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# RBI may hold policy rate

A plethora of economic uncertainties linger

**Rupa Rege Nitsure**

The Indian economy appears to have shown good resilience to many global and domestic economic events during FY23. India's macro indicators based on fiscal consolidation, current account deficit and inflation prints have been improving in recent months.

While the overall GDP statistics showed a good pick-up in growth momentum during Q4, FY23, there are a few hidden concerns. A sizeable contribution to GDP growth has come from the shrinkage of trade deficit, as imports declined at a faster pace than exports during this quarter. As the import intensity of Indian manufacturing sector is very high, 'shrinkage' of imports, in fact, reflects the weakness in the manufacturing activity.

For the past three quarters, the primary contributors to India's real GDP growth were agriculture, construction and contact intensive services and not manufacturing. From the expenditure side also, it was the government spending — both investment and consumption spending — that primarily supported economic growth during the fourth quarter rather than the private sector spending.

The CMIE data also showed a slowdown in private capital spending during FY23. Furthermore, completed investment projects stood at ₹5.7 trillion in FY23, lower than ₹6.1 trillion in FY22 indicating a slowdown in the pace of project completion due to various reasons like elevated prices, taxes and changes in foreign exchange rates.

## CREDIT DEPLOYMENT

A look at the sectoral deployment of credit data shows that bank credit primarily moved to agriculture, NBFCs, personal (retail) loans during FY23 but industrial credit growth decelerated during the second half of the fiscal year. Lingering weakness in the manufacturing sector (barring a few exceptions like the automobile, cement, steel, food processing and electrical equipment sectors) raises concerns over the sustainability of growth during FY24.

Yet, the Monetary Policy Committee (MPC) of the RBI may not start the rate-reduction cycle from the June policy meeting. Rather, it could maintain status quo on policy rates and stance for the following reasons.

**The MPC will** not ignore the potential risks like El Nino,

**POLICY STANCE.** Wait and watch

predicted in FY24. In fact, wheat and rice prices have been firming up in recent weeks in anticipation of future shortages. As repeated by the RBI, it will not let its inflation guard down until it sees a durable decline in inflation.

**A strong** growth momentum in contact-intensive services poses an upside risk to core inflation, going ahead.

**Good growth** momentum in the non-food credit extended by commercial banks despite an increase of 250 basis points (bps) in repo rate since May 2022 rules out the possibility of early interest rate cuts in the June policy.

**The RBI's** latest data showed a lingering divergence between the annual deposit growth (10.9 per cent) and credit growth (15.4 per cent) as on May 19th. Hence, relatively higher real interest rates are needed for better deposit mobilisation.

**The MPC** will retain its stance at 'withdrawal of accommodation', as even without altering the stance, liquidity in the banking system has started improving on account of aggressive spending by the government. As on June 3, liquidity in the banking system was in the surplus of ₹2.40 trillion as against ₹560 billion a month ago. Also, the RBI's prudent purchases of dollars from time to time is supportive of banking sector liquidity. Between early April and early June, RBI's foreign exchange reserves have gone up from $578 billion to $589 billion.

Given the plethora of economic uncertainties, it is likely that the MPC will adopt a 'wait and watch approach' in its June policy. India's growth performance has been attracting rich capital inflows. However, there could be a sudden wave of global risk-off sentiment, which may start weighing on the Indian currency. Hence, the main challenge for the MPC in FY24 is to protect the current growth-inflation mix' amid increased economic uncertainties.

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