

MNI RBI Preview – May 2021

Meeting Date: June 4 – 0530BST/1000IST/1230HKT

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MNI RBI Data Watch List									
Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend
CPI y/y	% y/y	5.0	6.9	↓	6.7	↓			
PPI y/y	% y/y	4.2	2.3	↑	0.4	↑			
Economic Activity		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend
India Manufacturing PMI	Index	55.4	56.4	↓	56.8	↓			
India Services PMI	Index	55.3	53.7	↑	41.8	↑			
Industrial Production YoY	% y/y	-1.6	4.5	↓	-10.5	↑			
Trade Balance	\$bn	-94.40	-89.70	↓	-104.60	↑			
Current Account	\$bn	33.0	-24.6	↑	-56.4	↑			
Trade Balance	\$bn	1359.38	1433.68	↓	1278.30	↑			
Consumer / Labour Market		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend
Consumer Confidence	Index	47.8	46.6	↑	47.5	↑			
Unemployment rate	%	4.90	0.00	↑	0.00	↑			
Markets		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend
Equity Market (Sensex)	Index	51849	47751	↑	38068	↑			
India 10-Year Yield	%	6.39	6.37	↑	6.23	↑			
USD/INR Mid	Index	73.08	73.07	↑	73.76	↓			

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

MNI POV: Ready To Act, But Not On Rates

The RBI is expected to keep rates on hold at a record low for the sixth straight month, of 35 analysts surveyed all but one expects the Repo Rate on hold at 4.00%, one call for a 25bps cut. All expect the Reverse Repo rate on hold at 3.35%, while give analysts expect a 50bps cut in the Cash Reserve Ratio and 15 expect to remain on hold at 4.00%. Likely more interesting than benchmark rates will be any extension of liquidity measures and changes in policy guidance.

The bank has previously intimated it will retain its dovish bias for as long as needed to secure the recovery from the pandemic, a message that will be reiterated with the country still in the grips of the pandemic. While there are signs the surge in cases is easing state lockdowns remain in place and have seen the output gap widen and jobless rate rise, though inflation remains stubbornly high due to elevated commodity prices.

The RBI is expected to note downside risks to growth forecasts, the bank previously predicted growth of 10.5%. Recent data indicates that this will be a difficult number to hit due to widespread lockdowns and a sluggish vaccination programme. Given the febrile situation and uncertain outlook the bank is expected to wait until August before publishing a new set of forecasts.

On inflation the RBI is likely to emphasise upside risks from higher input costs and disrupted supply chains, but subdued food inflation should help keep price growth close to the bank's forecast of 5% for the fiscal year. In April CPI rose 4.29%, slightly above expectations but broadly in-line with the bank's 2%-6% target band.

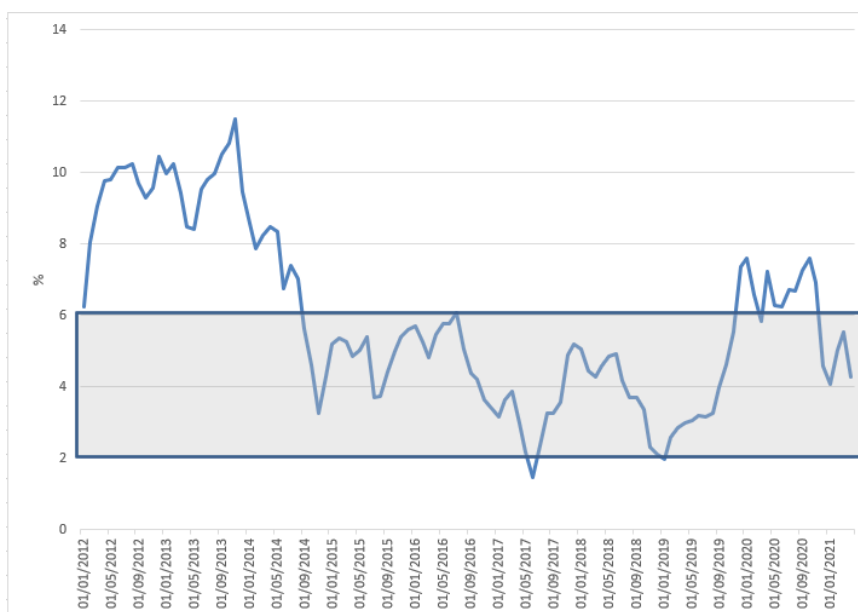


Fig.3: Indian CPI & 2%-6% Target Band

The RBI has developed a reputation being a pro-active central bank, as evidenced by the unscheduled announcement of several policy tools earlier in May. The bank is expected to unveil more measures at the June meeting, including an extension of the Government Securities Acquisition Programme (GSAP).

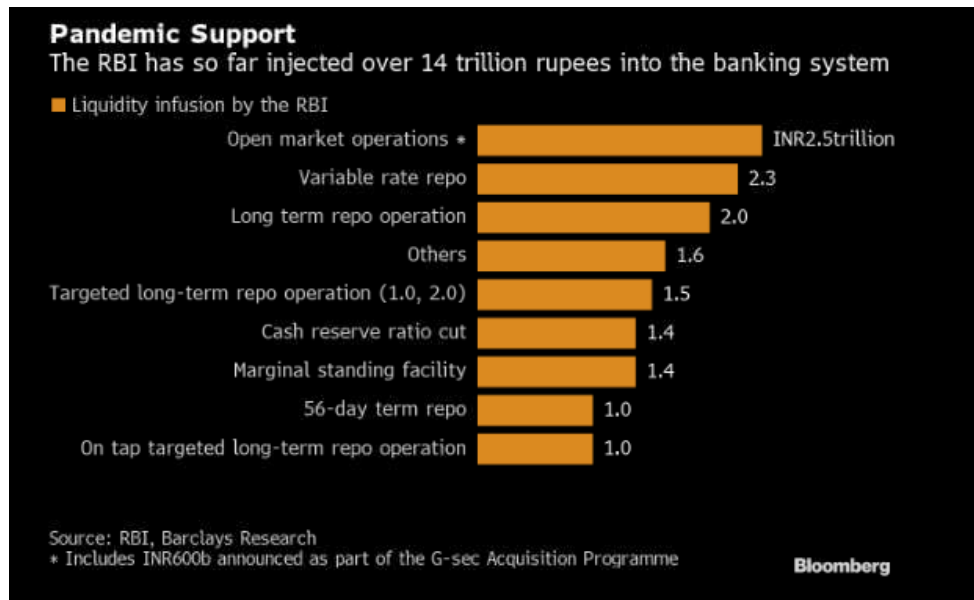


Fig.2: Liquidity Injected By RBI. Source: Bloomberg/RBI/Barclays

Under the first tranche the RBI has bought INR 600bn of a total INR 1tn. Given the government recently announced an increase of INR 1.58tn for this fiscal year borrowing, taking total borrowing up to INR 13.8tn. Given the increase in proposed borrowing the RBI will likely announce fiscal Q2 and potentially Q3 bond purchase plans in order to assuage concerns over liquidity. Other rounds are expected to be at least INR 1tn, with the potential for the bank to go even bigger as 10-year yields remain stubbornly close to the bank's tacit 6% threshold.

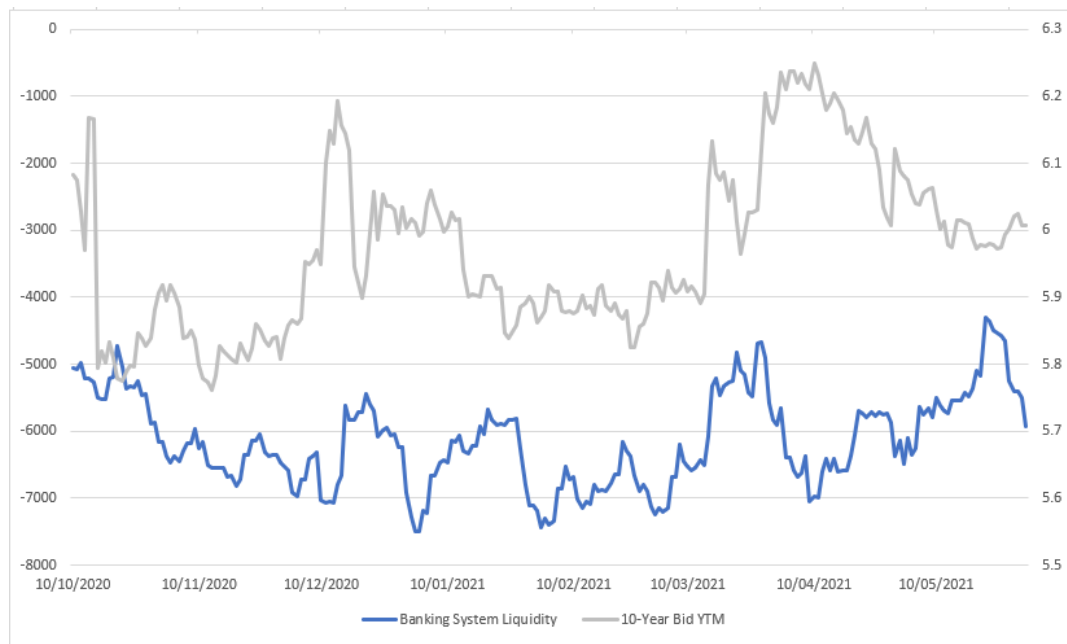


Fig.3: Banking System Liquidity v 10-Year Yield (Note: lower number on left Y-axis means liquidity surplus)

Pressure is also growing on the RBI to provide relief to banks who have already asked the RBI to extend the existing loan restructuring program until December 2023. If granted this will prevent downgrading of asset quality, and thus allow lenders mask the true extent of bad loans. Lenders have also urged the RBI to allow borrowers to continue access to higher amounts of working capital loans until the end of September after the relaxation ended in March.

On currency INR rose 2% in May, the biggest monthly gain in over two years. Data would appear to show that the RBI was comfortable with the currencies rise as reserves rose at a slower pace, with some speculating a stronger currency could help put the brakes on inflation. Additionally, foreign portfolio flows have shown signs of recovery in recent weeks after dropping during the peak of the second wave, and this momentum could continue in the coming months.

Previous Decision Reference Materials

May Governor Statement: https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=51526

April Meeting MPC Statement: https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=51381

April Meeting Governor's Statement: https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=51380

Transcript of RBI's April Monetary Policy Press Conference:
https://www.rbi.org.in/scripts/bs_viewcontent.aspx?Id=3985

Minutes of April MPC Meeting: https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=51456

RBI Monthly Bulletin Summary

A failure to contain India's deadly second wave of the pandemic in time risks disrupting domestic supply chains and carries inflationary implications, the central bank said in its most recent monthly bulletin.

In addition to ramping up pandemic protocols, vaccination and hospital capacity, the way forward involves "remaining resolutely focused on a post-pandemic future of strong and sustainable growth with macroeconomic and financial stability," Michael Patra, deputy governor for monetary policy, wrote in the chapter 'State of the Economy' with RBI researchers.

Gains in wholesale inflation last month showed higher commodity prices and firmer input costs may feed into retail prices, which are already inching toward the RBI's upper tolerance limit of 6%.

Firms surveyed by the RBI during the January-March period indicate a likely persistence of input price pressures well into 2021-22 and a gradual increase in selling prices, according to the bulletin.

The "outlook for the Indian economy is bright by any projection," RBI's Patra said. Even if the relatively conservative growth forecast holds, India's gross domestic product in 2021-22 will exceed its level in the pre-pandemic year of 2019-20.

The RBI retained its February forecast for a 10.5% expansion for the economy in the 12 months to March 2022. But risks of prolonged lockdowns in some of the most industrialized states in the country could dent some of the bullish forecasts. Nevertheless, policy makers have intimated they will overlook inflation concerns for now to support a nascent economic revival.

“Policy makers know from painful experience it is perilous to withdraw stimulus too soon; that inflation is less sensitive to demand pressures than once feared; that central banks will lean towards growth in pandemic times, knowing that inflation is still only catching up,” the researchers wrote. They added that when markets lose faith and bet on tightening policy, they may end up bringing it about sooner than it is appropriate.

SocGen On The Bulletin: The RBI bulletin, released after last month's unscheduled meeting, while trying to avoid pessimism on the growth front, alluded to multiple headwinds to demand, which we believe betrays their nervousness about growth. “The biggest toll of the second wave is in terms of a demand shock - loss of mobility, discretionary spending and employment”, stated the report. Even the multiple micro lockdowns have resulted in major sequential decline in e-way bills, sale of petrol & diesel and electricity generation, indicating the negative impact on economic activity. While the central bank did find solace in high GST collections in April, we think this is mainly because companies were allowed to make late GST payments for the previous quarter with no penalty, which artificially propped up revenue collection figures.

Sell Side Previews

Goldman Sachs: We expect the Reserve Bank of India (RBI) to keep its policy rate unchanged at 4.0% (Bloomberg consensus: 4.0%) while retaining its accommodative stance “as long as necessary to sustain growth on a durable basis”. FY22 headline Inflation is expected to remain in the upper half of the inflation target band at 4.9% yoy given sticky and elevated core inflation, rising commodity prices and building margin pressures. However, RBI is likely to continue to downplay inflation risks at this juncture given renewed growth risks due to the virus upsurge and containment policy tightening in Q2. We have pushed back our expectations for calibrated liquidity tightening, and expect RBI to extend the recent bond purchase program with another INR1tn of bond purchases in 2021 Q3 to maintain easy financial conditions in the face of adverse demand-supply fundamentals.

ING: It's the delicate policy balance the RBI ought to strike to revive growth without further stoking inflation. As the elevated inflation prevents the RBI from cutting policy interest rates further, the targeted easing remains their option. This is what underlined Governor Shaktikanta Das's unscheduled announcement earlier this month (5 May) of additional liquidity support for the healthcare and small business sectors. We believe Governor Das will reaffirm that support next week, though without any recovery in business confidence all that may be in vain.

JP Morgan: We expect RBI to remain on hold, annual report telegraphs no cut in GDP forecasts. We expect the MPC to retain its growth-supportive bias by remaining on hold, as monetary policy is already ultra-accommodative. In recent weeks, downside risks to GDP growth from the second wave have grown, with many states being forced to impose lockdowns to contain proliferation of the virus. On inflation, we expect the RBI to maintain its forecast of 5% average inflation for FY22, with balanced risks, which is similar to our forecast. The RBI is likely to acknowledge cost push inflation pressures from surging global commodity prices. However, on a %oia basis, which is what the RBI targets, despite elevated inflation momentum, favorable base effects from last year are likely to keep headline inflation contained, leaving the RBI the room to focus on supporting growth. To buffer the impact of the second wave, the RBI announced several targeted measures to support small businesses and the healthcare sector at the beginning of May. We expect the RBI to maintain the status quo on rates, and not undertake another round of easing, as monetary policy remains ultra-accommodative. To put it in perspective, the effective policy rate is currently at 3.35% while core inflation has averaged 5% since the start of 2020. Further,

as we argue in our research note this week, the efficacy of monetary policy is reduced in periods of elevated uncertainty. That's because monetary policy ultimately relies on economic agents, which in face of uncertainty are unlikely to consume or invest but, instead, would push up precautionary savings. This is reflected in subdued credit growth despite the sharp fall in lending rates. Consequently, the marginal utility of the additional rate cuts is rather limited. In our view, the focus should be on fiscal policy, particularly from the states, to contain the impact of the shock.

Morgan Stanley: In line with consensus, we expect the RBI to keep rates on hold at 4% and maintain its accommodative stance at the upcoming meeting. 2Q21 growth will likely register sequential moderation as a result of tighter localised containment measures amid the COVID-19 resurgence. The outlook for headline CPI inflation is to remain range-bound, even as core inflation remains sticky, with risks stemming from higher global commodity prices and elevated input price levels. We expect the RBI to announce another tranche of its GSAP programme to manage the yield curve and ensure benign financial conditions. In addition, we will remain watchful of any measures that influence short-term rates, currently tracking at the lower end of the policy rate corridor. Hence, as we expect the RBI to remain on the dovish side, we continue to like the front-end receiver 1y1y INR NDOIS. Inflation is a concern but we think that the central bank is likely to view it as a supply-side shock, and to look through it. We continue to expect the risk premium in the front end to be priced out. On the FX front, INR seems to be supported by the collapse in domestic demand, which improves the current account, as we saw last year. The equity outflows are ongoing but the size is relatively small. We believe that INR is likely to underperform given the RBI's dovishness and its preference for a weaker currency

TD Ameritrade: Downside risks to growth have intensified in the wake of the 2nd wave of COVID cases across the country. However, less extensive lockdowns suggest the hit to growth will be more limited. Inflation pressures have eased though this is in large part due to base effects while there is some uncertainty about the inflationary threat on supply disruptions following lockdowns.

Barclays: India has been on the opposite end of the spectrum in 2021, with COVID-19 cases growing at the fastest pace seen globally through late April-early May. Simultaneously, the vaccine drive has slowed; after touching highs in the week of 10 April, supply shortages have seen the weekly pace return to early March levels. Though case growth has slowed materially in the last two weeks, it has been driven in part by strict mobility restrictions across the country. The economic loss from restrictions, which we expect will last through June, is increasing, leading us to slash our growth forecast for the second time in a month. We now expect the economy to expand by 9.2% in FY2021-22, revised lower from 10% earlier and 11% before the second COVID-19 wave. Q4 FY21 GDP data, to be released next week, will already show signs of losing steam, in our view. We expect the Reserve Bank of India (RBI) to observe downside risks to its growth outlook, and downgrade GDP growth from its present 10.5% for FY2021-22 to somewhere in high single-digits. We believe the RBI's Monetary Policy Committee has no option but to stay accommodative, when it meets next week, even as it monitors incipient price pressures. Since May's policy announcements, the growth outlook has degraded further, with greater evidence that inflation headwinds may remain persistent going into H2 2021. However, with some relief on the virus front, the RBI can balance its message around prospects for a return to economic normality. The MPC will likely keep all rates on hold, while likely extending its Government Securities Acquisition Program (GSAP).

ANZ: We expect the Reserve Bank of India to hold the policy repo rate at 4.00% at its meeting next week. The central bank will likely focus on growth amid the second wave of the pandemic. This is not unwarranted. Unlike our earlier expectations, policy normalisation will be delayed. We expect an accommodative stance through FY22. Following the second wave of the pandemic and attendant lockdowns, we have tempered our expectations for

growth in this fiscal year. Although the intensity of the lockdowns is not the same as the nation-wide one in 2020, a host of real time data have plunged: (1) unemployment rate has risen again to around 10% after it dipped in the last few months, (2) overall mobility has fallen; and (3) power demand has moderated. While case counts are down from their peaks, the probability of a sub-20% GDP growth in Q1 FY22 (ending June 2021) is very high. On inflation, we note that while the April print was subdued, significant underlying pressures remain as domestic fuel costs are touching all-time highs and lockdowns could add to supply side bottlenecks. Despite this, we expect prices to stay within the RBI's target range of 2-6% amid our assessment of a favourable monsoon and weak demand. This should provide the central bank with the leeway to focus more on growth in the next few months. Contrary to our earlier expectations, we now believe policy normalisation will be delayed. We expect a firm pause on rates and an accommodative stance to be maintained through FY22. The central bank will likely focus on the risks to growth due to the pandemic but not temper growth forecasts just yet. On inflation, we believe the RBI will maintain its earlier forecasts.

SocGen: We expect the RBI to keep the policy rate unchanged at 4.0%. Also, given the policy tools in the arsenal of the central bank that were unleashed in an unscheduled meeting about a month back, we do not expect additional moves from the bank with regard to further conventional or unconventional policy measures. While we do expect, given the current macro backdrop, the central bank to announce it will continue its accommodative policy stance for longer, we also expect a potential downward revision of India's real GDP growth expectation for FY21-22. While it remained guarded in its recently released monthly Bulletin for May, the RBI discussed multiple channels through which a demand shock is seeping into the economy, and we believe this could be the harbinger of a lowered growth expectation by the bank. The implied RBI policy rate change is more skewed to a hike, even though, in our view, the bank is likely to remain on hold for longer. The RBI's proactive support of the bond market to lower domestic funding costs via ample liquidity, such as unconventional policy measures like Operation Twist and the GSAP (Government Securities Acquisition Programme), which is RBI's version of QE, has not only insulated IGB yields from other external market factors, but also has kept 10-yr bond yields within the RBI's targeted level of 6%. That said, we expect yields to rise beyond 6% as a slowing economy and falling revenue collection (both tax and non-tax) would likely push up deficit and concomitantly borrowing.