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## RBI's Monetary Policy Review

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The Monetary Policy Committee (MPC) presented its fourth bi-monthly monetary policy for the current financial year today. As anticipated by us, the MPC left policy rates unchanged while continuing with the accommodative policy stance despite the buildup in inflationary pressures.

This was the second policy meet under the newly formed MPC and all the members unanimously voted for maintaining status quo on the monetary policy.

The RBI in its policy decision has factored in the nascent signs of economic recovery while acknowledging that it has not been broad based. It has also acknowledged that the price pressures prevailing in domestic economy has been more severe than it has earlier estimated. The RBI expects a faster economic recovery and has revised upwards its outlook for GDP growth for FY21. At the same time its outlook for inflation has turned adverse leading it to raise its outlook on price levels.

### Key Monetary Policy Announcements

- Policy repo rate unchanged at 4%.
- Reverse repo unchanged at 3.35%, MSF and bank rate maintained at 4.25%.
- Accommodative policy stance to continue as long as necessary i.e. into FY22.
- OMO purchases and operation twists to be used from time to time.
- Upward revision in GDP growth for FY21 to -7.5% (from -9.5%).  
***This is closer to CARE Ratings GDP estimate of -7.7% to -7.9%.***
- Inflation outlook has hardened from earlier expectations.
- Extended liquidity support to 26 stressed sectors

Key Policy Rates						
	Feb'20	Mar'20	May'20	Aug'20	Oct'20	Dec'20
Repo Rate	5.15	4.40	4.00	4.00	4.00	4.00
Reverse Repo Rate	4.90	4.00	3.75	3.35	3.35	3.35
MSF	5.40	4.65	4.25	4.25	4.25	4.25
Bank Rate	5.40	4.65	4.25	4.25	4.25	4.25
CRR	4.00	4.00	3.00	3.00	3.00	3.00
SLR	18.25	18.25	18.00	18.00	18.00	18.00

Source: RBI

## Assessment of the Economy

- **Global Economy:** The surge in Covid-19 infections across Europe, the US and major emerging market economies and the associated lockdowns has clouded the growth outlook for Q4 2020. At the same time, progress on vaccines has given rise to optimism. Even though world trade recorded a rebound in Q3 with the easing of lockdowns, it is likely to slow in Q4 as pent-up demand is exhausted, inventory restocking is completed, and trade-related uncertainty rises. Retail (CPI) inflation has remained muted across major advanced economies (AEs) while it picked up in some EMEs on firming food prices and supply disruptions. Global financial markets remain buoyant, supported by highly accommodative monetary policies and positive news on the vaccine.
- **Indian Economy:**
  - The domestic economy contracted by 7.5% in Q2 FY21. In Q3 FY21, various high frequency indicators point to a recovery gaining traction. Following the favourable growth in October there has been a moderation in some of these indicators in November. The outlook for agriculture remains bright, with the rabi sowing this year being higher than that in the corresponding period last year under supportive soil moisture and reservoir conditions.
  - CPI inflation on the rise (from 7.3% in Sept further to 7.6% in Oct'20) with evidence of price pressures spreading.
  - Domestic financial conditions remained easy in October-November and systemic liquidity continued to be in large surplus. Non-food credit growth accelerated and moved into positive territory for the first time in November'20 on a financial year basis. Corporate bond issuances have been higher at Rs. 4.4 lakh crore during April-October 2020 as against Rs.3.5 lakh crore during the same period last year. India's foreign exchange reserves were US\$ 574.8 billion (as on November 27), up from US\$ 545.6 billion on October 2.

## Outlook on Inflation and Economic Growth

- **Inflation**
  - Outlook has turned adverse from earlier estimates.
  - Supply side disruption pushing up consumer prices.
  - Although cereal prices are expected to soften with kharif harvest arrival and vegetable prices to ease with the winter crop, other food prices are remain at elevated levels.
  - Crude prices which have risen on optimism of demand recovery OPEC+ production cuts are expected to be volatile in the near term.
  - Core inflation could firm up as economic activity normalizes and demand picks up.

RBI's Inflation Outlook		
	Oct'20	Dec'20
H2 FY21	4.5 to 5.4	5.8 to 6.8
H1 FY22	4.3	4.6 to 5.2

Source: RBI

We expect CPI inflation to be around 5.5% by March.

- **GDP Growth**

- Bullish on economic recovery gaining pace, prompting upward revision in earlier growth estimates.
- Recovery in rural demand is expected to strengthen further and urban demand is also gaining momentum with the unlocking led pickup in activity and employment.
- Concerns over a possible rise in infections in some parts of the country, prompting some local containment measures.
- Business sentiment of manufacturing firms is gradually improving.
- Private investment however continues to be subdued and capacity utilization yet to recover fully. Latest RBI data for Q1 shows utilization level of 47.3%.
- Demand for services is likely to remain subdued for some time due to social distancing norms and risk aversion.

RBI's GDP Growth Outlook (%)		
	Oct'20	Dec'20
Q3 FY21	-5.6	0.1
Q4 FY21	0.5	0.7
FY21	-9.5	-7.5

Source: RBI

We expect GDP growth in Q3 to be marginally negative and turn positive only in Q4.

### Policy Measures - Developmental and Regulatory

#### I. Liquidity Measures to Revive Activity

- **On Tap TLTRO – Extension of Sectors and Synergy with ECLGS 2.0:**

- 26 stressed sectors identified by the Kamath Committee along with the health sector to be bought within the ambit of sectors eligible under on tap TLTRO.
- Liquidity availed by banks under the scheme to be deployed in corporate bonds, commercial papers, and non-convertible debentures issued by the entities in specific sectors over and above the outstanding level of their investments in such instruments as on September 30, 2020.
- The liquidity availed under the scheme can also be used to extend bank loans and advances to these sectors.
- Investments made by banks under this facility will be classified as held to maturity (HTM) even above the 25 per cent of total investment permitted to be included in the HTM portfolio.
- All exposures under this facility will also be exempted from reckoning under the large exposure framework (LEF).

There is a clear signal to align the TLTRO with the emergency line of credit with government guarantee which is a good step. Hence, banks can take money from RBI under the TLTRO and use these funds for lending to these sectors as identified by the Kamath Committee and also get a guarantee from the government based on the terms of the scheme.

- **Facilitating More Efficient Liquidity Management for Regional Rural Banks (RRBs)**
  - Extend the Liquidity Adjustment Facility (LAF) and Marginal Standing Facility (MSF) to RRBs.
  - RRBs permitted to participate in the Call/Notice money market, both as borrowers and lenders

This move will help to integrate the RRBs and also provide more depth to the markets with additional players coming in.

## II. Regulation and Supervision

- **Dividend Distribution by Banks**
  - Scheduled commercial banks (SCBs) and cooperative banks shall not make any dividend payouts from profits pertaining to the financial year 2019-20.

Interestingly for FY20, out of the 12 PSBs, 7 had negative PAT and only 5 had positive PAT of around Rs 16,500 crore. With government being the main shareholder, the non-tax revenue will get affected. The non-tax revenue in the form of dividend from RBI and banks and FIs was to be around Rs 90,000 crore this year and any distribution would have helped. Further, 15 of the 18 private sector had positive PAT of around Rs 50,000 crore from which there would be no dividend paid.

- **Dividend Distribution Policy for NBFCs**
  - Guidelines on dividend distribution by NBFCs to be formulated.
- **Discussion Paper on Scale-based Regulatory Framework for NBFCs**
  - To review the regulatory framework in line with the changing risk profile of NBFCs.
- **Strengthening Audit Systems of Supervised Entities**
  - Guidelines to be issued to large UCBs and NBFCs on adoption of RBIA (Risk Based Internal Audit).
- **Digital Payment Security Controls**
  - Reserve Bank of India (Digital Payment Security Controls) Directions, 2020 to be issued for regulated entities to set up a robust governance structure for such systems and implement common minimum standards of security controls for channels like internet mobile banking, card payments, among others
- **Financial Literacy and Education**
  - Expand the reach of the Centres for Financial Literacy (CFLs) to every block in the country in a phased manner by March 2024.
- **Grievance Redress Mechanism in Banks**
  - Put in place a comprehensive framework comprising enhanced disclosures on customer complaints by the banks, a monetary disincentive in the form of recovery of cost of redress of complaints from banks when maintainable complaints are comparatively high, and undertaking intensive review of grievance redress mechanism and supervisory action against banks that fail to improve their redress mechanism in a time bound manner.

## III. Deepening Financial Markets

- **Review of Credit Default Swaps (CDS) Guidelines**
  - The guidelines for CDS that were last issued in January 2013 are to be reviewed. This is aimed at aiding the development of a liquid market for corporate bonds, especially for the bonds of lower rated issuers.

- **Review of Comprehensive Guidelines on Derivatives**
  - To promote efficient access to derivative markets while ensuring high standards of governance and conduct in OTC derivative business by market makers.
- **Comprehensive Review of Money Market Directions**
  - Being released for public feedback

#### IV. External Trade – Facilitation

- **Direct Dispatch of Shipping Documents**
  - Remove the monetary ceiling to enable AD banks to regularise cases, where export proceeds have been realised, irrespective of the value of export shipment.
- **Write off" of Unrealised Export Bills**
  - Allowing write-off to the AD banks, without limits in specified circumstances, viz., cases where overseas buyer has become insolvent or the settlement of the export proceeds to be received has happened through the Indian Embassy, Foreign Chamber of Commerce or similar organisations or if the goods had been destroyed by the Port/Customs/Health authorities in the importing country.
- **Set-off of Export Receivables against Import Payable**
  - Permit AD banks to allow Indian companies to set-off their export receivables against import payables in respect of goods and services with their overseas group/associate companies either on net basis or gross basis through a centralised treasury arrangement or otherwise.
- **Refund of Export Proceeds**
  - Allow AD banks to consider refund requests without insisting on import of goods, which are perishable in nature or had been auctioned/destroyed by the Port/ Customs/ Health authorities/ any other accredited agency in the importing country subject to production of documentary evidence

#### V. Payment and Settlement Systems

- **Enabling Posting of Settlement Files of Payment Systems on all days of the week**
  - Allow settlement files of payment systems (viz., AePS, IMPS, NETC, NFS, RuPay, UPI) to be posted to the Reserve Bank on all days of the year.
- **Card Transactions in Contactless Mode and e-Mandates on Cards for Recurring Transactions – Enhancement of Limit**
  - Enhance, at the discretion of the user, the limits for contactless card transactions and e-mandates for recurring transactions through cards (and UPI) from ₹2,000 to ₹5,000 from January 1, 2021.

#### CARE's Ratings View

- We do not foresee a rate cut in this fiscal year as inflation would remain at elevated levels and is unlikely to cool below the RBI's target 6%.
- Future rate cuts likely only post March '21 and would be driven by the inflation readings.
- Comfortable liquidity situation in the banking system to be maintained by the RBI with TLTRO and OMOs.
- All the 26 stressed sectors to be eligible for liquidity support through on tap TLTROs (of Rs. 1 lakh). We could expect more TLTROs going forward.

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