RBI expected to maintain rates on elevated inflation levels: Brickwork Ratings

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The Reserve Bank of India (RBI) is expected to maintain a rate pause in the upcoming Monetary Policy Committee meet, considering elevated inflation levels, **Brickwork Ratings** said on Wednesday.

As per the agency, to support economic activity, which was severely disrupted since March, the RBI is likely to continue with its accommodative stance; however, it is unlikely to reduce the repo rate in the December policy meeting, considering CPI inflation remains elevated.

Lately, CPI inflation has remained above the RBI MPC's median target of 4 per cent for the last 13 months and in October 2020, the inflation rate touched 7.61 per cent, the highest since May 2014, largely due to the high rate of food inflation.

"Price pressures are likely to be transient and are expected to ease gradually in the coming months if the economy normalises," the agency said. "However, the current level of CPI inflation is uncomfortably higher than the MPC's upper bound of 6 per cent while demand conditions in the economy continue to remain tepid and real interest rates are mostly in the negative zone."

Since March 2020, the RBI has reduced the repo rate by 115 points cumulatively and brought it down to 4 per cent in the May policy meeting.

Thereafter, the MPC maintained a pause, but continued with new liquidity tools such as, 'LTROs, TLTROs' and operation twist, along with 'OMOs' to keep adequate liquidity in the system and ensure a stable financial situation and supply conditions.

"These tools have helped the financial sector to manage stress to some extent but also in an effective monetary policy transmission. The transmission of rate cuts in terms of a fall in SBI's MCLR has been by 85 basis points between February and November 2020, as against the repo rate cut of 115 basis points during the same review period. Although the transmission of rate cuts has gradually improved, the monetary policy response thus far has not helped much in reviving demand conditions."

"Banks, particularly those in the public sector, continue to be risk averse and prefer to park excess liquidity in the RBI's reverse repo window. This is evident from the net absorption of daily liquidity by the RBI in its LAF window which crossed Rs 7.3 lakh crore on 19 November 2020, the highest since 27 May 2020, and continued to remain above Rs 6 lakh crore to Rs 7 lakh crore on a daily average basis on most days of the month."

According to the agency, the lack of demand in the economy despite low interest rates is evident from weak credit growth.

"The underutilisation of the 'Emergency Credit Line Guarantee Scheme' (ECLGS) to the MSMEs announced in May 2020 by the government, which has now been further extended to stressed sectors identified by the K V Kamath Committee, sums up the demand conditions."

On the other hand, the risk-free returns turned negative, making the savings unattractive, it said.

In addition, it said that better-than-expected Q2FY21 GDP numbers and progress in containing the pandemic in the major metro cities, the RBI may revise its GDP forecast for FY21 from the current (-)8.6 per cent in the upcoming MPC meeting.

"We expect the Q3FY21 GDP contraction to be substantially lower, and the economy may register positive growth in Q4FY21, supported by sustained recovery, coupled with a low base," the agency added.

The RBI's MPC will release its final resolution on the monetary policy for the calendar year 2020 on December 4.