CARE Ratings
Professional Risk Opinion

Expectations from RBIs Monetary Policy

April 5, 2021 I Economics

The Monetary Policy Committee (MPC) is to present its first bi-monthly monetary policy for 2021-21 on 7 April'21.

The announcements to be made by the RBI would set the tone for monetary policy for the current financial year.

With the policy coming in the backdrop of a resurgence in Covid-19 infections in the country and fresh restrictions, buildup of inflationary pressures, and rising bond yields, the RBI's announcement would be closely watched to see as to how it would support

a. economic growth,
b. control inflation and
c. manage the governments sizeable borrowing amid rising yields along with the higher demand for credit from the private sector.

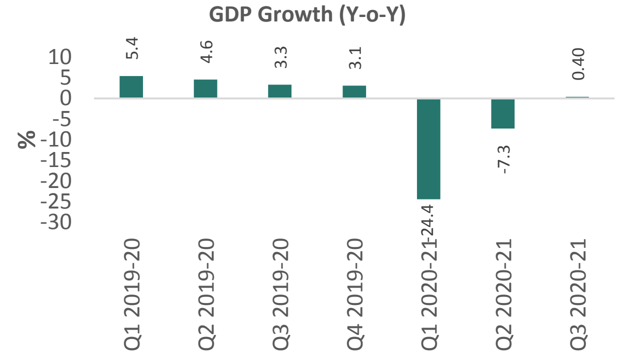
We expect the RBI to retain the policy rate at 4% and continue with the accommodative policy stance.

Key Monetary Policy Announcements since March'2020

- Reduced repo rates to a record low of 4% through 2 rate cuts of 75 bps in March'20 and 40 bps in May'20.
- Liquidity infusion through -(1) Targeted Long Term Repo Operations (TLTRO 1.0) of Rs. 1 Lakh crores (3 year tenure), (2) Additional targeted long-term repo operations (TLTRO 2.0) of Rs. 50,000 crores, and (3) On tap TLTRO of Rs. 1 Lakh crores.
- On tap TLTRO for the 26 stressed sector and the NBFC sector.
- Cut CRR (cash reserve ratio) by 100 bps to 3% of NDTL with a phased normalization by May'21 (3.5% from 27 March'21 and 4% from 22 May'21)
- Relaxation under the Marginal Standing Facility (MSF) to enable banks to avail funds under the MSF facility by dipping into the SLR up to additional 1% of the NDTL till 30 Sep'21.
- Increased OMO purchases (special and outright).
- OMO's in SDLs (State Development Loans)
- Increase in limit of SLR holding in HTM category (to 22% of NTDL) till 31 March'21.
- Liquidity Coverage Ratio (LCR) requirement for Scheduled Commercial Banks reduced to 80% from 100%
- 6 months moratorium (April-August'20) in respect on all term loans of commercial banks, all India financial institutions and NBFCs outstanding as on 1 March 2020.
- Interest on working capital facilities deferred for 6 months (April-August'20) without downgrade of asset classification.
- Period for resolution plan for stressed assets extended by 90 days
- The RBI has permitted to increase bank's exposure to a group of connected counterparties from 25% to 30% till June 30, 2021.
- A 60% increase in the WMA limit for states over the limit as on 31 March'20.

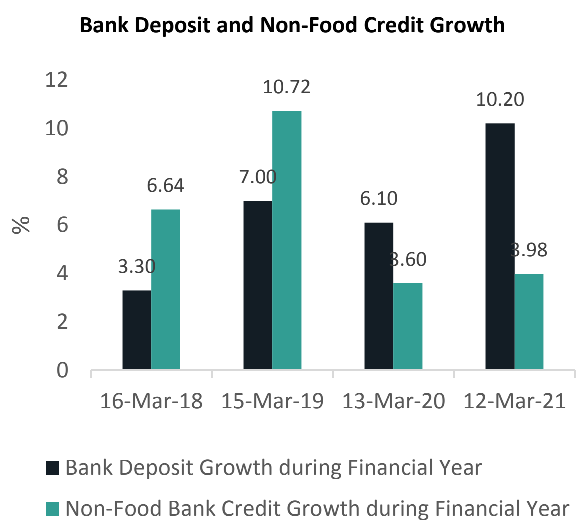
Macro- Economic Scenario

A. Recovery in Economy



- Following two successive quarters of contraction, the Indian economy returned to growth in Q3 FY21. The GDP growth of 0.4% in Q3 FY21 was nevertheless notably lower than that last year (3.3% in Q3 FY20).
- Although the recovery has been broad based across sectors, it has been at varying speeds given that certain segments, primarily in the services sector have been operating with restrictions.
- Consumption demand (private and government), although significantly lower than that in FY20 has witnessed an improvement and growth (y-o-y) in Q3 FY21 from the contraction in the first two quarters.
- Investments too picked up in Q3 FY21, registering a growth (year-on-year basis) after a gap of three quarters. As a percentage of GDP, investments at 28% in Q3 FY21 was at the highest rate in five quarters.

B. Subdued Bank Credit Offtake amid Deposit inflows



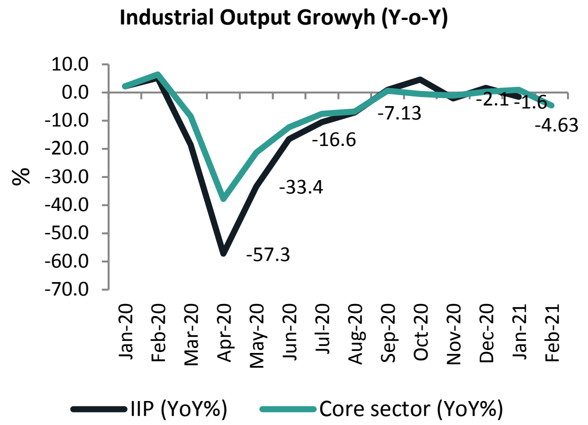
- Bank credit offtake has been restrained in FY21 amid strong deposit inflows. The lower credit growth can be attributed to risk aversion on the part of lenders as well as reluctance of businesses to add to their liabilities amid the uncertain economic and business climate. Several companies had taken the moratorium and hence were more cautious when borrowing. Also some were hoping for some further extension of this facility which was ruled out by the Court towards the end of March.
- The outstanding bank deposits as of 12 March'21 aggregated Rs.149 lakh crores, which is a 10% increase since end March'20. Bank credit growth during this period has been 4%.
- The non-food bank credit growth during Apr to mid- March of FY21 at 3.98% is only marginally higher than that in the comparable period of last year. There has been an uptick in bank credit offtake in recent months. It however continues to be significantly lower than the 11% credit growth of FY19.
- Incremental lending during FY21 when compared with FY20 has been marginally higher in the case of the services sector (2% growth) while it has declined in the case of the industry (by -4.3%) and the retail segment (from the 12.5% average annual growth in FY18-20 to 6.7% in FY21).

C. Bank credit deployment to industry

	Micro & Small	Medium	Large
% share	*14*	*5*	*82*
Apr-Jan'18	*1.1*	*−7.3*	*−2.8*
Apr-Jan'19	*−0.5*	*0.3*	*2.4*
Apr-Jan'20	*-0.7*	*0.4*	*-2.8*
Apr-Jan'21	*-2.5*	*25.2*	*-5.8*

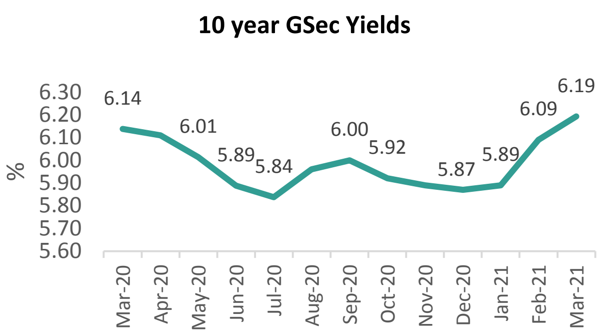
- In terms of bank borrowings by industry, the large enterprises accounted for the largest share of bank credit at over 80% during Apr-Jan of FY21. Credit offtake by them has however been 6% lower than year ago.
- On the other hand, incremental credit offtake by the medium size enterprise have seen a notable growth of 25% in FY21. This can be credited to the central governments credit guarantee support provided to these enterprises.

D. Industrial Output



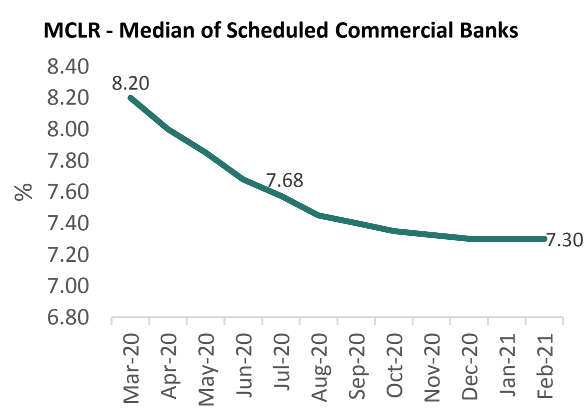
- Although, industrial output has picked up from the lows of Apr- Jul'20, the growth (y-o-y) in industrial output has been negative for a major part of FY21.
- Cumulative growth during Apr-Jan of FY21 has been negative 12.2% v/s the 0.6% growth in the same period of FY20.
- Output has been lower across the various segments reflective of the subdued consumption and investment demand.
- The output of all eight core sectors, which account for nearly 40% of the IIP, witnessed negative growth in all the segment in Februray'21. This raises concerns over the strength of the recovery in the domestic industrial sector.

E. G-Sec Yields on the rise



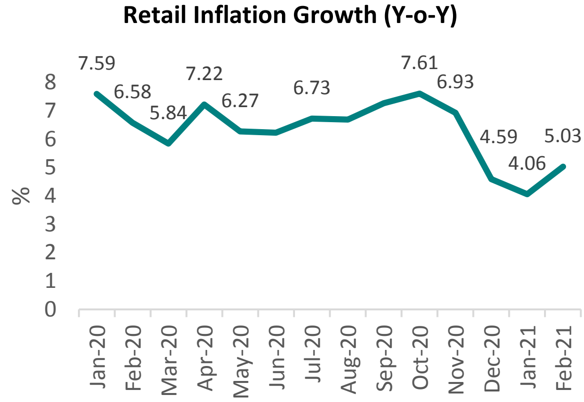
- GSec yields have been on the rise, with the average yields of the 10 -year benchmark securities having risen by 30 bps since Jan'21.
- Domestic as well as global factors have been pushing the yields higher. Demand for government securities has weakened given the huge supply of securities on account of the high market borrowings by the government in FY21 and FY22 amid the build-up in inflationary pressures. Unfavorable global market conditions i.e. the rise in global bond yields, increase in commodity prices along with the strengthening of the US Dollar, has been further pressuring GSec yields. The RBI measures to anchor yields through OMO purchases have had limited impact.
- This rise in yields and thereby cost of borrowing raises concerns over the governments sizeable borrowing programme for FY22 and its implication for overall cost of funds in the economy.

F. Interest Rates of Scheduled Commercial Banks



- The lending rate of banks viz. the marginal cost of funds based lending rate or the MCLR has been at a 5 year low of 7.3% since Dec'20.
- The median MCLR of SCBs has declined by 70 bps since Apr'20 following the policy rate cuts by the RBI by 115 bps since end Mar'20.
- The lower cost of borrowing has not stimulated bank credit off take.

G. Inflation



- India's headline inflation rebounded in February'21, reversing the decline of the preceding two months and rose to a three-month high of 5.03%, driven by the sharp rise in food prices and elevated fuel prices.
- The rise in retail inflation raises concerns over the re-emergence of price pressures.
- There has been a broad-based increase in the price levels across the key segment of the consumer price index.
- Core inflation (non-food, non-fuel) has risen to over a two-and- half year high level.

Predominant Economic Concerns

- Sustainability of Economic recovery: The resurgence of Covid-19 infections in the country and the accompanying restriction imposed across various regions could be a setback for the nascent recovery in the domestic recovery. The RBI view on growth for FY22 will be eagerly awaited.
- Inflationary pressure: The rise in global prices across commodities, the increase in food prices and the elevated levels of prices of the non-food and non-fuel segment would pressure price levels in the domestic economy in the coming months. Non-food inflation has been a major concern as this inflation tends to be sticky. The rise in inflation could come in the way of economic recovery and can pose a challenge to the RBI in maintaining an accommodative policy stance. There could be an upward revision in inflation forecasts for the first quarter.
- Balancing liquidity during the year in the light of high borrowings by the centre and states a recovery in private credit demand.
- Rise in yields: The recent surge in bond yields raises the cost of funds for the government and businesses alike. This would have adverse implications for the planned government borrowing program for the year and for business whose fund requirement would increase with higher levels of activity.

CARE Ratings Expectations

- No change in the repo rate. The accommodative monetary policy stance would be maintained to address economic growth concerns.
- The RBI is likely to announce further liquidity infusion measures (TLTRO's) to support credit growth during the course of the year if required.
- Open market operations would be announced periodically to anchor bond yields.

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