Press Release

Baby steps in the path of gradual normalization

MPC keeps status quo on rates but outlines plan to absorb excess liquidity

8 October 2021

In line with our expectations, the RBI maintained status quo on the policy rates in Oct-21, while reiterating its accommodative stance. With an aim to gradually moderate the current surplus liquidity of over Rs 9 Lakh Cr, RBI has embarked on the path of a gradual normalization by enhancing the size of fortnightly VRRR (Variable Rate Reverse Repo) from current Rs 4 Lakh Cr to Rs 6 Lakh Cr by end of Dec-21. Depending upon the evolving liquidity backdrop, RBI has also hinted at increasing the tenor of VRRR from current 14-days to 28-days, in order to further calibrate the liquidity levels. Given the liquidity overhang and lower borrowing requirement from the government, the MPC has additionally, abstained from announcing any further G-SAP (government security acquisition programme) at the current juncture. Essentially, the central bank has outlined a broad plan to reduce the surplus system liquidity from the current high levels to around Rs 2-3 Lakh Cr by the end of the current quarter.

While the RBI has maintained that the measures undertaken for rebalancing liquidity shouldn't be construed as a reversal of the accommodative policy stance, we believe that the measures are, in effect a precursor to a formal policy normalization process. However, such a process may take more time than expected given the approach of "gradualism" taken by RBI. Acuite therefore, believes that restoration of the LAF corridor width via increase in the reverse repo rate is likely to happen towards the end of FY22.

On growth front, the MPC continues to remain cautiously optimistic with positive advancement in most of high frequency indicators post the slump caused by the second Covid wave. While most of the indicators have almost touched their pre-second Covid levels, the recovery momentum is still uneven across various sectors leading the MPC to retain its growth forecast at 9.5% for FY22 with potential downside risks stemming from elevated global commodity prices and input costs, industrial raw material shortages, global market volatility and needless to say, any fresh risk of another wave of Covid infections.

Interestingly, the RBI significantly lowered its FY22 inflation forecast by 40 bps to 5.3% in FY22 amidst easing of inflation prints in the past two consecutive months. While softer food inflation expectations on the back of a healthy kharif crop may have prompted RBI to lower its inflation estimate to 5.3% for FY22, we would attach an upward bias to this forecast given elevated global prices across the categories of food, energy, metals, and freight along with shortages in industrial raw materials.

RBI has also extended the timeframes for a few support measures taken during the pandemic period to facilitate growth durability and credit growth. Recognizing the need for continued support to small business units and other unorganised sectors, special on tap three-year long-term repo operations (SLTRO) worth Rs 10,000 Cr for SFBs (small finance banks) has been extended till Dec-21. Additionally, amidst increased traction witnessed in delivery of credit by NBFC's to unserved segments of the economy, the classification of some bank loans to the sector under priority sector lending has been extended further for 6 months till Mar-22.

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