

MPC preview: A 25 bps hike likely, and then a pause

April 5, 2023

*The MPC is expected to increase the repo rate by **25 bps** in meeting scheduled this week. A pause in the rate hike cycle is expected after April, when RBI might adopt a wait-and-see approach to assess the impact of full transmission of the cumulative 275 bps increase to play out in the economy.*

*Changing the stance to '**neutral**' from 'withdrawal of accommodation' could be in the offing as that will allow the MPC to move in either direction later. Retail inflation printed at 6.44% in February and 6.52% in January 2023. We expect inflation for March 2023 to print at 6.1-6.3%.*

Global outlook

Globally, headline and core inflation continue to remain above the central banks' target for most countries. Of late, headline inflation has shown some moderation due to the easing of food and commodity prices – the latter a consequence of warmer winter in Europe. However, the moderation in headline inflation has not been matched by a concomitant decline in core inflation. Even though goods price inflation is coming down, services inflation is high owing to pass-through of transportation costs to retail consumer and strengthening demand.

Additionally, the oil production cut announced by OPEC+, appears to be a pre-emptive step amidst softening demand, and would only work to provide floor to the crude oil price instead of vigorously feeding into excessive price pressures. We expect crude oil prices are expected to hover in the range of \$80-90/bbl (RBI assumption of \$95/bbl). Further, banking sector stress issues in U.S. and Europe appear contained, and mostly abated. The 25 bps FOMC rate hike in March brought the target rate in range of 4.75%-5%, close to the terminal rate of 5.1% – suggesting another hike incoming in next meeting in May, as Fed becomes data-dependent.

Nupur Tandon (Economist) Email: nupur.tandon@go-yubi.com

Important disclaimers and disclosures can be found on the last page of this publication



Domestic inflation

In January and February 2023 headline inflation stood at 6.5% and 6.44% respectively. Despite some sequential easing, headline remains above the RBI mandate and core inflation is sticky. Upside risks to domestic inflation have not abated – weather vagaries (February rains, warmer predicted weather) can lead to possible damage to the rabi acreage, post-pandemic shifts in expenditure on health and education and elevated fuel prices continue to feed into inflation.

Meanwhile, WPI, which is often a precursor to changes in CPI, eased to 3.85% in February owing to reduced supply bottlenecks. Thus, it is expected easing of input prices will show in retail prices, albeit with a lag. Moving ahead, inflation for March is expected to print at 6.1–6.3% – still above the target, despite favourable base effects kicking in. Hence, RBI is most likely to overshoot its Q4FY23 inflation forecast of 5.7%. This should make up for one more rate hike of 25 bps bringing the repo rate at 6.75%, post which RBI may pause, or reduce the size of hikes depending upon the data and external factors.

System Liquidity

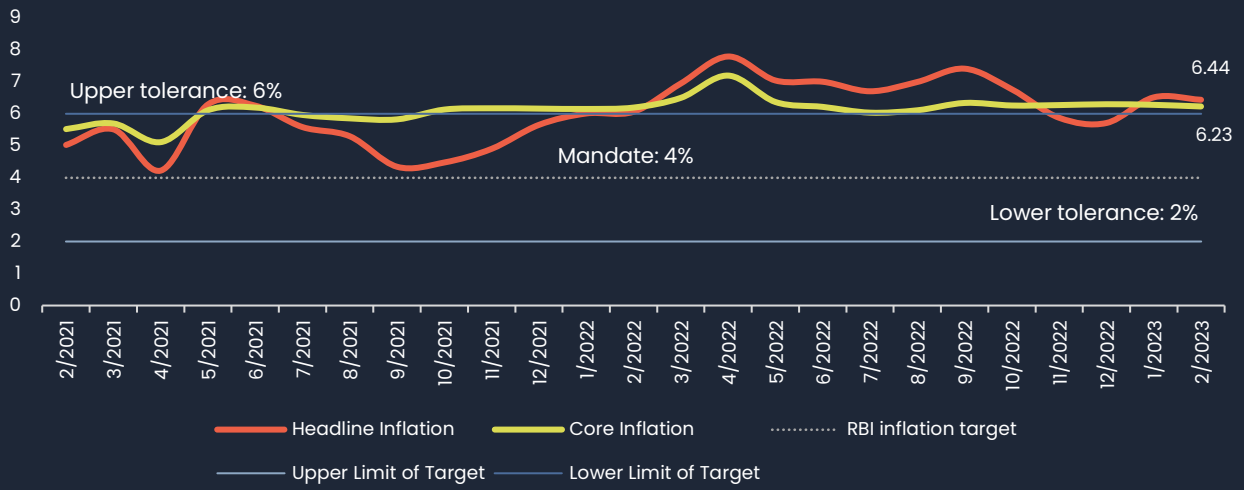
Liquidity, which is the readily available cash that banks might need to meet short term business requirements – has tightened during the last fiscal. FY23 began with a net system liquidity of Rs 7.1 trillion, and by the end this was down to Rs 1 trillion. Such a widening deficit in the system level liquidity will continue impact the short end of the curve, that is more responsive to policy rate change.

Further, strong macros and post pandemic pent-up demand aided faster credit growth (15.7%), however deposits growth lagged (10.3%) due to slower pace of transmission of rate hikes by the banks. This too, has somewhat contributed to widening of the liquidity deficit in the system. VRR operations by the RBI can help stem the deficit, but one can expect tighter liquidity in the incoming FY24 as 1) we begin with smaller surplus; 2) outstanding TLTRO maturities come due (Rs 661 billion). In this regard, we expect a pause after the April meet.

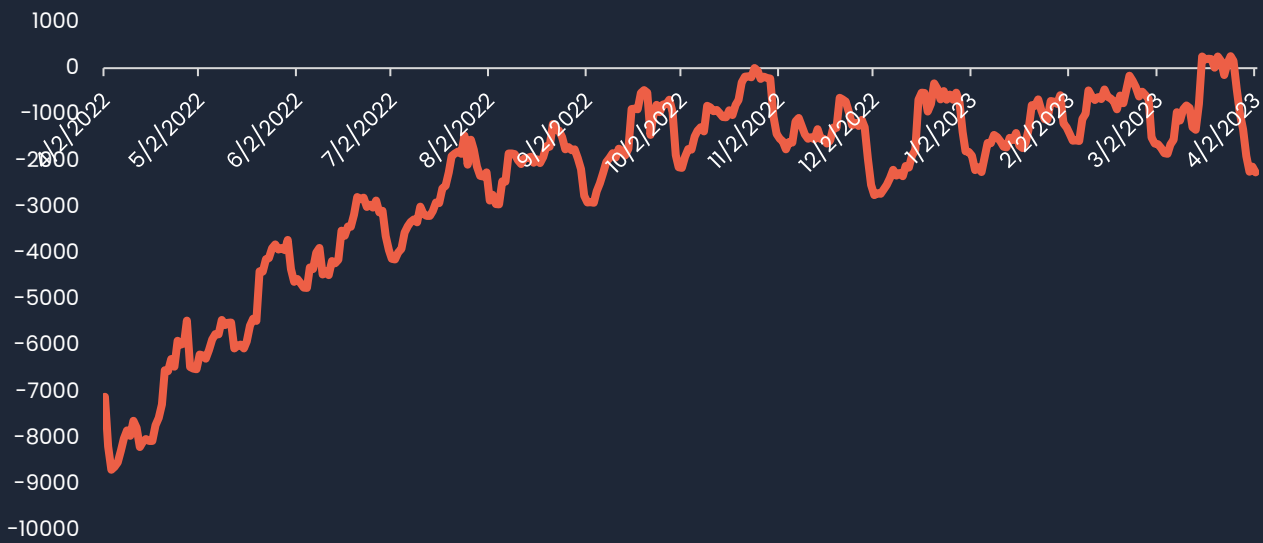
Nupur Tandon (Economist) Email: nupur.tandon@go-yubi.com

Important disclaimers and disclosures can be found on the last page of this publication

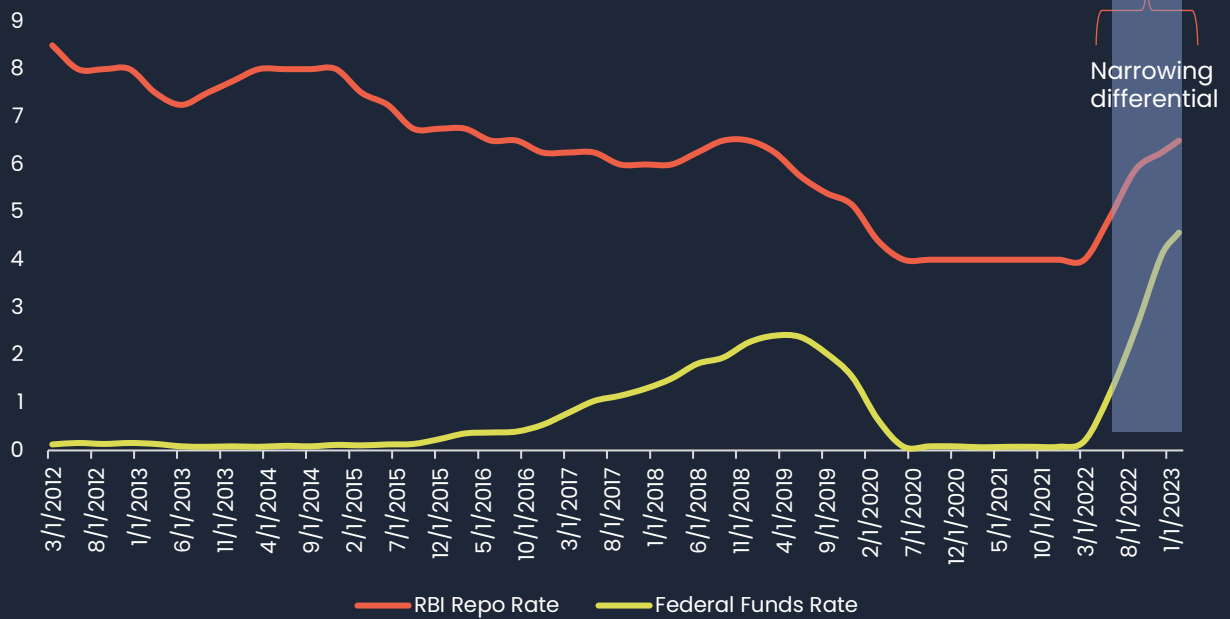
Inflation: Headline and Core



Banking System Liquidity has narrowed



Interest Rate Differential between US and India



Source: Bloomberg, CEIC



Disclaimer

This report is issued solely by CredAvenue Private Limited (“Yubi”). Any information in this report should not be construed as an offer, invitation, solicitation, solution or advice of any kind to buy or sell any securities, financial products or services as may be offered by Yubi or any of its affiliate entity, unless specifically stated so. The contents of this report do not take into account your personal circumstances. Before entering into any transaction, you should take steps to ensure that you understand the transaction and have made an independent assessment of the appropriateness of the transaction in light of your own objectives and circumstances, including the possible risks and benefits of entering into such transaction and should seek your own financial, business, legal, tax and other advice regarding the appropriateness of buying or selling any securities, financial products or services. Yubi or any of its affiliate entity, do not provide any financial advice, and is not your fiduciary or agent, in relation to the securities or any proposed transaction with you unless otherwise expressly agreed by us in writing. The information, opinions and material in this report (i) are derived from sources that Yubi believes to be reliable but the reliability or accuracy of which have not been independently verified (ii) are given as part of Yubi’s internal research activity and not as manager of or adviser in relation to any assets or investments and no consideration has been given to the particular needs of any recipient; and (iii) may contain forward looking statements, which may be materially affected by various risk, uncertainties and other factors. The opinions contained in such material, constitute the judgment of Yubi in relation to the matters which are the subject of such material as at the date of its publication, all of which are expressed without any responsibility on Yubi’s part and are subject to change without notice. Yubi has no duty to update this [document/report], the opinions, factual or analytical data contained herein. Yubi and/or its affiliates makes no representation as to the accuracy, completeness or reliability of any information contained herein or otherwise provided and hereby disclaim any liability with regard to the same. The recipient of the information should take necessary steps as they deem necessary prior to placing reliance upon it.

Nothing contained in this report, shall constitute or be deemed to constitute an offer to sell/purchase or as an invitation or solicitation to do so for any securities or financial products/ instruments of any entity. This report, is intended solely for an authorised personnel of Yubi and may contain proprietary, confidential or legally privileged information. No part of this report, may be copied, disseminated or redistributed by any recipient for any purpose without Yubi’s prior written consent. If the reader of this report, is not the intended recipient and has received this transmission in error, please immediately notify Yubi, Centre of Excellence, E-mail: E-mail: vibhor.mittal@yubisecurities.com or by telephone at +9820115980 and delete this report, from your system. Please also note that Yubi and/or its affiliates, is unable to exercise control or ensure or guarantee the integrity of/over the contents of the information contained in report and / or attachments and that any views expressed in this report and/or attachments are not endorsed by/binding on Yubi.

Before opening any attachments, please check them for viruses and defects and please note that Yubi accepts no liability or responsibility for any damage caused by any virus that may be transmitted by this report and/ or attachments thereto.

