RBI/MPC: Supporting growth with focus on liquidity

- **The Monetary Policy Committee (MPC) kept the policy Repo rate unchanged today and voted unanimously to maintain the status quo with an accommodative stance**
- **The Central Bank moved to a state-based guidance from a time-based one, indicating that the accommodative stance would be retained as long as required to support growth, while ensuring that inflation remains within the target**
- **The MPC retained its FY22 real GDP growth projection at 10.5% YoY and acknowledged that though risks to economic growth have risen given the second wave of infections, the economy is better prepared to handle the challenges**
- **While inflation forecasts saw modest upward revisions, inflation concerns seem to be on the backburner as long as the target range is not breached**
- **Re-iterating the RBI's commitment to provide ample liquidity in the system to promote orderly market conditions, and to give comfort to debt markets on the RBI's intention to smoothly manage the Government's borrowing programme, a secondary market G-Sec acquisition program (GSAP 1.0) was announced**
- **We maintain our view of the MPC keeping a long pause on the Repo rate over 2021, and do not expect a change in the MPC's stance till the economy is on a durably strong footing, and uncertainty ebbs**
- **On markets, while the longer tenures for the VRRR might lead to some hardening at the short-end of the curve, we expect the 10Y G-sec to trade in the range of 6% to 6.25% over this quarter**

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As widely expected, the MPC kept the policy rate unchanged today, and voted unanimously to maintain an accommodative stance in order to support growth. While highlighting the uncertain near term outlook due to the recent surge in infections, the MPC moved from a time-based forward guidance to a state-based forward guidance. Accordingly, the accommodative stance will be retained as long as necessary to sustain durable growth in the economy, while ensuring that inflation remains within the target band going forward. There were several measures announced for financial markets and the real economy, which clearly reflect the RBI's commitment to sustain growth momentum in the economy.

Key takeaways from the policy statement:

Supporting growth with an eye on inflation: At a time when the rising second wave of COVID infections and subsequent lockdowns are creating renewed uncertainties and muddying the growth picture, the MPC's intent to continue with easy monetary policy till growth picks up pace durably is a positive development. The Governor acknowledged the signs of recovery seen in both rural and urban demand despite the headwinds due to the resurgence of the virus. He also emphasized that the economy is in a better position to deal with the challenges posed by the 'second wave', as compared to the unpreparedness during the 'first wave'. Accordingly, the MPC retained its FY22 real GDP growth projection at 10.5% YoY, remaining watchful of the growth trajectory.

On inflation, while acknowledging that the evolving trajectory of inflation is likely to have both upside and downside pressures in coming months, it seems that inflation concerns are currently on the backburner in an attempt to prop up growth. This appears suitable as headline CPI inflation is expected to remain under the RBI's tolerance band in the coming months. Some concerns related to input cost pressures which can feed into inflation were expressed (particularly global commodity and food prices, and logistic risks), although the *rabi* harvest arrivals in the market and moderation in global crude prices could aid.

On core inflation, the MPC feels pandemic-related pressures are playing out, and they will probably continue to look through them in the near term. Thus, notwithstanding the slight upward revisions to the inflation forecasts, the MPC seems to have some comfort in this arena.

	MPC CPI projections		MPC Real GDP projections	
	Feb-21	Apr-21	Feb-21	Apr-21
Q4 FY 2021	5.2	5.0		
Q1 FY 2022	5.2	5.2	26.2	26.2
Q2 FY 2022	5.0	5.2	8.3	8.3
Q3 FY 2022	4.3	4.4	6	5.4
Q4 FY 2022		5.1		6.2
FY 2021-22			10.5	10.5

Source: RBI, ICICI Bank Research

A shift to 'state-based guidance' from 'time-based guidance':
The MPC moved to a state-based guidance from a time-based one, given considerable uncertainties on economic recovery. The statement today dropped the forward guidance it first provided in October and reiterated in December and February--that it had decided to maintain the accommodative stance at least during FY2021 and into FY2022. Given the ongoing second wave of COVID, the growth picture appears murky, and disentangling actual performance from the base-effect led optically favourable data will be key. The stance, through the liquidity channel, is also crucial for private capex to recover which will ensure durable growth. The change in the guidance gives the MPC more flexibility to run policy based on an actual evolving situation, rather than commit to a particular timeline for policy normalization amid uncertainties.

Liquidity guidance:
The Governor re-iterated the RBI's commitment to keep ample liquidity in the system to promote orderly market conditions in line with the accommodative stance of MPC.

In order to contain volatility in debt markets, the Governor announced the following measures:
1) conducting VRRR (variable rate reverse repo) auctions of longer maturities under the Revised Liquidity Management Framework announced on February 06, 2020
2) implementing secondary market G-sec acquisition program (GSAP 1.0) to ensure orderly evolution of the yield curve amid comfortable liquidity conditions. Under this program, the RBI will buy INR 1.0 tn worth of Government securities in Q1FY22 with its first purchase to be conducted on April 15th to the tune of INR 250 bn
3) Extension of on-tap TLTRO scheme by another six months till September 30th. This scheme was announced in the October policy last year and then was extended to 26 stressed sectors in sync with ELGS 2.0 in the December policy meet. The extension of the scheme would help improve the availability of credit to stressed sectors in the economy, which is positive for broad based recovery in FY2022
4) To provide liquidity support of INR 500 bn to all India financial institutions like NABARD, SIDBI and NHB in order to help support the nascent growth recovery witnessed in agriculture, rural non-farm and housing sectors

The RBI's continuing support for growth is reflected through these measures to keep liquidity abundant. A marginal upward revision in inflation projections notwithstanding, the MPC is likely to look through some aspects of inflation, as long as inflation remains within the target band. The longer tenures for the VRRR might lead to some hardening at the short-end of the curve. The announcement of the GSAP 1.0 is likely to support long term yields, capping the same. Debt markets will accordingly draw confidence regarding the absorption of the Government's borrowing requirements, with a timeline now being available. Additionally, the RBI/MPC can be expected to continue using unconventional policy tools, such as OMOs and OTs to avoid any untoward surge in yields. **We maintain our view of the MPC keeping a long pause on the Repo rate over 2021, and do not expect a change in the MPC's stance till the economy is on a durably strong footing, and uncertainty ebbs.** While we expect the 10Y Government benchmark security to trade in the range of 6% to 6.25% over this quarter, given comfort on the long-end, we retain our expectation of the range of 6% to 6.50% over FY2022.

Annexure: Statement on Developmental and Regulatory Policies

Extension of the TLTRO on Tap scheme

- TLTRO on the Tap scheme which was made available till 31st March 2021 has now been further extended for six months i.e., up to 30th Sep 2021. The sector coverage of scheme has now been extended to cover 26 stressed sectors as identified by the Kamath Committee in addition to the 5 sectors announced previously. This is expected to ease liquidity pressure for these stressed sectors and revive economic activities in them.

Liquidity Facility for All India Financial Institutions
- To provide liquidity support of INR 500 bn to all India financial institutions like NABARD, SIDBI and NHB. This measure will ensure continued flow of credit to important sectors like agriculture, small industries and housing which will in turn support the ongoing economic recovery post pandemic.

Financial inclusion
- The RBI will construct and publish a multiple indicator based Financial Inclusion Index (FI index) in July of every year for the financial year ending previous March.

Centralised Payment Systems (CPS) for entities other than banks
- Non -bank payment system operators like Prepaid Payment Instrument (PPI)s, card networks, white label AT, operators and Trade Receivables Discounting System (TreDs) platforms that are regulated by RBI will have membership in CPSs like NEFT and RTGS. This will reduce settlement risk in financial system as well as improve penetration of digital financial services.

- To enhance interoperability, RBI has increased current limit on outstanding balance from INR 0.1 mn to INR 0.2 mn for PPIs that are fully compliant with KYC norms. Additionally, full KYC PPIs of non-bank PPI issuers will be allowed to withdraw cash.

Committee on ARC
- In order to fully realised the potential of ARC in resolving stressed asset problems, RBI has proposed to constitute a committee to carry out a comprehensive review of their working. The committee will recommend appropriate measures to enable ARC to meet the growing requirements of the financial sector.

Extension of Bank's on-lending to NBFC
- On August 2019 bank's lending up to 5% of a bank's total Priority Sector Lending (PSL) to registered NBFCs for on-lending to Agriculture, MSME and housing could be classified as PSL. This dispensation which was available till 31st March 2021 has now been extended till 30th September 2020. This move will strengthen liquidity positions of NBFCs. Since NBFCs play a key role in providing credit to the bottom of the pyramid, extension of this facility will contribute significantly to employment generation and economic growth.

Higher WMA limit for States and UTs
- Aggregate Ways and Means Advances (WMA) of state governments/UTs has been increased by 46% to INR 470.1 bn as per advisory committee recommendations on WMA. RBI has also accepted committee's enhanced interim WMA limit recommendation of INR 515.6 bn (60% hike from current limit) for a period of six months till 30th Sept 2021 in wake of COVID-19 pandemic. The enhanced WMA limit will allow states to meet targeted commitments on expenditure in a situation of muted revenue flow during the pandemic.

Source: RBI

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