

## **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**

