MPC minutes: A mixed bag

- **The minutes showcased a MPC with divergent degree of concerns regarding persistence of elevated inflation, and risks to macro-financial stability through short-term rates operating below the operational policy rates**
- **Growth concerns and the need to support the incipient growth recovery was unequivocally voiced, leading to them retaining the accommodative stance**
- **There was also mention of easy financial conditions and provisioning of liquidity leading to a growth-enabling monetary environment and need to continue that support**
- **Given this background, we maintain our view of a long pause in policy rates, with possible change in stance to neutral in the June policy, if inflation remains elevated and growth momentum continues to pick-up pace. These could come in tandem with unwinding in the current easy monetary policy environment**
- **In the meantime, steps to absorb the current liquidity excesses could be introduced, though in a small, calibrated manner**

Key takeaways from MPC members:

Dr. Shashank Bhide: voiced concerns on 1) lack of information on the contribution of the informal sector to the recovery being seen 2) continued 'multi-speed recovery' across sectors 3) uncertainty around labour market conditions affecting sustained demand recovery 4) uncertain external demand. He went on to say that while easy financial conditions could assist investment uptick, consumption recovery could be dependent on employment conditions and would require fiscal push to support both consumption and investment. Risks to inflation were highlighted given 1) rise in global commodity prices, 2) production shortfalls in certain food groups, 3) low capacity utilisation and social-distancing norms, leading to higher emergent costs in manufacturing. These risks to inflation while emerging mostly from supply channels could get a buffer by improving demand conditions and could be a point of concern. Given these trends, he is of the view that easing conditions are required to enable investment which could in turn address supply constraints, which in turn could help ease inflationary pressures.

Dr. Ashima Goyal: is of the view that easy financial conditions have assisted industry and has helped demand recovery that is being seen in credit uptick in banking and other 'market-based' financing, movement in real estate inventory, deleveraging cycle that could lead to improvement in demand and nascent signs of recovery in private capex. She went on to say that despite these signs, recovery is still below normal and would require continued policy support. She attributed the high inflation prints to supply side rigidities, reflecting in the wedge between wholesale and retail prices, and is encouraged by the sharp fall in household inflationary expectations, which could lead to better price discovery by consumers as the economy opens-up. On real rates she mentioned that a negative output gap would call for policy rates to be negative in equilibrium and is of the view that they should rise somewhat as inflation eases over the coming months. On liquidity she mentioned that short-term rates have fallen below the effective anchor (reverse repo rates), and regulatory exposure norms could abate short-term borrowing being driven by excessively low rates. She advocated RBI's policy on Fx intervention, which according to her would prevent excess overvaluation, keep a check on export prices and could prevent large depreciation shocks arising later and went on to advocate use of reverse repos to sterilise the excess domestic liquidity, arising from the expanding forex reserves. Moreover, she is of the view that excess liquidity is not impacting headline inflation at the moment and a currency, which has a tendency towards appreciation, could assist in keeping inflation in check, as import prices are capped.

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December 18, 2020

Prof. Jayanth R Varma: re-iterating his concern on the usage of the word "decided" in the policy forward guidance, Prof. Varma, expressed concerns on short-term rates moving below the reverse repo rates. In his view, these could lead to built-up in inflationary pressures as they are stimulating a demand boost without creating supply and are encouraging speculative inventory accumulation, in turn leading to "cartelization and resurgence of pricing powers." He went on to highlight that the asymmetric degree of shock witnessed by the smaller firms has encouraged an oligopolistic structure, which, without adequate competition, are seeing return in pricing powers. This sustained low rates has started reflecting in asset markets and could start feeding into inflationary expectations in his view. On the other hand, the elevated term-premia, reflecting higher borrowing costs in the long-end could prevent a return in investment cycle necessary to create supply, which would assist in dampening medium-term inflationary pressures. He concluded by saying the "balance of risk and reward" tilted towards maintaining monetary accommodation, along with liquidity support to encourage short-term rates towards the "reverse repo and not the repo rate, while being wary of a drop below the corridor."

Dr. Saggar: mentioned that monetary policy is entering a "complex zone", given the high persistence of inflation on one hand, and below trend growth for the year (despite the recovery being seen in high-frequency indicators), on the other hand. He went on say that fiscal policy has been restrained, but he expects government spending to pick-up for rest of the fiscal. Moreover, investment focused policy reforms that have been announced would assist in growth recovery (given their higher multiplier effects), assisted by the support being provided by monetary policy. He went on to say that policy makers need to be mindful of emergent cost-push inflationary pressures (through food, commodity prices and taxes), which could emerge even if the economy is operating at a negative output-gap, if monetary policy remained accommodative for a long time, referencing to the 1973 oil shock and elevated demand push inflation post the GFC. However, he caveated this view by mentioning that the current risks were not pointing in that direction, supporting the liquidity infusion measures which have assisted in enabling credit conditions (seen in flow of resources to the commercial sector), and "preventing meltdown in markets", leading to further deepening of the recessionary environment. He went on to mention that increase in money supply has in turn prevented further fall in growth, given the sharp fall in velocity of money. In his view, policy normalization could take place in H2FY22 when he believes, the negative output-gap could show signs of closing. Defending the sanctity of the inflation-targeting regime, he mentioned that if there were signs that "output-gap closes faster than anticipated, core CPI inflation surges on back of observed momentum in some WPI inflation components or more supply-side shocks lead to generalisation of inflation, policy will need to respond appositely." On liquidity, he shared the views of the other members, to ensure macro-financial stability by preventing short-term rates moving lower than the policy corridor for a sustained time and introducing policies to sterilize the excess liquidity conditions arising from the large amount of capital inflows.

Dr. Patra: mentioned that the economy is "perched on the shoulder of the recovery phase," assisted by easy monetary conditions and the focus of the MPC on growth. These are evident in monetary aggregates of credit growth, deposits and money supply. He went on to mention that cyclical growth seems to be gaining traction, reducing the window in which MPC can look through elevated pressures. He went on to mention the high wedge between retail and wholesale prices, and expects elevated inflation to continue led by 1) retailers and supplier of services trying to recover "lost incomes" 2) returning cyclical demand allowing pass-through of input prices into output prices. Concluding his statement, he mentioned that despite growth requiring continued policy support, "the MPC's dilemma around its window of accommodation has become more acute than at the time of its last meeting."

Shri. Shaktikanta Das: Re-iterated the points on incipient signs of growth recovery, seen in demand, investment of flow of resources to the commercial sector, assisted by easing financial conditions. He also highlighted the concerns around elevated inflation through supply side disruptions, constraining monetary policy. However, in his view , a premature roll back of policy would be detrimental to the fledgling growth recovery. He concluded that they would have to remain watchful on both sides, "to revive growth on a durable basis and mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward" He also alluded to responding to any threats to financial stability emerging from the excess domestic liquidity situation exacerbated by global flows, with the use of various instruments. This he said would be done in a calibrated manner, while ensuring that ample system liquidity is available.

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