

06 August 2021

RBI remains accommodative given nascent growth, elevated inflation outlook

RBI's MONETARY POLICY

In its Monetary Policy Committee (MPC) review, the Reserve Bank of India (RBI) remained accommodative and maintained its stance of prioritizing durable growth on a sustained basis. It retained its real GDP projection of 9.5% for FY22 but downsized the projections for the next three quarters of FY22 while enhancing the growth projections for 1QFY22. This indicates the central bank's skepticism around growth revival despite better rural prospects, buoyant exports and improved government expenditure. The inflation outlook has been increased by 60bps at 5.7% for FY22 as demand-pull pressures have sustained due to the slack in the economy. Barring the extension of the existing measures, no major liquidity support was announced as the economy's liquidity condition remains strong at Rs 5.6bn. The RBI remains vigilant about the macro-financial conditions and asserted the calibration of its key financial instruments - such as G-sec acquisition programme (G-SAP), open market operations (OMOs) and operation twists (OT) - as required. It also emphasized the orderly management of the yield curve. We expect the central bank to keep repo rates unchanged till Jun'22 and bear inflation till it is confident of a sustained economic recovery. We estimate the 10-year G-sec curve to remain range-bound at 6.25-6.50% in FY22.

MPC maintains status quo:

The RBI's monetary policy committee kept its key policy rates unchanged and maintained an accommodative stance as long as necessary to revive and sustain growth on a "durable" basis. Repo rate remains at 4%, reverse repo rate at 3.35% and MSF (marginal standing facility) & bank rate at 4.25%.

Nascent growth outlook:

The real GDP growth projection for FY22 is retained at 9.5%, with 21.4% in 1Q, 7.3% in 2Q, 6.3% in 3Q and 6.1% in 4Q; it is projected at 17.2% for FY23. The growth outlook is backed by improved demand conditions with the ebbing of the second wave. Strong tailwinds are also likely from agricultural production and a resilient rural economy, buoyant exports and a pick-up in government expenditure as the lockdown restrictions ease and the vaccination rates improve.

Demand-pull factors impinge the inflation outlook:

CPI inflation should remain close to the RBI's upper tolerance level of 6% for a large part of FY22 but is likely to ebb in 3QFY22, supported by the arrival of Kharif crops and an improvement in the supply conditions. However, sustained demand-pull price pressures due to the slack in the economy are likely to keep inflation elevated. CPI inflation is thus projected at 5.9% in FY22, 5.4% in 2QFY22, 5.3% in 3QFY22 and 5.8% in 4QFY22.

RBI extends existing liquidity measures:

- 1) On-tap Targeted Long-Term Repo Operation (TLTRO) scheme is extended by three months, i.e. till December 31, 2021.
- 2) Statutory Liquidity Ratio (SLR) relaxation (upto 3% of Net Demand and Time Liabilities-NDTL) is extended by three months, i.e. till December 31, 2021.

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Exhibit 1: RBI MPC growth and inflation projections (%)

	Aug'21		Jun'21		% Change	
	CPI	GDP	CPI	GDP	CPI	GDP
FY22	5.7	9.5	5.1	9.5	0.6	0.0
FY23	5.1	17.2	-	-	-	-
1Q	-	21.4	5.2	18.5	-	2.9
2Q	5.9	7.3	5.4	7.9	0.5	-0.6
3Q	5.3	6.3	4.7	7.2	0.6	-0.9
4Q	5.8	6.1	5.3	6.6	0.5	-0.5

Source: RBI, Systematix Research

Exhibit 2: Quarterly projections for headline inflation (YoY)

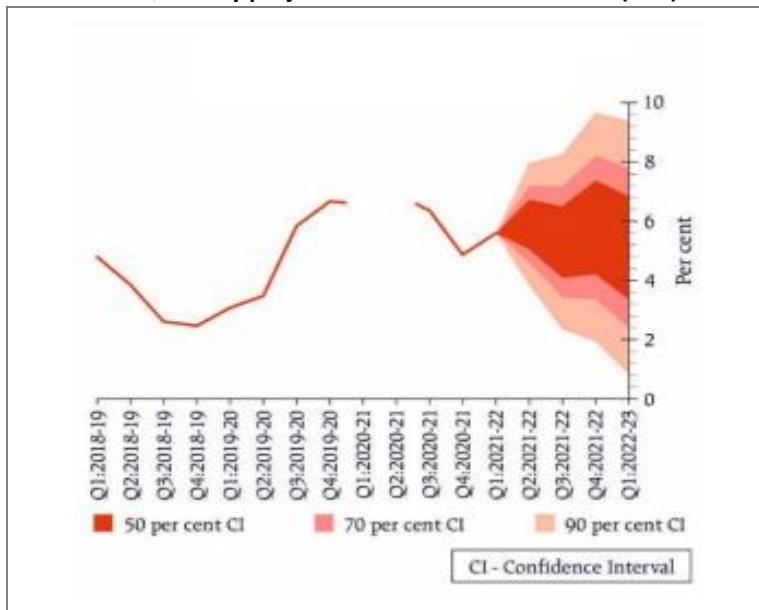


Exhibit 3: Quarterly projections for real GDP (YoY)

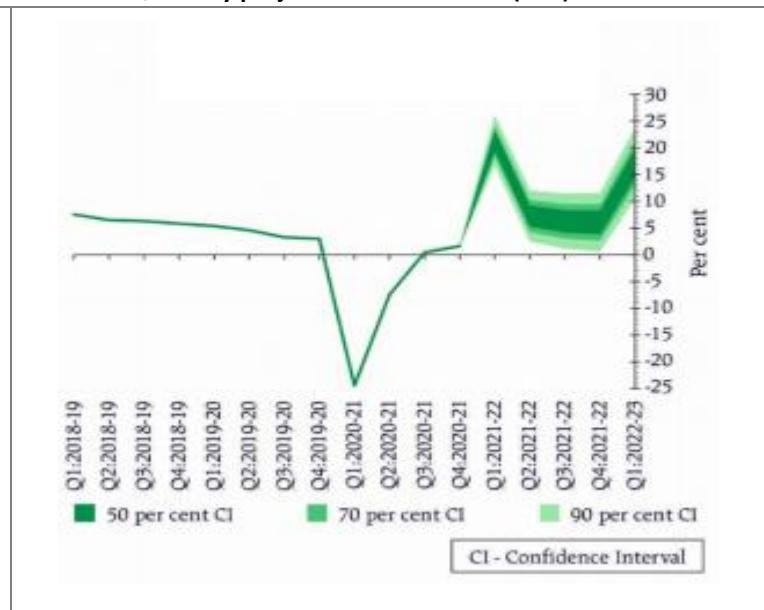


Exhibit 4: Surplus liquidity of ~Rs 5.6bn thus far

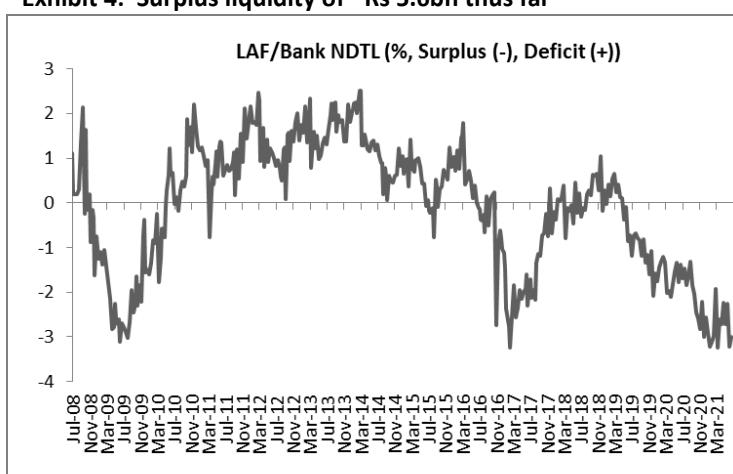
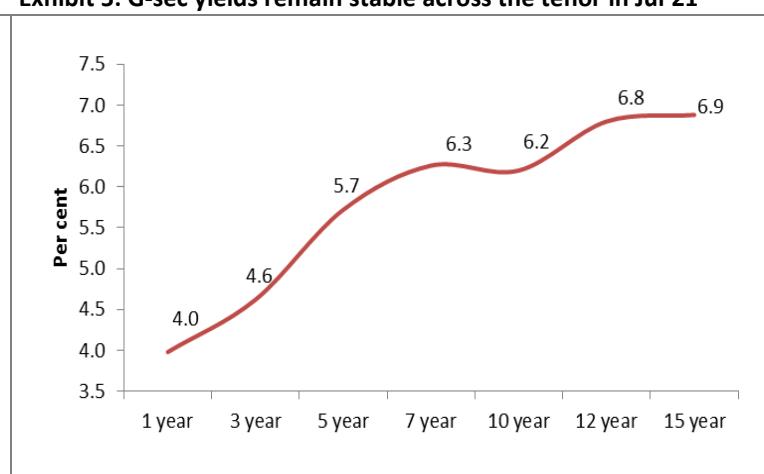


Exhibit 5: G-sec yields remain stable across the tenor in Jul'21



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