LKP Securities Ltd. 11th October, 2021

RBI MONETARY POLICY - OCTOBER 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, and consequently, inflationary pressures have accentuated in most advanced economies (AEs) and emerging market economies (EMEs), prompting monetary tightening by a few central banks in the former group and several in the latter. Change in monetary policy stances, in conjunction with a likely tapering of bond purchases in major advanced economies later this year, is beginning to strain the international financial markets with a sharp rise in bond yields in major AEs and EMEs after remaining range-bound in August.

- On the domestic front, real gross domestic product (GDP) expanded by 20.1 per cent year-on-year (y-o-y) during Q1:2021-22 on a large favourable base; however, its momentum was dragged down by the second wave of the pandemic. The level of real GDP in Q1:2021-22 was 9.2 per cent below its pre-pandemic level two years ago. On the demand side, almost all the constituents of GDP posted robust y-o-y growth. On the supply side, real gross value added (GVA) increased by 18.8 per cent y-o-y during Q1:2021-22.

- After a prolonged slowdown, industrial production posted a high y-o-y growth for the fifth consecutive month in July. The manufacturing PMI at 53.7 in September remained in positive territory. Services activity gained ground with support from the pent-up demand for contact-intensive activities. The services PMI continued in expansion zone in September at 55.2, although some sub-components moderated. High-frequency indicators for August-September – railway freight traffic; cement production; electricity demand; port cargo; e-way bills; GST and toll collections – suggest progress in the normalisation of economic activity relative to pre-pandemic levels; however, indicators such as domestic air traffic, two-wheeler sales and steel consumption continue to lag. Non-oil export growth remained strong on buoyant external demand.

- Headline CPI inflation at 5.3 per cent in August softened for the second consecutive month, declining by one percentage point from the recent peak in May-June 2021. This was primarily driven by an easing in food inflation. Fuel inflation edged up to a new high in August. Core inflation, i.e. inflation excluding food and fuel, remained elevated and sticky at 5.8 per cent in July-August 2021.

- System liquidity remained in large surplus in August-September, with daily absorptions rising from an average of ₹7.7 lakh crore in July-August to ₹9.0 lakh crore during September and ₹9.5 lakh crore during October (up to October 6) through the fixed rate reverse repo, the 14-day variable rate reverse repo (VRRR) and fine-tuning operations under the liquidity adjustment facility (LAF). Auctions of ₹1.2 lakh crore under the secondary market government securities acquisition programme (G-SAP 2.0) during Q2:2021-22 provided liquidity across the term structure.

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 Q2, 4.5 per cent in Q3; 5.8 per cent in Q4 of 2021-22, with risks broadly balanced. CPI inflation for Q1:2022-23 is projected at 5.2 per cent and projection for real GDP growth is retained at 9.5 per cent in 2021-22 consisting of 7.9 per cent in Q2; 6.8 per cent in Q3; and 6.1 per cent in Q4 of 2021-22. Real GDP growth for Q1:2022-23 is projected at 17.2 per cent.

KEY STATEMENTS ON DEVELOPMENTAL AND REGULATORY POLICIES:

1. On Tap Special Long-Term Repo Operations (SLTRO) for Small Finance Banks (SFBs) has been decided to be extended to 31th Dec'21.
2. Review of Ways and Means Advances (WMA) Limits and Relaxation in Overdraft (OD) Facility for the State Governments/UTs - it has been decided to continue with the enhanced WMA limits up to FY22. There is also enhancement of maximum number of days of OD in a quarter from 36 to 50 days and the number of consecutive days of OD from 14 to 21 days up to FY22.
3. Priority Sector Lending - Permitting Banks to On-lend through NBFCs - Continuation of facility till FY22.
4. Internal Ombudsman for NBFCs With a view to further strengthen the internal grievance redress mechanism of NBFCs, it has been decided to introduce the Internal Ombudsman Scheme (IOS) for certain categories of NBFCs which have higher customer interface.

Outlook: In-House

As expected, RBI maintained status quo. The Governor's speech indicated that India is in a better position with CPI well within the tolerance band, growth is on the right trajectory with covid resurgence being the downside risk the outlook. As per the speech, VRRR auctions appear to be the main instrument towards liquidity normalisation and will continue to be in the next 2 months. The pace of VRRRs have increased, but RBI clarified that VRRRs are a tool to rebalance liquidity as part of policy and not a tool to reverse previous announcements. Liquidity currently stands at approximately 9 lakh crore. No sign about GSAP brought about unrest in bond markets but RBI still has Operation Twists and various other tools. Going forward, bond yields are expected to be higher given the rising crude prices and other global risks. We do not see a policy repo rate hike for the whole of calendar year 2022. Reverse Repo rate hike can be expected prior to March 2022.

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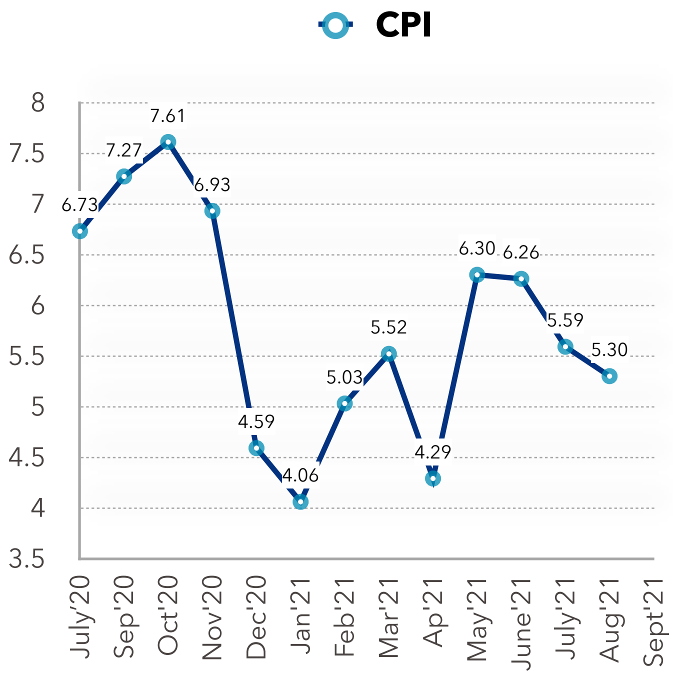

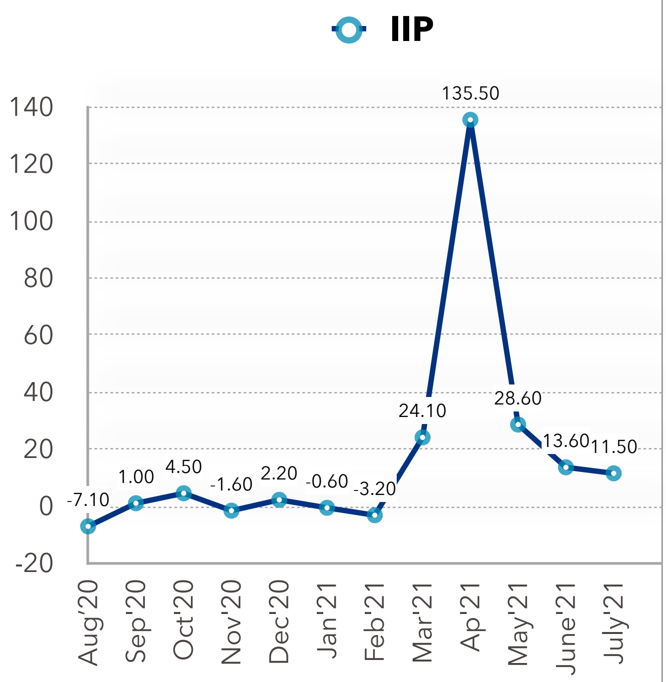

Sources: Reserve Bank of India, Reuters.

LKP SECURITIES LTD., 203, Embassy Centre, Nariman Point, Mumbai- 400021

For any queries contact – LKP Securities Ltd. Ph: (91–22) 66306555 Fax: (91–22) 2284 2415

E Mail: FixedIncomeResearch@lkpsec.com

Visit our website – http://www.lkpsec.com/