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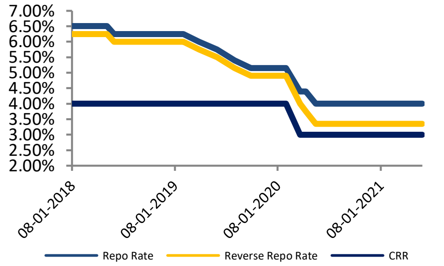
RBI Monetary Policy

'Status Quo maintained'

Jun 04' 2021

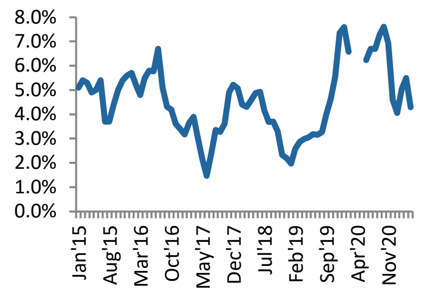
- Repo rate kept unchanged at 4%.
- Consequently, the reserve repo rate under LAF remains unchanged at 3.35%. MSF rate and bank rate remains at 4.25%.
- The MPC maintained 'accommodative stance' as long as necessary to sustain growth on a durable basis.
- GDP growth forecast for FY22 reduced to 9.5% from earlier estimate of 10.5%.
- RBI forecasted inflation at 5.1% in FY22.
- Announced G-SAP 2.0 of Rs1.2 lakh crore in Q2FY22.
- Restructuring a/c limit for banks enhanced to Rs50 cr from earlier Rs25 cr under resolution framework 2.0
- India's forex reserves rose to $598.2 bn.

RBI's Monetary Policy Stance



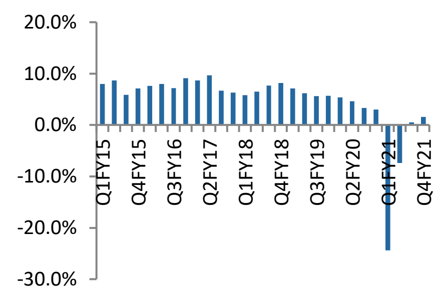
The MPC maintained status quo with accommodative stance in line with expectations amid concern of likely high inflation. MPC remained cautions on inflation outlook as firm oil prices and surge in logistic cost pose upside risks to inflation. Central bank raised its quarterly inflation expectation by ~30 bps, though at 5.1% forecast for FY22, inflation trajectory is likely to remain under the target range of 2-6%.

CPI Inflation Trend



Considering the second Covid wave impact on economic activity, GDP growth forecast for FY22 reduced to 9.5% from earlier forecast of 10.5%. High frequency indicators recorded sequential moderation in May reflecting the impact of restrictions and localised lockdowns imposed by states. The MPC raised concern over increased spread of Covid infection in rural areas which poses downside risk to economic growth. As per the MPC, second wave of Covid has altered the near-term outlook, necessitating urgent policy interventions from all sides – fiscal, monetary and sectoral to nurture recovery and expedite return to normalcy. Meanwhile the MPC maintained its accommodative stance to revive and sustain growth on a durable basis. Among other measures, additional aid provided to banks amidst ongoing pandemic turbulence as they can restructure loan a/c upto Rs50 cr (earlier limit was Rs25 cr). Additional liquidity support to SIDBI and on tap liquidity to contact intensive manufacturers to provided much needed assistance to MSME sector. MPC also ensured adequate liquidity in system and announced G-SAP 2.0 of Rs1.2 lakh crore in Q2.

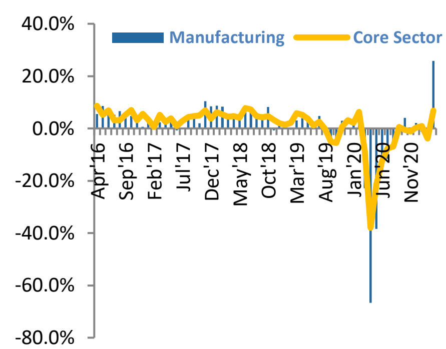
Indian GDP Growth Trend



All members of the MPC unanimously voted for keeping policy repo rate unchanged and maintain accommodative stance

RBI sets 5.1% inflation target in FY22

Rising trajectory of international commodity prices especially of crude and logistic costs pose upside risks to inflation. Though the impact to somehow offset by comfortable bumper food stocks which should help to keep cereal price pressures in check. Further, the expectation of normal monsoon augurs well for the agriculture sector. IMD forecast a normal south-west monsoon, with rainfall at 101% of the long period average (LPA).



Meanwhile central bank also expressed the need to adjust the excise duty, cess and tax imposed by states and centre in a coordinated manner to contain input cost pressures emanating from petrol and diesel prices. MPC expects supply side condition to improve with declining infections, restrictions and localised lockdowns across states, helping to reduce cost pressure. Weak demand conditions may also temper the pass-through to core inflation which also eased in April. The RBI forecasted CPI inflation at 5.1% in FY22: 5.2% in Q1 (earlier estimate of 5.2%); 5.4% in Q2 (from earlier estimate of 5.2%); 4.7% in Q3 (earlier estimate of 4.4%) and 5.3% in Q4 (from earlier estimate of 5.1%).

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RBI Monetary Policy

FY22 GDP forecast reduces to 9.5%

As per the MPC, there are indication of slowdown in economic activity in May due to localised lockdowns imposed by states to contain Covid second wave. High frequency indicators like E-way bills, electricity generation cement production, PMI among other recorded sequential moderation in May. Rise in infections in rural areas has also started weighed on rural demand as reflected by tractor and two-wheeler sales since April. Rural demand remained strong till now and expected normal monsoon bodes well for sustaining its buoyancy, but rise in infections in rural poses downside risks. Meanwhile new Covid-compatible occupational models by businesses may help to cushion urban demand which was hit hard by second infection wave, the MPC added.

Domestic economy is expected to get support from rise in exports driven by strengthening global recovery. Vaccination process is likely to gather steam in the coming months which will also help to normalise economic activity quickly. Overall, the RBI forecasted GDP at 9.5% in FY22 (10.5% earlier) consisting of 18.5% in Q1 (lowered from earlier estimate of 26.2%); 7.9% in Q2 (earlier estimate of 8.3%); 7.2% in Q3 (rose from earlier estimate of 5.4%) and 6.6% in Q4 (earlier estimate of 6.2%).

Addition measures to support economy

On-tap liquidity window for contact-intensive sectors:- The RBI announced a separate liquidity window of Rs15,000 cr with tenor of up to three years at repo rate till Mar 31' 2022 for contact-intensive sectors i.e., hotels and restaurants; tourism – travel agents, tour operators and adventure/heritage facilities; aviation ancillary services – ground handling and supply chain; and other services that include private bus operators, car repair services, rent-a-car service providers, event/conference organisers, spa clinics, and beauty parlours/saloons.

Banks, who lend money, will be eligible to park their surplus liquidity up to the size of the Covid loan book, created under this scheme, with the RBI under the reverse repo window at a rate which is 25 bps lower than the repo rate or 40 bps higher than the reverse repo rate. Banks desirous of deploying their own resources without availing funds from the RBI under the scheme for lending to the specified segments mentioned above will also be eligible for this incentive.

Special liquidity facility to SIDBI:- Special liquidity facility of Rs16,000 cr for SIDBI is announced in order to meet MSMEs' short- and medium-term credit needs to kick start the investment cycle. The facility will be available at the prevailing policy repo rate for a period of up to one year. Furthermore, the facility would be extended for on-lending / refinancing through novel models and structures including double intermediation, pooled bond / loan issuances, etc.

Enhancement of exposure thresholds under resolution framework 2.0 :- Banks are allowed to restructure loan a/c upto Rs50 cr (earlier limit was Rs25 cr) under the resolution framework for Covid related stress of MSMEs as well as non-MSME small businesses, and loans to individuals for business purposes. Borrowers which have not been restructured earlier under any of the specified restructuring frameworks, shall be eligible to be considered for resolution under Resolution Framework 2.0.

Placement of margins for govt securities transactions on behalf of FPIs:- In additonal measure to encourage investment by FPIs in Indian debt market, authorised dealer banks are permitted to place margins on behalf of their FPI clients for their transactions in Government securities (including State Development Loans and Treasury Bills), within the credit risk management framework of banks.

Other Measures:

- Regional rural banks (RRB) are permitted to issue CDs to eligible investors.
- Issuers of CDs will be permitted to buy back their CDs before maturity, subject to certain conditions.
- Availability of National Automated Clearing House (NACH) on all days of the week

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