Lighthouse Canton Capital India

RBI Monetary Policy Review

10 February 2022

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LIGHTHOUSE CANTON

RBI’s Monetary Policy Review – 10th February 2022

RBI Policy Stance

The Monetary Policy Committee (MPC) decided to continue with the accommodative stance as long as necessary to revive and sustain growth on a durable basis and continue to mitigate risk of Covid on the economy while ensuring inflation remains within the target range.

RBI’s decision to maintain an accommodative stance was done with a unanimous vote.

Key Highlights

- The liquidity in the system remains ample under the LAF, however it has come down from ₹8.6 lakh crore in October- November to ₹7.6 lakh crore in January 2022.
- The inflation forecast has been retained at 5.3% for FY 22 and inflation for 2022-23 is projected at 4.5%.
- Growth forecast for FY 23 is at 7.80% with decline in growth noted in Q3 and Q4 FY 23.
- Current account deficit is likely to remain contained below 2.0% of GDP during 2021-22.
- RBI opined that government’s thrust on capital expenditure and exports are expected to enhance productive capacity and strengthen aggregate demand.
- RBI has increased the Voluntary Retention Route (VRR) limit for investments under the scheme by ₹1.0 lakh crore taking it to ₹2.5 lakh crore with effect from 1st April, 2022.

Policy Rates	Pre Policy	Post Policy	Status
Repo	4.00%	4.00%	Unchanged
Reverse Repo	3.35%	3.35%	Unchanged
MSF	4.25%	4.25%	Unchanged
Bank Rate	4.25%	4.25%	Unchanged
CRR	4.00%	4.00%	Unchanged
SLR	18.00%	18.00%	Unchanged

Time Frame	Projection – Inflation		Projection - Real GDP	
	Dec-21	Feb-22	Dec-21	Feb-22
Q3 FY 22	5.10%		6.60%	
Q4 FY 22	5.70%	5.70%	6.00%	
FY 22	**5.30%**	**5.30%**	**9.50%**	**9.20%**
Q1 FY 23	5.00%	4.90%	17.20%	17.20%
Q2 FY 23	5.00%	5.00%	7.80%	7.00%
Q3 FY 23		4.00%		4.30%
Q4 FY 23		4.20%		4.50%
FY 23		**4.50%**		**7.80%**

RBI Repo Rate Trajectory

RBI’s Projection on Inflation and Growth

Chart 1: Quarterly Projection of CPI Inflation (y-o-y)

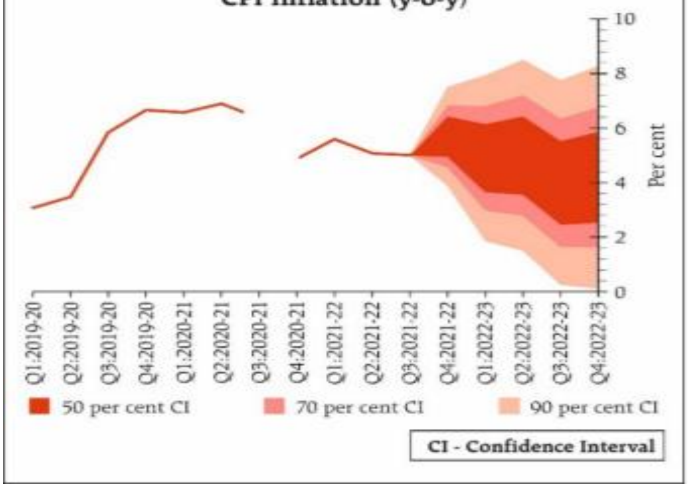
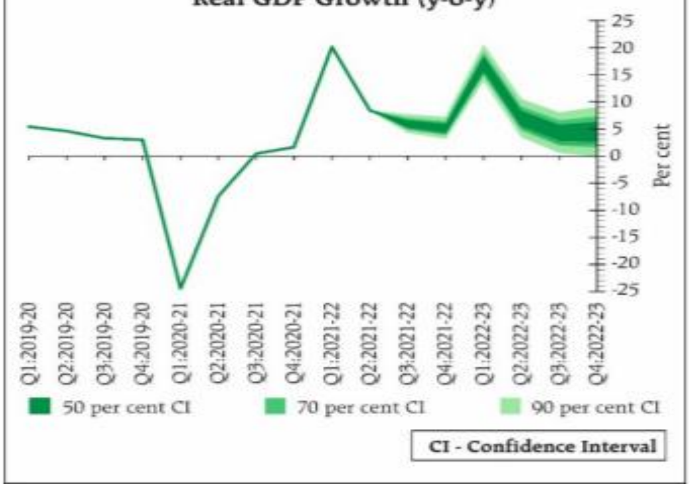


Chart 2: Quarterly Projection of Real GDP Growth (y-o-y)



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RBI's Assessment of Global and Domestic Economy

- CPI inflation in December 2021 inched higher primarily due to unfavorable base effect, however, it remains within the RBI's tolerance band. RBI expects inflation to moderate in H2 2022-23, hence monetary policy continues to remain accommodative. Core inflation remains sticky and while headline CPI may moderate going forward.
- Private consumption, the mainstay of domestic demand, continues to trail its pre-pandemic level. Overall, there is some loss of the momentum of near-term growth while global factors are turning adverse. Looking ahead, domestic growth drivers are gradually improving.
- Commodity and crude prices remain elevated and pose a risk to the estimates on inflation and growth.
- The balance sheets of Scheduled Commercial Banks (SCBs) are relatively stronger with higher capital adequacy, reduced NPA, higher provisioning cover and improved profitability
- The surveys done by the RBI reveal that capacity utilization is rising, and the outlook on business and consumer confidence remain in optimistic territory.
- Monetary policy would continue to be guided by its primary mandate of price stability over the medium term, while also ensuring a strong and sustained economic recovery.

Outlook

- The MPC's rate stance had dovish undertones and was divergent from the consensus analyst view which was tilted towards a 25 bps rate hike. Growth concerns continued to assume center stage in policy decisions.
- RBI's commitment to gradual, calibrated and nondisruptive policy stance will continue to provide comfort to market participants.
- We expect growth to remain robust as governments policies are expected to propel capital expenditure and build up aggregate demand. RBI's policies drive to provide impetus to investment activity is well established in the policy statement. Corporates have been able to deleverage and reduce debt which will improve profitability in the coming quarters.
- Additional measures like increase in VRR limit and review od CDS guidelines will ensure that the bond markets in India continue to strengthen and stay attractive for foreign participants.
- We expect yields in long dated bond yields to remain low post policy. We do not expect significant upside in yields in the longer end of the curve in the near future as long as crude oil price remains low. However, once the new borrowing calendar is announced, there may be knee jerk reactions if the borrowing program is not aided by support from RBI. The shape of the underlying curve remains steep and will continue remain so till liquidity remains in surplus mode. The potential risks of divergence between domestic accommodative stance in rates and FED announcements may continue to expose bonds to knee jerk reactions.
- At the current juncture we continue to maintain the view to stay in high carry portfolios with high grade underlying assets. Assets in the 3-5 year segment continue to remain attractive, hence roll down funds, SDL funds, high grade credits continue to remain attractive at this point in time.
- Equity markets remained exuberant post policy with banking stocks gaining momentum. We continue to remain bullish on small and mid cap stocks over the medium term in sectors which are expected to do well due to governments thrust on Capex and infrastructure spending. Corporates who have been able to deleverage will continue to do well in the coming quarters and the equity markets are expected to remain supported by RBI's policy measures.
- The next policy statement is due on 8th April, 2022.