

RESEARCH
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Inflation back in focus

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Financial crisis explained

SUMMARY
India Economics: Monetary Policy

RBI has kept the policy rates unchanged and is tilted towards what may be called a hawkish view as it has rephrased its accommodative stance while keeping it unchanged. Amidst the escalated concerns over geopolitical conflict and surge in global commodity prices; inflation forecast has been revised upwards and growth projections are revised downwards across all quarters for FY23. RBI's forecasts are now 7.2% for GDP and 5.7% for inflation. We expect inflation at 5.5-6% and growth at 7.4%-7.5% in FY23.

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India Economics: Sri Lanka

Sri Lanka has been embroiled in an economic crisis amidst record-high inflation and mounting debt. Prices of essential items including food, fuel and medicines have skyrocketed and foreign exchange reserves have plunged amidst a shortage of dollars to finance imports. The ruling government has been scrambling to secure finance from major international agencies such as IMF and ADB as well as seeking support from other neighbouring countries. In this note, we attempt to briefly understand the roots of the crisis.

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Daily macro indicators

Indicator	06-Apr	07-Apr	Chg (%)
US 10Y yield (%)	2.60	2.66	6bps
India 10Y yield (%)	6.92	6.91	0bps
USD/INR	75.76	75.96	(0.3)
Brent Crude (US\$/bbl)	101.1	100.6	(0.5)
Dow	34,497	34,584	0.3
Hang Seng	22,081	21,809	(1.2)
Sensex	59,610	59,035	(1.0)
India FII (US\$ mn)	05-Apr	06-Apr	Chg (\$ mn)
FII-D	28.1	166.2	138.1
FII-E	462.5	(186.9)	(649.4)

Source: Bank of Baroda Economics Research

BOBCAPS Research

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MONETARY POLICY

08 April 2022

Inflation back in focus

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Sonal Badhan | Jahnavi
Economist

RBI in its 1st meeting for FY23 has unanimously voted to keep the policy rates unchanged in line with expectations. The impact of the same can be seen on lending and deposit rates:

Lending rate: Since the onslaught of the Covid-19 pandemic, MPC has been proactive to support growth and keep inflation in check. Both the policy rates were last reduced in May'20 with repo at 4% and reverse repo at 3.35% and has since been kept at the historic lows. The loans linked to MCLR are likely to enjoy the ultra-low rates for an extended period, making the environment conducive for reviving and fostering demand. Though, there are expectations of upward pressure to emerge in the coming months with expectations of rate hike as early as Q1FY23.

Deposit rates: Recently with few banks announcing rise in FD rates, deposit accretion is likely to pick pace.

Hawkish moves: MPC while reiterating its accommodative stance has also rephrased with focus on withdrawal of accommodation as it ensures inflation remains in target with continuous support to growth.

Upside risk to inflation: MPC has revised the inflation projection upwards on the back of the evolving geopolitical tensions and its impact on overall global commodity prices. The Committee noted it remains watchful as it continues to monitor as elevated global price pressure in food items including edible oils, is expected to result in global supply shortages. These disruptions will add to input cost pressure too. Against the above backdrop along with assumption of normal monsoon and crude at US\$100/BBL, MPC has revised its forecast to 5.7% in FY23 (4.5% previously), for Q1FY23 to 6.3% (4.9% earlier), Q2 at 5%, Q3FY23 and Q4FY23 at 5.4% and 5.1% respectively. We expect inflation 5.5%-6% in FY23.

Inflation revised: MPC has changed its quarterly forecasts in the upward direction for FY23. Q1 and Q3 have witnessed the highest deviation in forecasts. For Q2 the forecasts remain unchanged.



SRI LANKA

08 April 2022

Financial crisis explained

Sri Lanka has been embroiled in an economic crisis amidst record-high inflation and mounting debt. Prices of essential items including food, fuel and medicines have skyrocketed and foreign exchange reserves have plunged amidst a shortage of dollars to finance imports. The ruling government has been scrambling to secure finance from major international agencies such as IMF and ADB as well as seeking support from other neighbouring countries. In this note, we attempt to briefly understand the roots of the crisis.

Aditi Gupta
Economist

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1. Risks brewing: Even before the Covid-19 pandemic hit, Sri Lanka was facing problems on several fronts. This included a constitutional crisis in 2018, resulting from dismissal of the Sri Lankan Prime Minister by the President. In 2019, Easter bombings in churches and luxury hotels killed hundreds of people. Further, government announced several tax cuts in 2019 which led to credit rating downgrade in 2020, thus impeding Sri Lanka access to international financial markets. This was followed by the Covid-19 pandemic in 2020.

2. Surging inflation: After remaining suppressed in 2020, due to a fall in demand during the Covid-19 pandemic as well as VAT cuts in 2019, inflationary pressures built up steadily since the mid of last year. This was due to a number of factors including, improved demand and higher global commodity prices. This coincided with a depreciating currency and supply shortages. Further, in 2021, government's banned chemical fertilizers in 2021, (the ban was later reversed) led to a significant decline in production of rice which is the staple diet of a majority of the population. From 4.1% in Mar'21, inflation has accelerated sharply to 18.7% in Mar'22 led by a steep increase in food inflation at 30.2%. It is likely to remain elevated in double-digits even in the coming quarters amidst both supply and demand side pressures. The Russia-Ukraine war and resulting surge in commodity prices is further fuelling inflation.

3. Monetary policy response: During the Covid-19 pandemic, Central Bank of Sri Lanka (CBSL) had cuts its key policy rates (standard lending and deposit rate) by a cumulative 200bps between, Mar'20 to Jul'21, before raising it by 50bps in Aug'21. However, in response to the surging inflation, it has raised policy rates by 150bps each this year. It must be noted that inflation has continuously remained above CBSL's target range of 4-6% since Oct'21. More recently, after delaying its recent policy meet, CBSL will announce its monetary policy statement later today. Market participants are expecting a 100bps increase in both the standard deposit and lending rates. Further rate hikes can also be not ruled out as inflation continues to run in double-digits.



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