LKP Securities Ltd.

8th December, 2021

RBI MONETARY POLICY - DECEMBER 2021

Announcement

- Repo Rate: Unchanged at 4.00% with an accommodative stance.
- Reverse Repo Rate: 3.35%
- CRR 3.50%

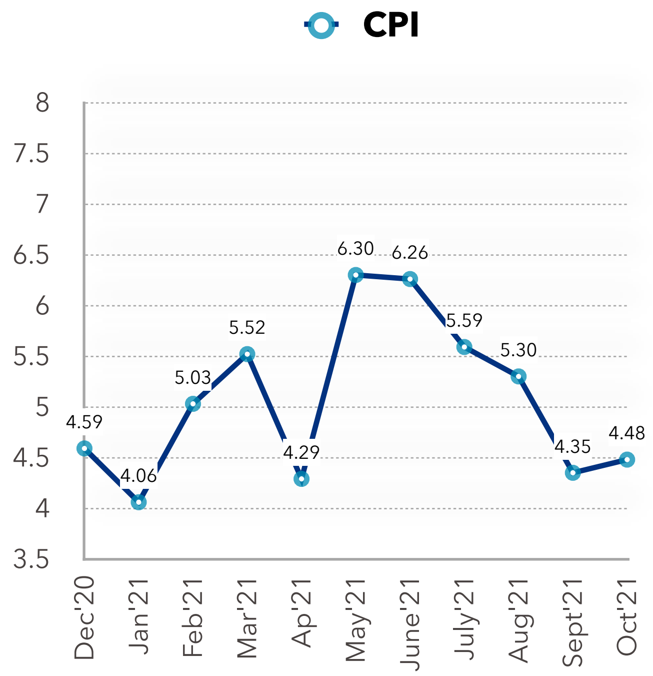
RBI's Assessment

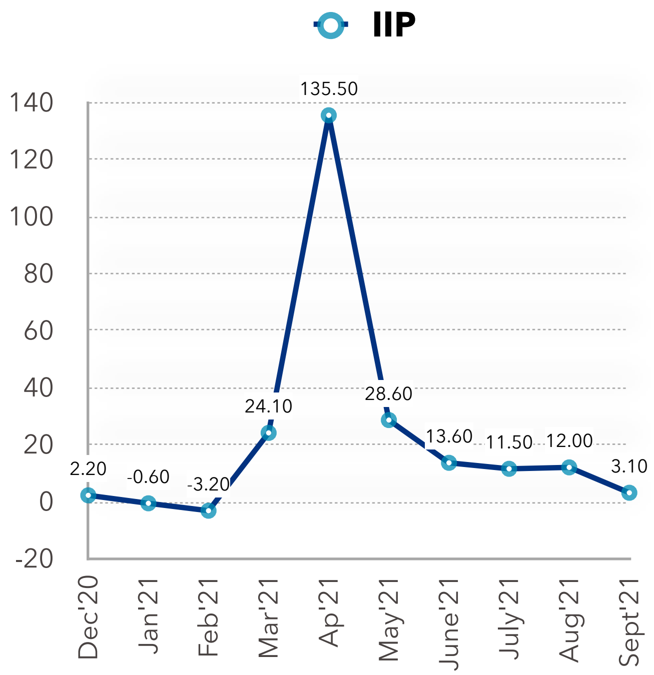
- Commodity prices remain elevated across the board, though there has been some softening since late October and further drop towards end-November following uncertainties from the new COVID-19 variant, among others. With the US Federal Reserve commencing tapering of its monthly asset purchases and the possibility of faster taper, renewed bouts of volatility and heightened uncertainties have unsettled global financial markets
- On the domestic front, data released by the National Statistical Office (NSO) on November 30, 2021 showed that real gross domestic product (GDP) expanded by 8.4 per cent year-on-year (y-o-y) in Q2:2021-22, following a growth of 20.1 per cent during Q1:2021-22. With the recovery gaining momentum, all constituents of aggregate demand entered the expansion zone, with exports and imports markedly exceeding their pre-COVID-19 levels. On the supply side, real gross value added (GVA) increased by 8.5 per cent y-o-y during Q2:2021-22.
- Urban demand and contact-intensive services activities are rebounding on improving consumer optimism, supported by festival demand. High-frequency indicators registered robust growth in October/November over the corresponding months of 2019. Automobile sales, steel consumption and air passenger traffic still remained below 2019 levels even though they gained momentum in October as supply side shortages eased. Investment activity is exhibiting modest signs of improvement – production of capital goods remained above pre-pandemic levels for the third month in a row during September, while import of capital goods in October rose at double-digit pace over its level two years ago. Prints of manufacturing and services PMIs for November 2021 suggested continued improvement in economic activity. Exports grew in November for the ninth month in a row, along with a surge in non-oil non-gold imports on the back of reviving domestic demand.
- Headline CPI inflation, which has been on a downward trajectory since June 2021, edged up to 4.5 per cent in October from 4.3 per cent in September on account of a spike in vegetable prices – due to crop damage from heavy rainfalls in October in several states, and fuel inflation – driven up by international prices of liquefied petroleum gas and kerosene. In fact, fuel inflation at 14.3 per cent in October surged to an all-time high. Core inflation or CPI inflation excluding food and fuel remained elevated at 5.9 per cent during September-October with continuing upside pressures stemming from clothing and footwear, health, and transportation and communication sub-groups.
- Liquidity conditions remained in large surplus, with daily absorptions through the fixed rate reverse repo and the variable rate reverse repo (VRRR) operations under the liquidity adjustment facility (LAF) averaging ₹8.6 lakh crore in October-November. Reserve money (adjusted for the first-round impact of the change in the cash reserve ratio) expanded by 7.9 per cent (y-o-y) on December 3, 2021. Money supply (M3) and bank credit by commercial banks grew y-o-y by 9.5 per cent and 7.0 per cent respectively, as on November 19, 2021. India's foreign exchange reserves increased by US$ 58.9 billion in 2021-22 (up to December 3, 2021) to US$ 635.9 billion.

CPI/GROWTH OUTLOOK: Taking into consideration all these factors, CPI inflation is projected at 5.3 per cent for 2021-22; 5.1 per cent in Q3; 5.7 per cent in Q4:2021-22, with risks broadly balanced. CPI inflation for Q1:2022-23 is projected at 5.0 per cent and for Q2 at 5.0 per cent and the projection for real GDP growth is retained at 9.5 per cent in 2021-22 consisting of 6.6 per cent in Q3; and 6.0 per cent in Q4:2021-22. Real GDP growth is projected at 17.2 per cent for Q1:2022-23 and at 7.8 per cent for Q2

KEY STATEMENTS ON DEVELOPMENTAL AND REGULATORY POLICIES:

1. Excess liquidity to be removed on a temporary basis through higher quantum 14-day VRRRs auctions by end of December 2021 on a fortnightly basis.
2. Banks permitted to prepay the outstanding amount of funds availed under the Targeted Long-Term Repo Operations (TLTRO 1.0 and 2.0).
3. Discussion Paper on Review of Prudential Norms for Investment Portfolio of Banks will be placed shortly.
4. Infusion of Capital in Overseas Branches and Subsidiaries of Banks and Retention/Repatriation/ Transfer of Profits by these entities-it has been decided that banks need not seek prior approval of the RBI if they meet the regulatory capital requirements.
5. Discussion Paper on Charges in Payment Systems-There have, however, been some concerns on the reasonableness of various charges incurred by customers for digital payments such as Unified Payments Interface (UPI) and the like. It is proposed to release a discussion paper on various charges in the payment system to mitigating the concerns so as to make digital transactions more affordable.
6. UPI: Simplification, Deepening and Enhancement of Limits-it is proposed to (i) launch UPI-based payment products for feature phone users, leveraging on innovative products from the RBI's Regulatory Sandbox on Retail Payments; (ii) make the process flow for small value transactions simpler through a mechanism of 'on-device' wallet in UPI applications; and (iii) enhance the transaction limit for payments through UPI for the Retail Direct Scheme for investment in G-secs and Initial Public Offering (IPO) applications from ₹2 lakh to ₹5 lakh.
7. At present, interest rates on ECB and trade credits are benchmarked to LIBOR or any other interbank rate applicable to the currency of borrowing. As we transition away from LIBOR, guidelines enabling use of any widely accepted interbank rate or alternative reference rate (ARR) for such transactions are being issued separately.





Outlook: In-House

Overall the MPC meeting indicated dovishness. With respect to uncertainties revolving around new covid variants and the economic recovery, we expect the RBI to remain cautious until the end of FY22.

We expect RBI to normalise its policy in a gradual manner with a reverse repo rate hike in the February 2022 policy given that economic developments take the desired future course. A repo rate hike is not expected until mid FY22-23. However, this cannot be ruled out in the February MPC policy if concerns over Omicron fade away and if the economy shows better than expected numbers.

In our view, continuing with higher quantum of VRRR is part of normalising liquidity which will cause short term rates to increase closer to the reverse repo rate.

Sources: Reserve Bank of India, Reuters.

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