Fourth Bi-monthly Monetary Policy Statement, 2021-22

October 08, 2021

Policy Actions

Keep the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 4.00 percent.

Accordingly, the marginal standing facility (MSF) rate and the Bank Rate remains unchanged at 4.25 percent and the reverse repo rate under the LAF remains at 3.35 percent.

The MPC also decided to continue with the accommodative stance as long as necessary to revive and sustain growth on a durable basis and continue to mitigate the impact of coronavirus (COVID-19) on the economy, while ensuring that inflation remains within the target going forward.

These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 percent within a band of +/- 2 percent, while supporting growth.

Policy Assessment

Since the MPC's meeting in August 21, the momentum of the global recovery has ebbed across geographies with the rapid spread of the delta variant of COVID-19, including in some countries with relatively high vaccination rates. World merchandise trade volumes remained resilient in Q2:2021, but more recently there has been a loss of momentum with the persistence of supply and logistics bottlenecks.

Commodity prices remain elevated, and consequently, inflationary pressures have accentuated in most advanced economies (AEs) and emerging market economies (EMEs), prompting monetary tightening by a few central banks in the former group and several in the latter. Change in monetary policy stances, in conjunction with a likely tapering of bond purchases in major advanced economies later this year, is beginning to strain the international financial markets with a sharp rise in bond yields in major AEs and EMEs after remaining range-bound in August.

On the domestic front, real gross domestic product (GDP) expanded by 20.1 percent year-on-year (y-o-y) during Q1:2021-22 on a large favourable base; however, its momentum was dragged down by the second wave of the pandemic. On the demand side, almost all the constituents of GDP posted robust y-o-y growth. On the supply side, real gross value added (GVA) increased by 18.8 percent y-o-y during Q1:2021-22

The south-west monsoon, after a lull in August, picked up in September, narrowing the deficit in the cumulative seasonal rainfall to 0.7 percent below the long period average and kharif sowing exceeded the previous year's level. Record kharif foodgrains production of 150.5 million tonnes as per the first advance estimates augurs well for the overall agricultural sector. By end-September, reservoir levels at 80 percent of the full reservoir level were above the decadal average, which is expected to boost rabi production prospects.

High-frequency indicators for August-September – railway freight traffic; cement production; electricity demand; port cargo; e-way bills; GST and toll collections – suggest progress in the normalisation of economic activity relative to pre-pandemic levels; however, indicators such as domestic air traffic, two-wheeler sales and steel consumption continue to lag. Non-oil export growth remained strong on buoyant external demand.

Headline CPI inflation at 5.3 percent in August softened for the second consecutive month, declining by one percentage point from the recent peak in May-June 2021. This was primarily driven by an easing in food inflation. Fuel inflation edged up to a new high in August. Core inflation, i.e. inflation excluding food and fuel, remained elevated and sticky at 5.8 percent in July-August 2021.

System liquidity remained in large surplus in August-September, with daily absorptions rising from an average of ₹7.7 lakh crore in July-August to ₹9.0 lakh crore during September and ₹9.5 lakh crore during October (up to October 6) through the fixed rate reverse repo, the 14-day variable rate reverse repo (VRRR) and fine tuning operations under the liquidity adjustment facility (LAF). India's foreign exchange reserves increased by US$ 60.5 billion in 2021-22 (up to October 1) to US$ 637.5 billion.

Outlook

Going forward, the inflation trajectory is set to edge down during Q3:2021-22, drawing comfort from the recent catch-up in kharif sowing and likely record production. Along with adequate buffer stock of food grains, these factors should help to keep cereal prices range bound. The resurgence of edible oils prices in the recent period, however, is a cause of concern. On the other hand, pressures persist from crude oil prices which remain volatile over uncertainties on the global supply and demand conditions. Rising metals and energy prices, acute shortage of key industrial components and high logistics costs are adding to input cost pressures.

The CPI headline momentum is moderating with the easing of food prices which, combined with favourable base effects, could bring about a substantial softening in inflation in the near-term. Taking into consideration all these factors, CPI inflation is projected at 5.3 percent for 2021-22; 5.1 percent in Q2, 4.5 percent in Q3; 5.8 percent in Q4 of 2021-22, with risks broadly balanced. CPI inflation for Q1:2022-23 is projected at 5.2 percent.

Domestic economic activity is gaining traction with the ebbing of the second wave. The substantial acceleration in the pace of vaccination, the sustained lowering of new infections and the coming festival season should support a rebound in the pent-up demand for contact intensive services, strengthen the demand for non-contact intensive services, and bolster urban demand. Projection for real GDP growth is retained at 9.5 percent in 2021-22 consisting of 7.9 percent in Q2; 6.8 percent in Q3; and 6.1 percent in Q4 of 2021-22. Real GDP growth for Q1:2022-23 is projected at 17.2 percent.

The outlook for aggregate demand is progressively improving but the slack is large: output is still below pre-COVID level and the recovery is uneven and critically dependent upon policy support. Compared to pre-pandemic levels, contact intensive services, which contribute around two-fifth of economic activity in India, still lag considerably. The MPC will remain watchful given the uncertainties surrounding the outlook for growth and inflation. Accordingly, keeping in mind the evolving situation, the MPC decided to keep the policy repo rate unchanged at 4 percent and continue with an accommodative stance as long as necessary to revive and sustain growth on a durable basis and continue to mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward.

All members of the MPC unanimously voted for keeping the policy repo rate unchanged at 4 percent.

All members of the MPC except Prof. Jayanth R. Varma, voted to continue with the accommodative stance as long as necessary to revive and sustain growth on a durable basis and continue to mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward. Prof. Jayanth R. Varma expressed reservations on this part of the resolution.

Statement on Development and Regulatory Policies

This Statement sets out various developmental and regulatory policy that directly address the stress in financial conditions caused by COVID-19.

1). **On-Tap Special Long Term Repo Operations (SLTRO) for Small Finance Banks:** ₹ 10,000 crs SLTRO which is available at Repo rate, has now been extended till 31st Dec 21

2). **Enhanced transaction limit in IMPS:** Enhancement of transaction limit for IMPS from ₹2 lakhs to ₹5 lakhs per transaction

3). **Extension of Ways and Means Advances (WMA) Limits and Overdraft (OD) facility for State Governments:** WMA limit of ₹ 51,560 crs to be continued for a further period of 6 months upto 31st Mar 22 and also the enhanced OD period upto 31st Mar 22.

4). **Variable Rate Reverse Repo (VRRR):** The RBI proposed to take 14-day VRRR options in a fortnightly manner in the following manner:

Date	Amount (In Rs. lakh crore)
08-Oct-21	4.00
22-Oct-21	4.50
03-Nov-21	5.00
18-Nov-21	5.50
03-Dec-21	6.00

Further, the RBI may also consider complementing the 14-day VRRR auctions with 28-day VRRR in a calibrated fashion, depending on the evolving liquidity conditions.

Our Views & Conclusion:

MPC as expected kept the policy rate unchanged and continued with its accommodative stance as long as necessary to revive and sustain growth on a durable basis and continue to mitigate the impact of COVID-19 on the economy. The RBI adopted a more calibrated and patient approach towards managing liquidity and monetary policy support, recognizing that there are still some downside risks to growth. The RBI has revised retail inflation outlook for FY22 from 5.7 percent to 5.3 percent. The RBI has retained its GDP growth forecast at 9.5 percent for FY 22.

The central bank suspended its G-SAP program and provided a calendar to further increase the limit of the VRRR window gradually to INR 6 lakh crore by December 2021. It also mentioned that if conditions permit, a 28 days VRRR is also on the table which would imply more durable liquidity absorption. On the back of this measures taken by RBI, we expect that the long term interest rates will firm up on a medium term basis. We will closely monitor the factors discussed above and we will remain invested in the low to medium term of the yield curve.

PROMOTED BY

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