RBI's Monetary Policy Review (FY21-22)

August 7, 2021

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MPC Keeps Rates On Hold To Support 'Nascent, Hesitant' Recovary

- India's Monetary Policy Committee (MPC) kept interest rates unchanged for the seventh straight meet.
- Following its third review of the current financial year, the MPC voted unanimously to keep the policy repo rate unchanged at 4%.
- The repo rate was last reduced in May 2020, making this the longest stretch of status quo in the benchmark policy rate over at least the last twenty years.
- The central bank decided to keep reverse repo rate unchanged at 3.35%.
- Calling the recovery "tentative" and "nascent" and inflation "exogenous" and "largely temporary", the MPC and the central bank laid the path for continued monetary policy accommodation.
- All members except Jayanth R. Varma, voted to continue with the accommodative stance.
- CPI inflation forecast raised to 5.7% for FY22 vs 5.1% earlier.
- Supply-side drivers could be transitory while demand-pull pressures remain inert.
- The revival of south-west monsoon and the pick-up in kharif sowing, buffered by adequate food stocks should help to control cereal price pressures.
- FY22 Real GDP growth forecast retained at 9.5%
- Q1 FY22 GDP growth projection revised up to 21.4% vs 18.5% earlier.
- Domestic economic activity has started normalising with ebbing of second wave, phased reopening of economy.
- Decided to conduct fortnightly VRRR auctions of Rs 2.5 lakh crore on August 13, 2021; Rs 3 lakh crore on August 27, 2021; Rs 3.5 lakh crore on September 9, 2021; and Rs 4 lakh crore on September 24, 2021.
- On-tap TLTRO scheme extended by three months till Dec 31, 2021.
- Marginal Standing Facility (MSF): Extension in Period of Relaxation until Dec 31, 2021.

GDP Outlook

Improving capacity utilisation and congenial monetary and financial conditions are preparing the ground for a long-awaited revival.

- Domestic economic activity is starting to recover with the ebbing of the second wave.
- Looking ahead, agricultural production and rural demand are expected to remain resilient. Urban demand is likely to mend with a lag as manufacturing and non-contact intensive services resume on a stronger pace, and the release of pent-up demand acquires a durable character with an accelerated pace of vaccination.
- Although investment demand is still anemic, improving capacity utilisation and congenial monetary and financial conditions are preparing the ground for a long-awaited revival.
- Taking all these factors into consideration, projection for real GDP growth is retained at 9.5% in FY22 consisting of 21.4% in Q1; 7.3% in Q2; 6.3% in Q3; and 6.1% in Q4 of FY22. Real GDP growth for Q1FY23 is projected at 17.2%.

Inflation Outlook

While crude oil prices at elevated levels, a calibrated reduction of the indirect tax component of pump prices by the Centre and states can help to substantially lessen cost pressures.

- Inflation will remain close to the upper tolerance band up to Q2FY22, but these pressures should ebb in the third quarter of FY22 on account of kharif harvest arrivals and as supply side measures take effect.
- High frequency indicators suggest some softening of price pressures in edible oils and pulses in July in response to supply side interventions by the government.
- Input prices are rising across manufacturing and services sectors but weak demand and efforts towards cost cutting are tempering the pass-through to output prices.
- With crude oil prices at elevated levels, a calibrated reduction of the indirect tax component of pump prices by the Centre and states can help to substantially lessen cost pressures.
- Taking into consideration all these factors, CPI inflation is projected at 5.7% during FY22, at 5.9% in Q2, 5.3% in Q3 and 5.8% in Q4, with risks broadly balanced.

Key Notes from Monetary Policy

Supporting The Nascent, Hesitant Recovery: Calling the recovery "tentative" and "nascent" and inflation "exogenous" and "largely temporary", the MPC and the central bank laid the path for continued monetary policy accommodation. The committee guided that the "accommodative stance would be maintained as long as necessary to revive and sustain growth on a durable basis, while ensuring that inflation remains within the target going forward".

Easing Deadline For One-Time Debt Recast: The RBI has decided to provide more time to corporate borrowers to meet certain financial benchmarks. An extension has been provided for four specific operational parameters including total debt-to-Ebitda ratio, current ratio, debt service coverage ratio and average debt service coverage ratio. The deadline has been extended to Oct. 1, 2022 from March 31, 2022.

Transition Away From Libor: The RBI continues to try and manage a difficult transition away from Libor. It made two announcements in this regard.

Banks can extend export credit in foreign currency using any other widely accepted alternative reference rate in the currency concerned.

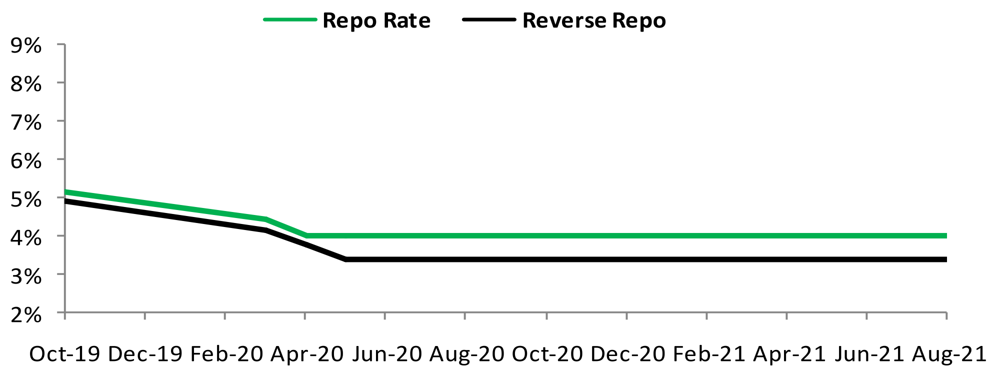
Change in reference rate from Libor/Libor-related benchmarks to an alternative reference rate will not be treated a as restructuring, the regulator said.

Bond Market Reacts

Shorter-dated bonds declined after the dissenting vote on policy stance. The yield on the 5.63% bond maturing in 2026 rose as much as 10 basis points to 5.81%, before paring gains. The benchmark 10-year yield was up three basis points to 6.24%.

The RBI also decided to increase the size of variable rate reverse repo auctions but reiterated that this should not be seen as a reversal of the accommodative monetary policy stance.

Repo & Revere Repo Trend



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