MONETARY POLICY REVIEW

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Inflation forecast revised downward; growth retained

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MPC maintained status-quo on rates. While growth forecast was retained, inflation forecast was revised downward to 5.3% from 5.7%. With the discontinuation of G-SAP, RBI also signaled normalisation. This was due to a more optimistic outlook on growth, supported by normal monsoon, government capex and exports. While, inflation is likely to get comfort from record Kharif production and favourable base, oil prices above US$ 80/bbl pose a significant risk. We expect inflation at 5.5% in FY22.

Key highlights

- RBI maintains status quo on rates, 5:1 vote on accommodative stance.
- CPI projections for FY22 revised downward by 40bps to 5.3% from 5.7% earlier.
- Growth projection retained at 9.5% in FY22.
- Normalisation begins with withdrawal of G-SAP

Rates on pause: In line with expectations, all MPC members voted to keep policy repo rate unchanged at 4%. It also retained the accommodative stance "as long as necessary to revive and sustain growth on a durable basis, while ensuring inflation remains within the target going forward" by a 5:1 vote. Prof. Varma disagreed.

Growth forecast retained at 9.5% for FY22: MPC retained the growth forecast for FY22 at 9.5%. However, growth forecast for Q2 and Q3 was revised upwards to 7.9% (+60bps) and 6.8% (+50bps). This was on the back of a sustained recovery in Aug-Sep'21 as Covid-19 cases plateaued and vaccination gathered pace. Going forward, RBI remained optimistic on growth on the back of pickup in monsoon activity and record kharif production. Services activity too is seen recovering. In FY23 growth is estimated at 7.8%, with 17.2% in Q1FY23.

CPI forecasts for FY22 revised downward: RBI has revised its CPI projection downward to 5.3% in FY22 from 5.7% earlier. The trajectory for Q2FY22 (5.1% from 5.9%) and Q3 (4.5% from 5.3%) has been revised downward by 80bps each. For Q4, it has been kept unchanged at 5.8%. For Q1FY23, it will be at 5.2% from 5.1% earlier. Record Kharif production and government's supply management policies will lend support. However, upside risk remain from higher oil prices and its pass-through to domestic inflation. For FY23, inflation is estimated at 4.9%.

Normalisation begins with withdrawal of GSAP: RBI has discontinued the G-SAP announced in Apr'21. However, Governor Shri. Das reiterated that liquidity conditions will remain favourable and the approach will be calibrated. Further Operation Twist and OMO purchase will continue. Other measures for conducive financial condition include- 1) extending the SLTROs for SFBs (Rs 100bn) till Dec'21 and also making it on-tap, 2) enhanced WMA limit of States (Rs 515.6bn) has been extended till 31 Mar 2022 (Sep'21 earlier), 3) extending on-lending NBFC program till 31 Mar 2022 (Sep'21). Notably, RBI has focused on VRRR based on evolving market demand. We expect RBI to reduce the gap between repo and reverse repo in Q4FY22 before lifting off repo rate in the beginning of FY23.

Regulatory announcements

- RBI has extended the SLTRO scheme for SFBs to 31 Dec 2021. Further, this will now be available on-tap.
- It has also been proposed to introduce a framework for making retail digital payments in offline mode across the country.
- RBI has also raised the per transaction limit for IMPS payments to Rs 0.5mn from Rs 0.2mn earlier for channels other than SMS and IVRS.
- RBI has also proposed to lay down a framework for geo-tagging of physical payment acceptance infrastructure such as Point of Sale (PoS) terminals and Quick Response (QR) codes used by merchants. This will enable the Payments Infrastructure Development Fund (PIDF) to deploy additional infrastructure and improving the digital payments.
- Under the Reserve Bank's Regulatory Sandbox (RS), three cohorts have been introduced. These are: 1) Retail payments, 2) Cross border payments and 3) MSME lending. It has been proposed to launch a new cohort 'Prevention and Mitigation of Financial Frauds' to support the growing fin-tech ecosystem.
- The enhanced interim WMA limits totaling Rs 515.6bn extended by RBI to States/UTs has been extended by 6 months to 31 Mar 2022. Further, the enhancement of maximum number of days of OD in a quarter from 36 to 50 days and the number of consecutive days of OD from 14 to 21 days has also been extended up to 31 Mar 2022.
- RBI has also extended the scheme permitting bank lending to registered NBFCs (other than MFIs) for on lending to agriculture (investment credit), micro and small enterprises and housing (with an increased limit) to be classified as priority sector lending has been extended upto 31 Mar 2022.
- RBI has also decided to introduce the Internal Ombudsman Scheme (IOS) for certain categories of NBFCs which have higher customer interface.

Fig 1 – Base line assumptions in MPR

Indicator	April 2020 MPR	October 2020 MPR	April 2021 MPR	October 2021 MPR
Crude Oil (Indian Basket)	US$ 35 per barrel during FY20	US$ 40.9 per barrel	US$ 64.6 per barrel during FY22	US$ 75/bbl during H2FY22
Exchange rate	75/US$	73.6/US$	72.6/US$	74.3/$ during H2FY22
Monsoon	Normal for 2020	9% above LPA	Normal for 2021	1% below LPA
Global growth	Contraction in 2020	Contraction of 4.9% in 2020, 5.4% growth in 2021	5.5% in 2021 4.2%in 2022	6% in 2021 4.9% in 2022
Fiscal deficit	To remain within BE FY20 Centre: 3.5% Combined: 6.1%	Given the Covid-19 impact on activity, revenues and expenditures and factoring in the additional borrowings announced, fiscal deficits are expected to be significantly higher	To remain within BE FY22 Centre: 6.8% Combined: 10.8%	To remain within BE 2021-22 Centre: 6.8% Combined:10.2%
Domestic macroeconomic/ structural policies during the forecast period	No major change	No major change	No major change	No major change

Source: RBI, Monetary Policy Report

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