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Pause in the time of uncertainty: by Rupa Rege Nitsure, Group Chief Economist

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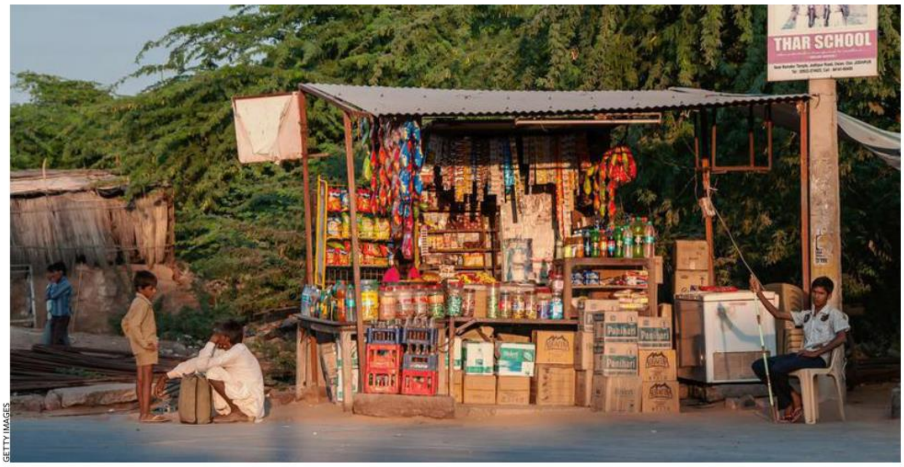

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Pause in the time of uncertainty

RATE MOVES. RBI is still keeping a close watch on inflation, but its upbeat view on GDP growth is surprising

Rupa Rege Nitsure

The RBI's pause from rate hikes must have been driven by increased global uncertainty and risks to financial stability, relatively stable rupee-dollar exchange rate in the calendar 2023 so far and the incomplete transmission of the 290 bps rate hikes since April 2022.

However, by retaining the policy stance at the "withdrawal of accommodation" and by keeping the doors open to further rate hikes, the MPC of RBI has clearly signalled that the war against inflation is still not over. To quote the Governor, "Our job is not yet finished and the war against inflation has to continue until we see a durable decline in inflation closer to the target. We stand ready to act appropriately and in time".

Given the upside risks to inflation in view of the recent OPEC+ threat of oil production cuts, upward revision of electricity tariffs and milk prices, the possibility of El Nino related weather disturbances, etc., the RBI does not wish to give a clear forward guidance at this stage. Rather it has adopted a "wait and watch" approach amid increased volatility in the global financial markets.

RURAL BOOST

The RBI's assessment of demand conditions matches our in-house expectations that the primary drivers of demand at this stage are located more in rural areas than in urban ones.

An expected uptick of 6.2 per cent in the Rabi foodgrains production, firming up of the rural wages, rich water reservoir levels and the boost to allied agricultural activities have started supporting rural cash-flows and demand. This is getting reflected in a sustained growth momentum in the demand for farm equipments (like tractors) and rural business finance, and micro loans.

Rural consumption demand too has started picking up. Recent reports from Maruti Suzuki, Hero MotoCorp, Godrej Appliances, and Panasonic confirm that broader business growth has now started to come back in the hinterland, with demand picking up. Better road connectivity, digital revolution and superior agricultural performance in FY23 will keep rural demand buoyant at least in H1, FY24.

Moreover, enough storage space with the government — thanks to the distribution of free foodgrains in the past two-three years and mandi prices holding above the Minimum Support Prices augur well for the "procurement" and farmers' income in H1, FY24. The rural outlook thereafter would depend upon the exact timing and the intensity of the potential El Nino.

However, what is most surprising is the upward revision by the MPC of the real GDP growth to 6.5 per cent in FY24 (from 6.4 per cent earlier) by revising upwards the growth expectations for the third and fourth quarters of FY24, which in fact are beset with tremendous uncertainty primarily due to the global headwinds. Many analysts are actually expecting a rapid reduction in the policy rates during H2, FY24, which is likely to see a significant slowdown.

There is also some degree of haziness on the front of liquidity management. On the one hand, the RBI has taken a pause in the interest rate hiking cycle and on the other, it has retained its stance at the 'Withdrawal of Accommodation'.

Though for the RBI, growth concerns amidst the global uncertainty has gained prominence for now, the rate hike cycle is not yet over

In the past two weeks, the RBI's intervention in the money market has also been two-sided, when it comes to liquidity management. This could well be the reason why one of the MPC members expressed reservations on retaining the policy stance at the current level.

As participants in the G-Sec and bond markets are not sure about the liquidity outlook, the initial euphoric reaction to the latest policy move got partially reversed after a few hours. Going ahead, we expect short-term money market yields to stay under some pressure.

EXPANDING UPI

RBI's announcement to expand the scope of United Payments Interface (UPI) by permitting operations of pre-sanctioned credit lines by banks through UPI is a major breakthrough in digital finance. This means banks will now be able to offer credit products, without actually issuing a credit card or requiring a bulky physical infrastructure such as POS or swipe machines.

This move will increase the importance of data analytics in the banking industry as there will be pre-approved credit by banks for customers based on data analytics carried out either on internal deposit customers or for non-customers using the information from credit bureaus, etc.

To summarise, the April monetary policy was driven more by the considerations of financial stability amid increased global volatility. The RBI's assurance on the banks and NBFCs' health, its increased supervisory vigilance, comfortable foreign exchange reserves and relatively stable currency send strongly positive signals to international investors.

However, a "pause" in the April policy should not be construed as the end of the rate hiking cycle. As stated by the Governor, the objective of the inflation targeting central bank is to bring about a durable decline in inflation closer to the target and the latest data points hint that inflation in India hasn't peaked yet.

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