# First Bi-monthly Monetary Policy Statement, 2021-22

**April 07, 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 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 February, lingering effects of the slowdown in the global economy in Q4 of 2020 have persisted, although recent arrivals of high frequency indicators suggest that a gradual but uneven recovery may be forming. The much anticipated boost to economic activity from the vaccination rollouts is being somewhat held back by new mutations of COVID-19, second and third waves of infections across countries and unequal access to vaccines more generally.

Inflation remains benign in major advanced economies (Aes), although highly accommodative monetary policies and large fiscal stimuli have added to concerns around market-based indicators of inflation expectations, unsettling bond markets globally. In a few emerging market economies (EMEs), however, inflation is ruling above targets, primarily driven by firming global commodity prices. This has even prompted a few of them to raise policy rates. Equity and currency markets have been turbulent with the increase in long-term bond yields and the steepening of yield curves.

The second advance estimates for 2020-21 released by the National Statistical Office (NSO) on February 26, 2021 placed India's real gross domestic product (GDP) contraction at 8.0 percent during the year. The resilience of agriculture is evident from food grains and horticulture production for 2020- 21, which are expected to be 2.0 percent and 1.8 per cent higher respectively than the final estimates of 2019-20.

Headline inflation increased to 5.0 percent in February after having eased to 4.1 percent in January 2021. Within an overall food inflation print of 4.3 percent in February, five out of twelve food sub-groups recorded double digit inflation.

System liquidity remained in large surplus in February and March 2021 with average daily net liquidity absorption of ₹5.9 lakh crore. Corporate bond issuances at ₹6.8 lakh crore during 2020-21 (up to February 2021) were higher than ₹6.1 lakh crore during the same period last year. India's foreign exchange reserves increased by US$ 99.2 billion during 2020-21 to US$ 577.0 billion at end-March 2021, providing an import cover of 18.4 months and 102 percent of India's external debt.

## Outlook

The evolving CPI inflation trajectory is likely to be subjected to both upside and downside pressures. The bumper food grains production in 2020-21 should sustain softening of cereal prices going forward. Pump prices of petroleum products have remained high. This could slow down the propagation of second round effects. CPI inflation is now projected as 5.0 percent in Q4:2020- 21; 5.2 percent in Q1:2021-22, 5.2 percent in Q2, 4.4 percent in Q3 and 5.1 percent in Q4, with risks broadly balanced.

Turning to the growth outlook, rural demand remains buoyant and record agriculture production for 2020-21 bodes well for its resilience. Urban demand has been gaining strength on the back of normalisation of economic activity and should get a fillip with the ongoing vaccination drive. Consumer confidence, on the other hand, has dipped with the recent surge in COVID infections in some states imparting uncertainty to the outlook. Real GDP growth for 2021-22 is retained at 10.5 percent consisting of 26.2 percent in Q1, 8.3 percent in Q2, 5.4 percent in Q3 and 6.2 percent in Q4.

The MPC notes that the supply side pressures on inflation could persist. It also notes that demand-side pull remains moderate. The renewed jump in COVID-19 infections in certain parts of the country and the associated localised lockdowns could dampen the demand for contact-intensive services, restrain growth impulses and prolong the return to normalcy. The MPC decided to continue with the accommodative stance as long as necessary to 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. Further, all members of the MPC voted unanimously to continue with the accommodative stance as long as necessary – at least during the current financial year and into the next financial year – to revive growth on a durable basis and mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward.

## 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). Govt Securities Buying Programme (GSAP 1.0) –** Along with regular Open Market Operations that RBI has conducted in last FY 21 (i.e. approx. ₹3.3 trillion, the RBI now introduces the Secondary Govt Securities Programme (G-SAP 1.0), wherein the RBI will commit upfront to a specific amount of open market purchases of government securities. For Q1 FY22, the amount for G-SAP is fixed at ₹1 Lakh Crore and the first purchase under the category will take place on April 15, 2021 for an amount of ₹25,000 Crore. This shall help in stable & orderly evolution of the Yield.

2). TLTRO on Tap Scheme has been extended by a period of six months from 31st March 21 to 30th Sep 21.

2). Under the Special Refinance facility, ₹50,000 crs for fresh lending to be provided in FY22 to NABARD (₹25,000 crs), NHB (₹10,000 crs), SIDBI (₹1500 crs).

3). Banks lending to registered NBFC's under Priority Sector Lending (to Agriculture, MSME and Housing) has been extended by six months upto 30th Sep 21.

4). RBI accepted the Advisory committee's recommendation, and enhanced the Ways and Means Advance (WMA) limit of states and UT's by 46 percent to ₹47,010 crs bn. In addition, it would continue the enhanced interim WMA limit of ₹51,560 crs for six more months upto 30th Sep,21.

## Our Views & Conclusion:

MPC as expected kept the policy rate unchanged and continued with its accommodative stance as long as necessary to sustain growth on a durable basis and continue to mitigate the impact of COVID-19 on the economy. The RBI lowered its Q4FY21 CPI estimate to 5.0 percent from earlier 5.2 percent and it marginally revised up its H1FY22 estimate to 5.2 percent from 5.0 percent - 5.2 percent earlier. There is significantly surplus liquidity in the system. The RBI announced a secondary market G-SAP 1.0 (apart from regular OMOs) worth INR 1 lakh crore in Q1 FY22. This is likely to stabilize and support long term yields. Governor has clearly stressed that RBI will do whatever it takes to preserve financial stability and to insulate domestic financial markets from global spillovers and the consequent volatility.

We believe that yield will steepen at the longer end of the curve due to large supply and also might get impacted due to global factors like US yield and crude moving up. RBI will ensure that rates will remain soft and as indicated by Governor in his address that RBI will do whatever it takes to support yield. We will closely monitor the factors discussed above and modify the duration accordingly.