Press Release

MPC minutes: Emphasis on nurturing uneven growth

Some members highlight the need to rationalize fuel taxes to mitigate inflation risks

25 October 2021

In the last MPC meeting held between 6-8 Oct 2021, the Monetary Policy Committee (MPC) unanimously decided to keep repo rate unchanged at 4.00%. However, the decision to continue an accommodative stance saw a dissent with 5-1 voting outturn for the second consecutive meeting.

The minutes of the meeting indicate that members were broadly in agreement that domestic growth scenario has been improving and inching closer to the pre-Covid levels facilitated by ebbing of infections, robust pace of vaccinations, re-opening of economy and healthy export growth. However, they highlighted that the pattern of recovery is uneven with the MSME and the informal sector continuing to face challenges. According to Dr. Bhide, one of the MPC members, some sectors in the non-IT services are still in the early stages of recovery. Similarly, Dr. Saggar believes that the 'growth recovery remains nebulous and there is anecdotal evidence that the second wave deepened the stress on small businesses'. He also highlighted that 55% of the 404 industries (for which data is available) are still operating at below FY20 levels and 63.4% are operating at below FY19 levels. This uneven recovery across different parts of the economic spectrum warrants a continuation of the accommodative policy and will keep the RBI cautious of any premature policy tightening.

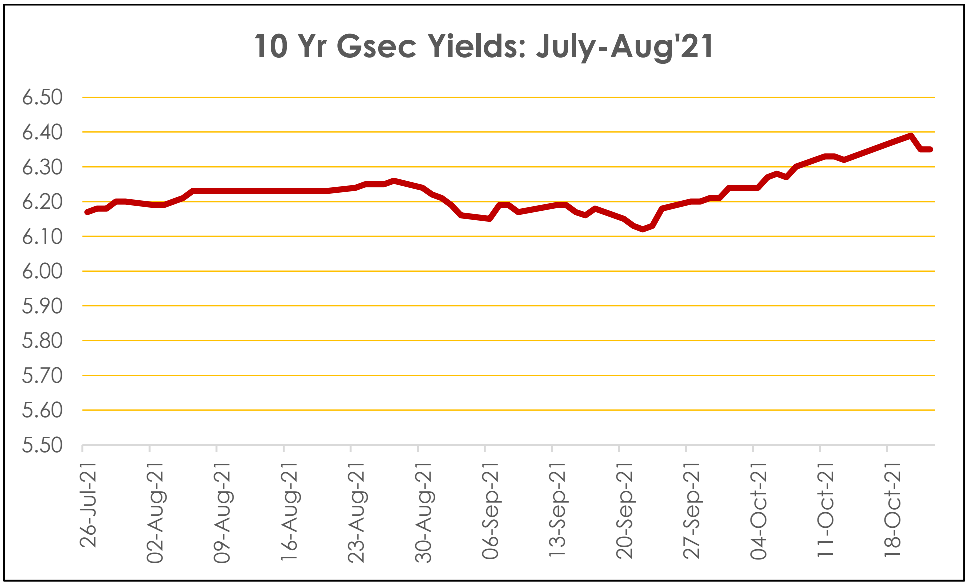
On the inflation front, most of the members have drawn comfort from declining food prices, advance estimates of a record kharif crop and some of the supply side measures taken by the government to control the prices of edible oils and pulses. However, there was a consensus on the stickiness of higher core inflation and the risks of its transmission to retail inflation if commodity prices remain persistently high. Almost all the members also highlighted that there can be a cascading impact of the rise in international commodity prices, shortage of raw materials (semi-conductors) and high transportation, logistics and freight costs, negatively impacting inflation as well as growth. Dr. Patra emphasized that global growth has been losing steam and the biggest risk to India's macroeconomic prospects are global factors which could materialise suddenly. As a solution, some of the members like Dr Bhide opined that reduction in indirect taxes would play an important role in insulating overall inflation from the shock of higher crude oil prices. Dr. Goyal was more assertive on the need for tax cuts on petroleum products 'to break the upward movement that could impart persistence to domestic inflation'.

Prof Jayanth Varma, the sole dissent for keeping the stance accommodative, maintained that fiscal policy is likely to be more effective than monetary policy in providing targeted relief to smaller business and weaker sections of the economy. He highlighted two other exogenous global risk factors – one, the ongoing transition to green energy worldwide that can create a series of energy price shocks and pose upside risks to the long term inflation trajectory and secondly, the risks to global growth from increased instability in China's financial sector. As in the last MPC meeting, he stressed the need for narrowing of the policy corridor by increasing the reverse repo rate as core inflationary pressures are not only increasing but are also showing greater persistence than anticipated earlier. As against the views of other MPC members, he believes that 'the pattern of policy making in slow motion that is guided by an excessive desire to avoid surprises is no longer appropriate'.

Nevertheless, the minutes reflect a broader consensus within the MPC that the nascent growth impulses need to be nurtured through the accommodative policy stance while remaining vigilant of any durable inflationary pressures. Given that the growth-inflation dynamics are fraught with increased uncertainties arising primarily out of the global factors, the actions of the central bank need to be gradual, calibrated, and well-timed to avoid any undue surprises.

Acuité believes that RBI has already taken its first step towards liquidity normalization by announcing an end to the GSAP operations along with an increase in quantum of variable reverse repo rate (VRRR) auctions. At the same time, there is a larger consensus in the MPC that in the current uncertain environment, monetary policy actions have to adhere to the principle of 'gradualism'. While there is a material likelihood of an increase in reverse repo rates in the Dec-21 meeting, the risks of a postponement of that decision onto next quarter is on the rise. The analogy given by the RBI Governor in his speech and in the minutes captures the thought process of the MPC fairly well "We are reaching the shore after sailing through a very turbulent journey, and we cannot afford to rock the boat at this crucial stage. We must ensure that we reach safely to begin the journey beyond the shore".

Chart 1: Gsec yields have climbed steadily due to inflationary and global tapering concerns



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Media Contacts:

Roshni Rohira Ph: + 91-9769383310 roshnirohira@eminenceonline.in	Neelam Naik Ph: + 91-9619699906 neelam@eminenceonline.in

Investor Outreach: **Analytical Contact:**

Rituparna Roy Deputy Vice President Ph: + 91-7506948108 rituparna.roy@acuite.in	Suman Chowdhury Chief Analytical Officer Ph: + 91-9930831560 suman.chowdhury@acuite.in