Fifth Bi-monthly Monetary Policy Statement, 2020-21

February 05, 2021

Policy Actions

Keep the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 4.00 percent.

Accordingly, the marginal standing facility (MSF) rate and the Bank Rate remains unchanged at 4.25 percent and the reverse repo rate under the LAF remains at 3.35 percent.

The MPC also decided to continue with the accommodative stance as long as it is necessary - at least during the current financial year and into the next financial year - to revive growth on a durable basis and mitigate the impact of coronavirus (COVID-19) on the economy, while ensuring that inflation remains within the target going forward.

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 percent, while supporting growth.

Policy Assessment

The global economic recovery slackened in Q4 (October-December) of 2020 relative to Q3 (July-September) as several countries battle second waves of COVID19 infections, including more virulent strains. In its January 2021 update, the International Monetary Fund (IMF) has revised upward its estimate of global growth in 2020 to (-)3.5 percent from (-)4.4 per cent and increased the projection of global growth for 2021 by 30 basis points to 5.5 per cent. Financial markets remain buoyant, supported by easy monetary conditions, abundant liquidity and optimism from the vaccine rollout. Global trade is also expected to rebound in 2021, with services trade on a slower recovery than merchandise trade.

The first advance estimates of GDP for 2020-21 released by the National Statistical Office (NSO) on January 7, 2021 estimated real GDP to contract by 7.7 per cent, in line with the projection of (-)7.5 percent set out in the December 2020 resolution of the MPC. The agriculture sector remains resilient - rabi sowing was higher by 2.9 percent year-on-year (y-o-y) as on January 29, 2021, supported by above normal north-east monsoon rainfall and adequate reservoir level of 61 per cent (as on February 4, 2021) of full capacity, above the 10 years average of 50 percent

After breaching the upper tolerance threshold of 6 per cent for six consecutive months (June-November 2020), CPI inflation fell to 4.6 percent in December on the back of easing food prices and favourable base effects. Food inflation collapsed to 3.9 percent in December after averaging 9.6 percent during the previous three months (September-November) due to a sharp correction in vegetable prices and softening of cereal prices with kharif harvest arrivals. On the other hand, core inflation, i.e. CPI inflation excluding food and fuel remained elevated at 5.5 percent in December with marginal moderation from a month ago.

Systemic liquidity remained in large surplus in December 2020 and January 2021, engendering easy financial conditions. Corporate bond issuances at ₹5.8 lakh crore during April-December 2020 were higher than ₹4.6 lakh crore in the same period of last year. India's foreign exchange reserves were at US$ 590.2 billion on January 29, 2021 – an increase of US$ 112.4 billion over end-March 2020.

Outlook

With the larger than anticipated deflation in vegetable prices in December bringing down headline closer to the target, it is likely that the food inflation trajectory will shape the near-term outlook The projection for CPI inflation has been revised to 5.2 percent in Q4:2020-21, 5.2 percent to 5.0 percent in H1:2021-22 and 4.3 percent in Q3: 2021- 22, with risks broadly balanced.

Turning to the growth outlook, rural demand is likely to remain resilient on good prospects of agriculture. Urban demand and demand for contact-intensive services is expected to strengthen with the substantial fall in COVID-19 cases and the spread of vaccination. Consumer confidence is reviving and business expectations of manufacturing, services and infrastructure remain upbeat. Real GDP growth is projected at 10.5 percent in 2021-22 – in the range of 26.2 to 8.3 percent in H1 and 6.0 percent in Q3

The MPC noted that the sharp correction in food prices has improved the food price outlook, but some pressures persist, and core inflation remains elevated. The Union Budget 2021-22 has introduced several measures to provide an impetus to growth. The recovery, however, is still to gather firm traction and hence continued policy support is crucial., The MPC decided to continue with an accommodative stance of monetary policy till the prospects of a sustained recovery are well secured while closely monitoring the evolving outlook for inflation.

All members of the MPC unanimously voted for keeping the policy repo rate unchanged at 4 percent. Further, all members of the MPC voted unanimously to continue with the accommodative stance as long as necessary – at least during the current financial year and into the next financial year – to revive growth on a durable basis and mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward.

Statement on Development and Regulatory Policies

This Statement sets out various developmental and regulatory policy that directly address the stress in financial conditions caused by COVID-19.

1). **TLTRO on Tap Scheme – Inclusion of NBFCs:** Since NBFCs are well recognised conduits for reaching out last mile credit and act as a force multiplier in expanding credit to various sectors, the RBI has allowed banks to provide funds to NBFCs under the TLTRO on Tap scheme. Exposure under this facility are exempted from Large Exposure Framework (LEF)

2). **Restoration of Cash Reserve Ratio (CRR) in two phases beginning March 20021:** To help banks tide over the disruption caused by COVID-19, the cash reserve ratio (CRR) of all banks was reduced by 100 basis points. This was available for a period of one year ending March 26, 2021. RBI has decided to gradually restore the CRR in two phases- one in march and another in may 21 by 50bps each

3). **Marginal Standing Facility (MSF) - Extension of Relaxation:** Banks were allowed to raise 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). This facility has been further extended for six months period i.e. from 31st March 2021 to 30th September 2021.

4). **SLR Holdings in Held to Maturity (HTM) category:** Limits on HTM on SLR holdings was increased from 19.5 percent to 22 percent of NDTL for securities acquired from 1st Sep 20 to 31st Mar 21, this will be extended upto 31st Mar 22. HTM limits to be restored to 19.5 percent from Jun 2023.

5). **Basel III Capital Regulations: Deferment of the Full Phase-in of Capital Conservation Buffer (CCB):** The implementation of last tranche of the CCB of 0.625% has been deferred till 1st October 2021.

6). **Retail Investors to Open Gilt Accounts with RBI:** To increase retail participation in government securities and to improve ease of access, RBI to provide retail investors online access to Government securities market- both primary and secondary- along with the facility to open their gilt securities account with the RBI.

7). **Foreign Portfolio Investors (FPIs) Investment in Defaulted Bonds:** FPI investment in defaulted corporate bonds will be exempted from the short-term limit and the minimum residual maturity requirement under the Medium Term Framework.

Our Views & Conclusion:

MPC as expected kept the policy rate unchanged and continued with its accommodative stance as long as necessary-at least during the current financial year and into the next financial year. The RBI lowered its Q4FY21 CPI estimate to 5.2 percent from earlier 5.8 percent and it revised up its H1FY22 estimate to 5.0 percent - 5.2 percent from 4.6 percent to 5.2 percent earlier. There is significantly surplus liquidity in the system. The Governor clearly stressed that market misconstrued RBI's liquidity stance post Variable reverse repo announcement and that the liquidity stance is unlikely to diverge from the accommodative policy stance in the near term. The Governor has indicated that they will ensure the orderly completion of the borrowing programme next year. It will use various instruments at the appropriate time, calibrating them to ensure that ample liquidity is available to the system.

RBI expects the recovery in rural demand to remain resilient and urban demand to strengthen with the substantial fall in COVID cases and the spread of vaccination. We believe that yield will remain rangebound at these levels as RBI will ensure that rates will remain soft and will continue to remain invested in sovereign and AAA corporate bonds.