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Mutual Fund

RBI Monetary Policy Update

December 08, 2021

Bi-Monthly Monetary Policy, FY 2021-22

December 8, 2021

Key Highlights

The RBI Monetary Policy Committee (MPC), for 9th consecutive policy meeting, unanimously decided to keep key lending rate or the repo rate "**unchanged"** and continued to maintain its stance as **"accommodative**". The decision was taken unanimously in order to support economy amid the rising fear of Omicron variant of Covid-19 across the world.

There was a 5:1 majority to retain MPC's Accommodative stance, mainly with a view to revive and sustain growth on a durable basis and to mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target range.

The central bank further decided to keep Reverse Repo Rate and the Marginal Standing Facility unchanged.

Projection for real GDP growth is maintained at 9.5 per cent. The central bank has however revised its Q3FY22 GDP growth to 6.6 per cent from earlier 6.8 per cent, and cut Q4FY22 GDP to 6 per cent from 6.1 per cent.

Consumer Price Index (CPI) inflation is retained at 5.3 per cent for FY22. The Consumer Price Index or retail index inflation measures the average change in prices over time that consumers pay for goods & services and is most widely used to measure the inflation.

Policy Tool	Pre RBI Policy	Post RBI Policy (December 8,2021)
Repo	4.00%	4.00%
Reverse Repo	3.35%	3.35%
MSF	4.25%	4.25%
Bank Rate	4.25%	4.25%
CRR	4.00%	4.00%
SLR	18.00%	18.00%

MPC Keeps policy repo rate under the liquidity adjustment facility (LAF) unchanged at 4.00%. 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%

Source: www.rbi.org.in

Economic Assessment

Global Economy

- Globally, the economic recovery has been significantly impacted by the surge in infections across geographies, emergence of the Omicron variant, the persistence of supply chain disruptions and elevated energy and commodity prices. Global merchandise trade is slowing after a sharp rebound from the pandemic due to the disruptions in port services and turnaround time, elevated freight rates and the global shortage of semiconductor chips, which could dampen future manufacturing output and trade.

- Global Commodity prices remain elevated across the board, following uncertainties from the new COVID-19 variant, among others. Headline inflation in several advanced economies (AEs) and emerging market economies (EMEs) has soared, prompting a number of central banks to continue tightening and others to bring forward policy normalisation. Bond yields which had risen in most countries, responding to inflation and monetary policy actions, eased from the last week of November. The US dollar has been trading higher in recent weeks against both AE and EME currencies.

Domestic Economy

- Domestically, real gross domestic product (GDP) expanded by 8.4 per cent year-on-year (y-o-y) in Q2:2021-22, following a growth of 20.1 per cent during Q1:2021-22. With the recovery gaining momentum, all constituents of aggregate demand entered the expansion zone, with exports and imports markedly exceeding their pre-COVID-19 levels. On the supply side, real gross value added (GVA) increased by 8.5 per cent y-o-y during Q2:2021-22.

- Headline CPI inflation, which has been on a downward trajectory since June 2021, edged up to 4.5 per cent in October from 4.3 per cent in September on account of a spike in vegetable prices – probably driven by crop damage from heavy rainfalls in October in several states, and fuel inflation – driven up by international prices of liquefied petroleum gas and kerosene. Fuel inflation at 14.3 per cent in October surged to an all-time high. Core inflation or CPI inflation excluding food and fuel remained elevated at 5.9 per cent during September-October with continuing upside pressures stemming from clothing and footwear, health, and transportation and communication sub-groups.

- Investment activity is exhibiting modest signs of improvement – production of capital goods remained above pre-pandemic levels for the third month in a row during September, while import of capital goods in October rose at double-digit pace over its level two years ago. Prints of manufacturing and services PMIs for November 2021 suggested continued improvement in economic activity. Exports grew in November for the ninth month in a row, along with a surge in non-oil non-gold imports on the back of reviving domestic demand.

Outlook:

As expected the Monetary Policy Committee (MPC) maintained status quo with accommodative stance. The expectation of change in reverse repo was belied with RBI continuing to using variable reverse rate repo auction (VRRR) as the main tool to manage liquidity as well manage short term rates. Growth projections were maintained 9.5% for FY2022 while inflation projections almost remained unchanged at 5.3% for FY2022. The MPC expects inflation to peak in 4QFY2022 and then moderate thereafter to around 5%.

The MPC continued to focus on growth. While noting that the Indian economy is gaining traction, it felt that private investment is still lagging while private consumption remains below Pre-Covid levels. Tightening of global financial conditions could further impact growth and the MPC judged that policy support was required for more broad based growth while keeping a watchful eye on inflation dynamics

The MPC was more sanguine on inflation as the cut in excise duties as well drop in international prices of oil is likely to bode well for inflation. Further the recent surge in food prices are likely to be tampered when winter *rabi* crops hit the market in the near term. The MPC is likely to watch core inflation closely and take necessary steps, if required, to keep it in check.

Markets reacted positively to the MPC outcome as some adjustment in reverse repo for expected. 10Y GSEC yield fell by about 3bps with similar action across the curve. In the near term, markets are likely to remain cautiously optimistic with more focus on global central bank tightening in the next few months.10Years yield is likely to trade in a range of 6.30%-6.40%.

Source: RBI, Bloomberg, internal research

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