# RBI POLICY REVIEW

## Event Update

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## Maintains Accommodative Stance; Assures Liquidity as Economy Rebounds

**RBI's monetary policy committee (MPC) has unanimously voted to keep rates on hold as was widely expected and reiterated that it will maintain the accommodative stance for as long as necessary. According to the central bank, the economy's growth outlook had improved and that inflation was expected to remain within its targeted range over the next few quarters. The repo rate was held at 4%, while the reverse repo rate was left unchanged at 3.35%. On liquidity conditions, MPC has decided to restore CRR in two phases (raised to 3.5% from March 27 and 4% from May 22). Considering the continuing stress on account of COVID-19, and in order to aid in the recovery process, the central bank has also decided to defer the implementation of the last tranche of the Capital Conservation Buffer (CCB) of 0.625% and also defer the implementation of Net Stable Funding Ratio (NSFR) by another six months from April 1 to October 1, 2021.**

### GDP growth projected at 10.5% for FY22

Consumer confidence is reviving and business expectations of manufacturing, services and infrastructure remain upbeat. High frequency indicators – railway freight traffic; toll collection; e-way bills; and steel consumption – suggest that revival of some constituents of the services sector gained traction in Q3FY21. The agriculture sector remains resilient - rabi sowing was higher by 2.9% YoY as on Jan 29, 2021, supported by above normal north-east monsoon rainfall and adequate reservoir level of 61% (as on Feb 4, 2021) of full capacity. Going forward the government will likely to accelerate public investment, although private investment remains sluggish amidst still low capacity utilization. Rural demand is likely to remain resilient on good prospects of agriculture. The Union Budget FY22, with its thrust on sectors such as health and well-being, infrastructure, innovation and research, among others, should help accelerate the growth momentum. Taking these factors into consideration, real GDP growth is projected at 10.5% in FY22– in the range of 26.2 to 8.3% in H1 and 6.0% in Q3.

### Lowers inflation projection to 5.20% for Q4FY21

CPI inflation, after remaining elevated (+ 6%) for most of 2020, has eased off, coming in at ~4.6% in Dec-20. While the easing was expected, the fall has surprised many. The fall in inflation was the back of easing food prices and favorable base effects. Food inflation dropped to 3.9% in Dec-20 after averaging 9.6% during the previous three months (Sep-Nov) due to a sharp correction in vegetable prices and softening of cereal prices with kharif harvest arrivals, alongside supply side interventions. On the other hand, core inflation, i.e. CPI inflation excluding food and fuel remained elevated at 5.5% in De-20 with marginal moderation from a month ago. Going forward, the bumper kharif crop, rising prospects of a good rabi harvest, larger winter arrivals of key vegetables and softer egg and poultry demand on avian flu fears are factors auguring a benign inflation outcome in the months ahead. On the other hand, price pressures may persist in respect of pulses, edible oils, spices and non-alcoholic beverages. International crude oil prices may remain supported by demand build up on optimism from vaccination and continuing production cuts by OPEC plus. Taking into consideration all these factors, the projection for CPI inflation has been revised by the RBI to 5.2 % in Q4FY21, 5.2 % to 5.0 % in H1FY22 and 4.3 % in Q3FY22, with risks broadly balanced.

### Outlook

RBI's decision to provide retail investors a direct option to invest in government securities is a good development from a long-term perspective. Besides, the central bank's plan for reviewing the regulatory framework for microfinance is a welcome step. Back to policy, this is the fourth consecutive bi-monthly policy review to keep rates unchanged since mid-2020. The recovery is still nascent and the fiscal push/higher borrowings seen in the Budget warrant continued support from RBI. We expect MPC to continue with its current policy stance for Q1FY22 and may gradually start withdrawal of surplus liquidity from Q2FY22 onwards.

| 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 |

## Other Major Announcements

- **TLTRO on Tap Scheme- Inclusion of NBFC's**
    - RBI has acknowledged that NBFCs are well recognised conduits for reaching out last-mile credit and act as a force multiplier in expanding credit to various sectors, it has proposed to provide funds from banks under the TLTRO on Tap scheme to NBFCs for incremental lending to the original five sectors and also 26 stressed sectors identified by KV Kamath Committee.

**One should hope that banks lend to smaller NBFC's (with slightly lower credit rating) as they are the one's still facing liquidity crunch.**

- **Restoration of CRR in two phases beginning March 2021**
    - To help banks tide over the disruption caused by COVID-19, the cash reserve ratio (CRR) of all banks was reduced by 100 bps to 3.0% of net demand and time liabilities (NDTL) effective from the reporting fortnight beginning March 28, 2020.
    - It has been decided to gradually restore the CRR in two phases in a non-disruptive manner. Banks would now be required to maintain the CRR at 3.5% of NDTL effective from the reporting fortnight beginning March 27, 2021 and 4.0% of NDTL effective from fortnight beginning May 22, 2021.
    - The CRR increase is to suck out the excess liquidity gradually from the system and not allow short term rates to spike up abnormally.

**We believe this cautious approach is welcome as RBI needs to keep short term and long term rates curtailed to spur growth.**

- **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 Rs 1.53 trillion and it has now been decided to continue with the MSF relaxation for a further period up to Sep 30, 2021.**

- **SLR Holdings in Held to Maturity (HTM) category**
    - On September 1, 2020, the central Bank increased the limits under Held to Maturity (HTM) category from 19.5% to 22% of net demand and time liabilities (NDTL) in respect of statutory liquidity ratio (SLR) eligible securities acquired on or after Sep 1, 2020, up to Mar 31, 2021.
    - It has now been decided to extend the dispensation of enhanced HTM of 22 per cent up to March 31, 2023 to include securities acquired between April 1, 2021 and March 31, 2022.

**This will enable banks to plan their investments in SLR securities in optimal manner as they need not publish mark to market gains/losses & Government borrowing programme also sails through.**

- **Credit to MSME Entrepreneurs**
    - In order to incentivise new credit flow to the micro, small, and medium enterprise (MSME) borrowers, Scheduled Commercial Banks will be allowed to deduct credit disbursed to 'New MSME borrowers' from their NDTL for calculation of the CRR.
    - For the purpose of this exemption, 'New MSME borrowers' shall be defined as those MSME borrowers who have not availed any credit facilities from the banking system as on Jan 1, 2021. This exemption will be available only for exposures up to Rs 25 lakh per borrower for credit extended up to the fortnight ending Oct 1, 2021 for a period of one year from the date of origination of the loan or the tenure of the loan, whichever is earlier.

**This will encourage entrepreneurs to start business, including those who lost their jobs due to pandemic. It's a very welcome step.**

- **Allowing Retail Investors to Open Gilt Accounts with RBI**
    - Continuing efforts to increase retail participation in government securities and to improve ease of access, RBI has decided to move beyond aggregator model and provide retail investors online access to the government securities market – both primary and secondary - along with the facility to open their gilt securities account ('Retail Direct') with the RBI.

**IF small savings rate become comparable to G-sec rates there can be a lot of retail participation, as there is Government of India guarantee on these securities**

- **FPI Investment in Defaulted Bonds**
    - At present, foreign portfolio investors (FPI) can invest in security receipts and debt instruments issued by Asset Reconstruction Companies and debt instruments issued by an entity under the Corporate Insolvency Resolution Process as per the resolution plan approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code, 2016 and these investments are exempted from the short-term limit and minimum residual maturity requirement under the Medium Term Framework (MTF) for investment by FPIs in corporate bonds.
    - In order to further promote investment by FPIs in corporate bonds, it is proposed to extend similar exemptions to defaulted corporate bonds.

**This is part of the effort to attract external capital to support stressed companies.**

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