RBI POLICY REVIEW

Event Update

Maintains Accommodative Stance; Continues to Look through Inflation

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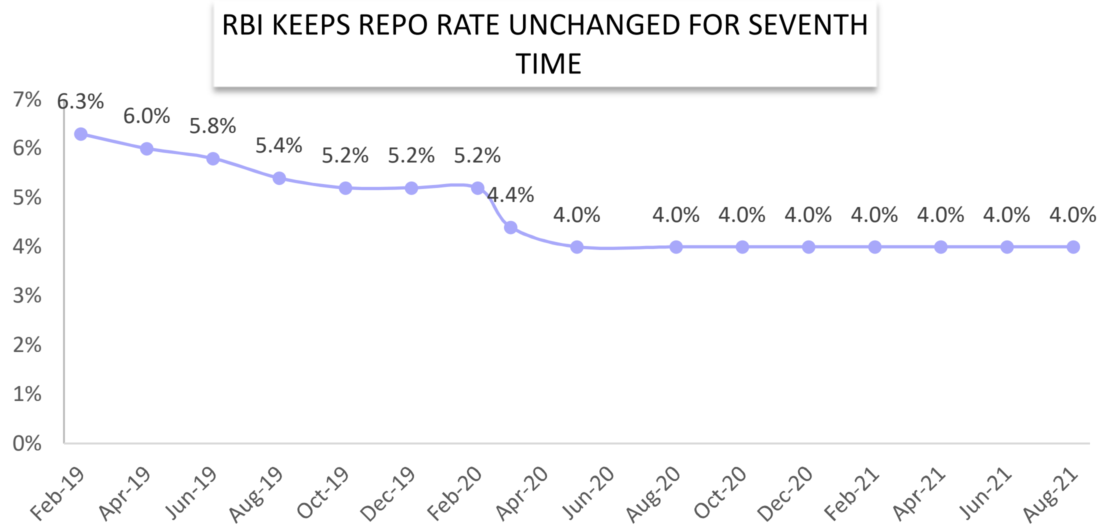
RBI's monetary policy committee has decided to keep key policy rates on hold and reiterated that it will maintain the accommodative stance for as long as necessary to sustain growth on a durable basis. This is the seventh time in a row that the RBI has maintained a status quo on policy rate. RBI has maintained that temproray supply shocks are driving inflation and is largely transitory. The repo rate was held at 4%, while the reverse repo rate was left unchanged at 3.35%. RBI believes a preemptive monetary policy response at this stage may kill the nascent and hesitant economic recovery.



Policy Tools	Policy rates	Status
Repo	4.00%	Unchanged
Reverse Repo	3.35%	Unchanged
Marginal Standing Facility (MSF)	4.25%	Unchanged
Bank Rate	4.25%	Unchanged
SLR	18.0%	Unchanged

MAINTAINS GDP GROWTH PROJECTION AT 9.5% FOR FY22

The central bank retained real GDP growth rate projection at 9.5% as economic activity is starting to recover with the ebbing of the second wave. The economy is likely to grow at the rate of 21.4% in Q1FY22, 7.3% in Q2FY22, 6.3% in Q3FY22 and 6.1% in Q4FY22. Going forward, agricultural production and rural demand are expected to remain resilient. Urban demand is likely to mend with a lag as manufacturing and non-contact intensive services resume on a stronger pace, and the release of pent-up demand acquires a durable character with an accelerated pace of people getting vaccinated.

Increases inflation projection to 5.7% for FY22 from 5.1%

CPI inflation is projected at 5.7% for FY22, with 5.9% for Q2FY22, 5.3% for Q3FY22, 5.8% for Q4 FY22 and 5.1% for Q1FY23, with risks broadly balanced. The revival of south-west monsoon and the pick-up in kharif sowing, buffered by adequate food stocks should help keep cereal price in check. High frequency indicators suggest some softening of price pressures in edible oils and pulses in July in response to supply side interventions by the Government. Inflationary pressures are being closely and continuously monitored.

Outlook

RBI's decision to maintain an accommodative stance is on expected lines. This will continue to support the credit off-take and maintain a benign interest rate scenario in the money market system. Maintaining FY22 GDP growth projection is a positive surprise. RBI believes inflation is transitory, but is closely monitoring the situation. The increase in quantum of variable rate reverse repo auctions (VRRR) from INR 2 trillion to INR 4 trillion is a clear indication that RBI wants to suck out the liquidity slowly but surely. The policy was not as dovish as the previous policies and we expect RBI to continue withdrawal of surplus liquidity.

Other Major Announcements

- TLTRO on Tap Scheme- Extension of deadline
    - With a view to increasing the focus of liquidity measures on revival of activity in specific sectors that have both backward and forward linkages and having multiplier effects on growth, the RBI had announced the On Tap TLTRO scheme. It has proposed to extend on tap TLTRO scheme further by a period of three months, i.e., till December 31, 2021.

One should hope that the stressed sectors identified by the Kamath Committee will avail credit and be back on the growth trajectory post second wave

- Increase in quantum of variable rate reverse repo auction
    - To suck out excess liquidity RBI has now been decided to conduct fortnightly VRRR auctions of INR 2.5 lakh crore on August 13, 2021; INR 3.0 lakh crore on August 27, 2021; INR 3.5 lakh crore on September 9, 2021; and INR 4.0 lakh crore on September 24, 2021.
    - RBI has stated that these enhanced VRRR auctions should not be misread as a reversal of the accommodative policy stance.

We believe this cautious approach is welcome as RBI needs to suck out excess liquidity from time to time. This will also enable RBI to do higher quantum of GSAP's.

- Marginal Standing Facility(MSF)- Extension of Relaxation
    - On March 27, 2020 banks were allowed to avail of funds under the marginal standing facility (MSF) by dipping into the Statutory Liquidity Ratio (SLR) up to an additional one per cent of net demand and time liabilities (NDTL), i.e., cumulatively up to 3% of NDTL.

This dispensation provides increased access to funds to the extent of **INR 1**.62 lakh crore and it has now been decided to continue with the MSF relaxation for a further period up to Dec 31, 2021.

- RBI Amends Rules For Smoother Transition Away from LIBOR
    - The Reserve Bank of India said it would amend the guidelines related to export credit in foreign currency and restructuring of derivative contracts as it looks to ensure a smooth transition away from the LIBOR.
    - As part of revised guidelines, banks can extend export credit in foreign currency using any other widely accepted alternative reference rate in currency concerned and change in reference rate from Libor/Libor-related benchmarks to an alternative reference rate will not be treated as restructuring.

RBI is engaging with banks and market bodies. Indian banks must find a suitable reference rate other than LIBOR by December 31 deadline when they have to stop entering into LIBOR linked contracts.

- Deferral of Deadline for achievement for Financial Parameters under Resolution Framework 1.0
    - The resolution plans implemented under the Resolution Framework for COVID-19 related stress announced on August 6, 2020 are required to meet the sector specific thresholds notified in respect of five financial parameters, four of which are related to the operational performance of the borrowing entity, viz. Total Debt to EBIDTA ratio (Total Debt/EBIDTA), Current Ratio, Debt Service Coverage Ratio and Average Debt Service Coverage Ratio, by March 31, 2022.
    - It has been decided to defer the target date for meeting the specified thresholds in respect of the above parameters to October 1, 2022.

It's a welcome step, but not of much consequence as these ratios are only projections and its up to the bank's discretion whether they will achieve these parameters or not to be eligible for restructuring.

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