

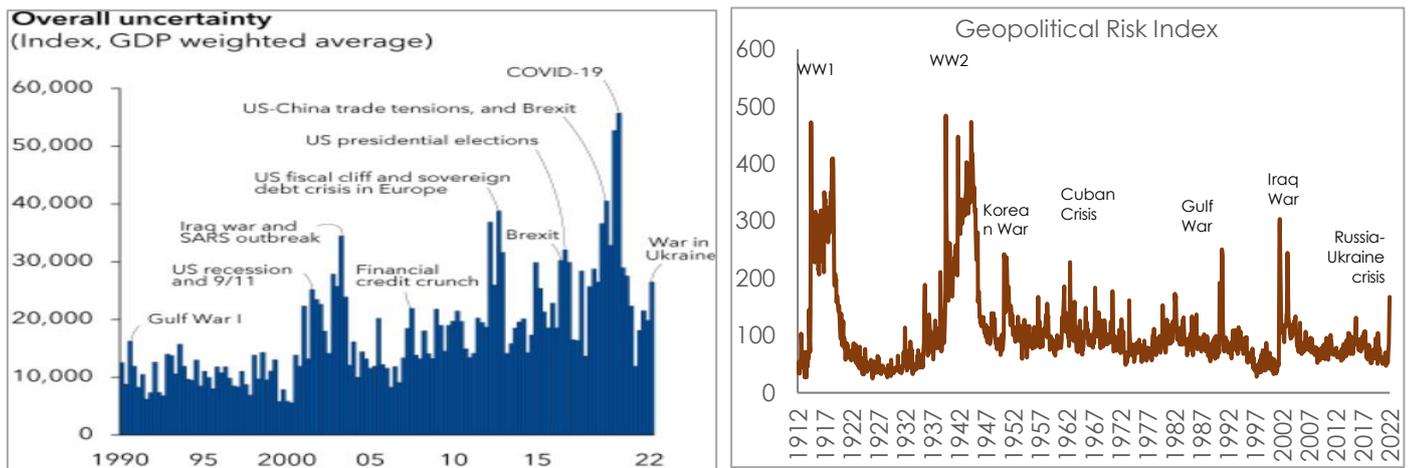
**Press Release**

**Global inflation surge leads to synchronized rate hikes**  
**More than 50% of major central banks move rates over pre-pandemic level**

**25 May 2022**

The prolonged Russia-Ukraine conflict has upended the fragile global economic recovery from the pandemic. This is clearly reflected in the IMF's global uncertainty index and Federal Reserve's geopolitical risk index which have surged and reached almost the levels seen during the Iraq war following the 9/11 attack in the US.

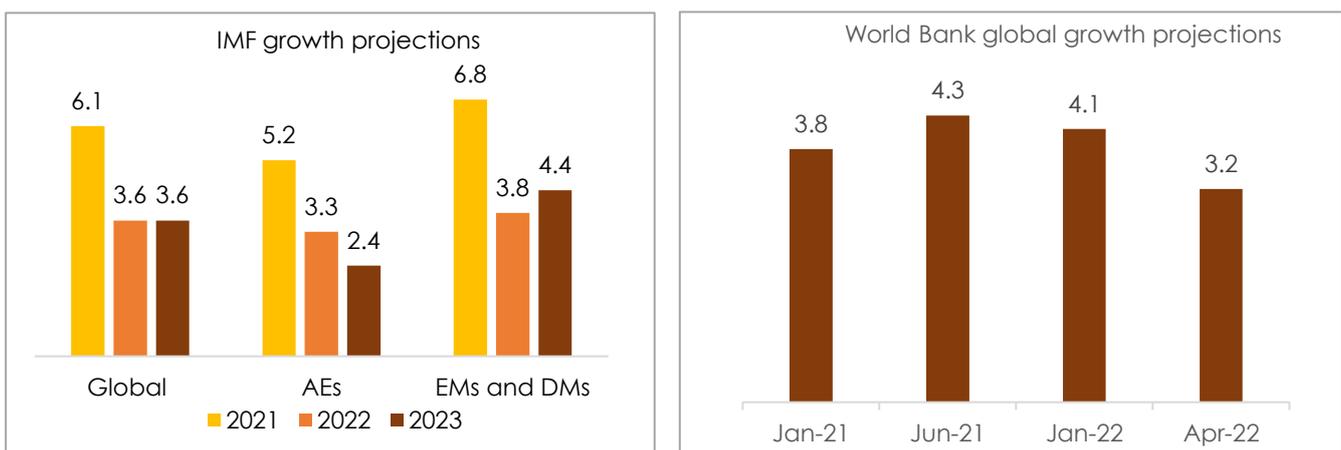
**IMF uncertainty index and geopolitical risk index surge to a near decade high level**



Source: IMF, policyuncertainty.com

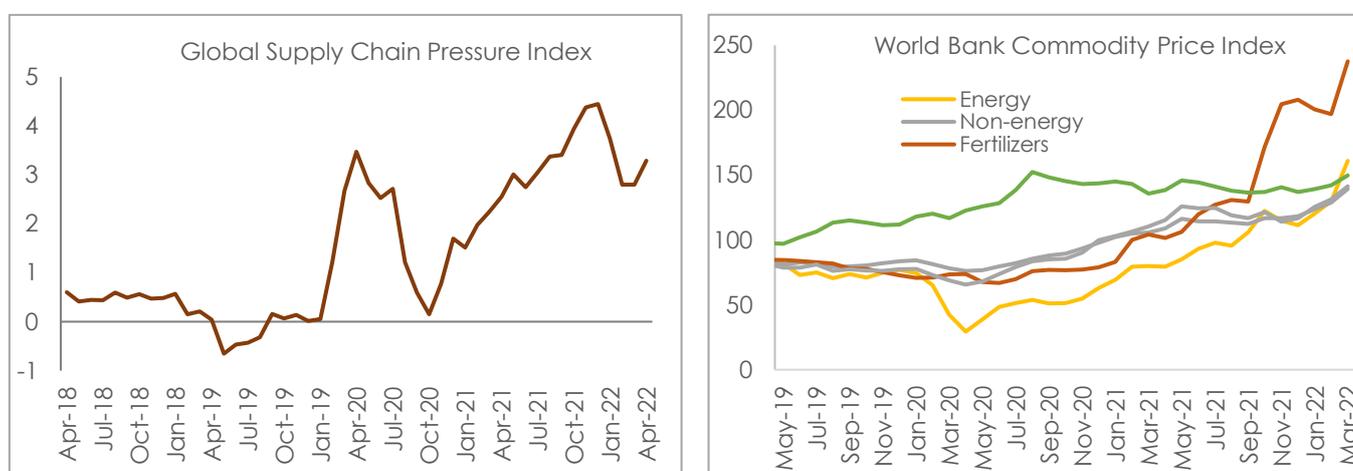
Clearly, downside risks to global growth have amplified due to the war along with outbreak of infections and lockdown in some countries leading many forecasters including the IMF and the world bank to slash their global output growth forecast for the current year. To recall, the IMF in its latest world economic outlook has estimated global growth to slow sharply from an estimated 6.1% in 2021 to 3.6% in 2022 and 2023. World Bank has also lowered its forecast by nearly a full percentage point to 3.2% for 2022. In a more pessimistic assessment compared to IMF's and the world bank, the United Nations Conference on Trade and Development (UNCTAD)'s Trade and Development Report released in Mar-22 downgraded global growth projection by 100 bps to 2.6% from its Oct-21 forecast of 3.6%, on the assumption that the sanctions and supply chain disruptions will last through 2022 even if the war ends.

**IMF and World Bank peg global GDP growth forecast for 2022 at 3.6% and 3.2% respectively**



Amidst escalating downside risks to growth, the surge in food and commodity prices and intensifying supply chain bottlenecks have exacerbated inflationary pressures across advanced (AEs) and emerging & developing markets (EMs and DMs). However, the extent of macroeconomic turbulence caused by the war would not be uniform and would vary across the economies depending on trade and financial linkages with Russia-Ukraine, exposure to commodity price increases, and concomitant rise in inflation. The adverse impact of the war and sanctions are expected to be more pronounced in the emerging and developing economies than in advanced economies. As per the IMF, the pace of inflation in advanced economies is expected to reach a 38-year high of 5.7%, while that in emerging market and developing economies is expected to accelerate to 8.7% in 2022 (the fastest clip since the global financial crisis in 2008).

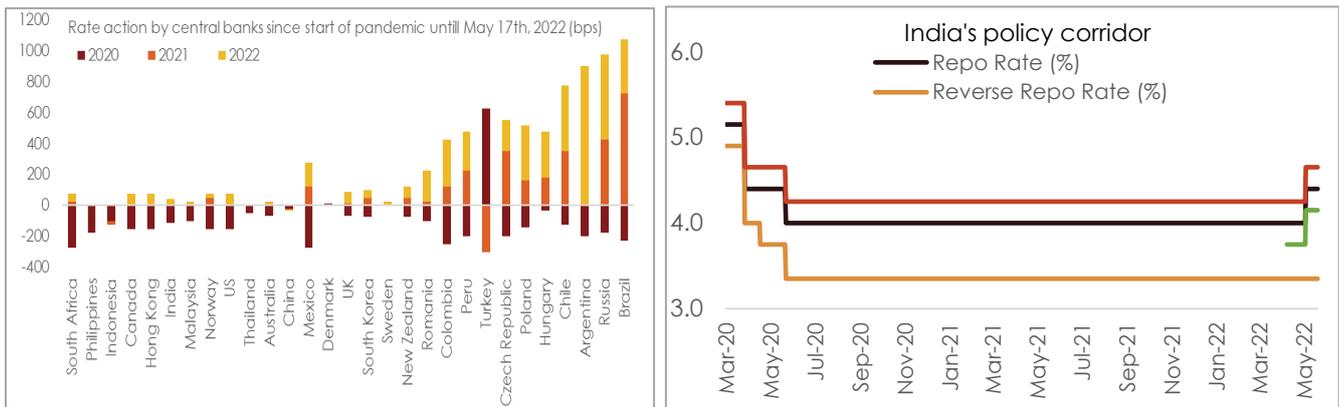
### **Supply chain bottlenecks and heated commodity markets causing prices to soar**



Source: NYFed, World Bank

Reacting to the adverse growth-inflation dynamics, monetary policy action across has become increasingly synchronised across both advanced and emerging market economies, with rate tightening cycle now firmly anchored in place. Among developed countries, the US Fed and the BoE have initiated their monetary policy normalization with an aim to emphatically address inflation risks. In line with market expectations, the Federal Reserve raised the policy rate by 50 bps to 0.75-1.0% in May-22, the first 50 bps hike since May-20. On the other hand, the Bank of England (BoE) raised its policy rate by 25 bps to 1.0%, the highest level since Feb-09, to take the cumulative rate tightening in this cycle to 90 bps now. In addition, the Bank of Canada and the Reserve Bank of New Zealand raised their policy rates by 50 bps each in Apr-22 to 1.0% and 1.5%, respectively along with a host of EM central banks following suit including Brazil, Poland, Peru and India.

**Most central banks have begun their monetary policy normalization journey**



Source: BIS, RBI

Among key central banks tracked by the BIS who effected rate action in the pandemic period, currently: i) 15 have their monetary policy rate below their pre pandemic levels (with median at 75 bps below pre pandemic level), ii) 1 has its monetary policy rate at its pre pandemic level, and iii) 18 have their monetary policy rate above their pre pandemic levels (with median at 225 bps above pre pandemic level).

From our domestic standpoint, after the surprise one-shot restoration of the width of the policy rate corridor from 90 bps to 50 bps (via introduction of the SDF rate at 3.75%) on Apr 8, 2022, the central bank shifted gears on its course of monetary policy normalization, in an unscheduled meeting held over May 2-4, 2022. In a completely unexpected move, amidst rising inflation pressures, the RBI raised repo rate by 40 bps to 4.40%, thereby resulting in the MSF and SDF rates to adjust upwards to 4.65% and 4.15% respectively. In addition, the RBI also announced a 50 bps increase in the CRR to 4.50% of bank's NDTL (net demand and time liabilities).

After exceeding the 6% policy tolerance threshold in Q4 FY22, CPI inflation is likely to average around 7% levels in Q1 and Q2 of FY23. This will mark the second instance of the breach of the policy mandate. While the first instance (Q4 FY20 to Q3 FY21) was completely ignored on account of the novelty of the Covid shock, the MPC now appears to be decisive in addressing inflation risks with the aim of guiding CPI inflation towards its 4% target in FY24. As such, we expect the RBI to go for an additional rate hike of 35-40 bps in the Jun-22 policy meeting. Overall, in our base case, we expect the RBI to raise repo rates by a cumulative 100 bps in FY23. Any further acceleration in global commodity prices could potentially tilt the balance in favour of additional hikes thereby taking the repo rates to the pre-pandemic level of 5.15% or higher. This is likely to be accompanied by an additional 50 bps hike in CRR to modulate liquidity conditions in line with the policy actions and stance. The front loading of rate action is expected to be in sync with the aggressive monetary policy normalization in several countries, led by the US.

### Annexure: Central Bank Policy Actions

Key Countries tracked by BIS	Rates during Covid (%)	Current rates	Last move date	Last Move	CPI YoY (%)
<b>Advanced Economies</b>					
Canada	0.25	1.0	Apr-22	Hike	6.7
United Kingdom	0.1	1.0	May-22	Hike	7
Japan	-0.1	-0.1	Jan-16	Cut	1.2
United States	0.125	0.875	May-22	Hike	8.3
<b>Emerging economies</b>					
Argentina	38	47	Apr-22	Hike	58
Brazil	2.0	12.75	May-22	Hike	12.13
Chile	0.5	8.25	May-22	Hike	10.5
China	3.85	3.7	Jan-22	Cut	2.1
Colombia	1.75	6.0	May-22	Hike	9.23
India	4.0	4.4	May-22	Hike	7.79
Indonesia	3.75	3.5	Feb-21	Hike	3.47
Malaysia	1.75	2.0	May-22	Cut	2.2
Mexico	4.0	6.5	Mar-22	Hike	7.68
Philippines	2.0	2.0	Nov-20	Cut	4.9
Poland	0.1	5.25	May-22	Hike	12.4
Russia	4.25	16.7	Apr-22	Cut	16.7
Saudi Arabia	1.0	2.0	May-22	Hike	2
South Africa	3.5	4.25	Mar-22	Hike	5.9
Thailand	0.5	0.5	May-20	Cut	4.65
Turkey	8.25	14.0	Dec-22	Cut	69.97
<b>Developing Economies</b>					
Australia	0.1	0.35	May-22	Hike	5.1
Czech Republic	0.25	5.75	May-22	Hike	14.2
Denmark	-0.5	-0.6	Oct-21	Cut	6.7
Hong Kong SAR	0.5	1.25	May-22	Hike	1.7
Israel	0.1	0.35	Apr-22	Hike	3.5
Iceland	0.75	3.75	May-22	Hike	7.2
Korea	0.5	1.5	Apr-22	Hike	4.8
Norway	0	0.75	Mar-22	Hike	5.4
New Zealand	0.25	1.5	Apr-22	Hike	6.9
Peru	0.25	4.5	Apr-22	Hike	7.96
Romania	1.25	3.0	Apr-22	Hike	13.76
Serbia	1.0	1.5	Apr-22	Hike	9.6
Sweden	0	0.25	May-22	Hike	6.4
Switzerland	-0.75	-0.75	Jan-15	Cut	2.5

Source: BIS, Central banks

**About Acuité Ratings & Research Limited:**

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