# First Bi-monthly Monetary Policy Statement, 2022-23

**April 08, 2022**

## Policy Actions

MPC in its 1st MPC decided to 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 remain unchanged at 4.25 percent. The standing deposit facility (SDF) rate, which will now be the floor of the LAF corridor, will be at 3.75 percent.

The MPC also decided to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

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 2022, the global economic and financial environment has worsened with the escalation of geopolitical conflict and accompanying sanctions. Commodity prices have shot up substantially across the board amidst heightened volatility, with adverse fallouts on net commodity importers. Financial markets have exhibited increased volatility. Crude oil prices jumped to 14-year high in early March; despite some correction, they remain volatile at elevated levels. Supply chain pressures, which were set to ease, are rising again. The broad-based jump in global commodity prices has exacerbated inflationary pressures across advanced economies (AEs) and emerging market economies (EMEs) alike causing a sharp revision in their inflation projections. The global composite purchasing managers' index (PMI) eased to 52.7 in March from 53.5 in February with output growth slowing in both manufacturing and services sectors. World merchandise trade momentum has weakened. Several central banks, especially systemic ones, continue to be on the path of normalisation and tightening of monetary policy stances. Resultantly, sovereign bond yields in major AEs have been hardening. Bullion prices had buoyed to near 2020 highs on safe haven flows, with some recent correction as bond yields rose. Global equity markets fell, although more recently they have recovered some ground. In recent weeks, strong capital outflows from the EMEs have moderated thus curbing the downward pressures on their currencies, even as the US dollar has strengthened. Overall, the global economy faces major headwinds from several fronts, including continuing uncertainty about the pandemic's trajectory. The second advance estimates (SAE) for 2021-22 released by the National Statistical Office (NSO) on February 28, 2022 placed India's real gross domestic product (GDP) growth at 8.9 percent, 1.8 percent above the pre-pandemic (2019-20) level. On the supply side, real gross value added (GVA) rose by 8.3 percent in 2021-22, with its major components, including services, exceeding pre-pandemic levels. GDP growth in Q3:2021-22 decelerated to 5.4 percent. In Q4:2021-22, available high frequency indicators exhibit signs of recovery with the fast ebbing of the third wave but the picture is mixed. Urban demand reflected in domestic air traffic rebounded in March and the pace of contraction in passenger vehicle sales moderated in February. On the other hand, rural demand mirrored in two-wheeler and tractor sales contracted in February. Import of capital goods increased robustly in February, although domestic production continued to contract. Merchandise exports remained buoyant and clocked double-digit growth for the thirteenth successive month in March 2022 and reached US$ 417.8 billion in 2021-22 surpassing the target of US$ 400 billion. All categories of imports, however, have risen even faster, leading to merchandise trade deficit at a record annual level of US $ 192 billion in 2021-22 or 6.1 percent of GDP. On the supply side, foodgrains production touched a new record in 2021-22, with both kharif and rabi output crossing the final estimates for 2020-21 as well as the targets set for 2021-22. The manufacturing PMI remained in expansion zone in March, although it moderated somewhat to 54.0 from 54.9 in February. Services sector indicators – railway freight; e-way bills; GST collections; toll collections; fuel consumption; and electricity demand – were in expansion in February-March. The services PMI continued in expansion mode, inching up to 53.6 in March from 51.8 in the preceding month. Headline CPI inflation edged up to 6.0 percent in January 2022 and 6.1 percent in February, breaching the upper tolerance threshold. Pick-up in food inflation contributed the most in headline inflation, with inflation of cereals, vegetables, spices and protein-based food items like eggs, meat and fish being the key drivers. Fuel inflation moderated on continuing deflation in electricity and steady LPG prices. Core inflation, i.e., CPI inflation excluding food and fuel remained elevated, though there was some moderation from 6.0 per cent in January to 5.8 per cent in February primarily due to the easing of inflation in transport and communication; pan, tobacco and intoxicants; recreation and amusement; and health. Overall system liquidity remained in large surplus, with average daily absorption (through both the fixed and variable rate reverse repos) under the LAF at ₹7.5 lakh crore in March, marginally lower than ₹7.8 lakh crore in January-February 2022. Reserve money (adjusted for the first-round impact of the change in the cash reserve ratio) expanded by 10.9 per cent (y-o-y) on April 1, 2022. Money supply (M3) and bank credit by commercial banks rose (y-o-y) by 8.7 percent and 9.6 percent, respectively, as on March 25, 2022. India's foreign exchange reserves increased by US$ 30.3 billion to US$ 607.3 billion in 2021-22.

## Outlook

Looking ahead, the inflation trajectory will depend critically upon the evolving geopolitical situation and its impact on global commodity prices and logistics. In this scenario, pro-active supply management is critical to contain inflation. International crude oil prices remain volatile and elevated, with considerable uncertainties surrounding global supplies. With the broad-based surge in prices of key industrial inputs and global supply chain disruptions, input cost push pressures appear likely to persist for longer than expected earlier. Their pass-through to retail prices, though limited till now given the continuing slack in the economy, needs to be monitored carefully. Manufacturing sector firms polled in the Reserve Bank's industrial outlook survey expect higher input and output price pressures going forward. Taking into account these factors and on the assumption of a normal monsoon in 2022 and average crude oil price (Indian basket) of US$ 100 per barrel, inflation is now projected at 5.7 percent in 2022-23, with Q1 at 6.3 percent; Q2 at 5.8 percent; Q3 at 5.4 percent; and Q4 at 5.1 percent. Going forward, good prospects of rabi output augur well for rural demand. With the ebbing of the third wave and expanding vaccination coverage, the pick-up in contact-intensive services and urban demand is expected to be sustained. The government's thrust on capital expenditure coupled with initiatives such as the production linked incentive (PLI) scheme should bolster private investment activity, amidst improving capacity utilisation, deleveraged corporate balance sheets, higher offtake of bank credit and congenial financial conditions. At the same time, the escalation of the geopolitical situation and the accompanying surge in international crude oil and other commodity prices, tightening of global financial conditions, persistence of supply-side disruptions and significantly weaker external demand pose downside risks to the outlook. The future course of the pandemic and the uncertainties about the pace of monetary policy normalisation in major advanced economies also weigh on the outlook. Taking all these factors into consideration, the real GDP growth for 2022-23 is now projected at 7.2 percent, with Q1 at 16.2 percent; Q2 at 6.2 percent; Q3 at 4.1 percent; and Q4 at 4.0 percent, with risks broadly balanced.

## Statement on Development and Regulatory Policies

**1. Introduction of the Standing Deposit Facility**

It has been decided to institute the SDF with an interest rate of 3.75 percent with immediate effect. The SDF will replace the fixed rate reverse repo (FRRR) as the floor of the LAF corridor. Both the standing facilities viz., the MSF and the SDF will be available on all days of the week, throughout the year.

The fixed rate reverse repo (FRRR) rate is retained at 3.35 percent. It will remain as part of the RBI's toolkit and its operation will be at the discretion of the RBI for purposes specified from time to time. The FRRR along with the SDF will impart flexibility to the RBI's liquidity management framework.

**2. Restoration of the Symmetric LAF Corridor**

It has now been decided to restore the width of the LAF corridor to its pre-pandemic level. With the introduction of the SDF at 3.75 percent, the policy repo rate being at 4.00 percent and the MSF rate at 4.25 percent, the width of the LAF corridor is restored to its pre-pandemic configuration of 50 bps. Thus, the LAF corridor will be symmetric around the policy repo rate with the MSF rate as the ceiling and the SDF rate as the floor with immediate effect.

**3. SLR Holdings in HTM category**

It has now been decided to enhance the limit for inclusion of SLR eligible securities in the HTM category to 23 percent of NDTL and allow the banks to include securities acquired between April 1, 2022 and March 31, 2023 under the enhanced limit of 23 percent. The HTM limits would be restored from 23 percent to 19.5 percent in a phased manner starting from the quarter ending June 30, 2023.

## Our Views & Conclusion:

As expected, RBI presented a hawkish Monetary Policy as it looks to withdraw steps taken during the pandemic. RBI is seen to move normalization as it focusses on moving towards withdrawal of accommodation to temper inflation going forward. The RBI is seen to be concerned on growth given its projection of 7.2 percent for the next year. On inflation side, its projection of CPI at 5.70 percent is expectedly high due to elevated levels of commodity prices. We expect the yield curve to remain steeper. Owing to this, we shall remain invested in the segments that offer value on a risk adjusted return basis.