RBI Monetary Policy Statement

December 2021

ASSOCHAM
Celebrating 101 Years

We appreciate the Monetary Policy Committee Members of the Reserve Bank of India (RBI) under the Chairmanship of Shri Shaktikanta Das, Hon'ble Governor, Reserve Bank of India, for an announcement on MPC on 08th December 2021 and based on an assessment of the macroeconomic situation and outlook. The MPC voted unanimously to maintain the status quo about the policy repo rate and by a majority of 5 to 1 to retain the accommodative policy stance. Consequently, the policy repo rate remains unchanged at 4 per cent. The stance remains accommodative as long as necessary to revive and sustain growth on a durable basis and continue to mitigate the impact of COVID-19 on the economy while ensuring that inflation remains within the target in the future. The marginal standing facility (MSF) rate and the bank rate remain unchanged at 4.25 per cent. The reverse repo rate also remains unchanged at 3.35 per cent.

We are pleased to share that today's announcements included some of the key recommendations made by ASSOCHAM on RBI Bi-Monthly Monetary Policy Statement for 2021-22.

Continuing The Accommodative Stance

- RBI to continue with an accommodative stance to revive and sustain growth on a durable basis.
- RBI keeps benchmark lending rate unchanged 9th time in a row at 4 per cent.

Urban demand has also shown signs of strengthening, with spending on travel and tourism surging in the last few months. Other indicators like railway freight traffic, port cargo, GST receipts, toll collections, petroleum consumption and air passenger traffic have also picked up in October/November.

Assessment of Growth and Inflation

- The NSO's release on November 30, 2021, confirmed that the recovery of the Indian economy is gaining traction, with real GDP growth at 8.4 per cent, year-on-year (y-o-y), for Q2:2021-22 after 20.1 per cent in the preceding quarter.
- All components of GDP registered y-oy growth, with exports and imports strongly surpassing their pre-COVID levels.
- Incoming information indicates that consumption demand has improved, with pent-up demand reinforced by the festive season.
- Rural demand is exhibiting resilience and farm employment is picking up with the robust performance of agriculture and allied activities, supported by a strong start to rabi sowing, continuing direct transfers under the PMKisan scheme and extension of free food grains under the Pradhan Mantri Garib Kalyan Anna Yojana (PMGKAY) till March 2022.
- The recent reductions in excise duty and state VAT on petrol and diesel should support consumption demand by increasing purchasing power.
- Government consumption is also picking up from August, providing support to aggregate demand.
- The Central Government's relaxation of additional market borrowings by states equivalent to 0.5 per cent of gross state domestic product (GSDP) subject to certain capex related milestones and the decision to front-load tax devolution are likely to bolster capital outlays of the states.
- The Government's focus on capex should crowd in private investment, which has remained in a prolonged state of muted activity.

Enabling conditions for a revival of investment activity are also falling into place. The production of capital goods remained above the pre-pandemic level for the third month in a row during September, while imports of capital goods increased by double digits during October for the eighth consecutive month.

Overall, the recovery interrupted by the second wave of the pandemic is regaining traction, but it is not yet strong enough to be self-sustaining and durable. This underscores the vital importance of continued policy support.

Downside risks to the outlook have risen with the emergence of Omicron and renewed surges of COVID-19 infections in several countries.

Hardening international energy prices have kept domestic LPG, and kerosene prices elevated for nearly three quarters, edging up fuel inflation to 14.3 per cent in October.

Cost-push pressures continue to impinge on core inflation, though their pass-through may remain muted due to the slack in the economy.

- Further, there has been significant deleveraging of corporate balance sheets amidst congenial monetary and financial conditions engendered by the Reserve Bank's liquidity measures.
- Besides, notwithstanding some recent corrections, headwinds continue to be posed by high international energy and commodity prices, potential volatility in global financial markets due to a faster normalisation of monetary policy in advanced economies, and prolonged global supply bottlenecks.
- Considering all these factors, the projection for real GDP growth is retained at 9.5 per cent in 2021-22, consisting of 6.6 per cent in Q3 and 6.0 per cent in Q4 of 2021-22. Real GDP growth is projected at 17.2 per cent for Q1:2022-23 and 7.8 per cent for Q2:2022-23.
- Headline CPI inflation ticked up in October to 4.5 per cent from 4.3 per cent in September, after falling sharply between June and September.
- This uptick mainly reflected a spike in vegetable prices due to unseasonal rains in some parts of the country.
- The persistence of high core inflation (i.e., CPI inflation excluding food and fuel) since June 2020 is an area of policy concern given input cost pressures that could rapidly be transmitted to retail inflation as demand strengthens. In this context, the reduction of excise duty and VAT on petrol and diesel will bring about a durable reduction in inflation by way of direct effects and indirect effects operating through fuel and transportation costs.
- Therefore, the inflation trajectory is likely to be in line with our earlier projections, and price pressures may persist in the immediate term.
- Vegetable prices are expected to see a seasonal correction with winter arrivals given bright prospects for the rabi crop.
- Supply-side interventions by the Government have limited the fallout of continuing high international edible oil prices on domestic prices. Though crude oil prices have seen some correction in the recent period, a durable containment of price pressures would hinge on strong global supply responses to match the pick-up in demand as pandemic restrictions ease.
- Over the rest of the year, inflation prints are likely to be somewhat higher as base effects turn adverse; however, it is expected that headline inflation will peak in Q4:2021-22 and soften after that. Taking into consideration all these factors, CPI inflation is projected at 5.3 per cent for 2021-22: 5.1 per cent in Q3; 5.7 per cent in Q4 of 2021-22, with risks broadly balanced.
- CPI inflation is then expected to ease to 5.0 per cent in Q1:2022-23 and stay at 5.0 per cent in Q2:2022-23.

Liquidity and Financial Market Conditions

As economies reopened, the spurt in catch-up demand has met with choked supply chains, shortage of critical inputs and tightening labour markets. Combined with high energy and commodity prices, this has ignited long-dormant inflation in several countries, even before output has returned to pre-pandemic levels.

The Reserve Bank has maintained ample surplus liquidity in the banking system to nurture the nascent growth impulses and support a durable economic recovery. This has facilitated swifter and more complete monetary policy transmission and the orderly conduct of the market borrowing programme of the Government. The Reserve Bank will continue to manage liquidity in a manner conducive to entrenching the recovery and fostering macroeconomic and financial stability.

- The global context is evolving rapidly. The appearance of the Omicron variant has added to the complexity of the situation even as several economies are still battling the virus. In contrast, others continue to deal with the lingering scars of COVID-19.
- Several central banks in advanced and emerging market economies have begun unwinding from crisis-time policies warranted by their growth-inflation dynamics. Now, with fears of further restrictions on travel and activity, there is considerable uncertainty at this moment on how the growth-inflation dynamics will pan out in the immediate months. The financial conditions are turning increasingly volatile as a consequence.
- The Reserve Bank will continue to rebalance liquidity conditions in a non-disruptive manner while maintaining adequate liquidity to meet the needs of the productive sectors of the economy. With this objective, it is now proposed to enhance the 14-day VRRR auction amounts on a fortnightly basis in the following manner: ₹6.5 lakh crore on December 17; and further to ₹7.5 lakh crore on December 31. Consequently, from January 2022 onwards, liquidity absorption will be undertaken mainly through the auction route.
- The Reserve Bank endeavours to put in place an effective liquidity management framework that is consistent with an economy emerging out of the pandemic and having a nascent but strengthening recovery. The Reserve Bank also stands committed to undertaking Operation Twists (OT) and regular open market operations (OMOs) as required for effective monetary transmission and anchoring of interest rate expectations in line with the evolving macroeconomic and financial conditions.
- As a step towards rebalancing the liquidity surplus, it has now been decided to provide one more option to banks to prepay the outstanding amount of funds availed under the Targeted Long-Term Repo Operations (TLTRO 1.0 and 2.0) announced on March 27 and April 17, 2020. It may be noted that banks had already prepaid ₹37,348 crores in November 2020, which constituted about one-third of ₹1,12,900 crore availed under the scheme.
- The on-tap liquidity windows of ₹50,000 crores for ramping up COVID-related healthcare infrastructure and services and ₹15,000 crores for specific contact-intensive sectors will continue till their terminal date, i.e., March 31, 2022.
- Further, given that the usage of the MSF window has been rare due to surplus liquidity conditions, we propose to return to the normal dispensation under the MSF. Consequently, banks will be able to dip up to 2 per cent of net demand and time liabilities (NDTL) instead of 3 per cent for overnight borrowing under the MSF from January 1, 2022. This dispensation which was provided at the beginning of the pandemic, had boosted market confidence at a crucial time

Additional Measures

Scheduled commercial banks' extant prudential norms on classification and valuation of the investment portfolio are largely based on a framework introduced in October 2000. Given the significant developments since then in domestic financial markets and global standards/best practices in this area, a need has been felt to review and update these norms following a consultative process.

- At present, banks incorporated in India can infuse capital in their overseas branches and subsidiaries; retain profits in these centres, and repatriate/ transfer profits from there with prior approval of the RBI. To provide operational flexibility to banks, it has been decided that banks need not seek prior approval of the RBI if they meet the regulatory capital requirements.
- Concerted efforts by all stakeholders have led to a significant increase in digital payments in recent years. However, there have been some concerns on the reasonableness of various charges incurred by customers for digital payments through credit cards, debit cards, prepaid payment instruments (cards and wallets), Unified Payments Interface (UPI) the like. It is proposed to release a discussion paper on various charges in the payment system to have a holistic view of the issues involved and possible approaches to mitigating the concerns to make digital transactions more affordable.
- UPI is the single most extensive retail payment system in the country in terms of volume of transactions, indicating its wide acceptance, particularly for small value payments. To further deepen digital payments and make them more inclusive, ease transactions for consumers, facilitate greater participation of retail customers in various segments of financial markets and enhance the capacity of service providers, it is proposed to (i) launch UPI-based payment products for feature phone users, leveraging on innovative products from the RBI's Regulatory Sandbox on Retail Payments; (ii) make the process flow for small value transactions simpler through a mechanism of 'on-device' wallet in UPI applications, and (iii) enhance the transaction limit for payments through UPI for the Retail Direct Scheme for investment in G-secs and Initial Public Offering (IPO) applications from ₹2 lakh to ₹5 lakh.
- At present, interest rates on ECB and trade credits are benchmarked to LIBOR or any other interbank rate applicable to borrowing currency. As we transition away from LIBOR, guidelines enabling the use of any widely accepted interbank rate or alternative reference rate (ARR) for such transactions are issued separately.