

Expectations from RBI's Monetary Policy

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The Monetary Policy Committee (MPC) is to present its fourth bi-monthly monetary policy for the current financial year later this week (4 December'20). This is the second policy meet under the newly formed MPC.

The MPC is expected to factor in its decision making the nascent signs of improvement in the domestic economy while also recognizing the fragile nature of this recovery and the underlying downside risks.

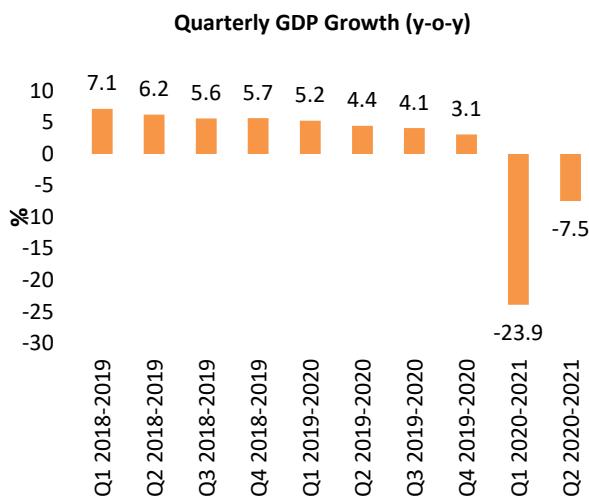
We expect the RBI to retain the policy rate at 4% and continue with the accommodative policy stance despite the buildup in inflationary pressures.

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
- **Cut CRR (cash reserve ratio) by 100 bps to 3% of NDCL**
- **Increased OMO purchases (special and outright)** to Rs.20,000 per auction.
- **OMO's in SDLs (State Development Loans)**
- **Increase in limit of SLR holding in HTM category** (to 22% of NDCL) 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

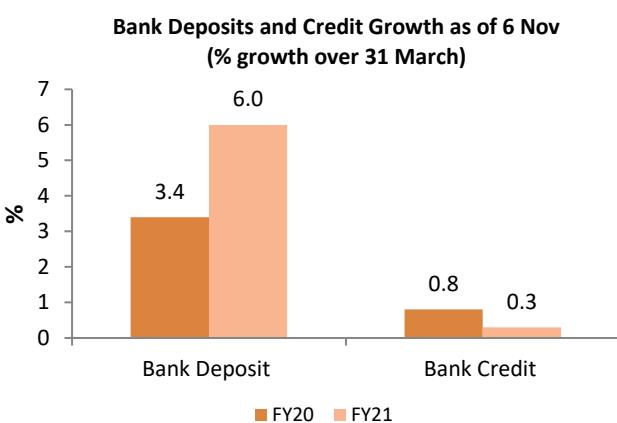
A. Economic Growth gaining momentum



Source: MOSPI

- India's GDP growth rate was (-)7.5% in Q2 FY21, a notable improvement from the (-)24% fall in Q1 FY21, suggesting that the resumption of economic activity has been gathering pace. Economic growth was however sharply lower than the 4.4% growth in Q2 FY20 being in the negative zone.
- The gains in the domestic economy in Q2 FY21 was powered by the manufacturing, electricity, and agriculture sector, all of which witnessed positive growth rates. The contact intensive service sectors continued to record a contraction in growth rates both, on a yearly and quarterly basis.
- Consumption demand i.e. private and government, in Q2 FY21 has been significantly lower than a year ago by 11% and 22% respectively. However, private consumption saw a pickup in Q2 FY21 and was 23% higher than that in the preceding quarter (Q1 FY21). Government consumption on the other hand was 26% lower in this period.
- Investment demand although weak and 7% lower in Q2 FY21 than a year ago saw a 60% increase from Q1 FY21.

B. Bank deposits growth surpassing credit growth



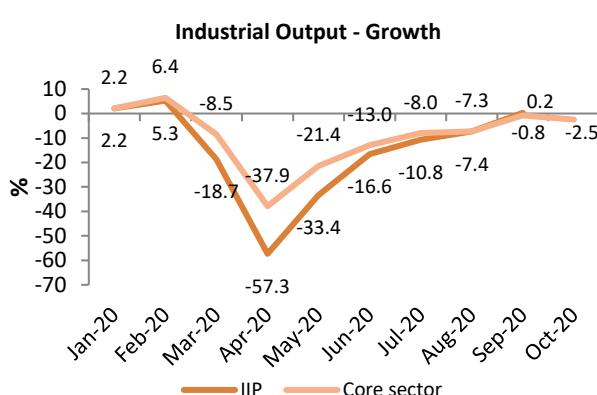
Source: RBI

- Bank deposits have been on the rise while credit offtake has been restrained in the current financial year. 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.
- The outstanding bank deposits as of 6 November'20 aggregated Rs.143 lakh crores, which amounts to an incremental growth of 6% since end March. The incremental growth in deposits in the comparable period of FY20 was 3%.
- The outstanding bank credit as of 6 November'20 at Rs. 104 lakh crores is 0.3% higher than that at the start of the financial year (April'20). The incremental bank credit growth in the corresponding period of FY20 was higher at 0.8%.
- The incremental credit offtake by the industrial as well as services sector has lower in FY21 v/s FY20 during first half of the year. The decline has been higher at (-)4.5% in case of the industrial sector as against the contraction of (-)0.7% for services sector.
- The lower credit offtake coupled with the higher deposit inflows has led to a sizeable liquidity surplus in the banking system (over Rs.5 lakh crores as of end November'20).

C. Credit to micro, small and medium enterprises

- As of end September'20, the outstanding bank credit to the micro, small and medium enterprises totalled Rs. 16.1 lakh crores which was (-)1.75% less than that in end March'20.
- Under the Rs. 3 lakh crores ECLGS (Emergency Credit Line Guarantee Scheme) for MSME's, banks have sanctioned Rs.2.05 lakh crores to 61 lakh borrowers upto 12 November'20. Of this Rs.1.52 lakh crores has been disbursed. The total sanctioned amount is 68% of the target, while the sanctioned amount is 51% of the target. The scope of the scheme was extended to cover the healthcare and 26 stressed sectors with credit outstanding of above Rs. 50 crores and up to Rs.500 crores as of end February'20.

D. Limited uptick in industrial production



Source: MOSPI

- Industrial output growth moved into positive territory after a gap of 7 months in September'20, registering a growth of 0.2% (over September'19)
- There has been a sequential improvement in industrial output from the lows of April'20 reflective of the pick- up in activity across key industrial sectors. There has been a broad based, albeit limited improvement across the various industrial sectors and segments.
- The output of the 8 core sectors reversed the sustained monthly improvement of recent months and saw a sharper contraction in October'20 (year-on-year), raising concerns over the sustainability of industrial recovery.

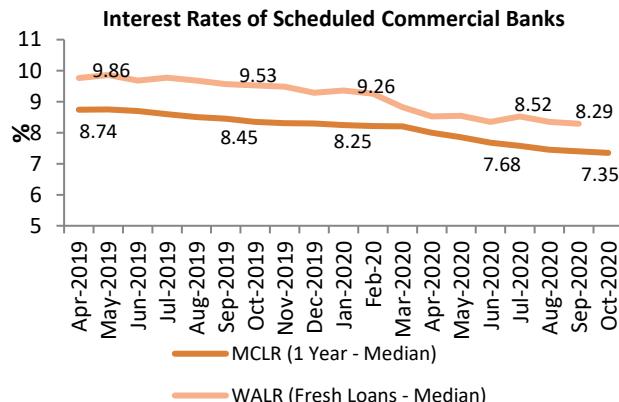
E. Moderation in G-Sec Yields



Source: FIMMDA

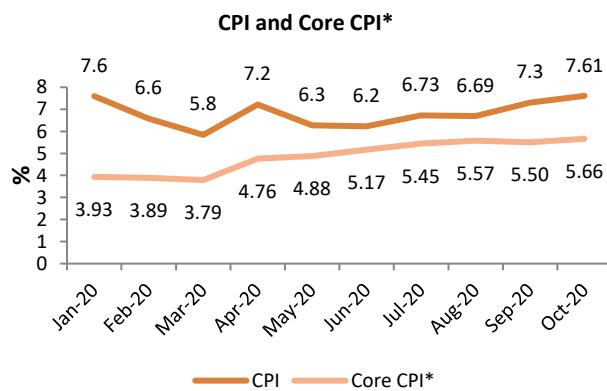
The benchmark 10 year GSec yields have softened following the RBI's measures at its last monetary policy (9 Oct'20) to boost demand for government securities viz. increase in OMO purchases , liquidity infusions through TLTRO and increased time limit for keeping government bonds in HTM category (till Mar'22). In addition, the surplus liquidity in the banking system helped stimulate demand and thereby lower yields. At the same time the decline in yields was limited by concerns over high inflationary and high borrowing of the government. The average benchmark 10 year GSec yields for November'20 at 5.89% is 3 bps lower than month ago.

F. Gradual decline in interest Rates of Scheduled Commercial Banks (SCBs)



Source: RBI

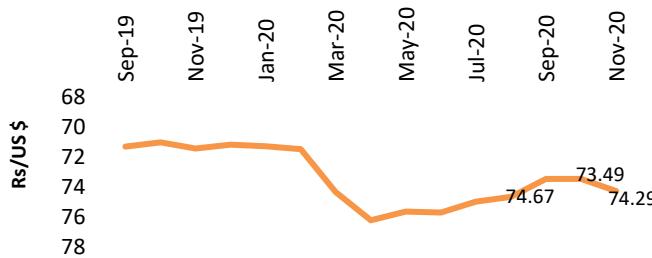
G. Elevated Inflation



*excludes food group and fuel

Source: MOSPI

H. Exchange rate



Source: RBI

- The lending rates of SCBs have fallen to their lowest levels in over 4.5 years, reflective of the progress in the transmission of the policy rate cuts.
- The median 1 year MCLR of SCBs in October 2020 at 7.35% was 5 bps lower than a month ago. Even though the RBI has cut key interest (repo) rate by 115 bps since end-March 2020, the median 1 year MCLR of scheduled commercial banks (SCBs) has declined by only 65 bps in the subsequent 7 months
- The weighted average lending rate (WALR) of fresh rupee loans sanctioned by scheduled commercial banks at 8.29% in September 2020 was 6 bps lower than a month ago. The WALR of scheduled commercial banks, has declined by 23 bps during April –September 2020.

- Retail inflation has been inching upwards in recent months and rose to a 9 month high of 7.6% in October'20, supported by a sustained broad-based increase across the various segments of the consumer price index.
- Core inflation (excludes food and fuel) for October'20 stood at 5.7%, which was the highest level in 2 years and 16 bps higher than month ago.

Rupee weakened in November'20 by weakened by nearly 1% to Rs.74.29 per dollar since the last credit policy (October'20). The persistent spread of the virus in the country and concerns over the economy amid domestic high price levels pressured the currency.

Predominant Economic Concerns

- **Sustainability and pace of economic recovery:** GDP growth although expected to improve in the remaining two quarters of 2020-21 with the improved pace of pickup in economic activity across most sectors faces downward pressure from the sustained spread of the pandemic in the country and the re-imposition of restrictions in various regions. Given the economic uncertainties consumption demand and investments are not unexpected to see a noteworthy pickup in the coming months. We expect the country's GDP to contract by -7.7% to -7.9% in FY21.
- **Persistent high inflation levels:** Inflationary pressures are expected to see only a gradual easing with the phased restoration of supply chains. The firming of non-food non fuel inflation is an area of concerns that could come in the way of further monetary easing.
- **Surplus Liquidity:** The liquidity infusion measures by the RBI intended to make available credit in the financial system has not had the desired impact with bank credit growth being tempered and the excess liquidity finding its way into select securities pulling down their yields and leading to market distortions. The banks surplus liquidity is also being parked with the RBI in the reverse repo facility (currently over Rs.6.7 lakh crores).
- **Increase in stressed assets of banks and NBFCs:** The RBI's moratorium (for 6 months till end August'20) has helped limit the rise in stressed assets of banks, albeit temporarily. In the coming quarters, an increase in the same is anticipated. The one-time restructuring of loans also paves the way for an increase in stressed asset in the future if the anticipated revival/ servicing of debt does not materialise. The financial stability report of the RBI has projected GNPA ratio to increase to 12.5% in baseline scenario and 14.7% with severe stressed scenario as on March'21 (from 8.5% in March'20).

CARE Ratings Expectations

- Although there would be no change in the repo rate, the accommodative monetary policy stance would be continued to address economic growth concerns.
- We do not foresee a rate cut in this fiscal year if inflation does not cool below 6%.
- We do not foresee a CRR cuts given the prevalence of high surplus liquidity in the banking system.
- The RBI may be expected to give guidance on a revised GDP and inflation forecast for the year/rest of the year.

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