Fact Sheet: Monetary Policy December 2021

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FICCI

RBI leaves repo rate unchanged, maintains accommodative stance

- The Monetary Policy Committee (MPC) unanimously voted to leave the repo rate unchanged at 4.0 percent in the monetary policy resolution announced on December 8, 2021
- Consequently, the reverse repo rate under the LAF remained unchanged at 3.35 per cent, while the marginal standing facility (MSF) rate and the Bank Rate remained at 4.25 per cent
- The MPC also decided to continue with the accommodative stance of monetary policy by a majority of 5 to 1. MPC decided to maintain an accommodative stance for as long as necessary to sustain growth on a durable basis while ensuring that inflation remains within the RBI's indicative target

RBI Policy Action

Key rates	December 2020	February 2021	April 2021	June 2021	August 2021	October 2021	December 2021
Repo rate	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Reverse repo rate	3.35%	3.35%	3.35%	3.35%	3.35%	3.35%	3.35%
MSF	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%
CRR	3.00%	3.50% - Mar 27	3.50%	4.00%	4.00%	4.00%	4.00%
SLR	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%
Bank rate	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%

Snapshot of RBI's Projections (%YoY)

	Oct-21 MPC					Dec-21 MPC				
	FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23
CPI Inflation	5.3	5.1	4.5	5.8	5.2	5.3	5.1	5.7	5.0	5.0
Change in outlook	Lowered	Lowered	Lowered	Retained	Raised	Retained	Raised	Lowered	Lowered	-
GDP	9.5	7.9	6.8	6.1	17.2	9.5	6.6	6.0	17.2	7.8
Change in outlook	Retained	Raised	Raised	Retained	Retained	Retained	Lowered	Lowered	Retained	-

Reserve Bank of India's Growth Guidance

RBI retains GDP growth estimate for 2021-22 at 9.5%

GDP growth is projected at 6.6% in Q3 and 6.0% in Q4 of 2021-22; Q1 2022-23 forecast stood at 17.2%, Q2 2022-23 at 7.8%

The latest GDP growth data indicates the strong resilience of the Indian economy. While private consumption spending inched closer to the pre-pandemic level in Q2 2021-22, capital formation in the economy as well as exports and imports crossed the pre-covid levels in Q2 2021-22.

Incoming information on the consumption spending has been witnessing signs of improvement as pent-up demand got reinforced by festive demand. While rural demand is exhibiting resilience (on the back of robust performance of agriculture and allied sectors, increased farm employment and continuation of cash transfers under PM-KISAN scheme and extension of free food grains distribution under the PMGKAY till March 2022), urban demand (gauged by increased travel and tourism spending) has also noted strengthening. Moreover, other high frequency indicators such as freight movement, GST receipts, fuel consumption, toll collections also gathered pace in the first two months of Q3 2021-22.

Furthermore, downside risks to the outlook have risen as well. Emergence of Omicron variant and renewed surges of COVID-19 infections in many countries has raised the level of uncertainty once again. In addition, headwinds posed by elevated international energy and commodity prices, potential volatility in global financial markets due to a faster normalization of monetary policy in advanced economies, and prolonged global supply bottlenecks can dampen the growth outlook.

Source: RBI's Monetary Policy Statement, December 8, 2021

Reserve Bank of India's Inflation Guidance

The MPC's outlook on inflation trajectory is within the targeted band of 4% (+/- 2%); inflation is projected at 5.1% in Q3 2021-22 which is much higher than the previous forecast of 4.5% for the same quarter. Inflation is likely to increase to 5.7% in Q4 2021-22 before easing to 5.0% in Q1 and Q2 of 2022-23.

Spike in food prices, mainly vegetables prices on the back of unseasonal rains in some parts of the country, majorly drove inflation. Moreover, rising international energy prices have kept domestic LPG and kerosene prices elevated for nearly three quarters, edging up fuel inflation to 14.3 percent in October. In addition, persistently high core inflation is emerging as an area of concern as increased input cost pressures get rapidly transmitted to retail inflation as consumer demand strengthens.

Going forward, while the inflation trajectory is expected to be in line with earlier estimates by the RBI, price pressures in the short term will remain. Supply side intervention by the government to address shortage in edible oils, winter arrivals pf vegetables, and reduction of excise duty and VAT on petrol and diesel are likely to cool inflationary pressures.

Reserve Bank of India's Liquidity Guidance

The Reserve Bank has maintained ample surplus liquidity in the banking system to nurture the nascent growth impulses and support a durable economic recovery and will continue to do so in the future as well. The Reserve Bank also retained the flexibility to conduct fine-tuning operations of varying amounts/maturities as and when required.

- 14-day variable rate reverse repo (VRRR) auctions - The MPC has decided to enhance 14-day VRRR auction amounts on a fortnightly basis in the following manner: Rs. 6.5 lakh crore on December 17; and further to Rs. 7.5 lakh crore on December 31. Consequently, from January 2022 onwards, liquidity absorption will be undertaken mainly through the auction route. The main operation of 14-day VRRRs will continue to be complemented by longer term VRRRs, the size and maturities of which will be decided basis assessment of the evolving liquidity conditions.
- In addition, as a step towards rebalancing the liquidity surplus, one more option has been provided to banks to prepay the outstanding amount of funds availed under the Targeted Long-Term Repo Operations (TLTRO 1.0 and 2.0) announced on 27th March and 17th April, 2020.
- The on-tap liquidity windows of Rs. 50,000 crore for ramping up COVID related healthcare infrastructure and services and Rs. 15,000 crore for certain contact-intensive sectors will continue till their terminal date i.e., March 31, 2022.
- Further, the RBI has proposed to return to the normal dispensation under the MSF. Consequently, banks will be able to dip up to 2 percent of net demand and time liabilities (NDTL) instead of 3 percent for overnight borrowing under the MSF from January 1, 2022.

Developmental & Regulatory Announcements

Regulation and Supervision

Infusion of Capital in Overseas Branches and Subsidiaries of Banks and Retention/Repatriation/Transfer of Profits by these entities

With a view to provide operational flexibility to banks, RBI has decided that banks meeting the regulatory capital requirements may, with the approval of their Boards, 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.

Discussion Paper on Review of Prudential Norms for Investment Portfolio of Banks

A need to review and update extant regulatory instructions on classification and valuation of investment portfolio by scheduled commercial banks has been felt given the significant developments in the global standards on classification, measurement and valuation of investments, the linkages with the capital adequacy framework as well as progress in the domestic financial markets,. Therefore, the RBI will place a discussion paper shortly covering all relevant aspects for comments.

Source: RBI's Monetary Policy Statement, December 8, 2021

Financial Markets

External Commercial Borrowing (ECB)/Trade Credit (TC) - Transition from LIBOR to Alternative Reference Rate (ARR)

In view of the imminent discontinuance of LIBOR, any widely accepted interbank rate or alternative reference rate (ARR) applicable to the currency of borrowing may be used as a benchmark. Therefore, all-in-cost ceiling has been revised from 450 bps to 500 bps and from 250 bps to 300 bps, respectively, over the ARRs. This will sort differences in credit risk and term premia between LIBOR and the ARRs, for new foreign currency ECBs and TCs.

Payment and Settlement Systems

Discussion Paper on Charges in Payment Systems

- A discussion paper which will cover all aspects related to charges involved in various channels of digital payments such as credit cards, debit cards, prepaid payment instruments (cards and wallets), UPI, etc. will be issued in about a month.
- The paper will also seek feedback on issues 3 related to convenience fee, surcharging, etc., and the measures required to make digital transactions affordable to users and economically remunerative to the providers.

UPI for Feature Phone Users

In the first cohort of RBI Regulatory Sandbox, some innovators had successfully demonstrated their solutions for feature phone payments, under the theme of 'Retail Payments'. These products, coupled with other complimentary solutions, will facilitate UPI-based digital payment solutions on feature phones to promote wider digitisation. The RBI has therefore proposed to launch a UPI-based payment product for feature phone users.

Simplification of Process Flow for Small Value Transactions over UPI and Increase in UPI Transaction Limit for Specified Categories

- A simpler process flow by enabling small value transactions through an "On-device" wallet in UPI app which will conserve banks' system resources, without any change in the transaction experience for the user will be offered.
- Moreover, to further encourage the use of UPI by retail investors, it is proposed to enhance the transaction limit for payments through UPI for Retail Direct Scheme and IPO applications from Rs. 2 lakh to Rs. 5 lakh.

FICCI's Comments

The status quo on the repo rate while continuing an accommodative stance was broadly expected especially in light of the latest global developments and the emergence of a new variant of concern. The latter poses a major downside risk going ahead and it remains extremely critical to maintain caution. In this context, RBI's policy statement is reassuring.

The Central Bank is maintaining a calibrated approach to liquidity management which is much appreciated. The Bank's emphasis on strengthening recovery, which is still nascent, is encouraging. Also, we agree with the Governor that we are still away from a self-sustaining growth and support through policy interventions will be necessary over the short to medium term.

On the regulatory side, the announcements regarding simplification and deepening of Unified Payments Interface will further enhance the outreach of digital payment system making it even more seamless.

As part of the transition from LIBOR, we also look forward to the guidelines on the use of interbank rate or alternative reference rate (ARR) as benchmarks for ECB/Trade Credit.