OCTOBER MPC MINUTES

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Calibrated policy response to support growth

MPC members noted that risks to growth have emerged from global factors. Further, several sectors of the economy are still below pre-pandemic levels. On inflation, MPC members agreed that, while food inflation has softened, supply side issues pose upside risks to overall inflation. However, MPC actions have been calibrated and data-dependent. We expect RBI to gradually reduce the gap between repo and reverse repo in Q4FY22, before lifting off repo rate in the beginning of FY23.

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Headwinds to growth remain: MPC members noted that growth recovery has been uneven and several sectors of the economy continue to remain below pre-pandemic levels. GDP is expected to reach pre-pandemic level in H2FY22. However, global factors such as shortage of raw materials, slowdown in global growth and financial risks in China remain key concerns going forward. In fact, Dr. Patra notes that “the biggest risks to India’s macroeconomic prospects are global and they could materialise suddenly”. However, Prof. Varma noted that since the impact of the pandemic remains uneven, “monetary policy is much less effective than fiscal policy for providing targeted relief”.

Supply shocks creating inflation woes: MPC members unanimously agreed that supply bottlenecks pose risk to inflation. Dr. Bhide pointed out that “external factors such as international commodity prices” would impart risk to inflation trajectory. Even Dr. Goyal pointed that global shortages and supply chain issues are impacting pass through to prices. Prof. Varma mentioned that “upside risks to long term inflation and to inflation expectations are now more aggravated”. Dr. Saggar said that if oil averages US$ 80/bbl in H2, it is expected to push inflation up by 15-20bps. Dr. Patra also highlighted concerns over second order effect from this transitory price shocks which might become resistant in nature. However, the decision to hold rates was based on data dependency and not to act hastily in the face of uncertainty.

Calibrated move a priority: Shri Das pointed out that “actions have to be gradual, calibrated, well timed and well-telegraphed to avoid any undue surprises”. Thus to attain growth on a durable and sustainable basis, MPC have stayed put. However, Prof. Varma resented and said that raising effective money market rates quickly towards 4% would ensure macroeconomic stability and help anchor inflation expectation appropriately. More specifically, he mentioned that repo rate of 4% corresponds to a negative real rate in the range of 1-1.5% and which deems fit to avoid an excessive risk of an inflationary spiral. RBI has already signalled policy normalisation through halting of G-SAP for now and auctions of VRRR. We expect further normalisation in the upcoming policy through reduction of the gap between repo and reverse repo in Q4FY22, before lifting off repo rate in the beginning of FY23.

Key highlights

- MPC members agree growth improved in Q1FY22 but still warrants handholding.
- Supply side bottlenecks pose considerable risk to inflation.
- Calibrated approach has been preferred in monetary policy action.
- Reverse repo rate to be increased in Q4FY22 and repo rate hike expected in early FY23.

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