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CANARA ROBECO Mutual Fund

RBI Policy Update

December 04, 2020

Assessment of 'Monetary Policy Committee's (MPC) December 4, 2020 Bi-Monthly Monetary Policy, FY 2020-21

RBI's Policy Stance:

The MPC has yet again decided to keep the benchmark interest rate unchanged and continued to maintain its stance as "accommodative" based on the current and evolving macroeconomic and financial developments. It will be maintained for as long as necessary, especially during the current financial year, to revive growth while ensuring that inflation remains within the MPC's target going forward. The MPC has noted that the signs of recovery are largely dependent on sustained policy support. **As has been the case for the last two monetary policies, the MPC has continued to display its commitment to achieve the medium-term target for headline inflation of 4% within a band of +/- 2% while supporting growth and decided to**:

- **keep** the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 4%;
- maintain the monetary policy stance as **accommodative**

Variable	Stands at
Repo	4.00%
Reverse Repo	3.35%
CRR	3.00%
MSF	4.25%
SLR	18.00%

Source: www.rbi.org.in

Policy Stance & Rationale:

- In the December 4, 2020 bi-monthly policy meeting of FY21, chaired by RBI governor Mr. Shaktikanta Das, the members voted unanimously to keep its benchmark interest rate unchanged and continued to remain accommodative, continuing its fight against the COVID-19 pandemic and its impact on the economy, while ensuring that inflation remains within the target going forward. The endeavour, going forward, will also be to restrict output and employment losses with an environment of macroeconomic and financial stability. **The MPC kept the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 4.0%. 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%.**

- Globally, a second wave of COVID infections was seen in Europe, the US and some major emerging market economies (EMEs) which led to the implementation of further lockdowns. This has also impacted the recovery of these economies which was underway in Q3 of 2020. **World trade is likely to slowdown in Q4 as pent-up demand is exhausted, inventory restocking is completed, and trade-related uncertainty is rising with the second wave.** CPI inflation has remained muted across major advanced economies (AEs) while it picked up in some EMEs on hardening food prices and supply disruptions. Accommodative monetary policies and positive news on the vaccine has helped the global financial markets to remain resilient.

- **On the domestic front, a contraction of 7.5% was seen in the real GDP in Q2 FY21.** It can be pointed out through high frequency indicators that recovery in the economy is gaining traction with double digit growth in passenger vehicles and motorcycle sales, railway freight traffic, and electricity consumption in October, although there was moderation in some of these indicators in November. In agriculture too, the outlook is positive, supported by favourable monsoon, and rabi sowing up 4.0% from the acreage covered at this time last year.

- **A matter of concern can be the CPI inflation rising sharply to 7.6% in Oct'20 with the pressure in prices still increasing.** Food inflation swelled to double digits in October across protein-rich items including pulses, edible oils, vegetables and spices. Core inflation, i.e., CPI excluding food and fuel, also picked up from 5.4 per cent in September to 5.8 per cent in October. Both three months and one year ahead inflation expectations of households have eased diffidently in the view of the seasonal moderation of food prices in the winter and easing of supply chain disruptions.

- The financial conditions in the country remained easy in the months of October and November, with systemic liquidity remaining in surplus. Reserve money increased due to a surge in currency demand. Besides, non-food credit growth accelerated and was positive for the first time in Nov'20. India's foreign exchange reserves have also gone up from the time of the MPC's last resolution.

Source: RBI

Outlook:

- On the global front, the economic growth is largely impacted due to the second wave of the pandemic and recoveries have slowed down in major economies. **Consumer spending and investment intentions continue to remain weak and household spending is expected to pick-up in Q1-2021 as restrictions relax.** The economic growth is likely to remain sluggish in the near term. The measures taken by major central banks would continue to remain accommodative to support the recovery of the economic as could be seen by liquidity infusion measures by the Bank of England and status quo of Fed rates in the United States.

- Domestically, various measures have been taken by the RBI to reduce volatility and going forward it will continue to respond to global uncertainty in order to secure domestic stability and ensure ample liquidity through various liquidity management operations. **The central bank has taken various policy measures to preserve the stability of the financial sector and would continue to remain accommodative and keep a close watch on all the threats to price stability and mitigate supply side pressure.** On the economic growth aspect, the RBI projected the GDP growth for H2 FY21 to remain positive at +0.1% for Q3 against -5.6% earlier and +0.7% for Q4 against +0.5% earlier and the real GDP growth for FY21 projected at negative 7.5%.

- Inflation has been presumed to be adverse relative to expectations in the last two months. While cereal prices may continue to soften with the copious kharif harvest arrivals and vegetable prices may ease with the winter crop, other food prices are likely to persist at high levels. Crude oil prices have picked up due to demand recovery, continuation of OPEC plus production cuts and are expected to remain volatile in the near-term. Cost-push pressures continue to be imposed on core inflation, which has remained sticky and could firm up as economic activity normalises and demand picks up. CPI inflation is projected at 6.8% for Q3 FY21, 5.8% for Q4 FY21; and 5.2% to 4.6% in H1 FY21-22.