

## MPC Keeps Rates On Hold; Maintains Guidance

**The MPC maintained its stance that policy would remain accommodative as long as necessary. However, it felt that elevated inflation constrains any room for further interest rate cuts at this juncture.**

**That recovery in rural demand is expected to strengthen further, while urban demand is also gaining momentum.**

**Commercial banks and cooperative banks will not be allowed to pay any dividends from the profits made in FY20.**

- ◆ India's Monetary Policy Committee (MPC) kept interest rates unchanged at its December FY21 review.
- ◆ The benchmark repo rate was left unchanged at 4% and reverse repo rate at 3.35%.
- ◆ The MPC also maintained its stance, reiterating the October guidance that policy would remain accommodative as long as necessary - at least during the current and into the next financial year to revive growth on a durable basis.
- ◆ The committee although, felt that elevated inflation constrains any room for further interest rate cuts at this juncture.
- ◆ The MPC resolution stated that the outlook for inflation has turned adverse relative to expectations in the last two months.
- ◆ CPI inflation is projected at 6.8% for Q3FY21, 5.8% for Q4FY21 and in the range of 5.2% to 4.6% for the first half of the next financial year.
- ◆ Real GDP growth is projected at -7.5% in FY21. GDP is estimated to grow by 0.1% in Q3 FY21 and by 0.7% in Q4 FY21.
- ◆ GDP is estimated to grow in the range of 21.9% to 6.5% in the first half of the next financial year.
- ◆ Long term repo operations to be expanded to cover wider set of stressed sectors.
- ◆ Commercial banks and cooperative banks will not be allowed to pay any dividends from the profits made in FY20.
- ◆ RBI has decided to formulate guidelines on dividend distribution by NBFCs.
- ◆ Regional rural banks will be allowed to access the liquidity adjustment facility, the marginal standing facility and the call money markets.
- ◆ Draft directions to be issued for credit default swaps.
- ◆ Draft guidelines for derivatives to be issued today.
- ◆ Discussion paper on supervision of NBFCs based on size to be issued in January.

## GDP Outlook

For the first half of FY2021-22, real GDP growth is estimated to be in the range of 21.9% to 6.5%.

The MPC noted that the recovery in rural demand is expected to strengthen further, while urban demand is also gaining momentum as unlocking spurs activity and employment, especially of labour displaced by COVID-19.

Consumers remain optimistic about the outlook, and business sentiment of manufacturing firms is gradually improving. Fiscal stimulus is increasingly moving beyond being supportive of consumption and liquidity to supporting growth-generating investment.

On the other hand, private investment is still slack and capacity utilisation has not fully recovered. While exports are on an uneven recovery, the prospects have brightened with the progress on the vaccines.

Considering these factors, the MPC projected a real GDP growth of - 7.5% in FY21. GDP is estimated to grow by 0.1% in Q3 FY21 and by 0.7% in Q4 FY21. GDP is estimated to grow in the range of 21.9% to 6.5% in the first half of the next financial year.

## Inflation Outlook

For FY2021-22, Inflation is estimated to move in a range of 5.2% to 4.6%.

The committee noted that the outlook for inflation has turned adverse relative to expectations in the last two months. The substantial wedge between wholesale and retail inflation points to the supply-side bottlenecks and large margins being charged to the consumer.

While cereal prices may continue to soften with the bumper kharif harvest arrivals and vegetable prices may ease with the winter crop, other food prices are likely to persist at elevated levels.

Crude oil prices have picked up on optimism of demand recovery, continuation of OPEC plus production cuts and are expected to remain volatile in the near-term. Cost-push pressures continue to impinge on core inflation, which has remained sticky and could firm up as economic activity normalises and demand picks up.

Considering these, the MPC projected CPI inflation at 6.8% for Q3 FY21, 5.8% for Q4 FY21; and 5.2% to 4.6% for H1 FY22.

## Key Notes from Monetary Policy

- **Liquidity Assurance:**

Contrary to expectations, the committee did not give any indication that the central bank was ready to begin exiting the ultra-easy liquidity stance it has maintain.

Surplus liquidity of more than Rs 5 lakh crore has driven down interest rates for short term government bonds and corporate commercial paper, with some instruments being issued below the repo and reverse repo rates.

The committee acknowledged the need to manage domestic liquidity implications of strong foreign capital flows but added that comfortable conditions would be maintained.

## Our View

As expected, the central bank's guidance was very dovish. It noted that inflation remains largely supply side-driven and that supporting growth remains its paramount priority. Our baseline projection is that the RBI will continue keeping policy rates on hold at least till the first half of CY2021.

On the liquidity front, While the RBI stayed away from any decisions on absorbing the liquidity surplus in the market, it can potentially address this issue separately.

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