

Focus on growth continues...

December 4, 2020

Repo rate.....Unchanged at 4%

CRR.....Unchanged at 3%

The Reserve Bank of India (RBI) maintained its repo rate at 4.0%, reverse repo rate at 3.35% and MSF at 4.25%. MPC members voted unanimously on status quo and kept the policy stance unchanged at 'accommodative' 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.

MPC was of the view that inflation is likely to remain elevated, with some relief in the winter months from prices of perishables and bumper Kharif arrivals. This constrains monetary policy at the current juncture from using the space available to act in support of growth. At the same time, the signs of recovery are far from being broad-based and are dependent on sustained policy support. Hence, rates have not been modified.

- The recovery in the rural economy is expected to strengthen further, while the turnaround in urban demand is gaining momentum. Real GDP growth in 2020-21 is expected to be negative at -7.5% for FY21, raised positively, with 0.1% in Q3; and 0.7% in Q4. Real GDP growth for H1:2021-22 has been at 21% to 6.5% with risks evenly balanced
- CPI inflation is projected at 6.8% for Q3:2020-21, 5.8% for Q4:2020-21 and 5.2-4.6% for H1:2021-22, with risks broadly balanced
- RBI has decided that commercial and cooperative banks will retain the profits and not make any dividend payout from the profits pertaining to financial year 2019-20 to preserve capital and ensure financial stability

While the market expectation going into the policy was of a non-event with no rate cut expectation, few market participants expected some commentary on tightening the current surplus liquidity (system liquidity currently over ₹ 5 lakh crore), which had led short term rates to trade below the reverse repo rate of 3.35%. However, MPC unanimously voted to continue with the accommodative stance during the current financial year as well as next financial year. This continuance of accommodative stance despite substantial higher revision in inflation forecast cheered the bond market. The 10 year benchmark G-Sec yield traded marginally down by around 2-3 bps after the policy announcement at around 5.9% levels.

The RBI Governor did not indicate the room for further rate cut as indicated in the last policy, indicating a slim chance of any further rate cut. However, the explicit priority on reviving growth and ignoring current as well as upward revised high inflation is more comforting than the rate cut itself.

RBI indicated that the outlook for inflation has turned adverse relative to expectations in the last two months. It revised its CPI inflation projection sharply to 6.8% for Q3FY20-21 (earlier 5.4%), 5.8% for Q4 (earlier 4.5%), and 5.2% to 4.6% in H1FY2021-22 (earlier 4.1%-4.4% for FF22).

Overall, the unanimous decision by MPC members to continue its accommodative stance is likely to keep the overall bond market well behaved around current levels. The steepness of the yield curve is likely to continue with short-term rates (90 day T-bill, three month CP/CDs) may remain around reverse repo level while supply concerns are likely to prevent any major rally in longer tenure yields.

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