

Chart A: CPI Fan Chart

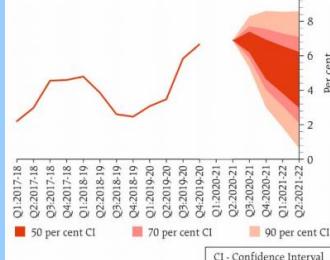
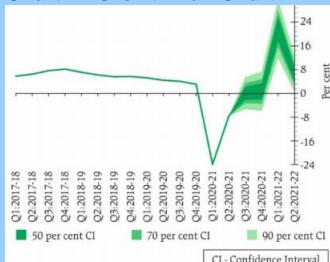


Chart B: Growth Fan Chart



Research Analyst:

Anagha Deodhar

anagha.deodhar@icicisecurities.com
+91 22 2277 7622

Economy

MPC holds rates; policy largely non-event

- ▶ **MPC holds rates in unanimous vote:** In line with our expectation, the Monetary Policy Committee (MPC) kept repo rate unchanged at 4%. Consequently, reverse repo and MSF rates remain unchanged at 3.35% and 4.25% respectively. The decision to keep rates unchanged was taken unanimously.
- ▶ **Consensus vote on 'accommodative stance' puzzling:** While the unanimous vote on repo rate was expected, the consensus vote on stance of monetary policy was a bit surprising. In the Oct 2020 review, new MPC member Prof. Jayanth Varma had noted that if an unforeseeable inflation shock were to hit the economy, the MPC may find it hard to remain accommodative. Since then, inflation has consistently surprised on the upside and growth impulses have proved to be stronger-than-expected. Hence, his vote to keep the stance accommodative is somewhat puzzling. We look forward to the minutes (to be released on 18 Dec 2020) for more clarity on this.
- ▶ **Committee ups inflation forecast sharply...:** The committee noted that outlook for inflation has turned adverse in the last two months and that price pressures in the economy are spreading. It pointed to supply chain disruptions, high retail margins, and indirect taxes and added that further efforts are required to mitigate supply-side driven inflation. While cereals and vegetables inflation may soften in the coming months, the committee expects other food prices to remain elevated. Accordingly, MPC upped CPI forecast to 6.8% in Q3 and 5.8% in Q4FY21 (implying 6.3% in H2FY21), and 4.6%-5.2% in H1FY22 with risks broadly balanced. This is a sharp revision compared to the Oct '20 review in which the MPC had expected inflation to print 4.5%-5.4% in H2FY21.
- ▶ **... and revises growth forecast to -7.5% in FY21; expects positive growth in Q3:** Commenting on the fiscal stimulus, the committee added that it is increasingly moving beyond supporting consumption and liquidity and towards supporting growth-generating investment. While it expects activity in contact-intensive sectors to remain subdued for some time, rural demand is expected to pick up further. However, positive impulses are clouded by the possibility of a second wave of infections. In his address, the Governor added that signs of recovery are far from broad-based and dependent on sustained policy support. The committee now expects real GDP to contract 7.5% in FY21, sharply up from -9.5% in Oct '20 review. Interestingly, the MPC expects growth to turn positive from the current quarter itself – it expects 0.1% growth in Q3 and 0.7% in Q4FY21. The confidence interval for H1FY22 is quite wide – the committee expects real GDP to grow 6.5%-21.9% with risks broadly balanced.
- ▶ **RBI continues to take measures to support growth outside the purview of MPC:** The RBI, on its part, continued to take liquidity and regulatory measures to support growth. In today's review, it extended 'On tap TLTRO' to include 26 sectors identified by Kamath Committee up from five sectors announced in Oct '20. Banks can use these funds to buy corporate bonds, CDs, NCDs or to extend loans to targeted sectors. It also allowed regional rural banks to participate in the money market, announced dividend distribution policy for NBFCs, prohibited banks from making dividend pay-outs for FY20 and announced several measures to support exporters.

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