

EXPERT TAKE

Hawkish review ahead



ADITI NAYAR
Principal Economist, ICRA

In December 2017, the Monetary Policy Committee (MPC) had left the repo rate unchanged at 6 per cent and retained the neutral stance of the

monetary policy. At that time, it had marginally increased its Consumer Price Index (CPI) inflation forecast for the second half of 2018-19 to 4.3-4.7 per cent, from the earlier 4.2-4.6 per cent.

Subsequently, the CPI inflation spiked from the modest 3.6 per cent in October 2017 to 4.9 per cent in November and 5.2 per cent in December, overshooting the upper end of the MPC's forecast range. This uptick in the CPI inflation was primarily led by food, housing and fuels.

Looking ahead, the impact of the revision in House Rent Allowance of central government employees is likely to continue to push up housing inflation to 9-10 per cent by June 2018, after which a favourable base effect would dampen the same. Crude oil and other commodity prices are likely to remain elevated in the near term. However, the ongoing moderation in prices of vegetables and sugar may help to cool the CPI inflation below 5 per cent in the fourth quarter.

The Union Budget for 2018-19 included some key proposals, the operationalisation of which may impact the trajectory of food prices. On one hand, Operation Greens should help to smoothen volatility in the prices of vegetables, whereas the proposal to enhance and extend minimum support prices to augment farmer incomes, may emerge as an inflation risk. Higher customs duty on some items may also push up imported inflation in the near term. At present, ICRA expects the CPI inflation to print at 4.7-5.4 per cent over the first half of 2018, before recording a base effect-led easing in the subsequent six months.

With the uptick in the CPI and rising inflation risks since the last policy review, the MPC is likely to revise its inflation forecast upwards. Moreover, the crystallisation of concerns related to a fiscal slippage is likely to contribute to a hawkish tone of the upcoming review. While the consensus view of the MPC may be to wait for additional data before hiking the repo rate or changing the stance of monetary policy, this is unlikely to be unanimous.

The Central Statistics Office recently pegged its Advance Estimate of GVA growth for 2018-19 at 6.1 per cent, which may not fully capture the expected pickup in growth in the fourth quarter. Nevertheless, this is significantly lower than the MPC's baseline forecast of 6.7 per cent, with risks evenly balanced. Therefore, the latter may undergo a modest downward revision in the upcoming review.

Systemic liquidity has started recording intermittent deficits since mid-December 2017. The Central Bank may reiterate that this is in line with the stance of maintaining neutral liquidity conditions. Additionally, the markets would look forward to some comments on the recent volatility and the extent of hardening in G-sec yields.