बैंक ऑफ़ बड़ौदा
Bank of Baroda

MONETARY POLICY REVIEW

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RBI revises its growth and inflation estimates

While revising GDP growth to (-) 7.5% from (-) 9.5% earlier, MPC members unanimously voted to keep policy rate unchanged and maintain accommodative stance in the current and next financial year to support growth. Notably, RBI acknowledged that inflation has turned adverse and revised its inflation estimate by 1.4% and 1.3% in Q3/ Q4 respectively. In H1 FY22, RBI expects CPI inflation at 5.2-4.6%. This constrains RBI to cut policy rate any further. Liquidity will support yields but broader direction will come from Budget.

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Status quo: MPC members unanimously voted to keep key policy rates unchanged and continue with accommodative stance during current financial year and into next one. RBI did revise its inflation forecast up by 1.4% in Q3, 1.3% in Q4. Growth estimates too have been revised upwards to (-) 7.5% from (-) 9.5% earlier with positive growth in Q3 and Q4.

GDP to contract by 7.5% in FY21: Upward revision in growth assumes positive growth in Q3 and Q4 at 0.1% (5.6% contraction earlier) and 0.7% (+0.5% earlier) respectively. With a benign base, growth will accelerate to 21.9-6.5% in HIFY22. However, in its assessment, recovery is not broad based and requires policy support. Thus the need for accommodative liquidity.

CPI forecasts see sharp upward revision: The statement clearly points out that inflation has turned adverse relative to expectations in the last two months. While RBI had projected inflation in Q3 at 5.4% earlier, the new estimate is as high as 6.8%. A similar revision has taken place in Q4. The new estimates are in sync with underlying trend seen in food and core inflation. For instance, as many as 6 out of 12 sub-indices of food are showing double digit inflation. Core inflation too remain sticky at 5.8% and higher international oil prices are likely to push inflation upwards (Indian pump prices are at record high).

Forward guidance: Given the above backdrop, RBI reiterated its guidance to support growth through adequate liquidity in this and next financial year. Policy rate is expected to remain on hold given India has very large negative policy rate. We expect bond yields to remain range bound between 5.75-6.00% in the near-term with clearer direction emerging after the Union Budget. Since the last policy, FX reserves have increased by ~US$ 30bn. The inflow into the economy not only supports RBI's liquidity stance but implies appreciating bias for INR is likely to continue.

KEY HIGHLIGHTS

- Policy rate kept unchanged at 4%.
- CPI forecast has been revised upward by 1.4% and 1.3% in Q3/Q4 respectively.
- GDP to contract by 7.5% in FY21 from 9.5% estimated earlier.

Regulatory announcements

- The on tap TLTRO scheme which was extended up to Mar'21 and included 5 stressed sectors, has now been extended to 26 stressed sectors. Health care sector with credit outstanding between Rs 0.5-5bn has also been included. These 26 sectors would be the same as identified under the ECLGS 2.0 scheme by Kamath committee. Banks will be encouraged to synergise the two schemes by availing funds from RBI under on tap TLTRO and seek guarantee under ECLGS 2.0 to provide credit support to stressed sectors.
- To enhance liquidity support for Regional Rural Banks (RRBs) , RBI has decided to extend the Liquidity Adjustment Facility (LAF) and Marginal Standing Facility (MSF) to RRBs. They will also be permitted to participate in the call/notice money market, both as borrowers and lenders.
- Given the backdrop of Covid-19 pandemic, RBI in Apr'20 had announced that SCBs and co-operative banks will not make dividend pay-outs from profits pertaining to FY20 until further instructions. This decision was to be reviewed following the results of Q2FY21. It has now been reviewed and RBI has confirmed that SCBs and cooperative banks will not make any dividend pay-out from the profits pertaining to FY20.
- RBI will formulate guidelines on dividend distribution by NBFCs. Different categories of NBFCs would be allowed to declare dividend as per a matrix of parameters, subject to a set of generic conditions. Draft guidelines will be made available to public for feedback.
- In addition, RBI sees a need to review the regulatory framework in line with the changing risk profile of NBFCs. It is felt that a 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 15 Jan 2021 for public comment.
- To strengthen the audit systems of Supervised Entities (SEs), it has been decided that RBI will issue guidelines for large UCBs and NBFCs on adoption of Risk Based Internal Audit (RBIA). Also, guidelines for harmonisation of appointment of statutory auditors for commercial banks, UCBs and NBFCs will be issued.
- To promote inclusive growth, deepen financial inclusion and protect the customers by promoting financial literacy, RBI had launched a pilot project in 2017 involving select banks and NGOs to spread financial literacy through community led participatory approach in 80 blocks by setting up Centres for Financial Literacy (CFL). This was extended to 20 more blocks in tribal/economically backward areas in 2019. It has now it has been decided to

expand the reach of the CFLs at every block in the country in a phased manner by FY24.

- With the objective to further develop the market for credit default swaps (CDS), the guidelines have been revised to broaden the market. Further, guidelines on derivatives will be reviewed in order to promote efficient access to derivative markets in line with international standards. Additionally, three set of draft directions on CDs, call, term money, commercial papers (CPs) and non-convertible debentures (NCD) will be released by providing consistency to issuers, investors and other participants.
- On external trade, RBI has extended and announced measures to govern export transactions by providing more powers to authorised dealer banks in order to improve ease of doing business. Irrespective of the value of export shipment (earlier US$ 1mn), monetary ceiling has been removed wherein the exports proceeds have been realised.
- On payment and settlement system, in order to enable better management of funds by member banks, it has been proposed to allow settlement files of payment systems to be posted on all days of the year on RBI, with round clock availability of RTGS and e-Kuber. Further, limit for contactless card transactions has been enhanced from Rs 2,000 to Rs 5,000 from 1 Jan 2021, with the objective to adopt digital payment system in safe and secure manner.

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