

Economy

‘Fragile recovery’ warrants continuing policy support: MPC minutes

- ▶ **MPC members say growth is still fragile...:** Since the onset of the Covid-19 pandemic, the MPC prioritised growth over inflation as it unleashed a variety of measures to mitigate the impact of the pandemic on the economy. In the Feb 2021 review minutes released today, MPC members noted that although there were green shoots of recovery in some sectors, many sectors were languishing below their pre-pandemic levels in what they characterised as ‘multi-speed recovery’. Members noted that while high-frequency indicators show that manufacturing sector has normalised to pre-pandemic level, contact-intensive services sector may take longer to normalise. While the rollout of the vaccination programme has brightened the growth outlook, members assessed the ongoing recovery to be ‘fragile’.
- ▶ **...and output gap is unlikely to close before Q3FY22:** The quarterly OBICUS survey released on 5 Feb 2021 showed that manufacturing capacity utilisation in Q2FY21 improved to 64.1% from a historical low of 47.3% in Q1. In his statement, MPC member Dr. Mridul Saggar added that capacity utilisation was likely to be about 70% by the end of next year, indicating persistently excess capacity over the medium term. He further added that output gap was unlikely to close before Q3FY22 and more likely only by the end of next fiscal year.
- ▶ **Hence, continuing policy support is required to sustain growth momentum:** Given the ‘fragile’ recovery and excess capacity, MPC members stressed on the need for continuing policy support by providing ample liquidity and keeping financial conditions soft ‘at least in the current financial year and into the next financial year.’ The minutes also mentioned the challenges monetary policy will have to face to keep borrowing costs low amidst large government borrowing programme.
- ▶ **Members expect inflation to remain soft:** The Feb 2021 review, the MPC revised CPI forecast for H1FY22 to 5.0%-5.2% from 4.6%-5.2% previously. In Q3FY22, it expects CPI to average 4.3%. Commenting on the inflation outlook, committee members noted that headline inflation is likely to remain soft in the coming months due to a number of reasons. Firstly, some of the members assessed that bulk of the food-price correction has already happened and food prices are likely at near-bottom now. Secondly, there are signs of continued supply chain normalisation. Thirdly, inflation expectations for the near term have declined and for the medium term have remained flat. This is significant given the high uncertainty. Finally, an expected bumper kharif harvest and rising prospects of good rabi production are likely to keep food inflation low. While some upside risks to inflation outlook remain – such as persistently high core inflation, rising input prices and prospects of higher oil prices in the future – members assess inflation in the near-term to remain benign.
- ▶ **Although risks to financial stability need to be monitored:** While committing to keep financial conditions soft and liquidity ample, MPC members also noted that concerns about financial stability have risen. Dr. Patra added that when the moratorium, restructuring and asset reclassification standstill provisions expire, stress in the financial sector could intensify.
- ▶ **Members stress on the need for fiscal consolidation in due course:** MPC members lauded the Union Budget FY22 for giving a thrust to infrastructure and improving quality of expenditure. However, they noted that a higher fiscal impulse will be able to crowd in private investment only so long as the private sector’s capex funding needs are limited. In due course of time when private investments pick up, there will have to be strong fiscal consolidation so as to not crowd out the same.

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