Press Release

MPC Minutes: Jun-22: All eyes on inflation

Additional 75 bps rate hike likely between Aug-22 and Dec-22 policy meeting

23 June 2022

The minutes of the MPC held on June 8, 2022, clearly highlight inflation control as the key priority for the MPC members, with all of them voting unanimously for repo rate hike by 50 bps to 4.9%. The MPC members coalesced around the need for calibrated monetary policy action to keep inflation expectations anchored and restrain the broadening price pressures. With elevated levels of inflation, Dr. Bhide emphasised the need to ensure that "policy rates are consistent with the requirements of moderating inflation expectations and liquidity conditions are consistent with the requirements of economic growth in an environment less constrained by the Covid pandemic". Further with a view to anchor inflation expectations and stabilize the bond markets, Prof. Varma advocated the need for providing projections for future path of the policy rates akin to the trend followed by key central banks. In addition, Dr. Ranjan pointed out the need for frontloading policy action in order to rein in inflation expectations, as in India inflation expectations are largely adaptive or backword looking.

The minutes also reflect some concerns over India's growth prospects. While broadly the growth drivers seem to be holding up as the economy emerges out the prolonged disruption caused by the pandemic waves, uncertainties have emerged on account of geo-political risks and the consequent adverse demand conditions as well as rise in inflation. According to Dr. Patra, if the inflation persistently stays elevated it could "corrode the foundations of the recovery that is gradually gaining traction". Taking into consideration the adverse impact on growth due to increasing inflationary headwinds, Dr. Bhide supported the need for changing the course of inflationary trajectory although the growth momentum remains modest one.

Prof. Varma stated that the RBI has a lot of catching up to do in terms of monetary normalization, with an aim to bring the real policy rate to a modestly positive level consistent with the emerging growth-inflation dynamics. On similar lines. Dr. Goyal also stated that "the one-year ahead real rate must not be more negative than -1%". Adding that "such a real interest rate, while not dampening the recovery much, will prevent a possibly inflationary further rise in demand and unsustainable current account deficit". Some cues for the future course for rate action can be derived from Dr. Patra's comments that "the objective should be to take the repo rate to a level that is at least above the four quarters ahead forecast of inflation".

Acuité continues to believe that interest rate increases by RBI will get front-loaded keeping in mind the elevated inflation risks in the near-term, fast evolving global monetary policy cycle and a weaker growth outcome anticipated in H2 vs. H1 FY23. We expect an incremental 60 bps - 75 bps hike in repo rate between Aug-22 and Dec-22. This will take the repo rate to 5.50% - 5.65% i.e. 35 bps-50 bps above the pre-pandemic level. The actual quantum of rate hike will however, depend on the inflation print and the growth indicators over the next 2 quarters. Post Dec-22, RBI may reassess the overall macro-economic scenario closely, with quantum of additional rate hikes dependent on the evolving growth-inflation dynamics.

Simultaneously, we expect the central bank to continue to wean off excess liquidity from the system as core liquidity surplus remains close to 3.7% of NDTL as of mid Jun-22. This is relatively high compared to RBI's own estimate of 1.5% level being non-inflationary (as per the Currency and Finance report). For liquidity withdrawal, an additional CRR hike of 50 bps remains our base case in this fiscal year although alternate tools via FX intervention, sale of g-secs or issuance of short-term cash management bills can also be deployed to achieve the same objective.

Says Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research "The minutes from the MPC members reflect a collective acknowledgement of the need for decisive frontloaded action and withdrawal of accommodation in the face of sharply increased inflationary headwinds. There is also a larger consensus that monetary policy actions should be supplemented with fiscal measures, wherever feasible to bring down the inflationary expectations. While RBI doesn't provide any glide path for policy rates as done by some central banks, we believe that the minutes provide a broad guidance for another 60-75 bps rate hike in the current financial year that is likely to happen by Dec-22. Importantly, further steps may be taken to absorb the excess liquidity in the system which may lead to a further increase in short term rates that have already seen a significant spurt over the last two months."

About Acuité Ratings & Research Limited:

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