RBI Monetary Policy Review

L&T Financial Services
Mutual Fund

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The Monetary Policy Committee (MPC) came out with their bi-monthly policy statement today. Some of the key announcements are as follows:

- The MPC members unanimously voted for keeping the policy rates unchanged
- The MPC also unanimously decided to continue with an accommodative stance as long as necessary to revive and sustain growth on a durable basis and continue to mitigate the impact of COVID-19 on the economy, while ensuring that inflation remained within the target going forward
- Growth projections have been revised downwards, with real GDP growth expected to be at 9.5% in FY2022 (vs earlier expectation of 10.5%)
- The projection for CPI inflation has been marginally revised upwards to 5.2% in Q1 FY2022, 5.4% in Q2 FY022, 4.7% in Q3 FY2022 and 5.3% in Q4 FY2022

Owing to the uncertainty around the evolving impact of the pandemic on growth, the MPC has continued to give state-based guidance on the accommodative stance (they had shifted from time-based guidance to state-based guidance in the last MPC meeting).

The Governor announced the last tranche of G-SAP 1.0 auction worth INR 40,000 Crs to be conducted on June 17, 2021. However, unlike previous G-SAP auctions, this leg would include INR 10,000 Crs of buying in SDLs. The Governor also announced the much-anticipated G-SAP 2.0. RBI would conduct INR 1.2 Lakh Crs worth of buying in securities under this program. Although this number is higher than G-SAP 1.0, markets now expect that G-SAP 2.0 would also include SDL purchase, hence G-Sec yields rose by a couple of bps post the announcement.

The Governor also mentioned that the RBI has been actively involved in the intervention in the foreign exchange market to stabilize financial markets and liquidity conditions thereby ensuring stability in the exchange rate even in times of heightened volatility globally.

Some of the other non-policy related announcements are as follows:

- On-tap liquidity window worth INR 15,000 Crs to contact intensive sectors
- Special liquidity facility of INR 16,000 Crs provided to SIDBI to be extended for on-lending and refinancing
- All issuers of CDs are allowed to buyback their CDs before maturity to provide greater flexibility

The Governor reiterated that RBI stands committed to act through various measures to ensure that growth trajectory is back on track and stability in financial markets is preserved.

Market impact

The clear growth focus of the MPC along with the state-based guidance has given enough assurance to the markets that the accommodative stance of the RBI MPC is likely to continue over the next 1-2 quarters atleast, and any normalization after that is also likely to be gradual. With hardly any meaningful surprises in the policy, bond market activity post-policy was subdued with relatively limited activity.

Short end rates remain well anchored, given abundant liquidity. Post policy, 2-3 year AAA corporate bonds saw some buying activity bringing down yields by a few basis points. On the G-Sec market, however, yields rose by a couple of basis points across the curve, possibly as the increased G-SAP 2.0 announcement was broadly expected and already discounted by the markets.

Overall, the RBI Governor has been very articulate in his communication that the RBI and MPC stand ready to support growth in the face of the second wave of the pandemic, and will ensure that the bond market functions in an orderly manner, with adequate provision of liquidity. This is especially crucial, in a global environment where inflation risks are on the rise, commodities are on a tear and sharp bond and currency market movements cannot be ruled out, especially in the US. In such a backdrop, the RBI will have to be very careful and vigilant about maintaining its policy credibility and investor confidence, while still supporting our growth recovery, using low-interest rates and abundant liquidity.

Source: RBI Press Release, internal