CARE Ratings
Professional Risk Opinion

RBI's Monetary Policy Review

April 7, 2021 I Economics

The Monetary Policy Committee (MPC) presented its first bi-monthly monetary policy for 2021-21 today.

In line with expectations, the RBI retained the key policy rates and pledged to continue with the accommodative policy stance till economic recovery is well secured.

Key takeaways

- Policy rate retained at 4%, which is the lowest level in over a decade
- The overall tone of the policy was supportive to the economy and markets alike.
  - Monetary policy geared towards aiding economic revival on a durable basis
  - To an extent addressed key market concerns about limiting volatility in bond yields and absorbing the increased supply of government securities.
- Surplus liquidity conditions in the system to be maintained and sustained
  - Ensure availability of adequate funds to aid economic recovery
  - LAF (long term repo/ reverse repo auctions) operations, forex operations and OMOs to continue.
- Fund availability for lending to productive sector
  - On-tap TLTRO to NBFC to continue
  - Refinance facility for All India Financial Institutions (AIFs)
- Measures to control the volatility in GSec yields and thereby anchoring the cost of funds
  - Commitment to purchase sizeable quantity of GSecs from the secondary market under the maiden GSAP 1.0 programme. This will presumably hold across the year with fresh announcements.
  - Support to the borrowing programme of the government by these measures.
  - Corporate bond yield spreads would be under control. This in turn is a positive for the bond markets and would facilitate higher borrowings by corporates.
- Prevalence of underlying inflationary pressures not to come in the way of accommodative monetary policy
  - Revival of economy growth taking precedence.
  - Inflation to range between 4.1% to 5.2% in FY22. Both upside as well downside pressures prevail.
  - Inflation outlook in line with CARE Ratings outlook of 5-5.5% for FY22.
- Economic growth outlook for FY22 retained at 10.5%. Quarterly breakup provided for the first time.
  - Outlook factors the uncertainty on account of the recent surge in Covid infections, resilient rural demand and expectation of normalization of activity with the vaccination programme.
  - In line with CARE Ratings estimate of 10.7% to 10.9%
  - More realistic than the IMFs forecast of 12.5% growth.

Key Policy Rates (%)

	Feb'20	Mar'20	May'20	Feb'21	Apr'21
Repo Rate	5.15	4.4	4	4	4
Reverse Repo Rate	4.9	4	3.75	3.35	3.35
MSF	5.4	4.65	4.25	4.25	4.25
Bank Rate	5.4	4.65	4.25	4.25	4.25

Source: RBI

RBI's Outlook

	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	FY22
GDP Growth	26.21	8.3	5.4	6.2	10.5
CPI Inflation	5.2	5.2	4.4	5.1	

Market Reaction to Monetary Policy (as of 11: 40 am)

- GSec yields have cooled post the policy announcement. The benchmark 10 year-GSec yields have decline to 6.07 from yesterday's last traded yield of 6.12%.
- Sensex has climbed 533 points from yesterday's close.

Policy Announcement and Implications

- **Extension of deadline of on tap- TLTRO Scheme by a period of 6 months till 30 September'21.**
  Implications: Ensures availability of funds for the designated sector i.e. the 26 stressed sectors and NBFCs.
- **Special refinance facility of Rs.50,000 crore to All India Financial Institutions (AIFIs) to facilitate fresh lending in FY22.** Under this facility NABARD is to receive (Rs. 25,000 crs), NHB (Rs.10,000 crore) and SIBDI (Rs.15,000 crs)
  Implications: Makes available funds for agriculture and allied activities, rural non-farm sector, NBFC-MFIs, housing sector and MSMEs.
- **Permitting banks to on lend through NBFCs under priority sector lending till 30 September'21.**
- **VRRR (Variable rate reverse repo) auctions of longer maturity to be conducted to manage liquidity**
  Implications: This will help to absorb surplus in the system and bring stability in the markets.
- **Secondary market G-sec acquisition programme or G-SAP 1.0:** RBI commits to purchase a specific amount of GSecs through open market to anchor bond yields and thereby cost of funds in the economy. Rs. 1 lakh crore of GSecs scheduled to be purchased in Q1 FY22 of which Rs.25,000 crore to be purchased on 15 April'21.
  Implications: This would help rein in volatility in yields, boost market sentiments and aid in the government's borrowing programme. This will run along with the other OMOs, Operation twist and LAF measures and hence adds to these measures.
- **Ways and Means Advances (WMA) limit for states and UTs enhanced** to Rs.47,010 crore, 46% increase from current limit that was fixed in February'16. Also, the enhanced interim WMA limit (of Rs.51,560 crore) due to pandemic to be extended by 6 months till 30 September'21.
  Implications: This could come to the aid of states who seek this facility to meet their short-term fund requirements. It could also result in lower borrowing through SDL issuance in case of some states as they come at a lower cost.

RBI's Assessment of the Economy

Global Economy

- Lingering effects of the slowdown in the global economy in Q4 of 2020 have persisted, although recent high frequency indicators suggest that a gradual but uneven recovery may be forming.
- The anticipated boost to economic activity from the vaccination rollouts is being impacted by the renewed wave of infection across countries and unequal rollout of vaccines.
- World trade activity improved in Q4:2020 and January 2021. Fresh lockdowns and consequent depressed demand along with escalation in shipping charges and container shortages a concern for global trade.
- Inflation remains benign in major advanced economies (AEs).
- Inflation ruling above target in some emerging market economies (EMEs), primarily driven by firming global commodity prices, prompting some of them to raise policy rates.
- Equity and currency markets have been turbulent with the increase in long-term bond yields and the steepening of yield curves.
- With the bond markets sell-offs, EME assets came under selling pressure and capital outflows imposed depreciating pressures on EME currencies in March.

Domestic Economy

- High frequency indicators – vehicle sales; railway freight traffic; toll collections; goods and services tax (GST) revenues; e-way bills; and steel consumption – suggest that gains in manufacturing and services activity in Q3:2020-21 extended into Q4.
- Purchasing managers' index (PMI) manufacturing at 55.4 in March 2021 remained in expansion zone, but lower than its level in February.
- The index of industrial production slipped into marginal contraction in January 2021, dragged down by manufacturing and mining. Core industries also contracted in February.

- Agriculture has been resilient as seen from the higher foodgrains and horticulture production for 2020-21.
- Inflation firmed to 5% in February after having eased to 4.1% in January 2021. Core inflation has hardened.
- Large surplus in system liquidity of (avg) Rs.5.9 lakh crore in February- March 2021.
- Driven by currency demand, reserve money (RM) increased by 14.2 per cent (y-o-y) as on March 26, 2021. Money supply (M3) grew by 11.8 per cent as on March 26, 2021 with credit growth at 5.6 per cent.
- Corporate bond issuances at ₹6.8 lakh crore during 2020-21 (up to February 2021) were higher than ₹6.1 lakh crore during the same period last year.
- Issuances of commercial paper (CPs) turned around since December 2020 and were higher by 10.4% during December 2020 to March 2021 than in the same period of the previous year.
- India's foreign exchange reserves increased by US$ 99.2 billion during 2020-21 to US$ 577.0 billion at end-March 2021, providing an import cover of 18.4 months and 102 per cent of India's external debt.

CARE Rating Views

The monetary policy continues to be growth centric, despite the underlying upside risks to inflation. This is so as it believes that the inflation today is short-term in nature while growth has to protected for long term sustainability. Although the assurance of retaining the accommodative monetary policy stance to support growth reduces the likelihood of a rate hike at least in H1 FY22, it also rules out the likelihood a rate cut.

The overall focus of the RBI is to make available adequate liquidity that it deems necessary for conduct of economic activity. Along with liquidity it is also striving to keep the cost of fund low by anchoring bond yields; and has indicated the scale of support to be extended towards this end. This is a positive as lower bond yields would facilitate higher borrowing by businesses.

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