RBIs Monetary Policy continues to be growth centric while trying to rein in liquidity surplus

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The RBI's Monetary Policy Committee (MPC) presented its fourth bi-monthly monetary policy for 2021-22 today. On expected lines, the RBI has retained the policy rate (repo rate) at a record low of 4% and has maintained the accommodative monetary policy stance. This is the eight meeting (since May'20) at which the central bank has maintained status quo in policy.

As in the last monetary policy review of 6 August'21, the decision of maintaining status quo on interest rates was unanimous by all the six MPC members. However, the vote on continuing with the accommodative policy stance was 5:1. An accommodative stance means that the repo rate will not be increased in the near future.

The central bank's focus on supporting economic revival and growth prevailed at the just announced policy review, even as it announced measures that can be read as a very gradual and calibrated move towards policy normalization.

The RBI announced measures to temporarily suck out excess liquidity from the system as well as paused some operations that injected liquidity. It however reiterated that it would continue to maintain adequate liquidity in the system to facilitate economic activity and demand.

Other than the extension of the duration of the special liquidity facility for small finance banks, no new measures were announced to support different segment of the economy.

It retained it economic growth outlook for FY22 and revised lower its inflation outlook for the period.

Key Policy Rates						
	Feb'20	Mar'20	Apr'20	May'20	Aug'21	Oct'21
Repo Rate	5.15	4.40	4.40	4.00	4.00	4.00
Reverse Repo Rate	4.90	4.00	3.75	3.35	3.35	3.35
MSF	5.40	4.65	4.65	4.25	4.25	4.25
Bank Rate	5.40	4.65	4.65	4.25	4.25	4.25

Policy and measures announced

The measures at today's monetary policy were centered around managing the surplus liquidity in the banking system in a gradual and calibrated manner.

- Key policy rates rated left unchanged.
- To remove excess liquidity from the system on a temporary basis, a fortnightly calendar of 14-day variable rate reverse repo (VRRR) auctions has been announced. As per the calendar, VRRR auctions amounting to Rs. 21 lakh crore are to be conducted during 22 Oct- 3 Dec'21.
- No fresh GSAP (government securities acquisition programme) to be undertaken, unless warranted based on liquidity conditions.
- Liquidity management operations such as Operation Twist (OT) and regular open market operations (OMOs) to continue.
- Extension of deadline of on-tap special long-term repo operations for small finance banks (SFBs) by a period of 2 months till 31 Dec'21.

- Enhancing Transaction Limit in IMPS to Rs. 5 lakh from Rs. 2 lakh currently.
- Introduction of retail digital payments solution in offline mode across the country to enable digital payment in remote places that are faced with internet connectivity issues.
- Geo-Tagging of Payment System Touch Points
- To continue with the enhanced Ways and Means Advances (WMA) limits and relaxation in overdraft (OD) facility for the State Governments / UTs.
    - WMA limits of ₹51,560 crore for States/UTs for a further period of six months up to March 31, 2022.
    - Enhancement of maximum number of days of overdraft (OD) in a quarter from 36 to 50 days and the number of consecutive days of OD from 14 to 21 days, up to March 31, 2022.
- Facility of priority sector lending by banks to NBFCs for on-lending to agriculture, MSME and housing has been extended for another 6 months till 31 March'22.

RBI's Outlook on Economic Growth and Inflation

Economic Growth

The outlook for the country's economic growth has been retained at 9.5% for FY22. The RBI however highlighted that despite improvements, overall demand in the economy needs to improve, output remains below pre-pandemic levels, recovery remains uneven and is dependent on continued policy support. Services sector, especially the contact intensive sector is expected to see a gradual pickup. At the same time, higher government capital expenditure along with the favorable financial conditions could bring about a much-awaited pickup in the investment cycle. The view is also that capacity utilization rates have been improving which is a good sign.

In terms of quarterly growth, it has revised upwards the GDP growth projections for Q2 and Q3 of FY22 from its earlier estimates of August'21 (by 0.6% and 0.5% respectively), while that of Q4 FY22 has been retained at 6.10%. The Q1 FY22 growth estimate too has been unchanged at 17.2%.

The central bank expects rural demand to be resilient while urban demand to be aided by festive and pent -up demand.

The RBI economic growth outlook for FY22 is higher than CARE's forecast of a growth of 9.1%

RBI's GDP Growth Outlook October'21					
	Q2 FY22	Q3 FY22	Q4 FY22	FY22	Q1 FY23
GDP Growth	7.90	6.80	6.10	9.50	17.20
Change from Aug'21 Outlook (%)	0.60	0.50	0.00	0.00	0.00
Change from June'21 Outlook (%)	0.00	-0.40	-0.50	0.00	17.20
Change from Apr'21 Outlook (%)	-0.4	1.4	-0.1	-1	

Inflation

The RBI estimates that inflation would remain within its target range of 4-6% till Q1 FY23.

The RBI has lowered it retail inflation projection for FY22 to 5.30% from 5.70% in August'21. For Q3 FY22, inflation estimates have been revised lower by 0.8% to 4.50%, while that for Q4 has been unchanged at 5.80%. Retail inflation is expected to be 5.20% in Q1 FY21, 0.10% higher than the previous estimate.

As per the RBI, inflation trajectory is more favorable than anticipated. Retail (CPI) inflation during July-August was lower than projected and within the RBI's target range (4-6%), after having overshot it in the preceding 2 months.

The RBI expects food prices to be muted in coming months but core inflation (excld food and fuel) to remain at elevated levels. It observes that even though there are input prices pressure (on account of rise in global crude oil prices and other commodity prices, combined with acute shortage of key industrial components and high logistics costs) there has been limited pass through to output prices given the prevailing weak demand conditions.

RBI's Inflation Outlook October'21				
	Q3 FY22	Q4 FY22	FY22	Q1 FY23
CPI Inflation	4.50	5.80	5.30	5.20
Change from Aug'21 Outlook (%)	-0.80	0.00	-0.40	0.10
Change from June'21 Outlook (%)	-0.20	0.50	0.20	5.20
Change from Apr'21 Outlook (%)	0.1	0.7		

Assessment and Implication of the monetary policy announcements

- The downward revision in the inflation target for FY22 provides space and comfort to the RBI to continue with its accommodative monetary policy stance. There are upside risks to these projections (given the rise in global headwinds) and the central banks would have to be watchful of the evolving inflation situation.
- The pause in the bond buying under the GSAP could pressure bond yields and push them higher. It would also limit to a limited extent the liquidity injection into the system. Domestic yields have been on the upward trajectory in recent days following the rise in US Treasury yields and the rise in global oil prices. The RBI however can be expected to conduct OMO purchases to limit the rise in yields as it must manage the government borrowings for the remainder of the financial year.
- The VRRR auctions that is proposed to be conducted, although done with the view of managing liquidity is unlikely to significantly impact system liquidity as the underlying aim of the RBI in the current and coming economic recovery period is to ensure liquidity surplus in the system.

Market Reaction to Monetary Policy

Market Movement			
	06-Oct-21	07-Oct-21	08-10-2021 (2:15 pm)
Sensex	59,190	59,678	60,124
Nifty	17,646	17,790	17,915
Rs/$	74.98	74.84	75.05
10 yr Gsec Yield	6.27	6.267	6.308

The benchmark equity indices rose after the monetary policy announcement while the domestic currency weakened against the dollar and bond yields rose to the highest level in 19 months (since April'20). The continuation of the accommodative policy stance and low interest rate regime has lifted sentiments in equity markets. The rise in bond yields can be attributed to the RBI not announcing buying under the GSAP programme.

CARE Ratings Views

Given the focus on economic revival, the accommodative monetary policy stance is likely to prevail for the remainder of FY22 and we do not foresee a change in interest rates in this period, despite global headwinds. If the economic growth momentum continues there would be progressive normalization of policy largely by way of measures to reduce the surplus liquidity in the system.

Bond yield would be pressured and are expected to move upwards. We expect the benchmark 10-year GSec to rule around 6.30%-6.40% for the remainder of Oct'21.

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