April 07, 2021 ECONOMIC UPDATE

Monetary Policy—April 2021

MPC kept Repo Rate Unchanged, Maintaining Accommodative Stance

The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) that began its 3-day huddle from 5th-7th April to decide lending rates and the decision on key rates, among others, gave the unanimous decision of maintaining status quo on the rates and the stance. The nascent economic growth and inflation dynamic warranted continued policy support from the RBI, especially with increasing Covid-19 cases. The MPC held the repo rate at 4% for the 5th consecutive time, Reverse repo rate at 3.35% and retained its **Accommodative stance** for as long as necessary amid rising inflation and elevated inflation.

Highlights of Monetary Policy:

- Repo Rate: 4.00% (4.00% in February 2021)
- Reverse Repo Rate: 3.35% (3.35% in February 2021)
- Bank Rate: 4.25% (4.25% in February 2021)
- Marginal Standing Facility: 4.25% (4.25% in February 2021)
- GDP Projection: Growth projected remains unchanged at 10.5% for FY22
- CPI Inflation: Revised to 5.0% (from the earlier projected 5.2%) for Q4FY21, 5.2% in Q1FY22, 5.2% in Q2FY22, 4.4% in Q3FY22 and 5.1% in Q4FY22

Some Highlights:

- Recent surge in Covid-19 infections has created uncertainty over economic growth recovery, hence focus should be on containing fresh infection spread and economic revival
- Prospects to FY22 have strengthened with vaccination programme
- Liquidity management has ensured borrowing of Rs22lakhcrore by the Centre, states in FY22
- Consumer Price Index (CPI) inflation trajectory is likely to be subject to both upside and downside pressures. Food inflation will depend on progress of the south-west monsoon and taxes on petroleum products
- RBI to ensure orderly conduct of government borrowing; preserve financial stability
- The RBI fulfilled a long-standing demand of bond market participants of having an open market operations (OMO) calendar of sorts, through which the central bank would commit its periodic support to the market
- The RBI will increase the scope of its variable rate reverse repo (VRRR) auctions with increased tenure

Other Measures Announced:

1) **RBI to buy Rs1-lakh-crore of G-Sec under GSAP in Q1:** The RBI announced Secondary Market G-Sec Acquisition Programme 1.0 under which Rs1-lakh-crore will be put in place for Q1FY22, where the first purchase of Rs25,000cr will be done on April 15 under G-SAP. RBI will commit to upfront buying of G-secs and attempts to ensure financial stability and G-sec stability from global uncertainty
2) **Targeted Long-Term Repo Operations (TLTRO) extension:** TLTRO on-tap scheme is extended by 6 months to Sep 30, 2021. This would help ease the liquidity needs of the system
3) **Liquidity facility for all India financial institutions:** Announced new liquidity support of Rs50,000cr for fresh lending during 2021 to national financial institutions namely Rs25,000cr to NABARD, Rs10,000cr to NHB and Rs15,000cr to SIDBI
4) **Enhancement of limit of maximum balance for payments banks:** The maximum end of the day balance limit has been doubled to Rs2 lakh
5) **Asset Reconstruction Companies:** A committee to be set up to review the functioning of ARCs and recommend measures as its potential is yet to be realized
6) **Permitting Banks to on-lend through NBFCs:** Bank lending to registered NBFCs other than MFIs under priority lending extended till Sept 30, 2021
7) **Priority Sector Lending (PSL)- Enhancement of Loan Limit against eNWR/NWR:** Loan limit under priority sector lending to agricultural sector increased from Rs50lakh to Rs75lakh
8) **Financial Inclusion Index:** Financial inclusion index based on various parameters to be published in July every year
9) **NEFT, RGTS to be extended beyond banks:** RBI raises Paytm, wallet accounts limit to Rs2 lakh; allows RTGS, NEFT connectivity to payment operators
10) Interoperability among full-KYC PPIs made mandatory
11) **Cash Withdrawal from Full-KYC PPIs issued by Non-banks:** Cash withdrawal by full-KYC PPIs issued by non-bank users allowed
12) **Relaxation in External Commercial Borrowing (ECB) Proceeds**: Under the extant ECB framework, borrowers are allowed to place ECB proceeds in term deposits with AD Category-I banks in India for a maximum period of 12 months. In view of the difficulty faced by borrowers due to the Covid-19 pandemic, it has been decided to permit parking of unutilised ECB proceeds drawn down on or before March 1, 2020 in term deposits with AD Category-I banks in India prospectively up to March 1, 2022
13) **Ways and Means Advances by 46%:** RBI will enhance the Ways and Means Advances (WMA) to Rs47,010cr, up 46% from the current limit of Rs32,225cr

Please Turn Over

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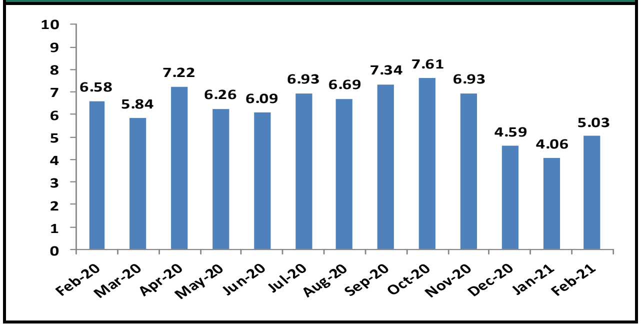
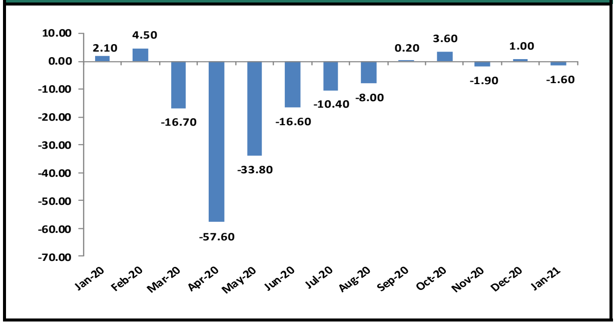
Inflation rate -CPI (%)



Source: tradingeconomics.com

Index of Industrial Production-IIP (Change YoY%)



Source: tradingeconomics.com

Our View:

Stuck between the second wave of Covid-19 infections and elevated inflation, the MPC announcement was on expected lines, taking the do-nothing option this time. Although a dovish pause was on the cards, if read carefully one can conclude that the stance is more dovish than expected with the governor reinforcing the central bank's commitment to remain accommodative to support & nurture the recovery as long as necessary. For the bond markets, governor's assurance to ensure an orderly evolution of the yield curve was confidence-inspiring seen through the movement in the 10-year yields. While the manufacturing firms continue to remain optimistic on demand picking up in FY22, the rural demand has been buoyant while the urban demand too has started gaining some traction. RBI interventions will help maintain adequate liquidity as well as prevent the hardening of yields in the bond market. These measures will ensure economic stability as well as keep real estate sector stay afloat during such precarious times. The Central Bank aims at ensuring ample liquidity in system so that productive sector has adequate credit and ensure orderly conduct of government borrowing while at the same time preserve financial stability. Although the recent surge in Covid-19 infections creates uncertainty over economic growth recovery, the focus will be on containing fresh infection spread and lay more emphasis on economic revival. The vaccination programme globally has strengthened the prospects of FY22. ***Finally, as indicated by the Governor, if patience is worth anything, it must endure to the end of time. And a living faith will last in the midst of the blackest storm.***

FINAL VERDICT			
MPC Meetings	**REPO**	**REVERSE**	**CURRENT STANCE**
February 2021	*4.00%*	*3.35%*	**ACCOMMODATIVE**
April 2021	**4.00%**	**3.35%**	

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