Online Portal:	The Hindu Business Line	Published Date:	October 03, 2023
Headline:	MPC may go for a hawkish pause		

https://www.thehindubusinessline.com/opinion/mpc-may-go-for-a-hawkish-pause/article67376322.ece

MPC may go for a hawkish pause

The RBI faces the challenge of lowering inflation to its target without significantly impacting macro-financial stability

Rupa Rege Nitsure

Global growth outlook has weakened. With a continued tightening bias in the monetary policies of advanced nations and a slowdown in China, global growth is expected to be weaker in 2024 than in 2023. However, the US economy remains resilient and hence, the dollar is continuously gaining strength. But risks to global inflation have been rising due to higher prices of crude oil and some non-energy industrial commodities and sticky core inflation rates.

Central banks of the world's largest economies have hinted that they will keep interest rates as high as needed to tame inflation. "Higher for longer" is now the official stance of the central banks of the US, the UK and the Euro zone. The only significant outliers are the central banks of Japan and China.

Indian growth picture remains mixed in Q2 FY24. Consumption indicators of the rich and upper middle classes, continued to pick up (like spending on premium cars and properties, air passenger growth, imports of electronic goods, etc) but others showed a loss of momentum. Thanks to the government's capex push, core industries have been growing strongly and order flows of capital goods manufacturers have increased healthily. But inadequate rainfall and its extremely uneven distribution pose risks to the kharif crop yields. The depleted water reservoirs could challenge timely sowing of rabi crops. This will not just keep food prices elevated but may also impair rural demand.

The government's direct tax revenue has weakened quarter-on-quarter, while indirect tax revenue remains strong, indicating a k-shaped pattern. Other concern is a multi-year dip in the household sector's savings rate to 5.1 per cent of GDP and increased indebtedness.

DOMESTIC INFLATION

India's CPI inflation averaged 7.14 per cent in July-August, primarily led by surging food-inflation at 10.7 per cent. Primary contributors to food-inflation were vegetable inflation (31.8 per cent) followed by inflation in spices (22.4 per cent), pulses (13.2 per cent) and cereals (12.4 per cent). Crude price for the Indian basket too increased from $77.89 per barrel in Q1 FY24 to $86.73 in Q2 FY24, up 11.3 per cent sequentially. Currently, the Brent price in the global market is ruling above $92 against the RBI's estimate of $85. Within food inflation, vegetable inflation may get corrected after the monsoon season. But other components like cereals, pulses, spices and also sugar (due to the shortages) may keep food inflation elevated in H2 FY24. Increased risks to rabi crops due to depleted ponds and groundwater reserves will keep food inflation elevated for a much longer period.

OUTLOOK. Risks to global inflation have been rising ISTOCK

Another risk to inflation is now stemming from global oil prices. Even if the government tries to cap domestic oil prices, inflation will inch up if oil prices remain above $90 per barrel for a longer period. Otherwise, the government will have to take a large hit to its fiscal balances. Systemic liquidity has been in deficit since September 15 and the deficit has been more than ₹1 trillion since September 18. The persistent liquidity deficit signals the RBI's wish to keep liquidity tight and short-term interest rates elevated given the pressures on currency and price stability.

Given the increased risks to inflation, exchange rate and the household sector's savings, we expect the MPC to keep the policy rates unchanged and extend the pause for a longer period. Until it sees a durable decline in inflation, it will retain the stance at 'withdrawal of accommodation.'

To ensure adequate festival-season liquidity, the RBI will continue to reduce the incremental CRR gradually until October 7. Increased government spending has also been aiding liquidity. Beyond this, we do not expect any additional liquidity measures in the policy. The evolving growth-inflation mix will prompt the RBI to lower its GDP forecast for FY24 from 6.5 per cent to 6.25 per cent and increase its inflation projection from 5.4 per cent to 5.6 per cent. The forward guidance and policy tone will remain hawkish.

The writer is Group Chief Economist, L&T Finance