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May 18, 2022

Minutes of the Monetary Policy Committee Meeting, May 2 and 4, 2022
[Under Section 45ZL of the Reserve Bank of India Act, 1934]

The thirty fifth meeting of the Monetary Policy Committee (MPC), constituted under section 45ZB of the Reserve Bank of India Act, 1934, was held during May 2 and 4, 2022 as an off-cycle meeting to reassess the evolving inflation-growth dynamics and the impact of the developments after its meeting of April 6-8, 2022.

2. The meeting was attended by all the members – Dr. Shashanka Bhide, Honorary Senior Advisor, National Council of Applied Economic Research, Delhi; Dr. Ashima Goyal, Emeritus Professor, Indira Gandhi Institute of Development Research, Mumbai; Prof. Jayanth R. Varma, Professor, Indian Institute of Management, Ahmedabad; Dr. Rajiv Ranjan, Executive Director (the officer of the Reserve Bank nominated by the Central Board under Section 45ZB(2)(c) of the Reserve Bank of India Act, 1934); Dr. Michael Debabrata Patra, Deputy Governor in charge of monetary policy – and was chaired by Shri Shaktikanta Das, Governor.

3. According to Section 45ZL of the Reserve Bank of India Act, 1934, the Reserve Bank shall publish, on the fourteenth day after every meeting of the Monetary Policy Committee, the minutes of the proceedings of the meeting which shall include the following, namely:

(a) the resolution adopted at the meeting of the Monetary Policy Committee;
(b) the vote of each member of the Monetary Policy Committee, ascribed to such member, on the resolution adopted in the said meeting; and
(c) the statement of each member of the Monetary Policy Committee under sub-section (11) of section 45ZI on the resolution adopted in the said meeting.

4. The MPC reviewed in detail the staff's macroeconomic assessment, and alternative scenarios around various risks to the outlook. Drawing on the above and after extensive discussions on the stance of monetary policy, the MPC adopted the resolution that is set out below.

Resolution

5. 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

6. 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

7. 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.

8. 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.

9. 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

10. 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.

11. 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.

12. 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.

13. 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.

14. 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.

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

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

Voting on the Resolution to increase the policy repo rate to 4.4 per cent

Member	**Vote**
Dr. Shashanka Bhide	Yes
Dr. Ashima Goyal	Yes
Prof. Jayanth R. Varma	Yes
Dr. Rajiv Ranjan	Yes
Dr. Michael Debabrata Patra	Yes
Shri Shaktikanta Das	Yes

Statement by Dr. Shashanka Bhide

17. In its meeting of April 6-8, the MPC had noted the building up of the inflationary pressures, not anticipated in February. As a result, the projected outlook for FY 2023 reflected an average inflation rate above the assessment provided in February. The year-on-year CPI inflation rate of 6.3 per cent was projected for

Q1FY2023 in the April meeting, well above 4.9 per cent projected in the February meeting.

18. It was also seen that overall GDP growth recovery, while significant, was incomplete, especially in terms of consumption demand. The growth environment was also subject to significant uncertainty in the short-term, given the supply chain interruptions in the global markets. GDP growth rate for FY2023 was projected at 7.2 per cent in April, below the 7.8 per cent projected in February.

19. The emerging need for policy response in the context of inflationary pressures was clearly recognised. But the uncertainty of both growth and inflation trajectories as a consequence of global economic conditions was also a significant consideration.

20. The CPI inflation rate for March 2022 that became available a week after the April meeting, showed a sharp increase in the headline number and the price rise was widely spread across all the main consumption items. The headline inflation rate was above 6 per cent for the third successive month in 2022. The inflationary pressures, while substantially emanating from the external developments - Russia-Ukraine war and the sanctions from the Western countries leading to supply disruptions - there are additional concerns in the form of ban on palm oil exports by Indonesia and the restrictions on economic activities in China as a result of emergence of new Covid 19 cases.

21. These external price and supply shocks have led to inflationary pressures both directly at the retail level and also indirectly through cost pressures on domestic supplies. The energy and food price increases in the international markets have impacted domestic prices. The external market conditions also have implications for trade and current account deficits and in turn, prices. The accommodative monetary conditions now in place to support growth are also not moderating transmission of price rise impulses through the supply chain.

22. On the growth front, the improvements are reflected in the broader indicators such as bank credit and GST collections and specific indicators such as PMI for manufacturing and services for the month of April 2022. Exports have been a driver of aggregate demand through FY 2022. However, uncertainty over growth trajectory is also significant in the context of expectations of slower world GDP and trade growth in 2023.

23. Given the present assessment of the inflation and economic growth conditions, monetary policy measures to break the inflation dynamics have become necessary. While the impact of such monetary policy measures may affect growth momentum adversely in the short-term, the overall external conditions also require that domestic inflation pressures are contained quickly. With some optimism on the lifting of the shadow of Covid pandemic on the domestic supply chains, focus is now needed on achieving price stability, with the headline inflation rate moving close to the target of 4 per cent. Each step would have to be taken keeping in view the evolving conditions.

24. Accordingly, I vote to increase the policy repo rate by 40 basis points to 4.4 per cent.

25. I also vote to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

Statement by Dr. Ashima Goyal

26. Indian growth remains quite robust despite a global slowdown especially since the threat of a possible 4th Covid-19 wave seems to be receding. Contact industries are also seeing a revival due to pent-up demand. As more and more countries seek to diversify their imports, MSMEs are benefitting from export orders.

27. Inflation is a concern, now. It has overshot official and private predictions in March as a result of unprecedented shocks. The prolonged Ukraine war is keeping international crude oil prices high. It is also aggravating food prices.

28. The history of past shocks in India shows food and oil price inflation together can give rise to second round effects. This is what happened in the 2010s. But so far pass through to wages is absent and consumer demand is soft. Higher agricultural productivity, food grain stocks, appropriate policy response, lower energy intensity and waning of war related price pressures may allow this time to be different.

29. Inflation is high due to multiple supply shocks following each other. Even so, in an inflation targeting regime it is necessary to respond to inflation persistently above tolerance bands in order to anchor expectations.

30. It is also necessary to respond in order to prevent large deviations in real rates, which cause risks of overheating or of a slowdown. Post GFC real interest rates were highly negative leading to overheating and in the 2010s they swung to large positive numbers (peaking at 4.85 per cent[1]), aggravating the slowdown. Policy should aim for equilibrium real rates and avoid large swings in real rates.

31. In view of a reasonable recovery and the sharp rise in inflation, which will also raise inflation projections, frontloading of rate hikes is required to prevent the real rate becoming too negative. Among risks from negative real interest rates include households buying gold thus aggravating the current account deficit and hurting financial intermediation.

32. In my last minutes I had warned that the pace of exit depends on incoming data and repo hikes could follow the normalization of the LAF corridor. Markets were already over-reacting to global risk and to adjustment in liquidity that started last year and have priced in excessive rate hikes. Since consumer demand continues to be soft, and inflation is likely to reduce it further, such excessive rate hikes may not be necessary to impose the quantum of output sacrifice required to moderate inflation. A surprise in timing with an unannounced meeting at the start of the rate hike cycle maybe better to mitigate further over-reaction.

33. Therefore, I vote to raise the repo rate by 40bps while remaining accommodative yet focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

34. A credible demonstration of commitment to inflation targeting, that brings down inflation expectations to the tolerance band, together with OMOs, should reduce the excessive yield spread. Spreads widened when short rates were cut and should now narrow when they rise, flattening the yield curve. Relatively good growth, and domestic liquidity in surplus, will support the stock market despite withdrawal of excess accommodation. There is healthy diversification with domestic investors taking a contrary view to foreign investors.

35. Government supply-side action can also reduce future rate rises, output sacrifice and borrowing costs. Both central and state taxes are buoyant and likely to exceed any rise in subsidy costs because of the Ukraine crisis, giving them space to cut taxes on fuels. Countercyclical fuel taxes are necessary to prevent a ratchet

[1] Goyal, A. 2022. 'Flexible Inflation Targeting: Concepts and application in India' IGIDR. Working paper no. WP-2022-003, available at: http://www.igidr.ac.in/pdf/publication/WP-2022-003.pdf

effect raising inflation, if fuel prices rise much more than they fall because taxes rise when crude oil prices fall but do not fall when prices rise. Such a ratchet occurred in the era of administered prices and is not compatible with inflation targeting. World crude oil prices were lower in early 2021 than they were in mid-2014. But Indian prices were higher. Fertilizer subsidy would also be reduced if energy price rise is contained. States that did not cut taxes in November last year should begin, that will trigger a second round of cuts. These have some of the highest fuel prices in the country, at a time when international crude oil prices are persisting at high levels and being passed through to consumers.

Statement by Prof. Jayanth R. Varma

36. MPC meetings outside the annual calendar are at the sole discretion of the Governor based on his opinion that an additional meeting is required. Therefore, I confine my statement to the consideration of the action to be taken at this additional meeting.

37. In my statement in April, I stated that the principal reason for not taking immediate action on the policy rate at that time was that the forward guidance given in the February meeting effectively precluded such action. I also stated that the withdrawal of the forward guidance and the absence of any stance in April meant that in future meetings, the MPC would consider itself completely free to take any action on the policy rates that may be warranted. This meeting is taking place almost a month after the April meeting, and the MPC is now at liberty to consider the rate increase that it could have done in April itself in the absence of the February forward guidance.

38. Since April, inflation risks have become more pronounced both in terms of magnitude and in terms of persistence. On the other hand, the growth shock appears to be less severe than I feared initially, as most nowcast estimates suggest that the economy is coping reasonably well with the geopolitical tensions and the Chinese lockdown. In this context, the need for monetary tightening has become much more acute. Moreover, there is a lot of catching up to do because the MPC (a) rightly prioritized economic recovery at the height of the pandemic in 2020 and early 2021, and (b) delayed the normalization by continuing the forward guidance for far too long after the pandemic abated. This means that it is now imperative to front-load the rate action to the extent possible.

39. It appears to me that more than 100 basis points of rate increases needs to be carried out very soon. My preference therefore is for a 50 basis points increase in the repo rate in this meeting. The majority of the MPC is in favour of 40 basis points for reasons which are not very clear to me. Whatever symbolic or psychological benefit there may be from keeping the hike below 50 basis points is outweighed by the simplicity and clarity of moving in round multiples of 25 basis points. Also reducing the hike by 10 basis points now would require an extra 10 basis point hike at some point (and perhaps sooner rather than later). Nevertheless, I have thought it fit not to dissent on this issue as the optimal rate hike is not something that can be calculated with mathematical precision, and 40 basis points is not materially different from 50 basis points. I am thankful to the majority for not making my decision more difficult by choosing a 37.5 basis point hike (exactly mid-way between 25 and 50). In view of all this, I vote in favour of increasing the policy repo rate to 4.40 per cent.

40. The second resolution is identical to that in April, and my arguments in favour of this decision at that time remain valid. Monetary policy remains extremely accommodative despite the 40 basis point hike in this meeting. In fact, if the real policy rate is measured by subtracting the latest inflation print from the nominal rate,

then the real policy rate after this meeting is lower than it was after the April meeting because the published headline CPI inflation has risen by much more than 40 basis points between the two meetings. Of course, it is more reasonable to calculate the real policy rate by subtracting the forecast inflation rate 3-4 quarters ahead, but even if one does that, it is obvious that the real policy rate continues to be sharply negative, and therefore highly accommodative. The first part of the second resolution is therefore simply a statement of fact, and the operative portion of the resolution is the second part which talks about withdrawal of accommodation. I have already explained why an expeditious withdrawal of accommodation is warranted.

41. However, most of the analyst commentary on the April meeting seemed to interpret the phrase "remain accommodative" as a stance despite the conscious decision to drop the word "stance". I hope that this time around, the MPC's intent will be more clearly understood, but if that does not happen, the MPC must consider rephrasing this resolution. It would not be wise for the MPC to persist with language that is pedantically correct, but falls short in communicative efficacy. But such rephrasing is a matter for a future meeting, and this time around, I vote in favour of the decision to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

Statement by Dr. Rajiv Ranjan

42. The global macroeconomic and financial environment has turned extremely adverse since February 2022 with the start of the war in Ukraine and is posing significant challenges to real-time macroeconomic assessment and management. Against this backdrop, it would be useful to briefly recap the fast-paced developments over the past 3-4 months. At the time of the monetary policy committee (MPC) meeting of February 10, 2022, before the outbreak of the war, inflation trajectory was projected to moderate significantly to the target of 4 per cent by Q3:2022-23, with an average inflation rate of 4.5 per cent for the financial year 2022-23, premised on stronger seasonal winter correction of vegetables prices, a likely bumper *Rabi* harvest and further normalization of supply chains in the backdrop of ebbing of COVID-19 infections. This provided room for monetary policy to remain accommodative, to prioritise growth and support the domestic recovery.

43. The situation, however, changed drastically since the start of the war in Europe on 24th February. Taking cognizance of the potential adverse global commodity price spillovers, the MPC resolution of April 8, 2022 raised the inflation projection for 2022-23 by 120 bps to 5.7 per cent. With the war posing sizeable upside risks to the inflation trajectory and downside risks to domestic growth, the MPC, on balance, continued with the accommodative stance, though price stability was prioritised over growth along with a focus on withdrawal of accommodation in a calibrated manner over a multi-year period. The liquidity adjustment facility (LAF) corridor was also normalised while introducing the standing deposit facility (SDF). The MPC highlighted five major risks in its April resolution to the baseline inflation and growth trajectory: (i) the ratcheting up of geopolitical tensions; (ii) generalised hardening of global commodity prices; (iii) the likelihood of prolonged supply chain disruptions; (iv) dislocations in trade and capital flows; and (v) divergent monetary policy responses and associated volatility. It was expected that these risks will play out over time, but recent developments suggest that the upside inflation risks have materialised earlier than anticipated as reflected in the March CPI print and projected higher April print, warranting an off-cycle meet of MPC.

44. The March 2022 CPI release pointed to a larger than anticipated, broad-based pass-through of global price shocks to the domestic economy. The hardening of food inflation, which in January was predominantly driven by cereals and vegetables, has since then spread to meat and fish, milk, edible oils, spices and prepared meals in addition to cereals and vegetables. Further intensification of core inflation pressures (CPI excluding food and fuel) to 6.4 per cent in March emanated from broad-based price pressures across sub-groups. Barring housing, pan-tobacco and intoxicants and education, inflation in all core sub-groups was above 6 per cent.

45. Let me give another perspective on the generalization of inflation in the latest print. Since the start of the COVID-19 pandemic, October 2020 registered the highest headline inflation reading at 7.6 per cent. In October 2020, the key drivers were vegetables, transportation, meat and fish, edible oils, personal care and pulses. These sub-groups (with a weight of around 28 per cent in the CPI basket) accounted for about 60 per cent of the inflation. In March 2022, the contribution of these items was only 41 per cent to the headline inflation of 7.0 per cent. This suggests a significant change in the drivers of inflation in the recent period.

46. The broadening of inflation pressures is also reflected in various CPI diffusion indices[2]. There has been a sharp pick-up in these indices for price increases at or above a seasonally adjusted annualised rate (SAAR) of 6 per cent, especially in March, confirming that it is not just incidence of broadening of price increases in CPI but also that of price increases at a very high rate. This is true for headline as well as core categories. The trimmed mean measures of CPI inflation[3] suggest that their pace of increase accelerated in March.

47. All of these indicate that amidst geo-political turmoil and heightened uncertainty, the sharp escalation in cost-push pressures is translating into a generalised upsurge in inflation, which became evident after the March CPI print was released on April 12th. It may be recalled that the CPI print crossed the 6 per cent mark even earlier on two occasions in 2020 and 2021. In each of these episodes, the MPC rightly decided to look through them as transitory price shocks. Though the current price rise is also essentially supply-shock driven, it cannot be ignored given its broad-based nature, spillover effects and persistence, which has a risk of unhinging inflation expectations. Thus, at this stage of macroeconomic dynamics, it is necessary to reinstate the primacy of price stability and strengthen the credibility of monetary policy through demonstrable actions.

48. With economic recovery better entrenched than before, it is time to address the concerns on the inflation front, the dynamics of which has been fundamentally altered by the outbreak of the conflict in Europe. Though monetary policy may not have a direct influence on exogenous global commodity price shocks brought about by the war, it can play an important role in avoiding the generalisation of inflationary pressures. If monetary policy decides to see-through these shocks, and especially if they are not transitory, inflation expectations could become unanchored, leading to a persistent upward drift that may not revert to the pre-shock level even after the initial shock completely dissipates. Given the recent inflation dynamics, a repo rate hike of more than the conventional 25 basis points would be more effective in anchoring expectations. I, therefore, vote for an increase in the policy repo rate by 40 bps, which is appropriate at this juncture, being neither too small nor too excessive. It is expected that this pre-emptive action in an off-cycle meeting will have more pronounced effect. I also endorse the unchanged stance from the April policy which

[2] The CPI diffusion index, a measure of dispersion of price changes, categorises items in the CPI basket according to whether their prices (seasonally adjusted) have risen, remained stagnant or fallen over the previous month and aggregates them to show whether the month-on-month (m-o-m) overall increase has been expansionary or contractionary. The diffusion indices constructed are weighted averages.

[3] In trimmed mean measures, CPI items which are located in the tails of the inflation distribution for every month (indicating highly volatile inflation movements) are excluded.

remains accommodative, consistent with our stance of maintaining adequate liquidity to sustain credit offtake and meet the productive requirements of the economy. In this regard, the increase in CRR by 50 bps is in consonance with our objective of withdrawing surplus liquidity gradually which would attenuate any unintended effects on the price front.

Statement by Dr. Michael Debabrata Patra

49. Geopolitical spillovers have thrust upon us a surge in the momentum of inflation we can ill afford. As long as the geopolitical crisis and retaliatory actions persist, so will inflation. As long as inflation stays and broadens in its ambit, people will increasingly be convinced it is going out of reach and this could un-anchor their expectations about its future path. So monetary policy authorities are being forced to respond to an elevation in prices brought on by shortages and bottlenecks they can do nothing about since the problem confronting them is not overstimulated demand but insufficient supply. In the absence of supply augmenting measures and/or easing of supply bottlenecks, they will do what they can do – front-load their actions, compress demand and render the recovery stillborn. Globally, stagflation could be transitioning from a risk scenario to a baseline scenario. The stagflationary shock is global but everywhere it is being exacerbated by country-specific factors in a synchronised way. The still raw scars of the pandemic will become even more excruciating to bear and more lasting.

50. At the same time, financial markets are telling us that the configurations that exist today – hardening US yields; ever strengthening US dollar; equity sell-offs; emerging currency depreciations and capital outflows; rising debt distress – are reminiscent of 1993-1994 after which followed a cascade of emerging market crises. At least, all the symptoms of a generalised financial deleveraging are in place.

51. In this milieu, a measured approach and a cool head is warranted. Recent incoming data suggest that India's macro-fundamentals, barring imported food and fuel inflation, are still intact and in sync with the recovery that has been tenaciously making its way through waves of the pandemic. Labour absorption in manufacturing and services is rising, capacity utilisation is improving and there are signs of new investment gradually coming in. Yet, the momentum of the recovery is still below full strength, warranting policy support. IPOs and the rotation of risk-on risk-off portfolio flows may give India a brief respite on a given day but on other days plunge our markets back into the turmoil that other EMEs are going through.

52. Against this turbulent backdrop and with headline inflation persisting above the upper tolerance band for the third month in a row with signs of second order effects, the approach of reversing the extraordinary accommodation – in terms of both the policy rate and liquidity - that was undertaken in response to the pandemic is, to my mind, the right approach. When it is done, we will have reached a stage of neutral accommodation – in contrast to extraordinary pandemic time accommodation – from where the next stage responses can be calibrated. Accordingly, I vote for an increase of 40 basis points in the policy rate – reversing the reduction in the policy rate effected on May 22, 2020 – and for the stance of remaining accommodative while focusing on withdrawal of accommodation, as articulated in the MPC's resolution of May 4, 2022.

Statement by Shri Shaktikanta Das

53. In my MPC statement of April 8, 2022, I had stated that the Reserve Bank will use all its policy levers to preserve macroeconomic and financial stability while enhancing the economy's resilience. I had also emphasised that the situation is dynamic and fast changing and our actions will be tailored accordingly. Together with the measures announced that day, the idea behind these statements was to convey the readiness of the RBI to effectively deal with the surge in inflation due to the war in Europe. Events since then have led to a further deterioration in the geo-political situation even as domestic inflation became more broad-based warranting immediate remedial measures. The off-cycle meeting held on 2nd and 4th May 2022 may be seen in this background.

54. Developments after the April MPC have caused further concern. First, headline CPI inflation for March, released on 12th April 2022, increased beyond expectations to 7 per cent, as the impact of adverse global commodity price shocks was felt across the CPI basket. Second, global commodity and food prices as reflected in indices of the Food and Agricultural Organisation (FAO) and the World Bank have touched historical highs in March with implications for the domestic food price situation. These pressures are likely to persist. Third, almost all measures of core inflation have registered a sharp pick-up in March, well above 6 per cent. Fourth, the revision in administered electricity tariffs across many states and the increase in prices of essential medicines pose further risks to inflation over the short-term. Fifth, the war in Europe – with its attendant consequences for supply chains, shortages and prices – is now expected to last much longer than earlier anticipated. Under these circumstances, the inflation print for April – to be released on May 12th – is expected to be further elevated. Hence, it becomes necessary to act through an off-cycle policy meeting. Waiting for one month till the June MPC would mean losing that much time while war related inflationary pressures accentuated. Further, it may necessitate a much stronger action in the June MPC which is avoidable.

55. Meanwhile, the rebound in domestic economic activity is gradually getting generalised. Improving contact-intensive services amidst revival in urban demand is driving personal consumption. The outlook for agriculture remains positive in the wake of normal southwest monsoon forecast for 2022, which would support rural consumption. Investment activity is gaining momentum with higher capacity utilisation and capital goods production registering an uptick. Exports remain resilient while persisting high import growth is suggestive of a revival in domestic demand. Nevertheless, higher global commodity prices in the wake of a long drawn geopolitical conflict, protracted shortage of critical inputs and policy tightening by major central banks pose downside risks to domestic economic activity.

56. The worsening outlook of inflation warrants timely action to forestall second round effects which could lead to unanchoring of inflation expectations. Heightened uncertainty and volatile financial markets could also add to such unhinging of expectations. Accordingly, decisive and measured monetary policy response is necessary to avoid any unintended shocks to the economy.

57. Considering all these factors, it has now become necessary to increase the repo rate on top of the increase in liquidity absorption rate done in April, 2022 through the standing deposit facility (SDF). Accordingly, I vote for an increase in the policy repo rate by 40 bps which is a reversal of our May 22, 2020 measure. Going ahead, we should keep our focus on withdrawal of accommodation to ensure that inflation remains within the target, while supporting growth. I, therefore, vote for maintaining *status quo* on the stance as in April policy. Further, the Reserve Bank will continue with liquidity withdrawal in a phased manner over a multi-year period in sync with

monetary policy and macroeconomic developments. Given the persistent liquidity overhang, a 50 bps increase in the cash reserve ratio (CRR) by the Reserve Bank signals our intent on withdrawing accommodation over a multi-year period.

58. As several storms hit together, our monetary policy response should be seen as an important step to steady the ship. The Indian as well as global evidence clearly shows that high inflation persistence hurts savings, investment, competitiveness and growth. It has also more pronounced adverse effects on the poorer segments of the population. Our monetary policy actions today aimed at lowering inflation and anchoring inflation expectations should thus help to strengthen the medium-term growth prospects of the economy and protect the purchasing power of the weaker sections of society. Given the highly uncertain situation, the incoming data and information would be constantly monitored to reassess the outlook and take necessary measures. Just as we had remained steadfastly vigilant and responded to fragilities in growth caused by the pandemic during the last two years, this time around also we will remain equally resolute and committed to bringing back inflation closer to the target through all possible instruments at our disposal.

(Yogesh Dayal)
Chief General Manager

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