



Brickwork Ratings expects RBI's MPC to continue with status quo in its upcoming MPC meeting

The inflation levels above the RBI's mandated 4% median target, rising fuel prices, surplus liquidity, frontloading of government borrowings, rising yields, second wave of Covid-19 in the country's major states, disruptions in economic activities due to partial lockdowns and uneven economic performances are among the major issues before the MPC when it meets for its first FY21 meeting during 5-7 April.

Brickwork Ratings, Mumbai, 5 April 2021:

The recent surge in Coronavirus cases has again begun to cause disruptions in economic activities as the major States have started imposing partial lockdowns to contain the virus spread. This is hampering the recovery process, which witnessed some improvement in the recent period. After contracting in two successive quarters, the GDP grew at 0.4% in Q3 FY21, as per the MOSPI's latest estimates. The rollout of Covid-19 vaccines and vaccination drive brightened recovery hopes, with some lead indicators such as GST collections and the PMI indicating economic recovery. However, chequered growth in the industrial sector and continued constraints on the back of social distancing in trade and travel related sectors signify emerging challenges on the growth front. The IIP contracted by 1.6% and the manufacturing sector by 2% in January, and eight core industries declined by 4.6% in February 2021.

On the other hand, rising oil prices and excess liquidity have posed risks on inflation, intensifying upside pressures on prices. Retail inflation inched up to 5.03% in February after easing in December 2020 and January 2021. The major concern is the elevated level of core inflation (5.9% in February), which continues to remain sticky, at above 5% levels since June 2020. Since the last MPC meeting, core, food and fuel inflation increased despite easing supply constraints. A sudden and sharp rise in crude oil prices is also posing inflationary threats.

The government has also decided to continue with a 4% flexible inflation target with a 2% leeway on either side for the next five-year period beginning 1 April 2021. Under the prevailing circumstances, maintaining retail inflation at 4% with a margin of 2% on either side may pose challenges, with the aggregate fiscal deficit of about 10.8% of the GDP (central fiscal deficit at 6.8% and the states' deficit of another 4%) for 2021-22. Going forward, excess



liquidity in the system, combined with volatility in crude oil prices, can pose upward risk to inflation. Once the current output gap narrows, surplus liquidity conditions could put pressure on prices, and the RBI will have to be vigilant. The current level of CPI inflation is still higher than the MPC's median target of 4%, although demand conditions in the economy continue to remain weak, and may therefore, not pose immediate problems.

In this situation, the RBI will have to be cautious in its policy action. The RBI has already reduced the repo rate under the LAF by 115 points cumulatively in March and May 2020 and introduced various liquidity boosting measures as a Covid-19 stimulus. Although the RBI maintained status quo in its subsequent policy meetings, it has continued to infuse liquidity to keep the yields on government securities in check and to neutralise the surge in foreign exchange. In the last MPC, the RBI initiated measures towards the rationalisation of excess liquidity from the system by announcing a phased hike in the CRR for restoration to 4%. In the current scenario, the RBI may like to drain in excess liquidity, while higher borrowings and the frontloading of 60% borrowings in H1 FY21 may put pressure on yields, and hence, the RBI may go slow in reversing its liquidity measures announced as a Covid stimulus since March 2020.

The recent spike in Covid-19 cases has also renewed uncertainty regarding the near-term growth outlook as the recovery process will be adversely impacted due to the imposition of fresh restrictions on businesses and normal activities. Thus, the continuation of the accommodative policy stance is likely to continue to support growth. We expect the inflation rate to remain close to the upper bound target of 6% in the Q1FY22, and therefore, the MPC may continue to pause on the interest rates. We do not expect the dilution of the accommodative stance anytime soon, and the RBI will continue to support growth as long as inflation does not become a serious problem. Even when there is a threat, the RBI will try to use other means to control prices, but may not change the accommodative stance.

Given the rise in the spread of Coronavirus and the imposition of fresh restrictions to contain the virus spread in the major parts of the country, the RBI is likely to continue with its accommodative monetary policy stance in the upcoming MPC meeting to be announced on 7 April 2021. Considering the elevated inflation levels, BWR expects the RBI MPC to adopt a cautious approach and hold the repo rate at 4%.



Contacts:

Dr M Govinda Rao

Chief Economic Adviser

Anita Shetty

Research Officer

Investors & Media Contact

91 95133 99706

1-860-425-2742

investordesks@brickworkratings.com

media@brickworkratings.com



ABOUT BRICKWORK RATINGS

Brickwork Ratings is India's home-grown credit rating agency built with superior analytical prowess from industry's most experienced credit analysts, bankers and regulators.

Established in 2007, Brickwork Ratings aims to provide reliable credit ratings by creating new standards for assessing risk and by offering accurate and transparent ratings. Brickwork Ratings provides investors and lenders timely and in-depth research across the Structured Finance, Public Finance, Financial Guaranty, Financial Institutions, Project Finance and Corporate sectors.

Brickwork Ratings has employed over 350 credit analysts and credit market professionals across 8 offices in India. Our experienced analysts have published over 12,000 ratings across asset classes.

Brickwork Ratings is committed to provide the investment community with the products and services needed to make informed investment decisions. Brickwork Ratings is a registered credit rating agency by Securities and Exchange Board of India (SEBI) and a recognised external credit assessment agency (ECAI) by Reserve Bank of India (RBI) to carry out credit ratings in India.

Brickwork Ratings is promoted by Canara Bank, India's leading public sector bank. More on Canara Bank available at www.canarabank.co.in

DISCLAIMER

Copyright © 2021 by Brickwork Ratings India Pvt Ltd., 3rd Floor, Raj Alkaa Park, 29/3 & 32/2, Bannerghatta Main Rd, Kalena Agrahara, Bengaluru, Karnataka 560076. Telephone: +91 80 4040 9940. Fax: +91 80 4040 9941. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings, Brickwork Ratings relies on factual information it receives from issuers and underwriters and from other sources Brickwork Ratings believes to be credible. Brickwork Ratings conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Brickwork Ratings' factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Brickwork Ratings' ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Brickwork Ratings relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Brickwork Ratings and to the market in offering documents and other reports. In issuing its ratings Brickwork Ratings must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

THE INFORMATION IN THIS REPORT IS PROVIDED "AS IS" WITHOUT ANY REPRESENTATION OR WARRANTY OF ANY KIND. A Brickwork Ratings rating is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that Brickwork Ratings is continuously evaluating and updating. Therefore, ratings are the collective work product of Brickwork Ratings and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Brickwork Ratings is not engaged in the offer or sale of any security. All Brickwork Ratings reports have shared authorship. Individuals identified in a Brickwork Ratings report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Brickwork Ratings rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time, for any reason in the sole discretion of Brickwork Ratings. Brickwork Ratings does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Neither Brickwork Ratings nor its affiliates, third party providers, as well as their directors, officers, shareholders, employees or agents (collectively, "BWR Reps") guarantee the accuracy, completeness or adequacy of the Report, and no BWR Reps shall have any liability for any errors, omissions, or interruptions therein, regardless of the cause, or for the results obtained from the use of any part of this publication. In no event shall any BWR Reps be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of any part of the Report even if advised of the possibility of such damages. Brickwork Ratings receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities.