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MPC Meet: RBI likely to maintain 'status quo' on policy rates, focus on liquidity

MPC Meet: RBI is seen holding repo rate at 4.0 per cent through but markets will be keenly watching its roadmap to provide additional liquidity measures after a higher than expected borrowing plan of Centre for fiscal year

RBI Governor Shaktikanta Das may announce a status quo on key policy rates during his monetary policy committee (MPC) announcement today. However, markets will be keenly watching the RBI's roadmap to provide additional liquidity measures after a higher than expected of the Centre for the fiscal year, which was announced in the Budget this week.

This is the last meeting of the RBI's MPC, which is happening a few days after Union Budget 2021-22. The Budget pegged the fiscal deficit at 9.5 per cent for the fiscal year and 6.8 per cent for FY23.

The RBI is seen holding repo rate at 4.0 per cent through the rest of 2021 and possibly beyond, according to the median estimate in a Reuters poll. Only five among 32 economists expect the central bank to cut repo rate today, according to a Bloomberg poll. They see the case for repo rate cut due to decline in inflation in December to 4.59 per cent, which may go further down to 4.4 per cent in January.

Notably, inflation fell to the MPC's target of 4 (+/-2) per cent range in December, which led to a huge drop in vegetable prices. The inflation rate in November 2020 stood at 6.93 per cent. This was the lowest point in retail inflation since March 2020, when it was pegged at 5.84 per cent, marking a return to the RBI's comfort range of 2-6 per cent.

Inflation in the food basket plunged sharply to 3.41 per cent in December from 9.50 per cent in November. The steep decline came on the back of 10.41 per cent deflation in vegetable prices. However, this was the only section that saw a decline in prices last month. Core inflation, however, has been higher at 5.34 per cent in December compared to 5.56 per cent in November.

"We expect the MPC to continue the pause. The fall in inflation rate was mainly due to fall in food prices. The core inflation rate has not come down. Excess liquidity needs to be watched. The vaccine availability is not going to impact macro economy immediately," M Govinda Rao, Chief Economic Advisor, **Brickwork Ratings** told news agency PTI

If the MPC keeps the rates unchanged, all eyes will be on its liquidity approach. The government has substantially increased its gross market borrowing estimates for 2020-21 to Rs 12 lakh crore from the budget estimate of Rs 7.8 lakh crore, an increase of more than 50 per cent, indicating it is taking a big hit on fiscal deficit. The high fiscal deficit target has pushed up the benchmark 10-year bond yield to above 6 per cent.

Experts believe the RBI will try to keep significant liquidity in the system for now. In December, the RBI projected the real GDP to grow 0.1 per cent in the quarter ending December, while 0.7 per cent in Q4. The high-frequency indicators seem to have performed better in December and January. These indicators suggest the RBI may signal comfort on the growth front.

The MPC has kept the key benchmark rate "unchanged" in its last three review announcements. The current repo rate -- rate at which RBI lends to banks -- is at a record low of 4 per cent. The reverse repo rate -- rate for funds parked by banks with RBI -- is 3.35 per cent.

The RBI had last revised its policy rate on May 22, 2020, in an off-policy cycle to perk up demand by cutting interest rate to a historic low. The central bank has cut policy rates by 115 basis points since February 2020.