horticulture, livestock and fisheries critical for a holistic perspective. Enhancing value addition in agriculture does not brook any delay.

The farm sector likely to grow at about 3 %. There is a compelling need to breach 3-4 % annual growth for robust macro growth, distributive equity and transformed lives and livelihoods with Innovative out of box thinking in Indian agriculture.

Agri credit disbursement rose from measure 64,000 crore FY 2002 to ₹15 lakh crore FY 21. Streamlining credit requires, as Bhanwala shows, differentiated needs-basedapproach, thrust on FPOs to enhance credit and direct credit to desired channels, horticulture and value chain financing. The Agri Ministry's thrust on public sector research and extension institutions+ private agritech players in digitization, e.g., kisan drones for crop evaluation, pesticides and nutritients, analytics, artificial intelligence, blockchain, etc. could raise productivity across regions.

Innovations in agricultural credit re needed because of rising stakes in transforming agriculture. AshokGulati et al cogently argue to revisit power and fertiliser subsidies and reorient MSP and procurement policies to minimise GHG emissions. Given the catalytic role of agriculture on lives and livelihoods, a paradigm shift is needed.

Taking agriculture to the next level is a must. The RBI shows Indian agriculture marked by record foodgrains production, horticulture diversification, greater significance of allied sectors and changing dynamics of agriculture trade. Key enablers, viz., productivity, mechanisation and irrigation to be strengthened.

Overcoming challenges of Indian agriculture. RBI- agricultural challenges of climate change, agriculture waste management, disguised unemployment and volatile food prices necessitate supplyside interventions, viz., higher public investment, storage infra and food processing industries to manage food inflation and volatility. Propelling agriculture to a higher orbit requires coordinated measures with a sense of urgency. EandY study shows India's agritech market at $ 24 billion by 2025 with high potential for supply-chain technology and output markets. 'On farm trials' and 'frontline demonstrations' to identify location specific technologies with applicability in crop and animal husbandry.

BANKING AND FINANCIAL SECTOR

Outstanding CDs by banks reaching a 2-year high of ₹ 1.12 lakh crore in Feb. manifests rising traction in economic activity. Inadequate loans yoy growth of 7.9 %; loans must grow robustly for all round development. There has been a traction in credit. Buoyed by retail loans, bank credit rose 8.7 % (March 11) yoy to ₹ 116.5 trillion. Retail loans grew by 12 %; personal and small business loans also rose smartly. Robust growth in bank loans needed for growth and transformation.

Deposits growth continues to outstrip advances growth. Bank credit grew by 7.9 % to ₹ 116.27 lakh crore, deposits rose by 8.6 % to ₹ 162.17 lakh crore in fortnight ended Feb. 25, 2022. In FY 21, bank credit rose by 5.56 % and deposits by 11.4 %; compelling need for faster extensive credit. The RBI's Trends and Progress of Banking shows 5% higher bank lending despite 7.3 % GDP contraction in FY 21, higher profitability because of slashed deposit rates and lower NPAs. Lower NPAs stem from delayed bad loan recognition and loan restructuring. Close analysis of performance of banks is needed.

Welcome growth in MSE Bank Lending. Yoy credit growth from banks to MSEs was negative at -2.2 %, -0.5 % and -2.6 % in Sept., Oct. and Nov. However, the RBI shows MSE credit in Dec. 2021 rose 9.1 % from Rs. 11.48 lakh crore to Rs. 12.53 lakh crore. This needs sustenance. Given the collapse of ILandFS, Dewan Housing, Srei, Reliance Capital, NBFCs need to be ring-fenced because of their systemic risk. Extension of PCA norms, harmonisation of scale based regulations and prudential norms level the playing field. This is welcome but monitoring is needed. Rakesh Mohan et al's excellent study on NPAs in Indian banking identifies rapidly increased corporate lending post 2000s and regulatory forbearance in aftermath of global financial crisis of 2008. This study provides a trategic perspective.

INFLATION

Persistently high WPI inflation is worrisome. India's WPI inflation rose from 13 % in Jan. to 13.1% in Feb. Modest dip in food inflation was more than offset by rise in core inflation. Higher food and fuel prices with cascading impact, reprised supply disruptions and rising input prices to lead to sustained high inflation trajectory. The CPI inflation seems to be going the WPI way. CPI rose to 6.07 % in Feb. because of higher food and fuel prices. Despite inadequate pass-through of high fuel prices, retail inflation breached the MPC mandated 6 % threshold for the second successive month. Retail inflation is likely to increase to 5.8 per cent in FY 23 because of rising oil prices.

Geopolitical tensions, passthrough of fuel prices, high coreinflation and divergence between CPI and WPI make the task of straddling growth-inflation trade-off uneasy. Challenging times are ahead. In case of digital inclusion, there is a need to push full steam ahead because digital inclusion can accelerate transformation from both supply (5G networks) and demand (higher awareness and digital skills) sides. Digital divide- deficient infrastructure and training- in Asia Pacific regions hampers development, particularly post Covid19. Bridging "access divide" requires partnerships across stakeholders, boosting awareness, carrying all along, regulatory action to promote data privacy and cybersecurity education and training. Public and private sectors must work in unison as partners in development to alter ground-realities.

POLICY ACTION

There is a cognisable dilemma for the MPC. With 6.07 % Feb. retail inflation (highest post June 2021) beaching 6% threshold for second successive month and distinct likelihood of elevated March inflation, the MPC will have to walk the tightrope between inflation and growth. Trade off in complex policy choices. GoI is meeting fiscal deficit target of ₹ 13.17 trillion for FY 22. RBI's predicament- ₹ defense would hike interest rates and govt. borrowing costs. Lower interest rate would entail thrust on market forces and fall in ₹ value. This situation is challenging.

Hence, the RBI is likely to maintain status quo on interest rates in its April monetary policy review but may change the stance in view of retail inflation braching its upper threshold limit, global uncertainties created by the ongoing Russia-Ukraine war and the urgency to protect and boost growth. Given the evoving macro-economic scenario, the MPC is likely to revise upwards its Consumer Price Index (CPI) - based inflation or retail inflation forecast and revise downwards its growth projections for FY 23.

RATING UPGRADES

There have been significant changes in number of rating upgrades:

Sectorwise rating upgrades downgrades in last two years (select sectors)							
Sector	FY21			FY22			Improvement in U/D ratio
	Rating Upgrades	Rating Downgrades	Upgrade to Down Grade Ratio	Rating Upgrades	Rating Downgrades	Upgrade to Down Grade Ratio	
Capital Goods-Non Electrical Equipment	451	2868	0.2	370	1479	0.3	0.1
Construction & Engineering	232	1390	0.2	158	726	0.2	0.1
Healthcare	170	409	0.4	145	168	0.9	0.4
Consumer Durables & Apparel	181	1835	0.1	166	865	0.2	0.1
Textiles	116	1296	0.1	108	598	0.2	0.1
Metals and Mining	110	716	0.2	140	357	0.4	0.2
Pharmaceuticals	104	216	0.5	75	81	0.9	0.4
Steel	94	593	0.2	124	290	0.4	0.3
Capital Goods - Electrical Equipment	59	337	0.2	34	191	0.2	0.0
IT	46	281	0.2	46	130	0.4	0.2
Sugar	24	54	0.4	26	34	0.8	0.3
Auto Components and Ancilliaries	35	305	0.1	34	129	0.3	0.1
Fertilizers & Agriculture chemicals	21	58	0.4	17	24	0.7	0.3
Cement	14	22	0.6	27	10	2.7	2.1
FMCG	4	14	0.3	4	10	0.4	0.1
Automobiles	1	17	0.1	2	7	0.3	0.2
Retailing	108	1289	0.1	85	583	0.1	0.1
NBFC	22	124	0.2	31	48	0.6	0.5
Financials	61	220	0.3	61	98	0.6	0.3

Source:SBI

RATE HIKES

RBI is likely to start a rate hike cycle in the second half of 2022, while a repo rate hike of 50-75 bps is expected by the end of the current fiscal.