MONETARY POLICY REVIEW

07 April 2021

Growth remains centre point of monetary policy

MPC kept repo rate on hold but removed time specific stance guidance in favour of one contingent on reviving growth. RBI also announced Rs 1tn of asset purchase in Q1 (Rs 3.13tn in FY21). Growth forecast for FY22 was maintained at 10.5%. At the same time, inflation in FY22/ FY23 is projected at 5%/ 4.7%. With inflation estimated to remain above RBI's target of 4%, we believe RBI is likely to normalise monetary policy first by reducing rate corridor between repo and reverse repo rate in H2FY22 and second by raising repo rate in FY23.

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Status quo: MPC members voted to keep repo rate on hold. While accommodative stance has been retained, it is contingent on growth revival and mitigating the impact of the pandemic. Time based guidance has been removed.

GDP growth forecast retained in FY22: RBI retained its growth forecast for FY22 at 10.5%. However, second Covid-19 wave has brought uncertainty. While GDP growth for Q1 and Q2 has been retained at 26.2% and 8.3% respectively, for Q3 growth has been revised lower to 5.4%. In FY23, RBI expects GDP growth at 6.8%.

CPI forecasts remain above MPC's target: RBI has revised its CPI projection downward to 5% in Q4FY21 from 5.2% earlier. While inflation projection for Q1FY22 has been retained at 5.2%, for Q2 and Q3 it has been revised upward to 5.2% (5% earlier) and 4.4% (4.3% earlier) respectively. While inflation is estimated to drop from 6.2% in FY21 to 5% in FY22 and 4.7% in FY23, in all three years it will remain above RBI's target of 4%. Thus today's policy opens up room for normalisation contingent upon growth outlook.

Liquidity support and normalisation: While announcing withdrawal of time based guidance, RBI has announced liquidity support for long-end bonds by introducing G-Sec Acquisition Program (GSAP), an asset purchase program of Rs 1tn in Q1FY22. The first purchase under this window will be Rs 250bn on 15 April 2021. Notably, RBI did net purchases of Rs 3.13tn in FY21. With this, RBI has been able to strike a balance between liquidity guidance and opening up room for normalisation of monetary policy. RBI's inflation target is 4%. As a first step to normalisation, we believe RBI will reduce the corridor between repo and reverse repo rate in H2FY22 before raising repo rate in FY23.

KEY HIGHLIGHTS

- Policy rate kept unchanged at 4%, accommodative stance to continue.
- CPI forecast for FY22 and FY23 at 5% and 4.7% respectively.
- GDP forecast for FY22 retained at 10.5%. In FY23, GDP to grow by 6.8%.

Regulatory announcements

- RBI had announced the TLTRO on tap scheme on October 9, 2020 which was available up to 31 Mar 2021. In addition to the five sectors announced under the scheme in Oct'20, 26 stressed sectors identified by the Kamath Committee were also brought within the ambit of sectors eligible under on tap TLTRO on 4 Dec 2020 and bank lending to NBFCs on 5 Feb 2021. RBI has now decided to extend scheme by a period of six months, till 30 Sep 2021.
- To support the continued flow of credit to the real economy in the aftermath of the Covid-19 pandemic, special refinance facilities for a total amount of Rs 750bn were provided during Apr-Aug'20 to All India Financial Institutions (AIFIs)-NABARD, SIDBI, NHB and EXIM bank. Now it has been decided to extend fresh support of Rs 500bn to the AIFIs for new lending in FY22. Out of which, Rs 250bn has been provided to NABARD, Rs 100bn to NHB and Rs 150bn to NHB. All these three facilities will be available at the prevailing policy repo rate.
- With a view to encourage the efforts of Payments Banks for financial inclusion and to expand their ability to cater to the needs of their customers, including MSMEs, small traders and merchants, it has been decided to enhance the limit of maximum balance at end of the day from Rs 0.1mn to Rs 0.2mn per individual customer.
- It has been proposed to constitute a Committee to undertake a comprehensive review of the working of ARCs in the financial sector ecosystem and recommend suitable measures for enabling such entities to meet the growing requirements of the financial sector.
- RBI has decided to extend the priority sector lending (PSL) classification for lending by banks to NBFCs for 'on-lending' to agriculture/MSME/housing for six months, up to 30 Sep 2021.
- RBI has enhance the loan limit from Rs 5mn to Rs 7.5mn per borrower against the pledge/hypothecation of agricultural produce backed by NWRs/ (e-NWRs) issued by warehouses registered and regulated by WDRA. The Priority Sector loan limit backed by other Warehouse Receipts will continue to be Rs 5mn per borrower.
- RBI has decided to enhance the aggregate limit for WMA (Ways and Mean advances) for all states and UTs to Rs 470bn (increase of 46%) and continue with the enhanced the interim WMA limit of Rs 515.6bn for a further period of 6 months (Sep'21).
- RBI will construct and publish 'Financial Inclusion' index annually in Jul'21, it will reflect the deepening and broadening of financial inclusion in the country.

- In order to encourage participation of non-banks across payment systems, it has been proposed to enable them to become members of RBI-operated centralised payment system (CSPs)-RTGS and NEFT.
- With the objective to enhance interoperability of PPIs (Pre-paid instrument) and incentive their migrations to full-KYCs, RBI has proposed to raise the limit of outstanding balance from Rs 0.1mn to Rs 0.2mn. Additionally, it has also proposed to allow cash withdrawal facility upto a limit for full -KYC PPIs.
- RBI has given one-time relaxation to ECB borrowers to park un-utilized proceeds in term deposits with AD category-1 till 1 Mar 2022.

FIG 1 – BASE LINE ASSUMPTIONS IN MPR

Indicator	October 2019 MPR	April 2020 MPR	October 2020 MPR	April 2021 MPR
Crude Oil (Indian Basket)	US$ 62.6 per barrel	US$ 35 per barrel during FY20	US$ 40.9 per barrel	US$ 64.6 per barrel during FY22
Exchange rate	71.3/US$	75/US$	73.6/US$	72.6/US$
Monsoon	10% above LPA	Normal for 2020	9% above LPA	Normal for 2021
Global growth	3.2% in 2019 & 3.5%in 2020	Contraction in 2020	Contraction of 4.9% in 2020, 5.4% growth in 2021	5.5% in 2021 & 4.2%in 2022
Fiscal deficit	To remain within BE 20BE Centre: 3.4% Combined: 5.9%	To remain within BE FY20 Centre: 3.5% Combined: 6.1%	Given the Covid-19 impact on activity, revenues and expenditures and factoring in the additional borrowings announced, fiscal deficits are expected to be significantly higher	To remain within BE FY22 Centre: 6.8% Combined: 10.8%
Domestic macroeconomic/ structural policies during the forecast period	No major change	No major change	No major change	No major change

Source: RBI, Monetary Policy Report

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