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Press Release

MPC Feb-22: Omicron derails policy normalization path

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Notwithstanding the hawkish pivots made by the major central banks in the form of accelerated taper of asset purchases and hikes in monetary policy rates amidst high global inflationary pressures, the RBI has continued to remain steadfast on its accommodative policy stance and postponed the initiation of any formal monetary policy normalization process with the continuous focus on supporting the uncertain growth revival trajectory.

Says Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research "Contrary to ours and the overall market expectations, RBI has maintained complete status quo on not only the interest rates but also its narrative on the accommodative stance. It is clear that the central bank wants to hold on to the supportive monetary policy and augment the growth focussed budgetary initiatives of the government till the data points to a strong pick up in domestic consumption demand." The decision on unchanged interest rates was unanimous backed by a 6-0 voting outturn but the one on accommodative policy continued to see a dissent with 5-1 voting outturn for the fourth consecutive meeting.

While the severity of infection has been less during the third wave as compared to the previous waves, the MPC did take into account some loss of momentum in economic activity particularly in the contact-intensive services sector due to the surge in the volume of cases driven by the Omicron variant in Jan-22. However, given the limited impact of the third wave on the economy, government's thrust on infrastructure segment underscored in the Union Budget and accommodative monetary and liquidity conditions, RBI pegs India's GDP growth for FY23 at a healthy 7.8%. This was, however, accompanied by a caution on the trajectory owing to the elevated commodity prices, persistent supply disruptions and global financial market volatility given that many central banks have initiated an exit from their ultra-accommodative monetary policy.

On inflation front, RBI highlighted concerns over a flare-up in crude-oil prices due geopolitical tensions and acknowledged its importance as a monitorable parameter. Nevertheless, it has retained the inflation forecast for FY22 at 5.3% with expectations of further easing of vegetable prices, prospect of another robust rabi crop output, supply-side interventions taken by the government to ease prices of edible oils and pulses along with moderate pass through of higher input costs due to slack in demand. Further, for FY23, the RBI has pegged inflation at 4.5% on the expectation of normal monsoon conditions and a significant moderation in crude oil prices as supply conditions turn favourable.

Adds Suman Chowdhury "In our opinion, RBI has taken a dovish stance on inflation, in the context of the severe global inflationary landscape. So far, the relatively weak domestic consumption demand has led only to a partial pass through of high input price pressures to end consumers. However, increasing compression in firms' profit margins due to elevated commodity prices and the expected improvement in demand scenario, increased pass-through is highly likely over the next few quarters, keeping core inflation sticky at elevated levels. Therefore, we attach an upward bias to RBI's inflation forecast with our headline estimate at 5.5% in FY22 and 5.0% for FY23 even in a moderately conducive scenario."

Although RBI is yet to take any formal steps on normalization of monetary policy, it has continued to focus on **'rebalancing of liquidity'** on a dynamic basis. As such, variable rate repo of varying tenors will be conducted as and when warranted by the liquidity and financial conditions. Secondly, variable rate repos (VRRs) and variable rate reverse repos (VRRRs) of 14-day tenor both will operate as the main liquidity management tool.

Concludes Suman Chowdhury "While RBI continues to keep status quo on its accommodative monetary policy, the global and the domestic factors have already led to a spike in both short and long term yields by at least 50 bps since the last MPC. The importance of the reverse repo rate as a benchmark has clearly reduced with the cut-off rate in VRRR auctions close to the 4.0% repo rate. Keeping market rates stable may prove to be a challenge for the central bank and will depend on the government's actual borrowing programme as well as banks' credit growth over the next few quarters. Going forward, as the recovery turns more sustainable, we expect the RBI to gradually revert to its pre-pandemic policy corridor by hiking the reverse repo rate either in April or Jun-22. However, the timing on the upward adjustment in the repo rate is difficult to comment on, given RBI's thrust on growth facilitation vs the timeliness of monetary policy normalization."

About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 9,000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Kanjurmarg, Mumbai.

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