Mr. Vipin Malik
Chairman & Mentor, Infomerics Ratings.

Mr. Sankhanath Bandyopadhyay
Economist, Infomerics Ratings.

RBI Monetary Policy

8th June 2022

Monetary Policy Announcement on 8 June 2022:

The Monetary Policy Committee (MPC) at its meeting (8 June 2022) decided to:

- Increase the policy repo rate by 50 basis points to 4.90 per cent from 4.40 per cent.
- The standing deposit facility (SDF) rate stands adjusted to 4.65 per cent and the marginal standing facility (MSF) rate and the Bank Rate to 5.15 per cent.[SDF=Repo-25 bps; MSF=Repo+25 bps]

The MPC decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

Reasons for Monetary Policy Stance:

- The projections indicate that inflation is likely to remain above the upper tolerance level of 6 per cent through the first three quarters of 2022-23.
- Considerable uncertainty surrounds the inflation trajectory due to global growth risks and geopolitical tensions.
- The supply side measures taken by the government would help to alleviate some cost-push pressures.
- At the same time, however, the MPC notes that continuing shocks to food inflation could sustain pressures on headline inflation. Persisting inflationary pressures could set in motion second round effects on headline CPI.
- Hence, there is a need for calibrated monetary policy action to keep inflation expectations anchored and restrain the broadening of price pressures. Accordingly, the MPC decided to increase the policy repo rate by 50 basis points to 4.90 per cent.

The MPC also decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

Global Economy:
Since the MPC's meeting in May 2022, the global economy continues to grapple with the following:

- Multi-decadal high inflation and slowing growth,
- Persisting geopolitical tensions and sanctions,
- Elevated prices of crude oil and other commodities
- Lingering COVID-19 related supply chain bottlenecks.

Global financial markets have been roiled by turbulence amidst growing stagflation concerns, leading to a tightening of global financial conditions and risks to the growth outlook and financial stability.

Developments in India

Growth Outlook

- According to the provisional estimates released by the National Statistical Office (NSO) on May 31, 2022, India's real gross domestic product (GDP) growth in 2021-22 was 8.7 per cent.
- This works out to 1.5 per cent above the pre-pandemic level (2019-20). In Q4:2021-22, real GDP growth decelerated to 4.1 per cent from 5.4 per cent in Q3, dragged down mainly by weakness in private consumption on the back of the Omicron wave.
- The recovery in domestic economic activity is gathering strength. Rural consumption should benefit from the likely normal south-west monsoon and the expected improvement in agricultural prospects.
- A rebound in contact-intensive services is likely to bolster urban consumption, going forward. Investment activity is expected to be supported by improving capacity utilisation, the government's capex push, and strengthening bank credit. Growth of merchandise and services exports is set to sustain the recent buoyancy.
- Spillovers from prolonged geopolitical tensions, elevated commodity prices, continued supply bottlenecks and tightening global financial conditions nevertheless weigh on the outlook.
- Given this backdrop, <u>the real GDP growth projection for 2022-23 is retained at **7.2 per cent**, with Q1 at 16.2 per cent; Q2 at 6.2 per cent; Q3 at 4.1 per cent; and Q4 at 4.0 per cent, with risks broadly balanced.</u>

Real GDP growth projections for 2022-23 (in Per cent)

[2022-23]	**GDP projection in 8 June 2022 Monetary Policy**	**GDP projections in April 2022 Monetary policy**	**GDP projections in 10 Feb 2022 Monetary Policy**	**[2021-22]**	**GDP projection in Dec'2021 M.P.**	**GDP projections in 8 October 2021 Monetary Policy**
Q1:2022-23	16.2%	16.2%	17.2%	Q1:2021-22	20.1%	20.1%
Q2:2022-23	6.2%	6.2%	7.0%	Q2:2021-22	7.9%	7.9%
Q3:2022-23	4.1%	4.1%	4.3%	Q3:2021-22	6.8%	6.8%
Q4:2022-23	4.0%	4.0%	4.5%	Q4:2021-22	6.1%	6.1%
2022-23 (overall)	**7.2%**	**7.2%**	**7.8%**	**2021-22 (overall)**	**9.5%**	**9.5%**
				Q1:2022-23		

Inflation Outlook

- CPI headline inflation rose further from 7.0 per cent in March 2022 to 7.8 per cent in April 2022, reflecting broad-based increase in all its major constituents.
- Food inflation pressures accentuated led by cereals, milk, fruits, vegetables, spices and prepared meals. Fuel inflation was driven up by a rise in LPG and kerosene prices.
- Core inflation (i.e., CPI excluding food and fuel) hardened across almost all components, dominated by the transport and communication sub-group.
- Sharp increase in domestic pump prices could trigger broad-based second round price pressures.
- A combination of high international commodity prices and elevated logistic disruptions could aggravate input costs across agriculture, manufacturing and services sectors. Their pass-through to retail prices, therefore, warrants continuous monitoring and pro-active supply management.
- International crude oil prices remain elevated, with risks of further pass-through to domestic pump prices. There are also upside risks from revisions in the prices of electricity. Early results from manufacturing, services and infrastructure sector firms polled in the Reserve Bank's surveys expect further input and output price pressures going forward.
- Taking into account these factors, and on the assumption of a normal monsoon in 2022 and average crude oil price (Indian basket) of US$ 105 per barrel, inflation is now projected at **6.7 per cent** in 2022-23, with Q1 at 7.5 per cent; Q2 at 7.4 per cent; Q3 at 6.2 per cent; and Q4 at 5.8 per cent, with risks evenly balanced.

CPI Projections for 2022-23(%)

2022-23	**CPI projection in 8 June 2022 Monetary Policy**	**CPI projections in 8 April 2022 Monetary Policy (%)**	**CPI projections on 10 Feb 2022**	**2021-22**	**CPI projection in 8 Dec'2021 M.P.**	**CPI projections in 8 October 2021 Monetary Policy (%)**
Q1	7.5%	6.3%	4.9%	Q1:2021-22	6.3%	5.3%
Q2	7.4%	5.8%	5.0%	Q2: 2021-22	5.3%	5.1%
Q3	6.2%	5.4%	4.0%	Q3:2021-22	5.1%	4.5%
Q4	5.8%	5.1%	4.2%	Q4:2021-22	5.7%	5.8%
2022-23 (full year)	**6.7%**	**5.7%***	**4.5%**	**2021-22 (full year)**	**5.3%**	**5.3%**
***Assumptions (based on)**	*Avg. Crude Oil Price(Indian basket):$105/barrel. Normal mansoon.	*Avg. Crude oil price(Indian basket):$100/ barrel. Normal Mansoon 2022.		**Q1:2022-23**		**5.2%**

Source: RBI Press Release on Monetary Policy upto 8 June 2022.

Liquidity Conditions:

- Overall system liquidity remains in large surplus, with the average daily absorption under the LAF moderating to ₹5.5 lakh crore during May 4 - May 31 from ₹7.4 lakh crore during April 8 - May 3, 2022 in consonance with the policy of gradual withdrawal of accommodation.
- Money supply (M3) and bank credit from commercial banks rose (y-o-y) by 8.8 per cent and 12.1 per cent, respectively, as on May 20, 2022. India's foreign exchange reserves were placed at US$ 601.4 billion as on May 27, 2022.

External Sector

- India's exports have performed remarkably well despite weakening recovery across major trading partners.
- The impact of rising crude oil prices on petroleum, oil and lubricants (POL) import bill has been partly offset by export of petroleum products, which also benefitted from better price realisations in recent months.
- Optimism on exports of both goods and services and remittances should help contain the current account deficit (CAD) at a sustainable level, which can be financed by normal capital flows.
- As on June 3, 2022, India's foreign exchange reserves were of the order of US$ 601.1 billion, which are further supplemented by a healthy level of net forward assets of the RBI.

Regulatory and Developmental Measures:

1. Enhancement of Limits in Individual Housing Loans by Cooperative Banks:

Considering the importance of cooperative banks in promoting inclusive growth, three measures are being announced for the cooperative banking sector:

i. The limits for individual housing loans being extended by Urban Cooperative Banks (UCBs) and Rural Cooperative Banks (RCBs- State Cooperative Banks and District Central Cooperative Banks) which were last fixed in 2011 and 2009 respectively are being revised upwards by over 100 per cent taking into account increase in house prices. This will facilitate better flow of credit to the housing sector.

ii. In line with the dispensation available to Scheduled Commercial Banks (SCBs) and UCBs, it is now proposed to permit Rural Cooperative Banks (RCBs- State Cooperative Banks and District Central Cooperative Banks) to extend finance to 'commercial real estate – residential housing' (i.e. loans for residential housing projects), within the existing aggregate housing finance limit of 5% of their total assets. This measure will further augment credit flows from the cooperative banks to the housing sector.

iii. It has also been decided to permit UCBs to extend doorstep banking services to their customers. This will enable UCBs to meet the needs of their customers, especially senior citizens and differently abled.

2. Margin Requirements for Non-centrally Cleared Derivatives (NCCDs):

- Well-established variation and initial margining requirements for over the counter (OTC) NCCD transactions contribute to financial stability and are a key component of the post-crisis G20 recommendations for these markets.
- With the objective of strengthening the resilience of OTC derivative market, the Reserve Bank had earlier issued a discussion paper to implement global practices related to margin requirements for OTC derivatives. The promulgation of the Act for Bilateral Netting of Qualified Financial Contracts, 2020, ensuring legal recognition for bilateral netting of an OTC derivative transaction, has put in place a significant enabler for efficient margining. Against this backdrop, Directions on exchange of Variation Margin (VM) for NCCDs were issued on June 1, 2022.[1]

3. e-Mandates on Cards for Recurring Payments – Enhancement of Limit:

- The framework on processing of e-mandate based recurring payments, inter-alia, provides for an Additional Factor of Authentication (AFA) during registration, sending a pre-debit notification, subsequent recurring transactions to be executed without AFA, and an easier avenue to withdraw such mandates.
- Benefits of convenience, safety and security are available to the users. The system also benefits from users' confidence. Major banks are providing the facility and the transaction volumes are seeing good traction.
- Till date, over 6.25 crore mandates have been registered under this framework, including for over 3,400 international merchants.
- Requests have been received from stakeholders to increase the limit under the framework to facilitate payments of larger value like subscriptions, insurance premia, education fee, etc.
- To further augment customer convenience and leverage the benefits available under the framework, it is proposed to enhance the limit from ₹5,000 to ₹15,000 per recurring payment.

4. Enhancements to Unified Payments Interface (UPI) – Linking of RuPay Credit Cards:

- UPI has become the most inclusive mode of payment in India. Currently, over 26 crore unique users and 5 crore merchants are onboarded on the UPI platform.
- In May 2022 alone, 594.63 crore transactions amounting to ₹10.40 lakh crore were processed through UPI. UPI currently facilitates transactions by linking Savings / Current Accounts through Debit Cards of users.
- The interoperability of PPIs has also facilitated access of PPIs to the UPI payment system for undertaking transactions.
- In order to further deepen the reach and usage, it is proposed to allow linking of credit cards to UPI.

[1] Draft Directions on exchange of Initial Margin (IM) for NCCDs are being issued for public feedback separately.

- To start with Rupay credit cards will be enabled with this facility. This arrangement is expected to provide more avenues and convenience to the customers in making payments through UPI platform.
- This facility would be available after the required system development is complete.[2]

5. Review of Payments Infrastructure Development Fund Scheme:

- The Payments Infrastructure Development Fund (PIDF) Scheme was operationalised by the Reserve Bank in January 2021 to incentivise the deployment of payment acceptance infrastructure such as physical Point of Sale (PoS), mPoS (mobile PoS), Quick Response (QR) codes in Tier-3 to 6 centres and North Eastern States.
- The Scheme had targeted 90 lakh Points of Sale (PoS) terminals and Quick Response (QR) codes to be deployed over three years (till end-2023). Beneficiaries of PM SVANidhi Scheme in Tier-1 and 2 centres were included in August 2021. As at end-April 2022, over 1.18 crore new touch points have been deployed under the Scheme.
- It is now proposed to make modifications to the PIDF Scheme by, inter-alia, enhancing the subsidy amount, simplifying the subsidy claim process, etc. This is expected to further accelerate and augment the deployment of payment acceptance infrastructure in the targeted geographies.

Future Outlook:

It seems that the RBI may have to overcome the affection with the term "accommodative" and gradually have to tilt towards "neutral" despite their current attempt to avoid this, given the remote possibility of inflation to be softened going forward. Among other factors, crude oil prices remain highly volatile, which is likely to move further northwards. Supply chain disruptions are unlikely to reduce given the ongoing geopolitical tussle. The fiscal deficit estimate 6.7% is also seems conservative amid the assumption of Crude (Indian basket) remains at $105/barrel (which is also to some extent optimistic). The 10-year G-Sec yield is hovering in the range of 7.50%-7.75% till Sept'22; thereafter it might move towards 8% due to supply pressures and elevated inflation. The future path would be 25 bps to reach 5.15, 25 next to 5.40, and then 35 to reach 5.75 and 25 more to reach 6 per cent repo rate, but the hike might be higher if the Central Bank wish to reduce the frequency which is more likely, as global scenario is so adverse. Further, the current move is directed more by the "No-brainer" to catch up in the rat race with other Central Banks globally in the battle of the "inflation obsession."

[2] Necessary instructions will be issued to NPCI separately.