

RBI keeps policy rates unchanged...

...while raising its inflation and growth projections for 2HFY21

- As per expectations, the Monetary Policy Committee (MPC) has kept the repo rate unchanged at 4%. The reverse repo and Marginal Standing Facility (MSF) rates were also kept unchanged at 3.35% and 4.25%, respectively. Besides rates, all members of the MPC voted unanimously to continue with its accommodative stance as long as necessary – at least during the current fiscal and into next fiscal.
- Inflation and growth projections, however, have been revised significantly, as anticipated by us [last time](#). The RBI now expects CPI inflation at 6.8% YoY in 3Q (in line with our forecasts) and 5.8% YoY in 4QFY21 (v/s our forecast of 6.1%). While it projects inflation between 4.6% and 5.2% in 1HFY22, our calculations suggest it will remain ~6%. Inflation is likely to remain elevated, which constraints the MPC from 'using the space available' to act in support of (declining) growth.
- On the growth front, the MPC expects real GDP to contract much slower by 7.5% YoY in FY21 from its earlier expectation of 9.5% YoY, which is largely in line with our [expectation](#). Moving into FY22, the forecasts turn highly volatile, with RBI projecting a growth between 6.5% and 21.9% in 1HFY22.
- Two other important measures announced by RBI were: 1) linking the on-tap Targeted Long Term Repo Operations (TLTRO's) with the government's Emergency Credit Line Guarantee Scheme (ECLGS 2.0) for 26 stressed sectors, in a bid to enhance credit facilities to severely affected sectors, and 2) letting banks retain their FY20 profits in full by not paying dividends. It is also putting in place a transparent criteria as per a matrix of parameters for declaration of dividends by different categories of NBFCs.
- As far as fresh regulatory announcements are concerned, the policy turned out to be a non-event as only liquidity measures initiated in earlier meetings would continue. While the upward revision in growth projection for FY21 reveals RBI's confidence in a recovery in economic activity, higher inflation implies that rate cuts are unlikely in the near future.

I. Policy interest rates kept unchanged third time in a row

- **Policy rates were kept unchanged...:** The MPC decided to keep policy rates unchanged – the repo rate at 4%, the reverse repo at 3.35%, and the MSF at 4.25%. Besides rates, all members of the MPC voted unanimously to continue with the accommodative stance as long as necessary – at least during the current and next fiscal (*Exhibit 1*).
- **...though inflation and growth targets were revised upwards:** Inflation and growth projections, however, have been revised significantly. RBI now expects CPI inflation at 6.8% YoY in 3QFY21 (in line with our forecasts) and 5.8% YoY in 4QFY21 (v/s our forecast of 6.1%). While it projects inflation between 4.6% and 5.2% in 1HFY22, our calculations suggest it will remain ~6%. Inflation is likely to remain elevated, which constraints the MPC from 'using the space available' to act in support of (declining) growth.

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- **Measures announced to support credit:** Compared to previous monetary policies this year, the RBI sobered down its regulatory announcements this time around. The two important announcements according to us are:
 - On 9th Oct'20, RBI decided to conduct on-tap TLTRO, with tenors of up to three years for a total amount of up to INR1t, at a floating rate linked to the policy repo rate, with the flexibility to enhance the amount and period after reviewing the response. As part of its 'Atmanirbhar Bharat Abhiyaan 3.0' package, the central government had launched the ECLGS 2.0 for 26 stressed sectors as identified by the Kamath Committee on 12th Nov'20. Accordingly, it proposed to bring the 26 stressed sectors within the ambit of sectors eligible under the on-tap TLTRO, wherein banks are encouraged to synergize the two schemes by availing funds from RBI under on-tap TLTRO and seek guarantee under ECLGS 2.0 to provide credit support to stressed sectors. **This would enable increased flow of credit into the system at a lower cost.**
 - In order to help banks conserve capital, while creating room for fresh lending, the RBI announced that commercial and co-operative banks will retain their profits and not make any dividend payout pertaining to FY20. A transparent criteria, as per a matrix of parameters, for declaration of dividends by different categories of NBFCs will also be put in place soon.
- **Liquidity surplus widened in the past two months:** Notwithstanding the festive seasons and the pick-up in economic activity in the past few months, the liquidity surplus in the banking system has widened towards the highest levels seen during COVID-19. The liquidity surplus moved from 1.4% of net demand and time liabilities (NDTL) in mid-Mar'20 to 4.3% of NDTL in late-Apr'20 and early-May'20, before retreating towards 1.5% of NDTL in late-Sep'20. During the past two months, the surplus has widened again to over 4% of NDTL as of early-Dec'20 (*Exhibit 2*). It reflects weak credit off-take in the economy amid stable-to-high deposits.
- **Rate cuts in the near future seem unlikely:** As far as fresh regulatory announcements are concerned, today's policy turned out to be a non-event as only the liquidity measures initiated in earlier meetings would continue with some extension in their coverage. While the upward revision in FY21 growth projection reveals RBI's confidence in a recovery in economic activity, higher inflation implies that rate cuts are unlikely in the near future.

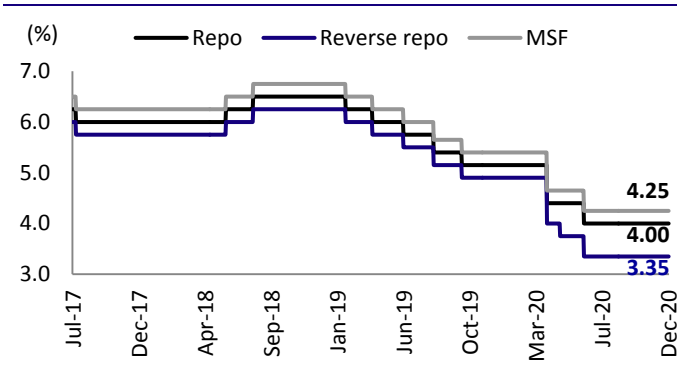
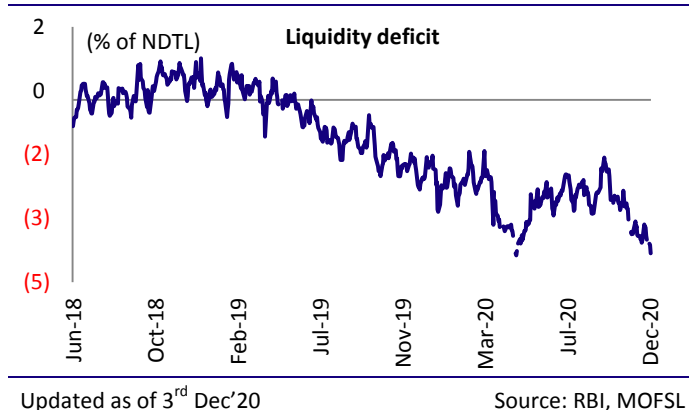
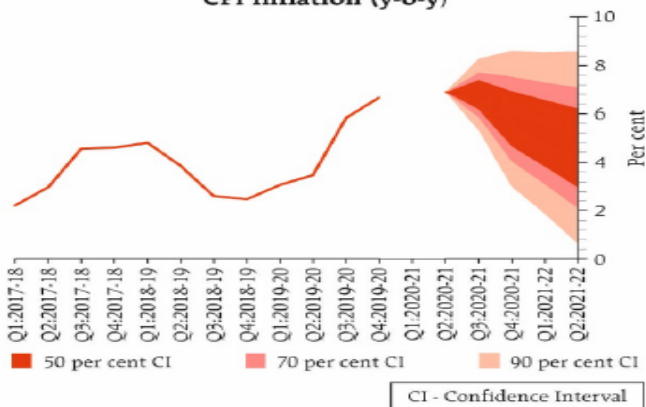
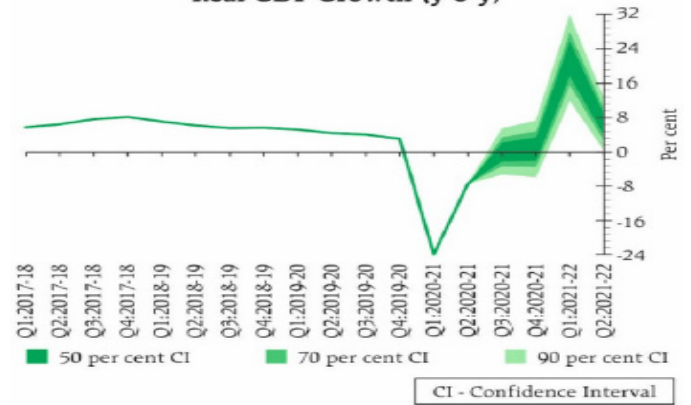
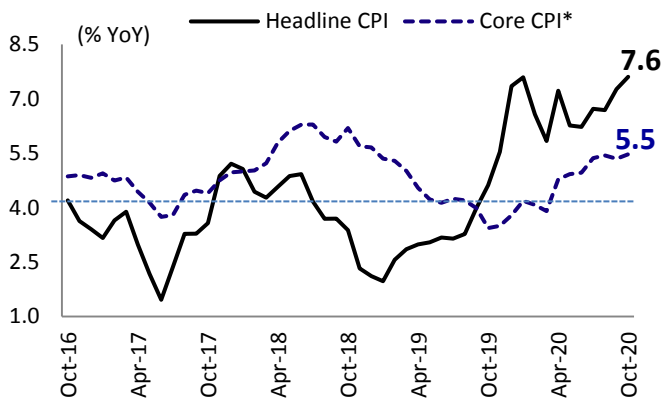
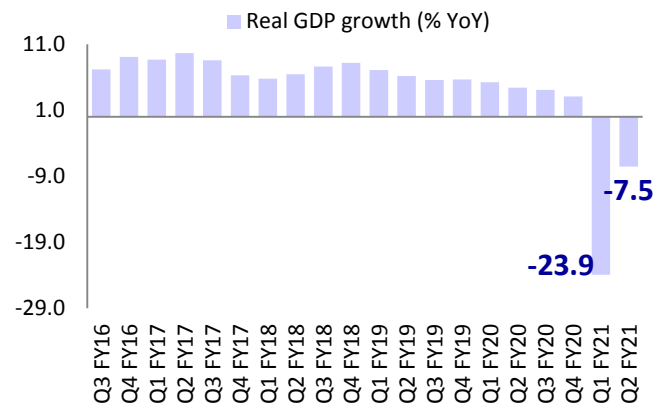
Exhibit 1: RBI has kept policy rates unchanged...**Exhibit 2: ...and system liquidity surplus has risen of late**

Exhibit 3: Expects inflation to retreat to ~5% in 1QFY22...**Chart 1: Quarterly Projection of CPI Inflation (y-o-y)****Exhibit 4: ...and GDP to contract 7.5% YoY in FY21****Chart 2: Quarterly Projection of Real GDP Growth (y-o-y)**

Source: RBI, MOFSL

Exhibit 5: CPI inflation came in flat at 7.6% YoY in Oct'20

* 'Housing', 'Clothing and Footwear' and 'Miscellaneous items'

Exhibit 6: GDP decline slowed to 7.5% YoY in 2QFY21

Source: Central Statistics Office (CSO), MOFSL

NOTES

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