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RBI behind the global policy curve

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RBI maintained status quo on rates. Both growth and inflation forecast was retained at 9.5% and 5.3% respectively, for FY22. 14-day VRRR was established as the main liquidity tool. RBI's approach has been 'patient' due to uncertainties surrounding Omicron and both upside and downside risks to inflation outlook. Thus it remained on the path of normalisation w.r.t. liquidity, but chose to remain dovish on rates. We expect reverse repo hike to begin in Q4FY22 followed by policy rate hike from Q1FY23.

Key highlights

- RBI maintains status quo on rates.
- Growth and inflation projection retained at 9.5% and 5.3% respectively.
- 14-day VRRR established as the main liquidity tool.
- We expect reverse repo hike in Q4FY22 and repo rate hike in Q1FY23.

RBI on hold: MPC members voted unanimously to keep policy repo rate on hold at 4%. Accommodative stance was also retained with a 5:1 vote (Prof. Varma disagreed).

Growth forecast retained at 9.5%: MPC noted that economic activity is recovering supported by lower Covid-19 cases and improved vaccinations. GDP rose by 8.4% in Q2FY22, higher than RBI's estimate of 7.9% growth. While rural demand has remained resilient, urban demand too has picked up. Contact-intensive sectors which were the worst hit due to the pandemic are also seeing a revival. Government consumption and capex is also inching up. Overall, RBI retained its growth forecast for FY22 at 9.5%; Q3 at 6.6% (6.8% earlier) and Q4 at 6% (6.1% earlier). For FY23, growth is projected at 7.8% (Q1 at 17.2% and Q2 at 7.8%). New strains of Covid-19, elevated commodity prices and global supply chain bottlenecks remain key risks.

CPI forecast unchanged at 5.3%: RBI has retained its inflation forecast at 5.3% for FY22. However, forecast for Q3FY22 was revised upwards to 5.1% from 4.5% earlier. Thereafter, the forecast is revised downwards to 5.7% from 5.8% earlier for Q4 and to 5% in Q1FY23 from 5.2% earlier. Even in Q2FY23, CPI is estimated to be at 5%. Risks to inflation remain balanced with downside risk from correction in oil prices, arrival of winter crops and government's measures. However, pent up demand and global supply chain bottleneck could pose upside risk.

VRRR to be the main liquidity tool: RBI has announced that from Jan'22, liquidity absorption will be routed through VRRR. Further it has increased the 14-day VRRR amounts, to establish it as the main liquidity tool. On policy, RBI followed a patient approach contingent on uncertainty over Omicron variant and its impact on growth, as well as weak investment demand. Core inflation still remains a cause of worry due to pent-up demand. Thus, RBI has remained behind the global policy curve which is broadly hawkish, as it chooses to be 'patient'. We expect normalisation to begin with reverse repo hike in Q4FY22, once the impact of Omicron is clearly visible. Thereafter, in Q1FY23, we expect a policy rate hike.

Regulatory announcements

- Banks have been allowed to infuse capital in their overseas branches and subsidiaries; retain profits in these centres; and repatriate/transfer profits therefrom without prior approval of RBI, subject to post facto reporting.
- RBI has also decided to place a Discussion Paper on classification and valuation of investment portfolio by SCBs on its website in order to update and review the existing framework.
- RBI has allowed the usage of any widely accepted interbank rate or alternative reference rate (ARR) post discontinuation of LIBOR. To take into account differences in credit risk and term premia between the two, the all-in-cost ceiling has been revised up from 450 bps to 500 bps and from 250 bps to 300 bps for ECBs and TCs respectively, over the ARRs. For existing ECBs and TCs linked to LIBOR, the all-in-cost ceiling has also been revised from 450 bps to 550 bps and from 250 bps to 350 bps respectively, over ARRs.
- RBI has proposed to issue a discussion paper to cover issues pertaining to charges of digital payment instruments such as credit/debit cards, PPIs (cards and wallets), UPI, etc. It will also seek feedback on issues related to convenience fee, surcharging, etc., and the measures needed to make digital payments affordable for consumers as well as economically viable for providers.
- RBI is also looking at expanding scope of digital payments for “feature phone users” as well.
- It has also been proposed to simplify the process flow for small value transactions through an “On-device” wallet in UPI app.
- The transaction limit for payments through UPI for Retail Direct Scheme and IPO applications has been proposed to increase to Rs. 0.5mn from Rs. 0.2mn earlier.

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