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EXPERT VIEW

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GDP MAY GROW BY 8.2%, THANKS TO IT, REALTY, STARTUPS

The Reserve Bank of India's (RBI's) monetary policy came in an environment of rising bond yields, hawkish pivot by the US Federal Reserve and the Bank of England, and the budget that surprised the bond markets by a higher-than-expected gross borrowing. The market consensus was that this policy would begin the normalization of the ultra-easy policy path set by the MPC post covid. The committee, however, surprised the markets by holding on to all rates and keeping the commentary dovish. The MPC held on to its earlier growth forecast of 7.8% for FY23. Buoyant exports, pick-up in capex by way of public spending and schemes such as performance-linked incentives (PLI), and recovery in contact intensive services sector as virus wanes should deliver these projections. In fact, we believe growth can be higher at 8.2%, given the uptick visible in the real estate sector and job momentum in the IT sector and startups.

On the inflation front, RBI surprised the markets with an inflation projection of 4.5% for FY23 while retaining its estimate of 5.3% for FY22. Since the last policy, oil prices have risen by $15/barrel. This calendar year, base metal prices are up by 6%. Given the backdrop, inflation estimates were trending higher. The inflation forecast for FY23 perhaps is based on a fall in oil prices in the second half of 2022 as Opec supply catches up and supply-side management by the government in the form of tax cuts as seen earlier in the case of fuel and food products. The current sowing trend and ample foodgrain stocks may have also given RBI comfort.

However, the biggest takeaway from the policy was the governor emphasizing the independent path being taken by the MPC amid a reversal of the global rate cycle and his confidence in India's ability to remain insulated from developments in other economies. RBI spoke on inflationary conditions in India and the US and Europe being very different. This shows that RBI is prepared to withstand any volatility emanating from global volatility. In fact, it seems RBI is banking on India's relative growth outperformance to pull in foreign capital to manage the rising current account deficit and minimize currency volatility. We expect the current account deficit to widen to 2.1% of GDP in FY23, with an upside risk if oil prices remain at current levels. The RBI governor also spoke on RBI's discomfort on yields as seen in its actions through auction cancellations and devolvement. There was also an indication that more steps might come to manage the government's massive borrowing programme.

> MPC surprised the markets by holding rates and keeping the commentary dovish

To meet the aggregate credit needs of the economy, RBI enhanced the limit for investments under the Voluntary Retention Route by ₹1 trilllion. This will lead to inflows in domestic debt markets. The introduction of credit-default swap guidelines and allowing Indian banks to transact in the Foreign Currency Settled Overnight Indexed Swap (FCS-OIS) market are very positive for deepening the financial markets. FCS-OIS will deepen the interest-rate derivatives market and ensure convergence between offshore and onshore markets and much better price discovery. We believe the current policy has laid out a glide path of inflation, which is quite optimistic and has justified the no-action policy, pushing the policy normalization further out. The sequence of normalization can possibly change with the shift in stance coinciding with full normalization of the corridor (instead of our earlier view of a two-step normalization followed by a stance change). In aggregate, we expect a total of 75bps repo rate increase in FY23.

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