LIGHTHOUSE CANTON

RBI Monetary Policy Review

Prepared by LC Capital India

8 December 2021

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RBI's Monetary Policy Review – 8 December, 2021

RBI Policy Stance

The Reserve Bank of India (RBI) made a unanimous decision to maintain an accommodative stance.

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

Key Highlights

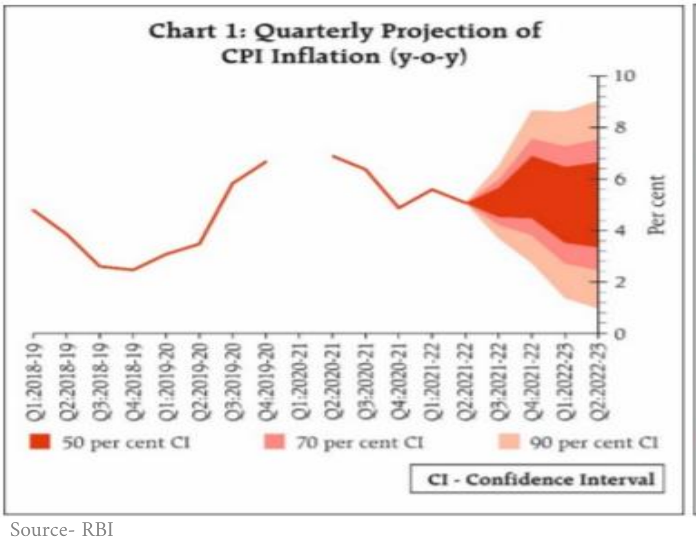
- The liquidity in the system remains ample with October and November seeing an average liquidity adjustment facility (LAF) of ₹ 8.6 lakh crore of surplus.
- The RBI will enhance the 14-day variable rate reverse repo (VRRR) auction amounts on a fortnightly basis in the following manner: ₹6.5 lakh crore on December 17, 2021; and further to ₹7.5 lakh crore on December 31, 2021.
- The inflation forecast has been retained at 5.3% for FY 22 and growth forecast has been retained at 9.50% for FY 22.
- Going forward, the main operation of 14-day VRRRs will continue to be complemented by longer term VRRRs.
- The Reserve Bank stands committed to undertake Operation Twists (OT) and regular open market operations (OMOs) as required for anchoring of the rate expectation
- Banks will be able to dip up to 2% of net demand and time liabilities (NDTL) instead of 3% for overnight borrowing under the MSF from January 1, 2022.

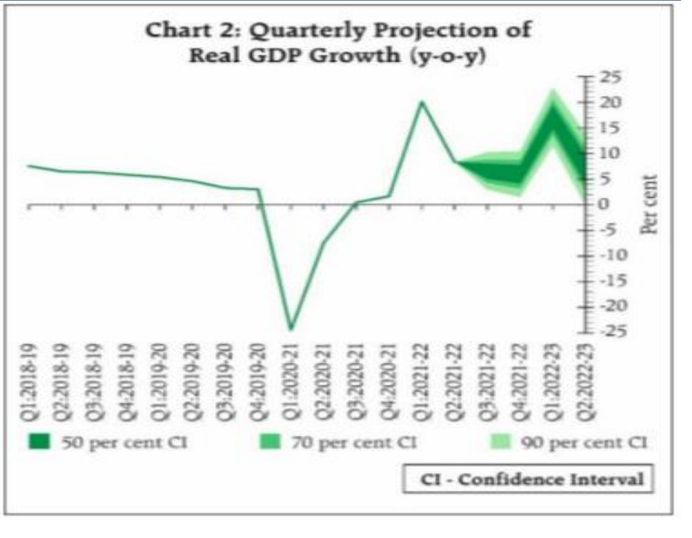
Policy Rates	Pre Policy	Post Policy	Status
Repo	4.00%	4.00%	Unchanged
Reverse Repo	3.35%	3.35%	Unchanged
MSF	4.25%	4.25%	Unchanged
Bank Rate	4.25%	4.25%	Unchanged
CRR	4.00%	4.00%	Unchanged
SLR	18.00%	18.00%	Unchanged

Time Frame	Projection – Inflation		Projection - Real GDP	
	Oct-21	Dec-21	Oct-21	Dec-21
Q2 FY 22	5.10%		7.90%	
Q3 FY 22	4.50%	5.10%	6.80%	6.60%
Q4 FY 22	5.80%	5.70%	6.10%	6.00%
FY 22	**5.30%**	**5.30%**	**9.50%**	**9.50%**
Q1 FY 23	5.20%	5.00%	17.20%	17.20%
Q2 FY 23		5.00%		7.8%

RBI Repo Rate Trajectory

RBI's Projection on Inflation and Growth





Source- RBI

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RBI's Assessment of Global and Domestic Economy

- The emergence of the Omicron variant, persistent supply chain disruptions and elevated energy and commodity prices continue to weigh on global economic activity.
- The composite global purchasing managers' index (PMI), however, improved to a four-month high in November, with services continuing to perform better than manufacturing for eight consecutive months.
- Commodity prices remain elevated across the board, though there has been some softening since late October and further drop towards the end of November following uncertainties from the Omicron variant.
- Domestically, with recovery gaining momentum, growth domestic product (GDP) growth remained buoyant with almost all components of GDP registering a year on year (YoY) growth. This was aided by the expanding vaccination coverage, the rapid subsiding of new infections and release of pent-up demand.
- Exports and imports markedly exceeded their pre-COVID-19 levels.
- Core inflation remains sticky and elevated at 5.9%, while headline CPI edged up to 4.5% in October from 4.3% in September on account of a spike in vegetable prices. This was due to crop damage from heavy rainfalls in October in several states, and fuel inflation.

Outlook

- The MPC's rate stance had dovish undertones and was broadly in line with market expectations. Growth concerns continued to assume center stage in policy decisions.
- RBI's commitment to a gradual, calibrated and nondisruptive policy stance will continue to provide comfort to market participants.
- We expect growth to remain robust as supply chain issues resolve, vaccination levels increase, and more employees return to the workforce.
- The emergence of the Omicron variant and uncertainty towards its severity will remain a concern going forward as any adverse surprises may dent growth prospects.
- In the policy statement, RBI has mentioned its readiness to undertake operation twists as and when warranted and VRRR would be the primary mode of liquidity management. Hence, we expect the rates on the shorter end of the curve to remain pressed till liquidity continues to be in surplus mode.
- We expect long date bond yields to remain in check with RBI's promise of intervention as and when required. Hence, we do not expect significant upside in yields in the longer end of the curve. However, the shape of the underlying curve seems to be shifting and will continue to be challenged by Federal Reserve (FED) actions which intend to fast track tapering. The divergence between domestic pause in rates and FED announcements may expose bonds to knee jerk reactions.
- We believe that spread compression between the credit space and government securities curve and flattening of the yield curve will remain the key themes for the upcoming quarter. 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 continue to remain attractive at this point in time.
- Since, solid economic growth is supportive of credit fundamentals, and low interest rates remain supportive for credit markets. Hence, we expect structured credit will do well till rates remain low.
- Equity markets remained exuberant post policy with banking stocks showing strength. We continue to remain bullish on small and mid cap stocks over the medium term which have low exposure in segments which could be affected by a possible third wave.
- The next policy statement is due on 9 February, 2022.