RBI continues with dovish stance; reaffirms impetus to support economic growth

- Mr. Sampath Reddy, Chief Investment Officer, Bajaj Allianz Life

RBI's Monetary Policy Committee (MPC) unanimously voted to keep the key policy rate (repo rate) unchanged at 4.0%, and the reverse repo rate unchanged at 3.35%. The MPC also unanimously voted to maintain an accommodative stance to revive and sustain growth on a durable basis and mitigate economic impact of Covid.

RBI has continued with its dovish stance in this monetary policy as well. The central bank announced the second tranche of its G-Sec acquisition programme (GSAP 2.0) of buying government bonds worth Rs. 1.2 trillion in Q2FY2022. RBI will also complete its planned bond purchase of Rs. 1 trillion under GSAP 1.0 by buying remaining quantum of Rs. 40,000 crore in June 2021. It will include purchase of Rs. 30,000 crore of central government and Rs. 10,000 crore of state government bonds. The government has a large market borrowing programme for this year, therefore this may help to control the bond market volatility to some extent and keep borrowing costs in control.

Headline consumer price inflation (CPI) for the month of April 2021 fell to 4.3%YoY from 5.5%YoY in the previous month largely due to favourable base effect. With rising international commodity prices, logistical bottlenecks and high domestic taxes on fuel, RBI expects inflation to average at 5.2% in Q1 FY2022. RBI also increased the inflation forecast for Q2 FY2022 to 5.4% (from earlier forecast of 5.2%), 4.7% in Q3 (from 4.4%) and 5.3% in Q4 (from 5.1%). Overall inflation forecast for FY22 is 5.1% which is within the 2-6% range (with 4% as the anchor target point).

On the economic front, the RBI expects the renewed restrictions to adversely affect its earlier growth forecast for the fiscal. As a result, it has downgraded its GDP growth forecast for FY22 to 9.5% from its earlier forecast of 10.5% in the April policy.

Some other additional measures announced by the RBI were as follows:

- Separate on tap liquidity window of Rs. 15,000 crore with tenor of upto 3 years for certain sectors such as hotels and restaurants, tourism related businesses etc.
- Special liquidity facility of Rs. 16,000 crore extended to SIDBI to meet credit needs of MSMEs
- All issuers of Certificate of Deposits will be allowed to buyback their securities subject to certain conditions to allow better flexibility to manage their liquidity

Outlook:

The RBI's aim is to keep borrowing cost in control by flattening the yield curve to some extent, while providing ample liquidity and other impetus to support the economic growth recovery. It has been taking various steps to manage the large upcoming market borrowing programme in a smooth and efficient manner.

The dovish undertone in today's policy indicates that the RBI will continue to support bond yields through regular open-market-operations and operation twists. Although we are the end of the rate cycle, the central bank will continue to remain accommodative for some time, with an eye on the inflation trajectory. However, rise in global bond yields and commodity prices could once again but some pressure on bond yields. From a fixed income perspective, we prefer the short to medium term part of the yield curve.

The accommodative monetary policy should benefit the equity markets by keeping borrowing costs in check for some time. However, the pace of vaccination and withdrawal of restrictions could impact economic recovery path and also cause some market volatility in the short term. Investors can use any market volatility / dips to increase their equity exposure gradually (as per their individual risk profile).