

Bi-Monthly Monetary Policy - August 2021

Why in news?

In its latest meeting, the Monetary Policy Committee (MPC) of the RBI has revised the interest rates and updated growth and inflation forecasts.

What are the highlights?

- The key policy rate (Repo rate- the RBI's lending rate to banks) is kept unchanged at 4% for the seventh time in a row.
- Reverse repo rate [RBI's borrowing rate from banks] is kept at 3.35%.
- The MPC has raised the inflation target for fiscal 2021-22 to 5.7% from 5.1% projected earlier.
- But it has maintained the growth forecast at 9.5%.

What is the rationale?

- The nascent and hesitant economic recovery post-pandemic needs to be nurtured through fiscal, monetary and sectoral policy levers.
- Elevated inflation level and delayed recovery in the economy would have prompted the panel to keep rates steady.
- This accommodative stance will thus continue as long as necessary to revive and sustain growth and to mitigate the impact of Covid-19.
- The MPC however sees to it that inflation remains within the target.

What about the inflation scenario?

- The new inflation target of 5.7% for fiscal 2021-22 is below the RBI's upper band of inflation target of 6%.
- But adverse effects on cost conditions for manufacturing and services exist, driven by -
 - i. elevated prices of industrial raw materials
 - ii. high pump prices of petrol and diesel
 - iii. logistics costs
- However, the weak demand conditions are affecting the pass-through of the cost burden to output prices and core inflation.
- Crude oil prices are volatile with implications for imported cost pressures on inflation.
- A calibrated reduction of the indirect tax component of fuel prices by the Centre and states can help to substantially lessen cost pressures.
- Given all these factors, inflation may remain close to the upper tolerance band up to Q2 of 2021-22.
- Nevertheless, these pressures should reduce in Q3 of 2021-22 on account of kharif harvest arrivals and as supply side measures take effect.

How is the growth forecast?

- The MPC has retained the real GDP growth at 9.5% in 2021-22.

- The investment demand is still weak.
- But, improving capacity utilization, rising steel consumption, higher imports of capital goods are expected to revive growth.
- The supportive monetary and financial conditions, and the economic packages offered by the government will help keep the momentum.
- Innovation and working models adopted during the pandemic by businesses will continue to reap productivity gains even after the pandemic recedes.
- This should help trigger a virtuous cycle of investment, employment and growth.
- The recovery remains uneven across sectors and needs to be supported by all policy makers.

What is RBI's VRRR auction plan?

- The RBI has decided to conduct fortnightly variable reverse repo rate (VRRR) auctions.
- It plans to conduct four VRRR auctions in the fortnight beginning August 13 till September 24, 2021.
- This is to absorb surplus liquidity from the banking system.
- These enhanced VRRR auctions should not be misread as a reversal of the accommodative policy stance.
- Because, the system-level liquidity will still be more than Rs.4 lakh crore at the end of September 2021.
- So, the amount absorbed under the VRRR window forms part of system liquidity.
- After this, the RBI will continue with its overnight fixed-rate reverse repo auction.
- The RBI will also conduct two more [Government Security Acquisition Programme](#) (G-SAP) operations of Rs.25,000 crore each on August 12 and 26, 2021.
- The overall priority now is to nurture the existing growth impulses to ensure a durable recovery along a sustainable growth path.

Monetary Policy Committee

- RBI Act, 1934 has been amended by the Finance Act, 2016 to provide for a Monetary Policy Committee.
- It is responsible for fixing the **benchmark interest rate** in India while keeping in mind the objective of growth.
- It usually meets once in 2 months and is mandated to meet at least 4 times a year .
- The committee comprises 6 members - 3 officials of the RBI and 3 external members nominated by GOI.
- Members from the RBI - Governor (ex-officio chairman of the MPC), a Dy Governor & one officer of the RBI.
- Government members are appointed by the Centre on the recommendations of a search-cum-selection committee headed by the Cabinet Secretary.
- The Members appointed by the Government shall hold office for 4 years and are not eligible for reappointment.
- Quorum of the MPC - 4 members.
- Decisions are on the basis of majority vote and in case of a tie, RBI governor has a casting vote. He doesn't enjoy veto power.
- The current mandate of the MPC is to maintain inflation within the targeted range of 4%+2%, till March 2021.
- The Financial Markets Operations Department operationalizes the monetary policy, mainly through day-to-day liquidity management operations.
- The Financial Markets Committee meets daily to review the liquidity conditions so as to ensure

that the operating target of the weighted average call money rate.

- Once every 6 months, the RBI is required to publish Monetary Policy Report to explain the sources of inflation and the forecast of inflation for 6-18 months ahead.

Source: The Indian Express, Business Line

