DALAL & BROACHA
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RBI Event Note @ Dalal & Broacha

RBI POLICY REVIEW *(Inflation remains stubbornly high while growth is gaining traction)*

- RBI's monetary policy committee has decided to keep key policy rates unchanged at 4%, amid rising inflation. Headline CPI inflation rose sharply to 7.3% in September and to 7.6% in October as pressures accentuated across food and core constituents.
- Consequently, the reverse repo rate under the LAF also remains unchanged at 3.35% and the MSF rate and the Bank Rate at 4.25%.
- The committee has maintained an accommodative monetary policy stance and intending to keep it that way as long as necessary to revive growth on a durable basis and mitigate the impact of COVID-19 on the economy.
- These decisions are in consonance with the objective of achieving the medium-term target for CPI inflation of 4% within a band of +/- 2% while supporting growth.

Key Policy rates:

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
CRR	3.00%	Unchanged
SLR	18.0%	Unchanged

Economic Indicators:

- **Growth Forecast: According to the central bank's estimates, the economy will contract by 7.5% in FY21 as it revised the growth estimate upward from -9.5%**. GDP is estimated to expand by +0.3% in Q3 FY21 and +0.7% in Q4. Meanwhile, Real GDP growth for H1 FY22 is placed at 6.5-21.9%
  - While rural economy is expected to further strengthen, urban demand recovery is also gaining momentum.
  - Business sentiment of manufacturing firms is improving.
  - Private investment is still slack and capacity utilization has not fully recovered
  - While exports are on an uneven recovery, the prospects have brightened with the progress on the vaccines.
- **Inflation Estimates**: **According to the central bank outlook for inflation has turned adverse**. CPI inflation is projected at 6.8% for Q3 FY21, 5.8% for Q4 and 5.2%-4.6% in H1 Fy22 with risks broadly balanced.
  - While cereal prices may continue to soften with the bumper kharif harvest arrivals and vegetable prices may ease with the winter crop, other food prices are likely to persist at elevated levels
  - Crude oil prices have picked up on optimism of demand recovery, continuation of OPEC plus production cuts and are expected to remain volatile in the near-term.
  - Cost-push pressures continue to impinge on core inflation, which has remained sticky and could firm up as economic activity normalises and demand picks up.
- **Liquidity:**
  - Domestic financial conditions remained easy in October-November and systemic liquidity continued to be in large surplus.
  - Reserve money increased by 15.3 per cent (y-o-y) (as on November 27, 2020), driven by a surge in currency demand. Money supply (M3), on the other hand, grew by only 12.5 per cent as on November 20, 2020.
  - Ample liquidity will be provided for reviving growth.

Outlook

- Since the latest headline Inflation reading remains well above its comfort level of 6%, RBI held back from cutting policy rates, though maintained the policy stance accommodative. Policymakers are waiting for a durable reduction in inflation, before using elbow room to support growth.
- **Growth has shown strong recovery, it is extremely positive that RBI expects GDP to move back from contraction phase to expansion phase in H2'21**
- Overall, the tone of the policy was dovish but we feel it will be extremely difficult for RBI to cut rates at these elevated inflation levels.

Other Important Announcements

- **On Tap TLTRO – Extension of Sectors and Synergy with ECLGS 2.0**
  - In addition to the five sectors announced under the scheme on October 21, 2020, it is now proposed to bring the 26 stressed sectors identified by the Kamath Committee within the ambit of sectors eligible under on tap TLTRO.
  - Banks are encouraged to synergise the two 2 schemes by availing funds from RBI under on tap TLTRO and seek guarantee under ECLGS 2.0 to provide credit support to stressed sectors.
  - Liquidity availed by banks under the scheme should be deployed in corporate bonds, commercial papers, and non-convertible debentures issued by the entities in specific sectors over and above the outstanding level of their investments in such instruments as on September 30, 2020.

- **Dividend Distribution by Banks**
  - In view of the ongoing stress and the heightened uncertainty on account of COVID-19, it is imperative that banks continue to conserve capital to support the economy and absorb losses, if any.
  - It has been decided, on a review, that SCBs and cooperative banks shall not make any dividend pay-out from the profits pertaining to financial year 2019-20 in continuation with the decision taken in April 2020.

- **Discussion Paper on Scale-based Regulatory Framework for NBFCs**
  - Scale-based regulatory approach linked to the systemic risk contribution of NBFCs could be the way forward.
  - It has been decided to carry out consultation with stakeholders before finalising the revised regulatory framework. A Discussion Paper in this regard will be issued before January 15, 2021 for public comments.

- **Strengthening Audit Systems of Supervised Entities (SEs): (i) issuance of guidelines to large UCBs and NBFCs on adoption of Risk Based Internal Audit (RBIA); (ii) harmonisation of guidelines on appointment of statutory auditors for commercial banks, UCBs and NBFCs**
  - Risk Based Internal Audit (RBIA) was mandated by RBI for commercial banks in 2002. It has now been decided to issue guidelines to large UCBs and NBFCs on adoption of RBIA. This will enable the creation of independent risk focussed internal audit system.
  - It has been decided to harmonise guidelines on appointment of Statutory Auditors for commercial banks, UCBs and NBFCs.

- **Card Transactions in Contactless Mode and e-Mandates on Cards for Recurring Transactions – Enhancement of Limit**
  - To further the adoption of digital payments in a safe and secure manner, it is proposed to enhance, at the discretion of the user, the limits for contactless card transactions and emandates for recurring transactions through cards (and UPI) from ₹2,000 to ₹5,000 from January 1, 2021.

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