RBI Monetary policy Review

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Current Economic Scenario in India

The impact of second wave of Covid-19 was catastrophic in India. Consequently, many international rating agencies have revised the GDP growth estimates for India (Table 1).

Table 1. GDP growth estimates 2021-22 for India

RBI	IMF	World Bank	CRISIL	Credit Suisse	Nomura
10.5%	9.5%	8.3%	8.2%	8.5%-9%	10.4%

(Source: Latest available data on the respective websites as on July, 2021)

International Monetary Fund (IMF) predicts India's GDP growth to be 9.5% for the FY 2021-22. It is expected that this growth may further decline if the next wave of pandemic leads to a lockdown situation in the country. As per the NCAER recent report, on account of second wave the Business Confidence Index (BCI) declined by 27.5% in the 1st quarter of FY 2021. According to the recent IIP report (2021), there is overall decrease of 35% in service sector, 32.3% in capital good sector, 17% in intermediate goods sector and 33% in the consumer durable sector. Agriculture sector has performed well compared to other sectors(ibid).

However, in last few months Industrial growth was sluggish owing to the restrictive measures taken to control the second wave of COVID-19. As per the IIP report (2021), Industrial growth in the month of May 2021 (29.3%) decreased in comparison to the figures reported for the month of April 2021 (134.6%). All major sectors (except for mining) experienced a decrease in the month of May 2021 as compared to the previous month. A sharp decline is being recorded in case of capital goods (-20%) and consumer durables (27.7%). We foresee agriculture and manufacturing sector to provide momentum to the economic growth this year as the performance of service sector will be low. While the agriculture sector is largely dependent on the normal monsoon and kharif crop.

As per the recent released data on money supply by RBI on 29th July 2021, liquidity is in surplus in the market. The growth of Broad Money (M3) witnessed a Year on Year (YoY) growth of 10.8% in July 2021 in comparison to the growth in the previous year (July 2020). Among different categories of M3 the growth in demand deposits with banks stood at 23%, currency with public at 11% and time deposit with banks at 9%.

Analysis of Monetary Policy announced by RBI on June 4, 2021

The Monetary Policy Committee (MPC) in order to mitigate the impact of COVID-19 on the economy took the accommodative stance as long as required. At this point of time, managing inflation is a major challenge which is driven largely by supply led disruptions, therefore accommodative stance of RBI may boost economic growth.

Accommodative stance of RBI is very much needed considering the present scenario when economy is uneven. Second wave of COVID-19 has further aggravated the pace of economic recovery and growth. Under the current dispensation, the major challenge in front of the policymakers is to keep retail inflation within the range of 2-6%. As per NSO data for the month of June 2021, CPI (General) in rural areas- 6.16%, urban areas-6.37% & combined CPI-6.26%. CPI (General) values increased by 0.62% and 0.56% (from May 2021 to June 2021) in rural and urban areas respectively. There is overall increase in inflation value of items such as food & beverages (5.58%), Pan tobacco & intoxicants (3.98%), clothing & footwear (6.21%), housing (3.75%), fuel & light (12.68%) and miscellaneous (7.28%). Inflation numbers suggest that fuel prices are pushing up prices of other commodities. The food inflation is linked with the temporal and spatial progress of the south-west monsoon in 2021.

The increasing CPI value is an alarming sign. As per the Bloomberg report India's wholesale and retail inflation is likely to be on higher side in the next half of the year

2021. We expect that in upcoming months retail inflation to be under pressure considering the higher global commodity prices, supply-side limitations and increasing demand. As per the RBI recent article inflation is likely to persist in for some months and expected to ease at the time when kharif harvest will reach in the market in the third quarter of the year 2021-22.

It is difficult task for the government to manage the inflationary pressures and rising borrowing cost simultaneously. Additionally, weak demand condition due decline in labour force participation rate and employment condition post 2nd wave along with the likelihood of third COVID-19 wave in future could constraint the path of economic recovery. Thus, we suggest RBI to consider the accommodative stance. If RBI takes an accommodative stance, it is expected to create a positive impact on inflation-targeting by RBI given the transitional phase the economy is going through.

In next section we provide detail key points for consideration by RBI.

Recommendations

RBI can retain its monetary accommodation for a while to enable the recovery to become ingrained. Post second wave of COVID-19, India is gradually getting back to normal with opening of business and various economic activities. The Government of India drive for vaccination is expected to further improvise the situation. In country like India with great diversity in economic levels sustaining a uniform policy environment is a great challenge especially in the current pandemic.

Taking cognizance of the current economic scenario, we suggest:

- Monetary policy committee to opt for a pause while striving to normalize the liquidity conditions (Table 2). MPC may consider policy rate revisions in the second quarter of FY2022 to preserve the financial stability.

Table 2. RBI Policy rates in India (May 2020- June 2021)

	May'20	**Aug'20**	**Oct'20**	**Dec'20**	**April'21**	**June'21**	**August'21 (Estimate)**
Repo Rate	4.00	4.00	4.00	4.00	4.00	4.00	**4.00**
Reverse Repo Rate	3.75	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**
Bank Rate	4.25	4.25	4.25	4.25	4.25	4.25	**4.25**
CRR	3.00	3.00	3.00	3.00	4.00	4.00	**4.00**
SLR	18.00	18.00	18.00	18.00	18.00	18.00	**18.00**

(Source: RBI website, note: Authors estimates for August 2021)

- MPC may consider various methods to normalize the liquidity conditions like by allowing the currency appreciation, market stabilization schemes, prolonged status quo, etc.
- MPC should keep in focus the economic growth perspective as well. Economic growth can be supported by supply-side push from reforms and easing of regulations, push for infrastructural investments, boost to manufacturing sector through the Production-Linked Incentive (PLI) schemes, recovery of pent-up demand, increase in discretionary consumption subsequent to rollout of vaccines and pick up in credit given adequate liquidity and low interest rates.
- There is need to enhance the private consumption through policy interventions.

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Other Sources:

- Newspaper, research article/reports
- Websites: World Bank, IMF, NSSO, CRISIL, CMIE, CARE rating,etc.