MONETARY POLICY REVIEW

06 August 2021

Initial signs of normalisation

Sameer Narang |
Dipanwita Mazumdar | Aditi Gupta
chief.economist@bankofbaroda.com

MPC maintained status quo on rates. While growth forecast was retained, inflation forecast has been increased to 5.7% (5.1% earlier). This perhaps explains 5:1 vote on continuation of accommodative stance as long as necessary to revive growth on a durable basis. Commentary on growth is far more positive than last policy. Rural consumption, government spending, exports and investments are looking up. RBI's growth forecast for Q1FY23 is 17.2%. This sets the base for normalisation of policy.

Rates on hold: MPC unanimously voted to keep policy repo rate unchanged at 4%. It also retained its 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.

FY22 growth forecast unchanged at 9.5%: While growth forecast for FY22 is unchanged at 9.5%, there is significant inter quarter variation with Q1 growth revised up to 21.4% (18.5% earlier). Forecast for other quarters has been cut. Commentary is far more positive this time with growth expected to revive led by rural demand, improving vaccinations, exports, government spending, in particular capex, and private investments. Notably, growth in Q1FY23 is estimated at 17.2%.

CPI forecasts revised upward: RBI has revised its CPI projection upward to 5.7% in FY22 from 5.1% earlier. The trajectory for Q2FY22 has been revised upward by 50bps (5.9% from 5.4%). For Q3, by 60bps (5.3% from 4.7%) and for Q4 by 50bps (5.8% from 5.3%). Even in Q1FY23, headline CPI is estimated to be above MPC's 4% target at 5.1%. Notably, in Q1FY22 actual print overshot RBI's projection by 40bps to 5.6%. While inflation continues to be supply-led in the form of higher commodity prices and oil prices and the resultant pass-through, inflation in certain food components such as edible oils and pulses have been persistent.

Normalisation on the cards: RBI had re-introduced variable rate reverse repo auctions (VRRR) in Jan'21. The absorption amount under VRRR has now been increased to Rs 4tn from Rs 2tn. This is on the back of reverse repo absorption increasing to Rs 8.5tn in Aug'21. At the long end, RBI will continue to provide liquidity through operation twist and GSAPs. The increase in VRRR auction amount along with change in voting pattern is perhaps inkling upcoming turn in monetary cycle in the coming quarters. We expect RBI to reduce the gap between repo and reverse repo in Q4FY22 before lifting off repo rate in beginning of FY23. Our view is based on limited or no impact of another Covid-19 wave on the economy.

Key highlights

- RBI maintains status quo on rates, 5:1 vote on accommodative stance.
- CPI projections for FY22 revised upward by 60bps to 5.7% from 5.1% earlier.
- Growth projections retained at 9.5% in FY22.
- Nprmalisation visible in liquidity management framework.

Regulatory announcements

- RBI has extended the on-tap TLTRO scheme for stressed sectors and bank lending to NBFCs and MSF relaxation of 1% for banks by another 3-months till 31 Dec 2021.
- In order to facilitate smooth transition from LIBOR, the RBI has announced several steps such as: 1) Banks have been permitted to extend export credit in any other widely used Alternative Reference Rate (ARR) instead of LIBOR, 2) For derivatives contracts, change in reference rate from LIBOR to ARR to be considered as "force majeure" event and will not be treated as restructuring.
- The deadline for achieving the financial parameters under the Resolution Framework for COVID-19 1.0 has been deferred by 6-months to 1 Oct 2022. This applies to four parameters (out of five) relating to operational efficiency. These are: Total debt to EBIDTA ratio (Total Debt/EBIDTA), current ratio, debt service coverage ratio and average debt service coverage ratio. However, the fifth parameter which is Total Outside Liabilities/Adjusted Total Net Worth (TOL/ATNW), reflects the revised capital structure which was expected to be crystallised upfront as part of the resolution plan. Hence, the date for achieving the same remains unchanged, i.e. 31 Mar 2022.

Disclaimer

Visit us at www.bankofbaroda.com

For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
chief.economist@bankofbaroda.com