Monetary Policy Highlights: February 2021 -part 1

February 8, 2021

In news : Recently, RBI released the Monetary Policy review for February 2021

Key highlights

The Monetary Policy Committee (MPC) met on 3rd, 4th and 5th February, 2021 and deliberated on current and evolving macroeconomic and financial developments, both domestic and global. Following are the key highlights of the Monetary policy;

- **Repo rate:** The MPC voted unanimously to leave the policy repo rate unchanged at 4 percent.
- It also unanimously decided to continue with the accommodative stance of monetary policy as long as necessary – at least through the current financial year and into the next year – to revive growth on a durable basis and mitigate the impact of COVID-19, while ensuring that inflation remains within the target going forward.
- **MSF & Bank rates:** The Marginal Standing Facility (MSF) rate and the Bank rate remain unchanged at 4.25 per cent. The reverse repo rate stands unchanged at 3.35 per cent.
- **CPI:** The central bank has the mandate to keep retail or the consumer price index (CPI) based inflation at 4 percent, with a bias of plus/minus 2 percent on either side.

- **Inflation:** As per MPC, for the first time during the COVID-19 period, inflation has eased below the upper tolerance level of 6 per cent.

- **Factors of stable near-term outlook: Factors that could shape the food inflation trajectory in coming months**, including the likely bumper kharif harvest arrivals in markets, rising prospects of a good rabi crop, larger winter supplies of key vegetables and softer poultry demand on fears of avian flu are all indicative of a stable near-term outlook.

Assessment of Growth and Inflation

RBI says that the new year 2021 has begun on a strong positive note with vaccination drives in major economies as well as in India. India's response to COVID-19 reminds us of an excerpt from Mahatma Gandhi's proclamation that **"determined spirits fired by an unquenchable faith in their mission can alter the course of history.**" While the year 2020 tested our capabilities and endurance, 2021 is setting the stage for a new economic era in the course of our history.

Growth

- Signs of recovery have strengthened further since the last meeting of the MPC
- High frequency coincident and proximate indicators suggest that the list of normalising sectors is expanding.
- **Manufacturing sector:** The RBI's survey points towards improvement in capacity utilisation in the manufacturing sector to 63.3 per cent in Q2:2020-21 from 47.3 per cent in the preceding quarter.

Consumer confidence is reviving, and business expectations of manufacturing, services and infrastructure remain upbeat.

- **Trading activity:** The movement of goods and people and domestic trading activity are growing at a robust pace.
- **Normalisation of economic activity:** Electricity and energy demand reflect a broader normalisation of economic activity than in December, even as fears of a

second wave abate.

- **Real estate sector:** Data for sales and new launches of residential units in major metropolitan centres reflect a renewed confidence in the real estate sector.
- **Purchasing Managers' Indices (PMI):** Manufacturing, services and composite purchasing managers' indices (PMI) are in expansion zones – the manufacturing PMI rose to 57.7 in January 2021 from 56.4 in December 2020 and and the services PMI rose to 52.8 in January 2021 from 52.3 in December 2020.
- **Indian pharma industry:**The vaccination drive is expected to provide an impetus for the restoration of contact intensive sectors and a leading edge to the Indian pharma industry in the global market.
- **FDI & FPI:** Foreign Direct Investment and Foreign Portfolio Investment to India have surged in recent months, reposing faith in the impressive recovery in the Indian economy.
- **National highways:** Ahead of a broader infrastructure revival, the speed of daily national highways construction is rising and the pace of award of national highway projects in 2020-21 has doubled year-on-year.

Inflation

- **CPI Inflation:** After breaching the upper tolerance threshold continuously since June 2020, C**PI inflation moved below 6 per cent in December for the first time in the post-lockdown period, supported by favourable base effects and a sharp fall in key vegetable prices**, the latter accounting for around 90 per cent of the decline in headline inflation during November and December.
  - Both higher fresh arrivals and active supply side interventions contributed to this favourable development.
  - It is expected that vegetable prices will remain soft in the near-term, while pressures may

continue to persist in certain key food items.

- **Core Inflation:** The outlook for core inflation is influenced by the escalation in cost-push pressures seen in recent months.
- Petroleum product prices have reached historic highs as international crude prices surged in recent months and the high indirect taxes remain, both in the Centre and States.
- These, along with the sharp increase in industrial raw material prices have resulted in a broad-based increase in prices of services and manufacturing products in recent months.
- **Policy action:** concerted policy action by both Centre and States, is critical to ensure that the ongoing cost build-up does not escalate further.
- Taking into consideration all these factors, the projection for **CPI inflation has been revised to 5.2 per cent for Q4:2020-21, 5.2 per cent to 5.0 per cent in H1:2021-22 and 4.3 per cent for Q3:2021-22, with risks broadly balanced.**

Reviewing the inflation target

By March 2021, the Government would be reviewing the inflation target for the next five years. The experience with successfully maintaining price stability and the gains in credibility for monetary policy since the institution of the inflation targeting framework, barring the COVID-19 period, needs to be reinforced in the coming years even as we exit the pandemic and seek to exploit the opportunities of the post-COVID world. Price stability is the foundation on which the economy can strive to reach its potential in a virtuous cycle of higher financial savings and investment; reduced uncertainties for firms in investment and wage decisions; reduced term and risk premia in financial markets; and increased external competitiveness.