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May 04, 2022

Monetary Policy Statement, 2021-22
Resolution of the Monetary Policy Committee (MPC)
May 2 and 4, 2022

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) at its meeting today (May 4, 2022) decided to:

- Increase the policy repo rate under the liquidity adjustment facility (LAF) by 40 basis points to 4.40 per cent with immediate effect.

Consequently, the standing deposit facility (SDF) rate stands adjusted to 4.15 per cent and the marginal standing facility (MSF) rate and the Bank Rate to 4.65 per cent.

- The MPC also decided to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 per cent within a band of +/- 2 per cent, while supporting growth.

The main considerations underlying the decision are set out in the statement below

Assessment

Global Economy

2. Since the MPC's meeting in April 2022, disruptions, shortages and escalating prices induced by the geopolitical tensions and sanctions have persisted and downside risks have increased. The International Monetary Fund (IMF) has revised down its forecast of global output growth for 2022 by 0.8 percentage point to 3.6 per cent, in a span of less than three months. The World Trade Organization has scaled down projection of world trade growth for 2022 by 1.7 percentage points to 3.0 per cent.

Domestic Economy

3. Domestic economic activity stabilised in March-April with the ebbing of the third wave of COVID-19 and the easing of restrictions. Urban demand appears to have maintained expansion but some weakness persists in rural demand. Investment activity seems to be gaining traction. Merchandise exports recorded double digit expansion for the fourteenth consecutive month in April. Non-oil non-gold imports also grew robustly on the back of improving domestic demand.

4. Overall system liquidity remained in large surplus. Bank credit rose (y-o-y) by 11.1 per cent as on April 22, 2022. India's foreign exchange reserves declined by US\$ 6.9 billion in 2022-23 (up to April 22) to US\$ 600.4 billion.

5. In March 2022, headline CPI inflation surged to 7.0 per cent from 6.1 per cent in February, largely reflecting the impact of geopolitical spillovers. Food inflation increased by 154 basis points to 7.5 per cent and core inflation rose by 54 bps to 6.4 per cent. The rapid rise in inflation is occurring in an environment in which inflationary pressures are broadening across the world. The IMF projects inflation to increase by 2.6 percentage points to 5.7 per cent in advanced economies in 2022 and by 2.8 percentage points to 8.7 per cent in emerging market and developing economies.

Outlook

6. Heightened uncertainty surrounds the inflation trajectory, which is heavily contingent upon the evolving geopolitical situation. Global commodity price dynamics are driving the path of food inflation in India, including prices of inflation sensitive items that are impacted by global shortages due to output losses and export restrictions by key producing countries. International crude oil prices remain high but volatile, posing considerable upside risks to the inflation trajectory through both direct and indirect effects. Core inflation is likely to remain elevated in the coming months, reflecting high domestic pump prices and pressures from prices of essential medicines. Renewed lockdowns and supply chain disruptions due to resurgence of COVID-19 infections in major economies could sustain higher logistics costs for longer. All these factors impart significant upside risks to the inflation trajectory set out in the April statement of the MPC.

7. As regard the outlook for domestic economic activity, the forecast of a normal southwest monsoon brightens the prospects for *kharif* production. The recovery in contact-intensive services is expected to be sustained, with the ebbing of the third wave and the growing vaccination coverage. Investment activity should get an uplift from robust government capex, improving capacity utilisation, stronger corporate balance sheets and congenial financial conditions. On the other hand, the worsening external environment, elevated commodity prices and persistent supply bottlenecks pose formidable headwinds, along with volatility spillovers from monetary policy normalisation in advanced economies. On balance, the Indian economy appears capable of weathering the deterioration in geopolitical conditions but it is prudent to continuously monitor the balance of risks.

8. Against this background, the MPC is of the view that while economic activity is navigating the vortex of forces confronting the world with resilience on the strength of underlying fundamentals and buffers, the risks to the near-term inflation outlook are rapidly materialising, as reflected in the inflation print for March and the developments thereafter. In this milieu, the MPC expects inflation to rule at elevated levels, warranting resolute and calibrated steps to anchor inflation expectations and contain second round effects. Accordingly, the MPC decided to increase the policy repo rate by 40 basis points to 4.40 per cent. The MPC also decided to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

9. All members of the MPC – Dr. Shashanka Bhide, Dr. Ashima Goyal, Prof. Jayanth R. Varma, Dr. Rajiv Ranjan, Dr. Michael Debabrata Patra and Shri Shaktikanta Das – unanimously voted to increase the policy repo rate by 40 basis points to 4.4 per cent.

10. All members, namely, Dr. Shashanka Bhide, Dr. Ashima Goyal, Prof. Jayanth R. Varma, Dr. Rajiv Ranjan, Dr. Michael Debabrata Patra and Shri Shaktikanta Das unanimously voted to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

11. The minutes of the MPC's meeting will be published on May 18, 2022.

12. The next meeting of the MPC is scheduled during June 6-8, 2022.

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(Yogesh Dayal)
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