

RBI Monetary Policy: Status quo on rates; liquidity support strengthened

The RBI's Monetary Policy Committee (MPC) unanimously decided to keep the policy rates unchanged (repo rate: 4%) and continue with the accommodative stance as long as necessary. While growth outlook for FY22 has strengthened, the RBI underscored the need to support and revive growth on a durable basis particularly in the wake of downside risks emanating from COVID resurgence and consequent implementation of regional lockdowns. The RBI has retained its FY22 GDP growth forecast at 10.5%—a tad higher than our estimate of 10.0%. Inflation, on the other hand, faces upside risks from higher commodity prices and logistics costs, and is expected to average at ~5% in FY22—**higher than the RBI's medium-term target of 4%** (retained for the next five years).

With an aim to enable an orderly evolution of the sovereign yield curve which acts as a benchmark for other financial market instruments, the RBI announced a secondary market G-sec Acquisition Programme (G-SAP 1.0) for FY22 wherein the RBI would commit upfront to a specific amount of open market purchases of Government securities. For Q1FY22, **G-SAP amount is pegged at Rs1trn. This is in addition to RBI's regular liquidity management tools** including regular and special open market operations. The RBI also announced a slew of measures to strengthen liquidity support including a) Extension of TLTRO (Targeted Long-term Repo Operations) On Tap Scheme by six months, b) Additional liquidity support of Rs500bn to All-India Financial Institutions (AIFIs) for fresh lending during FY22, c) Extension of permission granted to banks to on-lend to registered NBFCs by six months, d) Increase in farm loan limit under priority sector lending (PSL) from Rs5mn to Rs7.5mn against warehouse receipts, and e) Enhanced Ways and Means Advance (WMA) limit for states and UTs.

Persistence of supply-side and cost-push pressures on inflation rules out any possibility of a rate cut in the foreseeable future. At the same time, increasing COVID-led uncertainty on growth outlook would ensure sustenance of an accommodative stance and status quo on rates at least through the current financial year. **The RBI's focus is likely to remain on ensuring ample liquidity in the system to support the ongoing recovery process and ensure smooth execution of the Government's borrowing programme without hurting financial stability.**

- RBI keeps policy rates unchanged; maintains an accommodative stance: In the first bi-monthly monetary policy review of FY22, the RBI's MPC unanimously voted to keep the policy rates unchanged. As such, the repo, reverse repo and bank/Marginal Standing Facility (MSF) rates remain unchanged at 4.0%, 3.35% and 4.25% respectively. While economic recovery has remained steady and outlook for FY22 has strengthened, the MPC acknowledged rising uncertainty to the growth outlook emanating from the recent spike in COVID cases and consequent reimposition of localised and regional lockdowns. The MPC therefore remained committed to maintaining an accommodative stance as long as necessary to support growth on a sustainable basis and mitigate the impact of COVID-19, while ensuring inflation remains within the target band of 4% +/- 2%.
- Growth forecasts retained but uncertainty mounting: The RBI provided a stable growth outlook, citing buoyant rural demand and recovering urban demand. While the ongoing vaccination drive should provide further fillip to urban demand, fiscal impulse in the Budget in the form of higher capital expenditure and increase in capacity utilisation bode well for investment demand. The RBI has retained its FY22 GDP growth forecast at 10.5%—a tad higher than our estimate of 10.0%, with Q1, Q2, Q3 and Q4 growth forecasts pegged at 26.2%, 8.3%, 5.4% and 6.2% respectively. That said, the recent spike in COVID infections and tightening of restrictions by some state governments has imparted significant uncertainty to the domestic growth outlook.
- Inflation expected to average at 5% in FY22: Supply-side pressures on inflation are expected to persist for now, thanks to rising COVID cases, even as it is likely to keep demand-side pressures contained. While pulses and cereals prices are likely

The RBI expectedly kept policy rates unchanged and maintained an accommodative stance, reiterating the need to support growth amidst rising COVID cases.

The RBI has retained its FY22 GDP growth forecast at 10% and expect inflation to average at ~5%.

to come off amidst a bumper food-grain production in FY21, incoming *Rabi* supplies and imports, cost-push pressures on the manufacturing as well as services sectors are expected to remain high thanks to higher commodity prices and logistic costs. Tax relief on fuel prices may help mitigate the impact of rising crude oil prices on consumers. Overall, the RBI expects the headline retail inflation to average at ~5% in FY22, projecting a print of 5.2% in Q1 and Q2, 4.4% in Q3 and 5.1% in Q4.

- **Yield curve management through assured G-sec purchases:** With an aim to enable an orderly evolution of the sovereign yield curve which acts as a benchmark for other financial market instruments, the RBI announced a secondary market G-sec Acquisition Programme (G-SAP 1.0) for FY22 wherein the RBI would commit upfront to a specific amount of open market purchases of Government securities. For Q1FY22, G-SAP amount is pegged at Rs1trn, with the first purchase worth Rs250bn scheduled for April 15th. **This is in addition to RBI's regular liquidity management tools** including longer-term repo/reverse repo auctions, forex operations and regular and special open market operations. While this would calm bond markets and bring down yields particularly at the long end which has shot up amidst growth and fiscal concerns as well as expectations of a reflationary cycle in the US, it would also facilitate smooth execution of the Govt.'s borrowing plan.
- **Additional measures to strengthen liquidity support:** Other key measures announced to strengthen liquidity support include: a) Extension of TLTRO (Targeted Long-term Repo Operations) On Tap Scheme announced on October 9, 2020 by six months up to September 30, 2021, b) Additional liquidity support of Rs500bn to All-India Financial Institutions (AIFIs) for fresh lending during FY22—Rs250bn to NABARD, Rs100bn to NHB and Rs150bn to SIDBI, c) Extension of permission granted to banks to on-lend to registered NBFCs by six months up to September 30, 2021, d) Increase in farm loan limit under priority sector lending (PSL) from Rs5mn to Rs7.5mn against warehouse receipts issued by warehouses registered with the Warehousing Development and Regulatory Authority (WDRA), and e) Enhancement in WMA limit for states and UTs by 46% to Rs470.1bn and continuation of enhanced interim WMA limit of Rs515.6bn for an additional six months up to September 30, 2021.
- **Liquidity and yield curve management to remain in focus:** Persistence of supply-side and cost-push pressures on inflation rules out any possibility of a rate cut in the foreseeable future. At the same time, increasing COVID-led uncertainty on growth outlook would ensure sustenance of an accommodative stance and status quo on rates at least through the current financial year. **The RBI's focus is likely to remain on ensuring ample liquidity in the system to support the ongoing recovery process and facilitate smooth execution of the Government's borrowing programme without hurting financial stability.**

The RBI's commitment towards assured G-sec purchases from the secondary market, pegged at Rs1trn for Q1FY22, would provide comfort to bond markets by ensuring orderly evolution of yield curve.

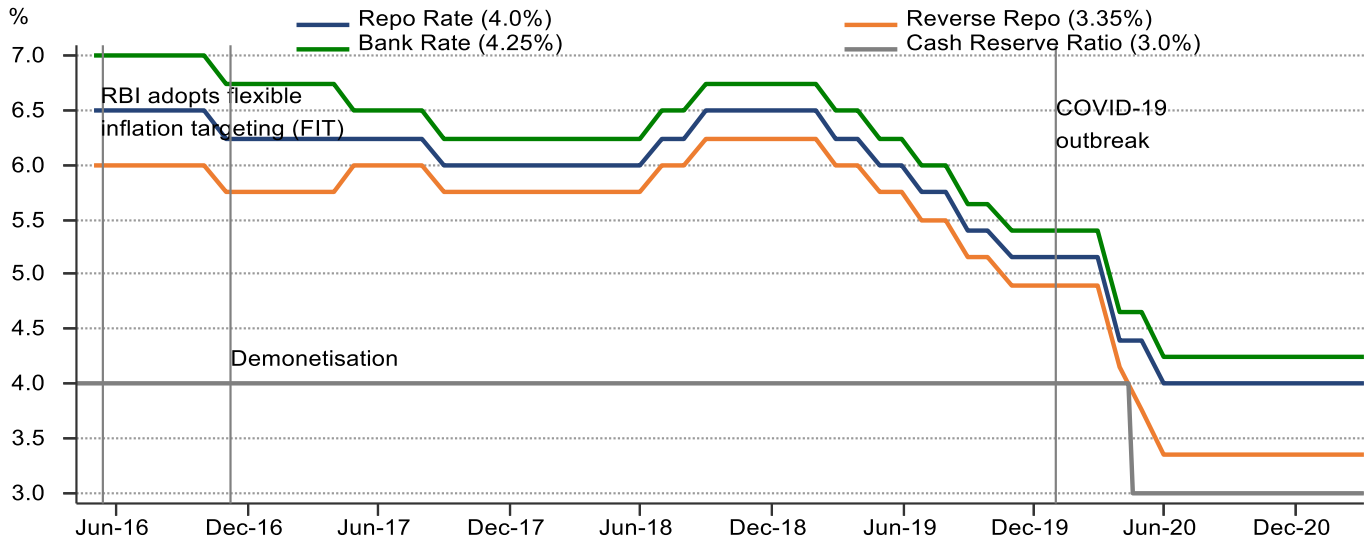
Liquidity and yield curve management are likely to remain the focus areas of the RBI in FY22.

Figure 1: Current policy rates

Key rates	Current value
Repo Rate	4.0%
Reverse Repo Rate	3.35%
Marginal Standing Facility (MSF) Rate	4.25%
Bank Rate	4.25%
Cash Reserve Ratio (CRR)	3.0%
Statutory Liquidity Ratio (SLR)	18.0%

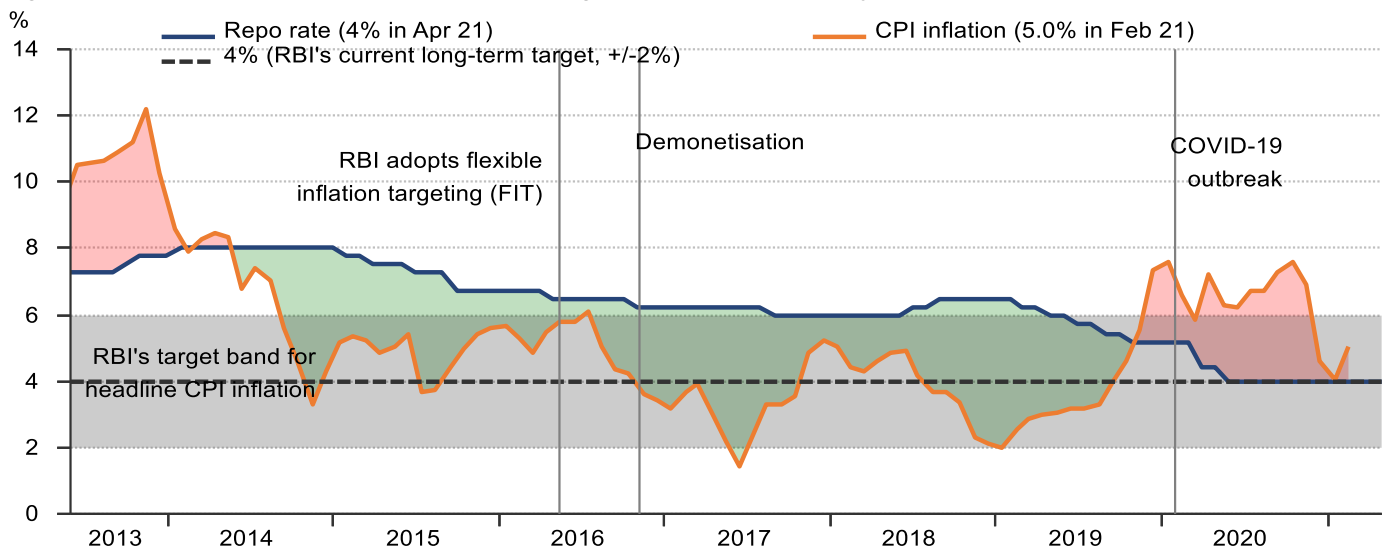
Source: RBI

Figure 2: Policy rates kept unchanged



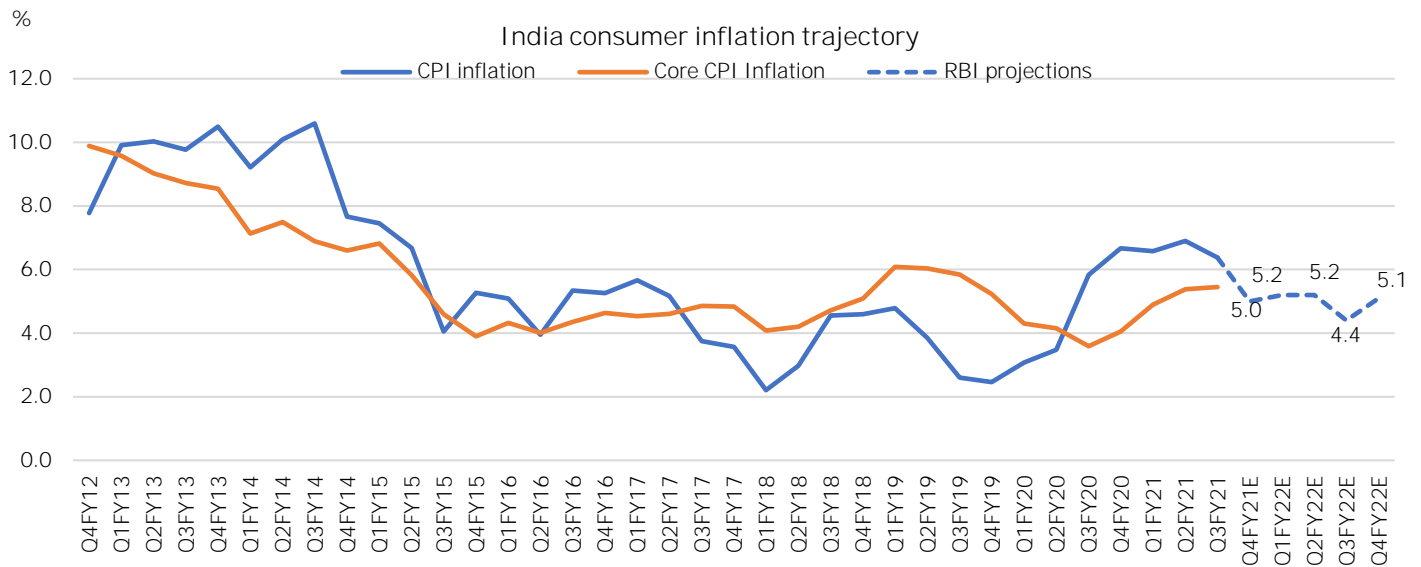
Source: Refinitiv Datastream.

Figure 3: Real interest rates have remained negative for more than a year now



Source: Refinitiv Datastream.

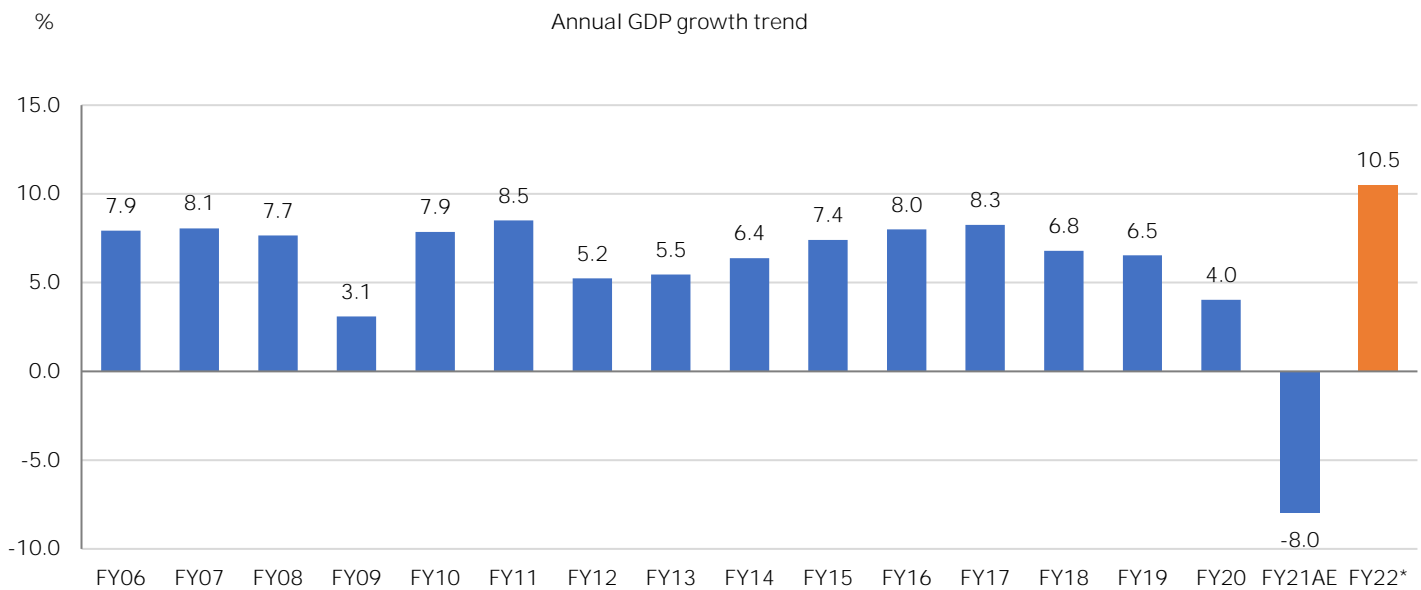
Figure 4: RBI expects headline CPI inflation to average at 5.0% in FY22



Source: CSO, RBI. Core inflation is calculated as CPI inflation excluding food, pan, tobacco & intoxicants and fuel & light.

Figure 5: GDP growth trend and estimate for FY22

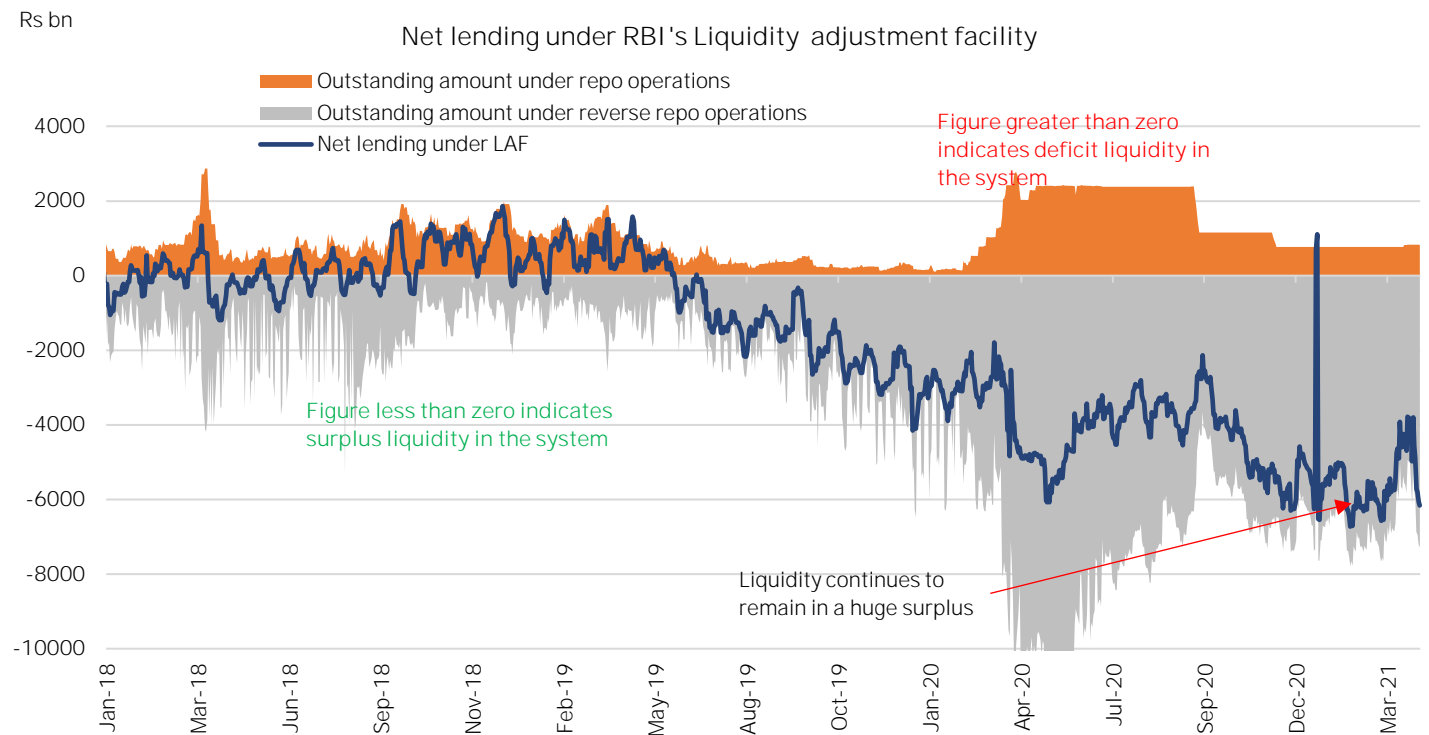
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Source: RBI. * FY22 figure is RBI's estimate.

Figure 6: Net lending under RBI's Liquidity Adjustment Facility

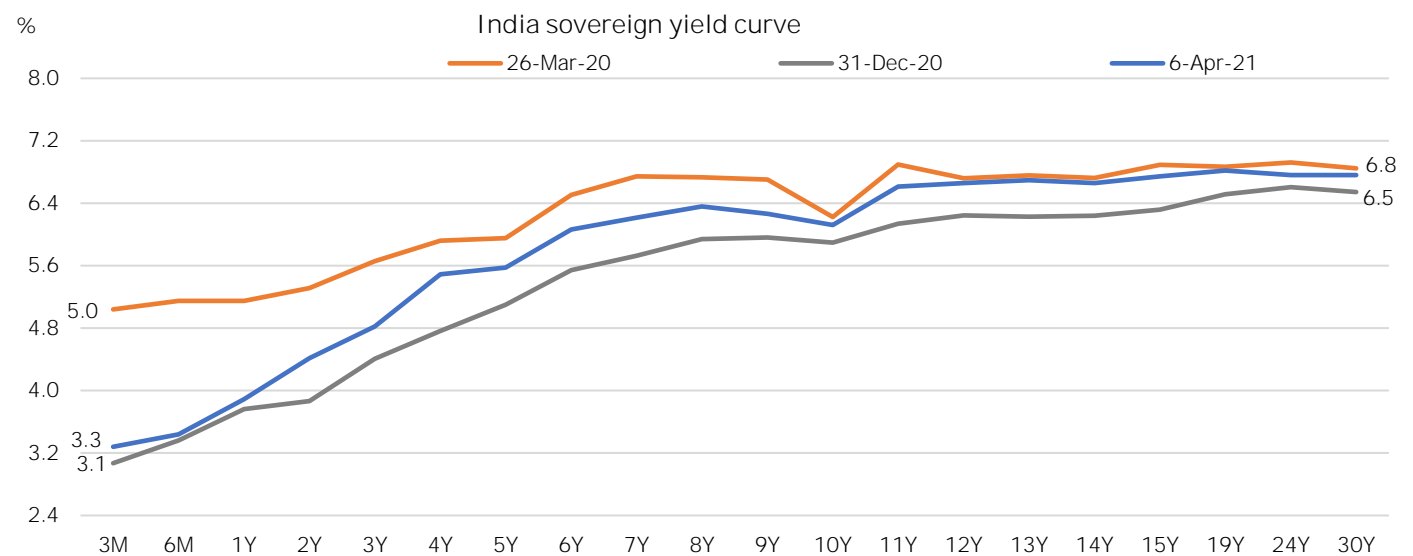
Surplus liquidity in the system has remained north of Rs5trn in 2021 thus far.



Source: CMIE Economic Outlook, NSE

Figure 7: India sovereign yield curve

The India sovereign yield curve has risen meaningfully this year, particularly in the belly and long-end of the curve, resulting in significant steepening of the curve. This has been primarily on the back of sharp surge in US bond yields amid expectations of onset of a reflationary cycle as well as growth and fiscal concerns back home. The RBI's commitment to buy an assured amount of G-secs from the secondary market, pegged at Rs1trn for FY22, should bring down the yield curve and consequently rates on other financial market instruments, thereby facilitating the ongoing economic recovery.



Source: Refinitiv Datastream, NSE.

Economic Policy & Research

Tirthankar Patnaik, PhD	tpatnaik@nse.co.in	+91-22-26598149
Purna Singhvi, CFA	psinghvi@nse.co.in	+91-22-26598316
Runu Bhakta, PhD	rbhakta@nse.co.in	+91-22-26598163
Ashiana Salian	asalian@nse.co.in	+91-22-26598163
Sparsh Chhabra	schhabra@nse.co.in	+91-22-26598163
Simran Keswani	skeswani@nse.co.in	+91-22-26598163
Aanchal Dusija	consultant_adusija@nse.co.in	+91-22-26598163

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