

## **RBI to remain cautious at next policy meeting**

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The emergence of the new Covid-19 variant, Omicron, has again made the global growth prospects uncertain. In its latest economic outlook, the Paris-based Organisation for Economic Co-operation and Development (OECD) has lowered its global growth forecast for 2021 by cutting the outlook of top economies, including the US, China, and the Eurozone. According to the OECD, Omicron's emergence has coincided with the global economic recovery losing some of its steam due to global supply chain disruptions, soaring consumer prices, and rising cases of Covid-19 in Europe. The OECD has asserted that monetary policymakers across the globe should be cautious and need not raise interest rates as a result of supply shortages.

At this juncture, it is not at all clear whether the new Covid-19 wave will be inflationary or deflationary and a lot would depend on country-specific infection rates and policy responses.

Coming to the Indian scene, between the last monetary policy review and now, headline consumer price index (CPI)-based inflation has noticeably eased mainly aided by a favourable statistical base. Real gross domestic product (GDP) in the second quarter of financial year 2021-22 (FY22) has come back to pre-Covid levels but has recorded just a 0.2 per cent growth on a two-year CAGR (compound annual growth rate) basis. While some high-frequency activity indicators for manufacturing and mining have shown definite improvement in recent months, indicators for services and employment continue to remain weak. In India, a two-speed recovery is clearly visible between the organised versus unorganised sector, urban versus rural sector, and large versus small companies. Aggregate demand remains weak as reflected in the negative growth momentum for consumer durables and nondurables in the latest industrial production statistics.

To talk about the forward looking picture, while the recent excise duty cuts on petrol and diesel by the central government and the consequent reduction in value added taxes by several state governments augur well for the non-core CPI inflation, the recent surge in vegetable/fruit prices due to the untimely excessive rains and sticky prices of pulses and edible oils pose upside risks to non-core CPI inflation. Both these factors are exerting influence on inflation from the supply side.

In case of the real growth trajectory, the trend GDP after the Covid shock continues to remain flat. Moreover, increased frequency of extreme rainfall events, fertiliser shortage, lower level of mandi prices in relation to minimum support prices for major kharif crops and wide variation in the average daily wage level under MGNREGA have clouded the cash-flow prospects for agriculture and rural belts in the ongoing crop year.

Interestingly, the minutes of the October Monetary Policy Committee (MPC) meeting reveal that except for J.R. Varma, the rest of the members have highlighted uncertainties in external environment and unevenness in sectoral growth as the reasons to stay accommodative and not to raise even the reverse repo rate immediately. While for Ashima Goyal it is important that policy remains steady and supportive in times of great uncertainty, Reserve Bank of India's Executive Director Mridul K. Saggar stresses

the need for accommodative policy to shore up consumption demand. RBI Deputy Governor Michael Debabrata Patra is awaiting stronger evidence on demand-led inflationary pressures. Given that all these considerations continue to remain valid even today and there is an additional scare of omicron, we expect at least five members of the MPC to vote for status quota on the stance and rates in the upcoming policy review. However, the RBI will continue with its calibrated liquidity normalisation, as this move is having the desired impact of raising short-term money market rates without creating unnecessary spikes in the long-term cost of borrowing.

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