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RBI Monetary Policy Expectations

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We expect a 40-50 bps hike this June'22 Monetary Policy.

While controlling inflation is a priority now, RBI is also cautious in dealing a balance between demand recovery and inflation control. In the fourth-quarter of 2021-22, the estimated GDP shows a modest 4.1% growth. Another positive is that India's core 8 sector industries grew at 8.4% in April'22 compared to 4.9% in March'22. Therefore, there is a sign of nascent recovery. A welcome step is that the Government of India (GoI) has taken certain steps to address supply-side inflation (e.g. reduction in petrol and diesel excise duties, customs duty reduction on certain iron & steel products to smoothen out raw material prices and availability etc.) which will compliment and help RBI to address inflation challenges.

During the pandemic, the RBI offered liquidity facilities of the order ₹17.2 lakh crore of which ₹11.9 lakh crore was utilised. So far ₹5.0 lakh crore has been returned or withdrawn on the lapse of various facilities on their due dates. Further, CPI projections have been raised to 5.7% from 4.5% earlier, whereas GDP growth projections are revised downwards to 7.2% from 7.8%.

The CPI projection of 5.7% is based on two crucial assumptions (1) normal monsoon (2) Crude remains at \$100/barrel. Going forward, Inflation trajectory will largely depend on raw material availability, volatility in prices and external situations as well as external developments. Despite the news that oil production will be enhanced after the OPEC meeting, [monthly increase in oil production will be raised by 50% from 432,000 barrels/day in recent months to 648,000 barrels/day for July and August], the concern is that oil prices remain very volatile. Saudi Arabia, the world's top oil exporter, raised July crude oil prices for Asian buyers to higher-than-expected levels. Meanwhile it is worth noting again that US shale production continues to disappoint despite the higher oil price. While total crude oil production in the seven US shale regions increased by 527,816 barrels/day to 8.49m barrels/day in

April'22, it remains 794,756 barrels/day or 8.6% below the peak of 9.28m barrels/day reached in November 2019.

We see major risks as supply chain disruptions, oil price volatility, INR/USD parity, food and global commodity inflation. Given the current context, the inflation projection has to be raised upwards (we are expecting 6.5% inflation projection for FY23 from the current 5.7%). As of now we don't expect a hike in CRR, as already Rs. 87000 crore is sucked out. However, a gradual increase of CRR by 25 bps in next policy meeting can't be ruled out, depending upon the situation going forward. The LAF Corridor has been normalized, so we don't expect much change in this context.

Inflationary Expectations Survey by RBI reveals that 89.9% respondents in March 2022 believed that prices will increase going forward, higher than the January 2022 estimate (85.6%). More people believe that prices will increase further (more than the current rate) [67.2% in March 2022 compared to 61.4% in January 2022]. Further, while 89.6% in March 2022 believes that food inflation is not going to soften, which is higher than the January'2022 estimate (83.7%), 88.4% believes in March 2022 that non-food prices will also increase compared to January 2022 estimate(80.4%). The same is true for other categories like cost of housing, services category thus indicating an overall higher household inflation expectations going forward. In this context, we believe a gradual hike of 40-50 bps going forward will help in anchoring inflation expectations.