MONETARY POLICY REVIEW

05 February 2021

Rates on hold, focus on liquidity

MPC members unanimously voted to keep policy rate unchanged and maintain accommodative stance in the current and into next financial year. RBI did raise its growth estimate for H1FY22 up by 3%. It also raised its inflation estimate up by 0.2% and expects inflation to come down to 4.3% in Q3. We continue to believe we have come to an end to rate cycle. However, liquidity will remain accommodative. The focus will be on absorbing elevated supply of government paper through OMOs and banks (extension of HTM limit of 22% to Mar'23).

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Status quo: MPC members unanimously voted to keep key policy rates unchanged and continue with accommodative stance as long as necessary—at least during current financial year and into next year—to revive growth.

GDP growth expected at 10.5% in FY22: RBI notes that growth impulses have strengthened in Jan'21 as seen in improvement in capacity utilisation, consumer confidence and electricity demand. While rural demand is holding up well, urban demand is likely to improve with rollout of vaccine. Thus, RBI has revised its H1FY22 growth estimate to 8.3-26.2% from 6.5-21.9%. For FY22 growth estimate is 10.5% from 7.7% contraction in FY21. We believe both the estimates may be revised upwards given the underlying economic momentum.

CPI forecasts revised: While RBI now expects inflation to fall to 5.2% in Q4FY21 from 5.8% earlier, inflation in H1FY22 is estimated to be higher at 5-5.2% from 4.6-5.2% earlier. The upward revision in H1 is led by entrenched core inflation, rising commodity prices and normalisation of economic activity. RBI expects inflation to come down to 4.3% in Q3 led by a favourable base. With inflation estimated to remain above target of 4% (under revision), we do not see RBI cutting rates. RBI supports continuity of existing regime.

Liquidity support for government borrowing: RBI reiterated its commitment to provide ample liquidity. One of the primary objective next year is to meet government's extended borrowing. For this, new bonds bought by banks next year will quality for HTM segment which was revised to 22% of NDTL till Mar'23. While this along with RBI's OMOs will ensure demand for government bonds, excess liquidity with the banking system is being reduced by normalisation of CRR from 3% in 2 phases- 3.5% from 27 Mar 2021 and 4% from 22 May 2021. RBI is also tapping retail investors directly now with direct access to g-sec market.

KEY HIGHLIGHTS

- Policy rate kept unchanged at 4%, accommodative stance to continue.
- CPI forecast for Q4FY21 has been revised downwards by 0.6%. CPI estimate for H1FY22 revised upwards to 5.1% from 4.9%.
- GDP forecast for H1FY22 revised upwards to 17.3% from 14.2% earlier. For FY22, GDP growth expected at 10.5%.

Regulatory announcements

- The on tap TLTRO scheme will now be extended to NBFCs in order to provide incremental lending.
- CRR to be gradually restored in two phases from 3% to 3.5% of NDTL from 27 Mar 2021 and to 4% from 22 May 2021.
- RBI extended relaxation under MSF by 6-months to Sep'21. Under this, banks can dip into SLR by up to an additional 1% of NDTL-cumulatively up to 3% of NDTL. This is expected to unlock Rs 1.53tn liquidity for banks.
- Enhanced HTM limit of 22% of NDTL extended to 31 Mar 2023 to include securities acquired between 1 Apr 2021 and 31 Mar 2022. HTM limits will be restored to 19.5% in a phased manner starting from Jun'23.
- SCBs will be permitted to exclude credit disbursed to "new MSME borrowers" (MSME borrowers who have not availed any credit as on 1 Jan 21) from NDTL for CRR calculation. This will only cover exposures upto Rs 2.5mn for credit extended upto fortnight ending 1 Oct 21 for a period of 1 year from the date of taking the loan/tenure of the loan.
- Implementation of last tranche of Capital Conservation Buffer (CCB) and Net Stable Funding Ratio (NSFR) has been deferred to 1 Oct 2021.
- RBI to introduce a comprehensive regulatory framework covering all microfinance institutions.
- RBI will also set up an Expert Committee on Urban Co-opertaive Banks (UCBs) to provide a medium-term road map to strengthen the sector..
- Resident Indians are being allowed to make remittances under the Liberalised Remittance Scheme (LRS) to International Financial Services Centre (IFSCs) for investment in securities issued by non-resident entities in IFSCs. For this, resident individuals will be allowed to open a non-interest bearing Foreign Currency Account (FCA) in IFSCs.
- RBI will also allow retail investors to participate in the government securities market – both primary and secondary – directly through the Reserve Bank ('Retail Direct') making India one of the few countries to offer this facility.
- FPI investment in defaulted corporate bonds to be exempted from the short-term limit and the minimum residual maturity requirement under the Medium-Term Framework.
- RBI stated that CTS system will be made operational across all branches by Sep'21. It has decided to implement the 'Positive Pay' system in order to

enhance safety of cheque transactions. Further, RBI has proposed to set up a centralised industrywide helpline 24*7 for digital payment service by Sep'21.

- It has also been decided to integrate the Ombudsman schemes for banks, NBFCs and non-bank prepaid payment issuers (PPIs) into a centralised processing of grievances following a 'One Nation One Ombudsman' approach.

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