SBI RESEARCH

ECOWRAP

RBI PAUSE IN APRIL VINDICATED AS CPI DROPS TO 18 MONTHS LOW, WITH CORE CPI AT 5.06%

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CPI at 4.7% in April substantiates the RBI decision to pause in April. Core CPI plunged to 5.06%, falling to almost 3-years low of 5.06% in Apr'23 as against 5.74% in Mar'23, due to decline in fuel and light prices supported by a base. A **distribution of core CPI (since Sep-21) indicates that the recent print is even below the mean-2*SD mark. This is an optimistic number and may impact the future policy trajectory of RBI.**

Item-wise analysis reveals that weighted contribution of food and beverages declined by a maximum by 41 bps in Apr'23 mainly on account of wheat/atta (other sources). Fruits inflation too decelerated significantly with weighted contribution of mango declining by 11 bps in Apr'23.

With CPI declining at 4.7% in April, the question is whether 6.5% is the terminal rate. We have constructed 4 mutually exclusive scenarios of repo rates by training the data of RBI rate deciding manner for the period of Feb 22 to Nov 22. Data has been trained with 1 month lag. In the fourth and most important scenario wherein **if MPC has considered domestic CPI headline inflation, CPI Core inflation & Fed rate hikes, while taking a call on repo rate, the current repo rate would have been at 6.22%. Given that the current rate of 6.5% is already higher than the required rate of 6.22%, we expect one more pause by RBI MPC meeting in June 23, while carefully watching the CPI and Core CPI number in ongoing months. We believe that our machine learning is indicating that this terminal rate could decline to 6% with the next quarter. This would possibly open up opportunities for RBI to look at the data trends more carefully for a rate action towards the end of the year.**

However, the concern remains on growth front.

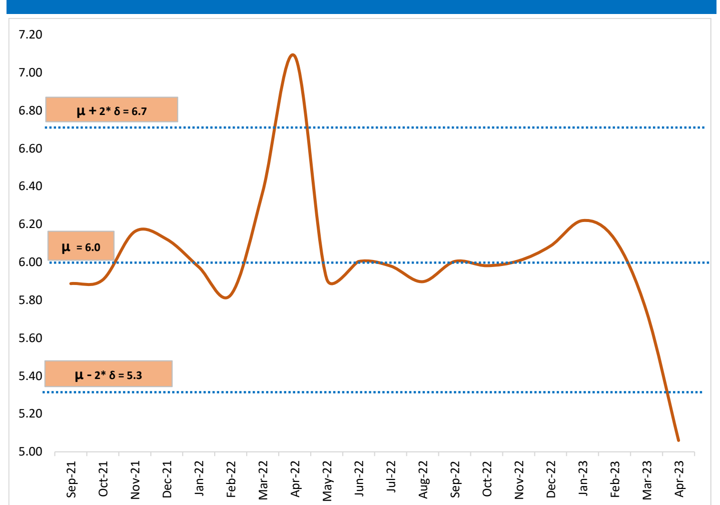
More importantly India remains at the forefront of the most vulnerable countries to the likely adverse impacts of climate change, ranking 7th out of 181 in the Global Climate Risk Index 2021 despite slew of controlling measures initiated on Green House Gas emissions along with promoting renewable energy and curtailing energy usage/consumption while adopting futuristic climate policy of late. More than 3/4th of Indian districts are considered hotspots for extreme climate events which have a direct bearing on price prints volatility (mostly supply side). It is evident that climate change poses a significant threat to India, impairing future growth materially if friction points remain significantly unchecked in time.

While Skymet has projected disparities in average rainfall this year for the country (Below Normal), IMD projections are more upbeat and tuned to a normal distribution pattern. Credit, Insurance and Capital markets remain quite vulnerable to both physical as also transition risk emanating from multiple drivers as we brace for the return of El Nino this year. On a positive cue, we believe Fed has likely reached its terminal rate, soothing frayed nerves of markets going ahead.

CPI INFLATION IS AT 18-MONTHS LOW OF 4.70%

- CPI inflation moderated to almost 18-months low to 4.70% (SBI estimate: 4.70%) in Apr'23 as compared to 5.66% in Mar'23 due to sharp deceleration in fuel inflation. However, cereals and spices CPI are still growing in double digits.
- Core CPI plunged to almost 3-years low to 5.06% in Apr'23 as against 5.74% in Mar'23, due to decline in fuel and light prices supported by abase. Fuel and light CPI decelerated from 8.91% in Mar'23 to 5.52% in Apr'23.
- **A distribution of core CPI (since Sep-21) indicate that the recent print is even below the mean-2*SD mark. This is a highly optimistic number and may impact the future policy trajectory of RBI.**

Distribution Curve of Core CPI



Source: SBI Research

- With the continued efforts of RBI in controlling inflation, it is observed that both CPI and Core CPI inflation are below repo rate from Feb'23 onwards. With the decline in CPI and Core CPI inflation and US inflation also cooling down, it is expected that 6.5% Repo rate could be a terminal repo rate and no further rate hikes would be needed to tame inflation.
- We expect, in FY24 average CPI would be 5.12%, compared to 6.66% in FY23.

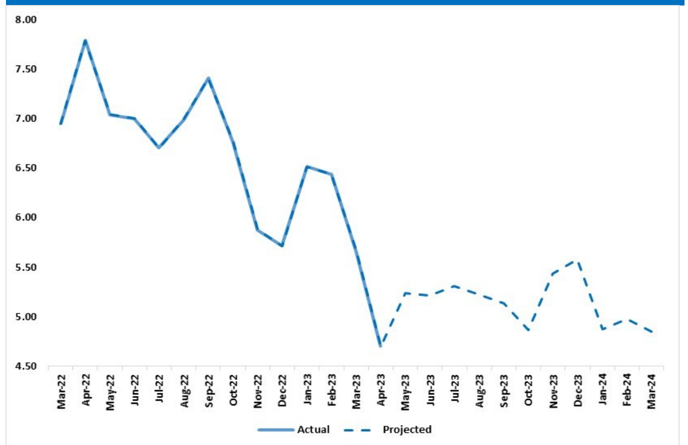
RBI POLICY EXPECTATIONS FOR NEXT MPC MEETING IN JUNE 23

- It may be recalled that we have earlier correctly predicted a pause by RBI MPC meeting in April 23, based on the dissent taken by MPC Members in earlier meetings, by developing a Skewness Index.
- Market participants were expecting one more rate hike, in RBI MPC meeting in April 23.
- In April 23 MPC meeting, the decision by all MPC members was unanimous and there was no skewness present in their approach while deciding the repo rate.
- **Our machine learning model simplifies the approach taken by RBI MPC members in final rate setting by the majority, based on concerning variables such as CPI Inflation, Core CPI Inflation, and Fed Rate.**

THE GREAT DECELERATIONS

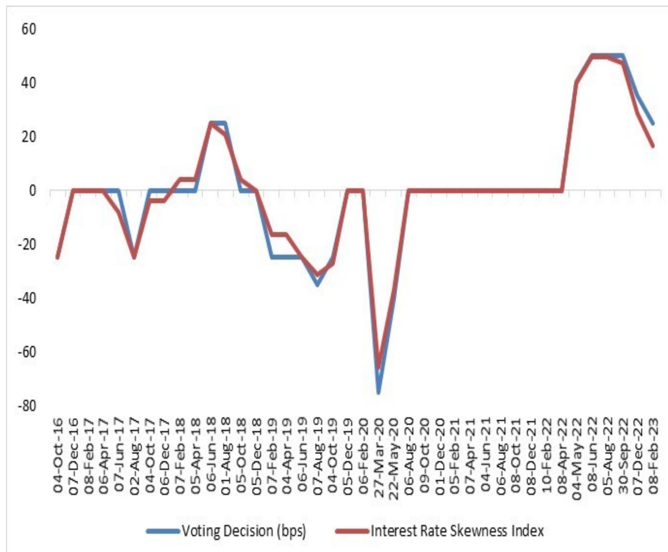
- The CPI inflation was pulled down by sharp contraction in prices of Oils and fats and vegetables by 12.33%. The oil prices have fallen mirroring the combined effect of stable world palm oil prices and lower soya, rapeseed and sunflower oil. Falling demand and bumper supply explains the sharp fall in prices of oils and fats.
- The vegetable prices have fallen by 6.5% on account of better harvest, despite episodes of unseasonal rains hurting supplies in some parts.
- Item-wise analysis reveals that weighted contribution of food and beverages declined by a maximum by 41 bps to 1.94% in Apr'23 from 2.35% in Mar'23, mainly on account of wheat/atta (other sources). Fruits inflation too decelerated significantly with weighted contribution of mango declining by 11 bps in Apr'23 compared to Mar'23. Kerosene PDS and petrol too witnessed decline in inflation.

CPI Inflation (% YoY) : Actual vs Future Trajectory



Source: SBI Research

Interest rate Skewness Index



Source: SBI Research

YIELD OUTLOOK AND RUPEE

- With the onset of general price correction, the yield of 10-year Gsec is expected to moderate in the near future. The 10-year yield is already sub-7% and is expected to be range bound. With buoyant FII inflows, moderating inflation, the USD/INR pair which is in the range of ₹82-82.5 will see some appreciation. However the general trend in rise in rates in the US and UK might check any large gains on both front.

SCENARIOS OF REPO RATES BASED ON ARTIFICIAL NEURAL NETWORK (ANN) MODEL OF MACHINE LEARNING

- We have constructed 4 mutually exclusive scenarios of repo rates by training the data of RBI rate deciding manner for the period of Feb 22 to Nov 22.Data has been trained with 1 month lag.
- In the first scenario wherein if MPC had only considered domestic CPI headline inflation numbers, while taking a call on repo rate, the peak rate in the cycle would have been at 5.20% and the current rate at 2.17%.
- In the second scenario wherein if MPC had considered only Fed rate hikes, while taking a call on repo rate, the peak rate in the cycle would have been at 6.19% and the current rate also at 6.19%.
- In the third scenario wherein if MPC had considered both domestic CPI headline inflation & Fed rate hikes, while taking a call on repo rate, the peak rate in the cycle would have been at 6.22% and the current rate also at 6.21%.
- In the fourth and most important scenario wherein if MPC had considered domestic CPI headline inflation, CPI Core inflation & Fed rate hikes, while taking a call on repo rate, the current rate is at 6.22%.
- **Given that the current rate of 6.5% is already higher than the required rate of 6.22%, we expect one more pause by RBI MPC meeting in June 23, while carefully watching the CPI and Core CPI number in ongoing months.**

INDEX OF INDUSTRIAL PRODUCTION

- India's industrial production rose 1.1% in Mar'23 (5-months low). While mining increased by 6.8% electricity declined by 1.6%. Manufacturing grew by only 0.5%. For the fiscal FY23 fiscal, IIP had risen 5.1% as against a growth of 11.4% in FY22 on the back of 8.9% growth in electricity generation.

ASSESSING CLIMATE RISK IMPACT

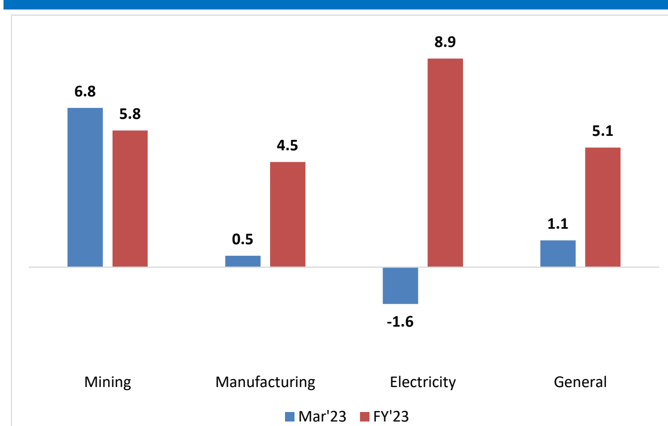
- India remains at the forefront of the most vulnerable countries to the likely adverse impacts of climate change, ranking 7th out of 181 in the Global Climate Risk Index 2021 despite slew of controlling measures initiated on Green House Gas emissions along with promoting renewable energy and curtailing energy usage/consumption while adopting futuristic climate policy of late.

Repo Rate Decomposition

Month	Repo Rate	Optimal Repo Rate based on mutually exclusive scenario			
		Scenario 1: If the MPC had considered only CPI for deciding Repo rate	Scenario 2: If the MPC had considered only Fed Rate for deciding Repo rate	Scenario 3: If the MPC had considered both CPI and Fed Rate for deciding Repo rate	Scenario 4: If the MPC had considered CPI, Core CPI and Fed Rate for deciding Repo rate
Feb-22	4	3.94	4.01	3.98	3.92
Mar-22	4	4.21	4.01	3.99	4.02
Apr-22	4	5.15	4.23	4.25	4.24
May-22	4.4	5.20	4.23	4.30	4.27
Jun-22	4.9	5.15	4.65	4.64	4.74
Jul-22	4.9	5.15	5.20	5.17	5.15
Aug-22	5.4	5.06	5.60	5.59	5.46
Sep-22	5.9	5.15	5.60	5.60	5.61
Oct-22	5.9	5.19	5.88	5.90	6.02
Nov-22	5.9	5.10	5.88	5.89	5.86
Dec-22	6.25	3.66	6.05	6.07	5.93
Jan-23	6.25	3.11	6.13	6.16	6.04
Feb-23	6.5	4.91	6.13	6.17	6.19
Mar-23	6.5	4.79	6.16	6.20	6.27
Apr-23	6.5	3.01	6.19	6.22	6.26
May-23	6.5	2.17	6.19	6.21	6.22

Source: SBI Research

Index of Industrial Production



Source: SBI Research

- More than 3/4th of Indian districts are considered hotspots for extreme climate events which have a direct bearing on price prints volatility (mostly supply side). It is evident that climate change poses a significant threat to India, impairing future growth materially if friction points remain significantly unchecked in time.
- Global Climate Risk Index 2021 estimates India's (ranked 7 against 5 prior year) absolute losses at $68.8 billion, the highest among top 10 most affected countries (2019). While Skymet has projected disparities in average rainfall this year for the country, IMD projections are more upbeat and tuned to a normal distribution pattern. Credit, Insurance and Capital markets remain quite vulnerable to both physical as also transition risk emanating from multiple drivers as we brace for the return of El Nino this year.

Global Climate Risk Index (CRI)'2021

Ranking 2019 (2018)	Country	CRI score	Fatalities	Fatalities per 100 000 inhabitants	Absolute losses (in million US$ PPP)
1 (54)	Mozambique	2.67	700	2.25	4 930.08
2 (132)	Zimbabwe	6.17	347	2.33	1 836.82
3 (135)	The Bahamas	6.50	56	14.70	4 758.21
4 (1)	Japan	14.50	290	0.23	28 899.79
5 (93)	Malawi	15.17	95	0.47	452.14
6 (24)	Islamic Republic of Afghanistan	16.00	191	0.51	548.73
7 (5)	India	16.67	2 267	0.17	68 812.35
8 (133)	South Sudan	17.33	185	1.38	85.86
9 (27)	Niger	18.17	117	0.50	219.58
10 (59)	Bolivia	19.67	33	0.29	798.91

Source: SBI Research, GCRI'2021 (TOP 10 Most affected countries in 2019)

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