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CANARA ROBECO Mutual Fund

RBI Policy Update

April 07, 2021

Assessment of Monetary Policy Committee's (MPC)

April 7, 2021 Bi-Monthly Monetary Policy, FY 2021-22

RBI's Policy Stance:

The MPC has decided to keep the benchmark interest rate unchanged for the 5th consecutive meeting and continued to maintain its stance as "accommodative" due to the surging COVID-19 cases again in the country. Keeping with the general expectations, it will be maintained for as long as necessary, to revive growth on a durable basis while ensuring that inflation remains within the MPC's target and also to mitigate the impact of the pandemic in the economy, now that the country is fighting the large surge in cases. **While recognizing that CPI inflation remains elevated, the MPC noted that it would likely stay within the policy of 4+/-2% in FY2022 as well and decided to**:

- **keep** the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 4%;
- maintain the monetary policy stance as **accommodative**

Variable	Stands at
Repo	4.00%
Reverse Repo	3.35%
CRR	3.50%
MSF	4.25%
SLR	18.00%

Source: www.rbi.org.in

Policy Stance & Rationale:

- In the first bi-monthly policy meeting of FY22, chaired by RBI governor Mr. Shaktikanta Das, the members voted unanimously to keep its benchmark interest rate unchanged and continued to remain accommodative with an aim to mitigate the impact of COVID-19 on the economy with rise in cases, while ensuring that inflation remains within the target going forward. The importance to keep the reviving economy growing on a durable basis has also been stressed upon. **The MPC kept the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 4.0%. The reverse repo rate under the LAF too continues to stand at 3.35%, and the marginal standing facility (MSF) rate and the Bank Rate at 4.25%.**

- Globally, the second and third wave of infections across various countries have slowed down the economic recovery from the effects of the pandemic. The impact of vaccination drives to boost economic activity is somewhat being hindered by the new mutations of COVID-19. Further, unequal access to vaccines poses a major hurdle in the road to recovery. **Inflation remains benign in the major advanced economies (AEs), although highly accommodative monetary policies and large fiscal stimuli have added to concerns around market-based indicators of inflation expectations and unsettling bond markets globally. In a few emerging market economies (EMEs), however, inflation is ruling above targets, primarily driven by stiffening global commodity prices.** World output, as projected by the Organisation for Economic Co-operation and Development (OECD), is to reach its pre-pandemic level by mid-2021. However, the same will be largely reliant on the pace of vaccine distribution and its efficacy against the emerging variants of the virus.

- In the domestic sphere, the National Statistics Office (NSO) announced India's GDP contraction at 8% during the year. High frequency indicators – vehicle sales, railway freight traffic, toll collections, goods and services tax (GST) revenues, e-way bills, and steel consumption – suggest that gains in manufacturing and services activity in Q3 FY2020-21 extended into Q4. Purchasing managers' index

(PMI) manufacturing at 55.4 in Mar'21 remained high, but lower than its level in Feb'21. The index of industrial production reduced marginally in Jan'21, pulled down by manufacturing and mining. Core industries also contracted in Feb'21. **Agriculture continues to be resilient due to food grains and horticulture production for 2020-21, which are expected to be 2.0% and 1.8% higher respectively than the final estimates of 2019-20.**

- The CPI inflation, after falling to 4.1% in Jan'21, had again risen to 5.0% in Feb'21, primarily due to an adverse base effect. The CPI inflation trajectory is most likely to remain volatile in the near term. The MPC has noted that the supply side pressures on inflation could continue. It also noted that demand-side pull remains moderate. While cost-push pressures have risen, they could be partially balanced with the normalisation of global supply chains. The bumper food grains production in FY2020-21 should result in softening of cereal prices going forward. **The price pressures on key food items such as protein-based components and edible oils can be countered depending on supply-side measures and easing of international prices. Input cost pressures can be appeased if the recent softening of crude prices sustains.**

- System liquidity remained in large surplus in Feb'21 and Mar'21 with an average daily net liquidity absorption of INR 5.9 lakh crore. Corporate bond issuances at INR 6.8 lakh crore during 2020-21 (up to Feb'21) were higher than INR 6.1 lakh crore during the same period last year. Issuances of commercial paper (CPs) since Dec'20 was higher by 10.4% during Dec'20 to Mar'21 than in the same period of the previous year. India's foreign exchange reserves increased by USD 99.2 billion during 2020-21 to USD 577.0 billion at the end of Mar'21, providing an import cover of 18.4 months and 102% of India's external debt.
  Source: RBI

Outlook:

- Domestically, with the rise in spread of infections and surging cases, the focus is largely on containing the spread and its impact on the economy. It will also prove to be important to strengthen macroeconomic stability in order to ensure the revival of India's economy. The focus of the Union Budget 2021-22 on investment-led measures with increased allocations for capital expenditure, the expanded production-linked incentives (PLI) scheme and rising capacity utilisation (from 63.3% in Q2 FY2020-21 to 66.6% in Q3 FY2020-21) will reinforce the process of economic revival. **The MPC expects growth to clock 10.5% in FY2022. Rural demand remains resilient and record agriculture production for 2020-21 proves well for its resilience in the near future. Urban demand has been gaining pace due to the normalisation of economic activity and should get a further boost with the ongoing vaccination drive.**

- The RBI surprised markets by announcing INR 1 lac crore G-Sec acquisition programme (G-SAP 1.0) for April-June 2021. Through this programme the RBI will buy, through open market operations, government bonds in 1Q FY2022. **This is the first time, in recent times, that RBI has given commitment of buying amount from secondary market.** The first OMO of 25,000cr has been announced for 15th April 2021. RBI further acknowledged that liquidity in system was high and hence they are likely to do more longer-term variable reverse repo rate (VRRR) auctions.

- Markets rallied post the OMO news, with the longer end rallying more as news of VRRR impacted sentiment on short end. Curve may flatten from here as RBI is cautious on excess liquidity in the system and may try to sterilise it through normal liquidity operations like VRRR. However, the long end may not rally too much on large government supply. 10 year G-Sec yield dropped to around 6.07% level post the Governor's speech as market sentiment got a fillip on G-SAP announcement. Further, it may remain a fixture for rest of the year, depending on market conditions. **Going forward, the markets will likely look towards incoming data like CPI inflation as well demand in government auctions starting this week.** Global cues like the US rate movement, oil price, etc. will continue to drive the sentiment.

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