

AUGUST MPC MIUTES

20 August 2021

Growth remains a priority

August minutes show MPC members are worried about growth and remain steadfast on supporting the nascent recovery underway. Apart from Prof Varma, members are agreeing to a glide path in which CPI inflation will be lower than the upper tolerance band of 6% in FY22 from 6.2% last year. This will provide much needed stimulus since India's economy will just about reach pre-pandemic level by Mar'22. We expect RBI to raise reverse repo rate in Q4FY22. US Fed policy direction remains a risk to our view.

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Recovery to be slow: While RBI revised Q1FY22 growth to 21.4% in Aug'21 from 18.5% earlier, MPC members agreed that recovery is at a very nascent stage. Dr. Sagggar highlighted that risks to growth remain from virus mutation, delayed monsoon and sowing deficiency. He also pointed out that "over two-thirds of high frequency indicators remain below pre-pandemic levels" and "capacity utilization rates are still abysmally low". Dr. Patra noted that "even as near term prospects have brightened, aggregate demand conditions are taking more time to heal".

Recent inflation data offers relief: While the Jun'21 CPI inflation print and now Jul'21 gave much needed relief, MPC members spoke about bringing inflation below upper tolerance band from last year's level of 6.2%. Dr. Sagggar said "even though nature of inflation is cost push, persistence of inflation is worrisome..." Prof Varma pointed that "Inflationary expectations may be becoming more widely entrenched". However, RBI Governor, Shri Shaktikanta Das pointed out that resurgence in inflation is transitory and likely to be one-off. Weak demand conditions will limit pass-through. RBI's inflation projection is 5.7% in FY22 and 5.1% in Q1FY23.

When should RBI move?: Prof Varma called for increasing the reverse repo rate since inflation as per current assessment even in Q1FY23 is projected at more than 5%. This will give RBI room to maintain repo rate at 4% for longer. Dr. Sagggar was of the view "It is not unusual for central banks to set policies based more on current conditions than forecasts in times of crisis or extreme uncertainties." He emphasised on awaiting clarity from incoming data. Dr. Patra reiterated that highest priority is to revive growth. He added, "The price to be paid for this policy choice is inflation in upper reaches of but within the tolerance band..." RBI Governor, Shri Shaktikanta Das emphasised "the need of the hour is twofold: first, continue the monetary policy support to the economy; and second, remain watchful of any durable inflationary pressures and sustained price momentum in key components so as to bring back the CPI inflation to 4%...". This suggests a glide path of gradually bringing inflation towards target band. We expect RBI to raise reverse repo rate in Q4FY22 and incrementally reduce the surplus liquidity in the coming months. Any change in US monetary policy may require a reassessment of our view.

Key highlights

- MPC members agree growth at a nascent stage and requires monetary policy support.
- Inflation a supply-side issue as demand conditions remain weak.
- Reverse repo rate to be increased in Q4FY22 and repo rate hike expected in early FY23.



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