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Monetary Policy Review

EVENT UPDATE

6th August 2021

Monetary Policy update - August 2021

Retained Accommodative stance; Growth outlook maintained

RBI kept Repo Rate and Reverse Repo Rate unchanged

Key highlights

- The RBI maintained status quo on the rate and stance unanimously. The repo rate remains at 4% and stance at accommodative.
- RBI will remain vigilant against the possibility of third wave.
- It kept its policies and strategies in order to handle the monetary resources required to handle growth.
- It has retained the growth outlook and increased inflation forecast.

Inflation forecast increased marginally

The RBI has increased the inflation forecasts to 5.7% in FY22 - 5.9% in Q2, 5.3% in Q3 and 5.8% in Q4- with risks broadly balanced from 5.1 % - 5.4%, 4.7% and 5.3% respectively in each quarter. CPI inflation for Q1FY23 is projected at 5.1%. The revival of south-west monsoon and the pick-up in kharif sowing, buffered by adequate food stocks should help to control cereal price pressures. With crude oil prices at elevated levels, a calibrated reduction of the indirect tax component of pump prices by the Centre and states can help to substantially lessen cost pressures.

Overall GDP forecast retained

The projection of real GDP growth for 2021-22 is retained at 9.5% in FY22, consisting of 21.4% in Q1; 7.3% in Q2; 6.3% in Q3; and 6.1% in Q4 from the earlier estimate of 18.5% in Q1; 7.9% in Q2; 7.2% in Q3; and 6.6% in Q4. RBI expects expansion in production volumes and new orders in Q2FY22, which is likely to sustain through Q4FY22. The agricultural production and rural demand are expected to remain resilient. Urban demand is likely to mend with a lag as manufacturing and non-contact intensive services resume on a stronger pace, and the release of pent-up demand acquires a durable character with an accelerated pace of vaccination. The expected pick-up in government expenditure, including capital expenditure, and the recent economic package announced by the Government will provide further impetus to aggregate demand.

Other measures:

- Given the nascent and fragile economic recovery, RBI has decided to extend the On Tap TLTRO scheme further by a period of three months, i.e., till December 31, 2021.
- The banks were allowed to avail of funds under the marginal standing facility (MSF) by dipping into the Statutory Liquidity Ratio (SLR) up to an additional 1% of net demand and time liabilities (NDTL), i.e., cumulatively up to 3% of NDTL. This dispensation provides increased access to funds to the extent of INR 1.62 lakh Cr and qualifies as high-quality liquid assets (HQLA) for the LCR. It has now been decided to continue with the MSF relaxation for a further period of three months, i.e., up to December 31, 2021.
- It has been decided to permit banks to extend export credit using any other widely accepted Alternative Reference Rate in the currency concerned.
- The change in reference rate from LIBOR is a "force majeure" event, banks are being advised that change in reference rate from LIBOR/ LIBOR related benchmarks to an Alternative Reference Rate will not be treated as restructuring.
- RBI to conduct two more auctions of INR 25,000 Cr each on August 12 & 26 under the G-Sec Acquisition Programme (G-SAP 2.0)

Our View:

We retain our view. We anticipate that the RBI will maintain its focus on growth. The economy's suffering is likely to continue in the near term. We believe that keeping the rate unchanged, in conjunction with the RBI's growth-boosting initiatives, will assist to minimize uncertainties and promote stability of the financial system.

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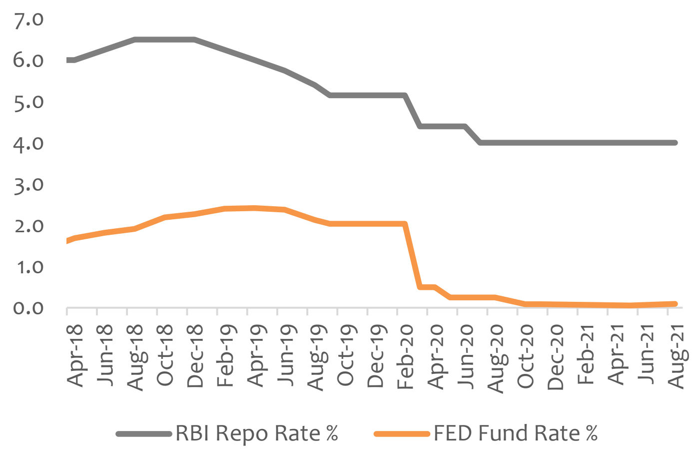
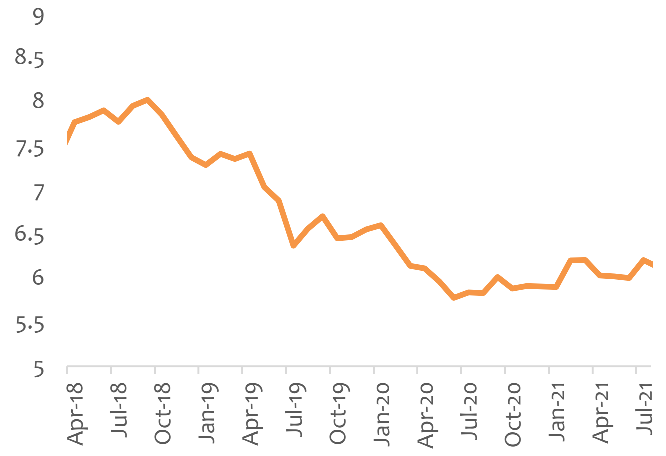
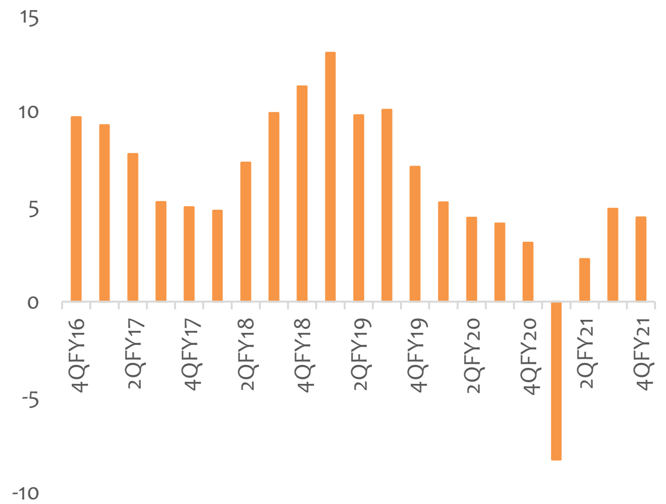
Policy rate: Status Quo



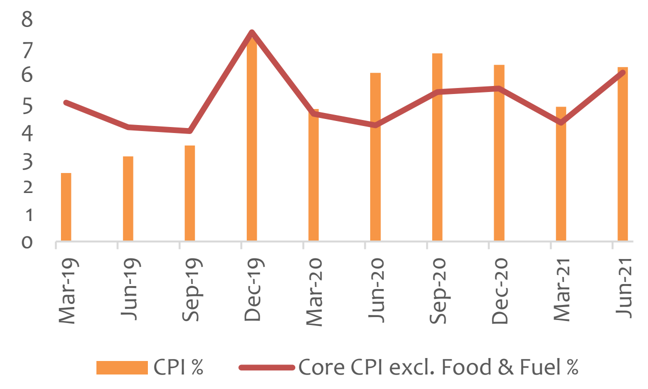
Yields: Largely Steady



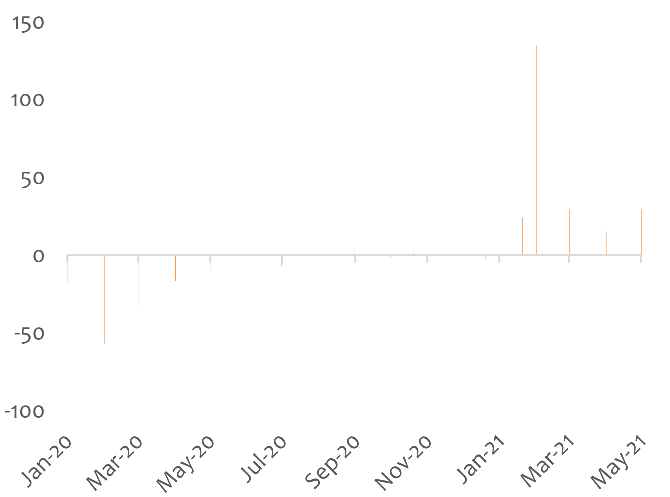
Real GDP growth (YoY): As expected



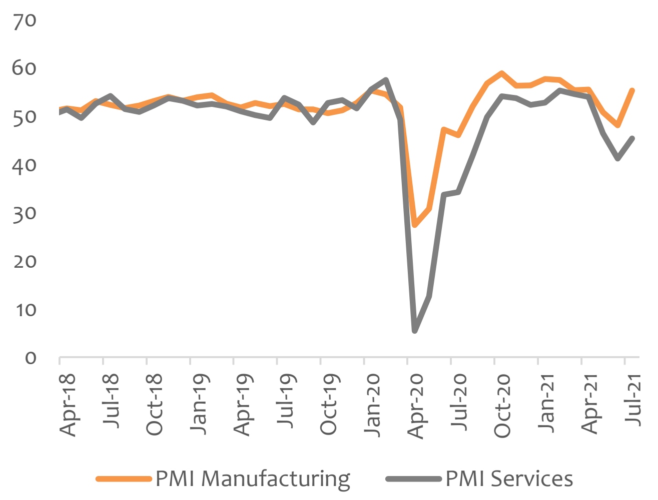
Inflation: Forecast increased



IIP: Industrial activity recovering



PMI (Manufacturing and Services): Steady improvement



Source: RBI, Bloomberg, KRChoksey

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