

## OCTOBER MPC MINUTES

23 October 2020

### Emphasis on forward guidance

**MPC members favoured forward guidance on accommodative conditions to anchor market expectations of liquidity. This along with purchase of government securities has led to reduction in term premium. Minutes show MPC members believe inflation will ease as supply restrictions are removed. Demand conditions are weak. So is pricing power with corporates. On growth, members believe consumption recovery may be short lived and an investment led recovery is likely to take time and contingent on public sector spending.**

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**Growth to recover gradually:** MPC stated that growth is expected to recover gradually from a steep contraction in Q1, as several economic indicators suggest a pickup in activity. A second wave of COVID-19 infections pose a risk to growth. MPC members also pointed out that potential output may take several years to repair. Dr. Patra noted that empirical evidence suggests that consumption led recoveries are shallow and short-lived. In addition, he believes there is an anecdotal sense that economy's potential output has fallen.

**Inflationary pressures to subside:** All the MPC members were of the view that inflation will begin to subside from Q3FY21 onwards with Dr. Saggiar expecting a decline beginning in Oct'20 with headline converging to core inflation, and both softening. The key reasons for this are: removal of supply side bottlenecks, good monsoon and weak demand. According to Dr. Patra, deviation of inflation from its target was mainly owing to supply shocks in food and fuel category (71% contribution), followed by unanchored inflation expectations (28%) and exchange rate and asset prices (12%). Inflation is pulled down by 15% by negative demand shock.

**MPC remains accommodative:** Shri Shaktikanta Das, RBI Governor, noted that there exists space for rate cuts if inflation evolves in line with expectations. In the current policy, focus was on forward guidance. Shri Das stated that enhanced guidance should strengthen and quicken the pace of transmission to longer-term yields. Dr. Patra too said that policy should remain accommodative and exploit the headroom that opens up when inflation recedes. With supply side restrictions easing, RBI expects inflation to recede to 5.4% in Q3 and 4.5% in Q4. It will settle in the range of 4.1-4.4% next year. Any further increase in international commodity prices and mean reversion in certain core inflation categories may lead to an upward surprise.

### KEY HIGHLIGHTS

- MPC members see inflation ebbing in H2FY21.
- Growth to recover only gradually.
- Further rate cuts seem difficult.



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