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# RBI is saving its ammunition

## While we expect further accommodation in H2, the monetary policy committee would need more clarity and certainty over lowering of inflation on a durable basis before taking on further action

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**MARKET PARTICIPANTS WENT** into the policy acknowledging the tough decision that confronted the MPC to manage their primary objective of inflation targeting (at the back of the recent high inflation prints and uncertain outlook), at a time when growth and outlook continue to be weak. While the pause on policy rates was largely on expected lines, the key takeaway from the policy was the shift in emphasis from addressing the stress in financial markets towards addressing the stress in the real economy and the possible stress in the banking system.

Time and again, the MPC has not relented in its primary objective of price stability, and this was showcased in this policy as well. The policy statement acknowledged concerns over the outlook for inflation (even while recognising the imputation process done to compute April and May inflation). Supply-side disruptions impacting both core and non-core as well as upside risks through broad based cost-push factors were enunciated. Moreover, the caveat of lowering inflation trajectory in H2 only on the base effects would indicate that MPCs outlook for inflation remains uncertain. On growth, while refraining from giving a growth forecast, the MPC expressed concern, parking real GDP growth for the fiscal at contractionary levels.

While the markets would find some comfort on the insinuation of rates remaining lower for longer through the statement on continuation of accommodative stance as long as required to revive growth, the bar for further rate cuts has risen in our view. While we expect further accommodation in H2, the committee, as explained above, would need more clarity and certainty over lowering of inflation on a durable basis before taking on further action.

Moreover, the statement highlighted that the RBI/MPC was more or less comfortable with the measures that have been taken for the financial markets. Indications by the Governor on the success on transmission across markets seen in lowering of corporate spreads and lowering interest rates in money, bond and credit markets showcased RBI's comfort on the steps taken so far to ease financial conditions.

RBI would also draw comfort from the fact that despite the large supply of government paper, long end yields have seen ranged trading. Given the current rhetoric and the surplus liquidity in the system, we believe that the central bank would assess markets and use tools such as OMO purchases only if there are indications of sustained elevation in yields. Moreover, contrary to expectations, the fact that HTM hike was not announced, also indicates that RBI could be saving these ammunitions for later if the situation escalates or worsens going ahead.

Despite the lack of steps to absorb supply, the markets would continue to have confidence in the central bank to intervene when required. Hence, we feel that despite the spike seen in the long end post policy and some degree of further curve steeping expected, yields would probably settle in an acceptable range going ahead.

Moving to the measures announced for the real economy, the clear focus of the policymakers remain in easing the stress arising out of Covid-19 disruptions while at the same time ensuring credit discipline. In this regard, we welcome the steps taken to minimise the stress in the housing sector and NBFC'S from liquidity disruptions, by extending the special refinance facilities for NABARD and NHB. In addition, recognising the continued strain faced by MSMEs, RBI has extended the ongoing debt restructuring framework for MSMEs. Moreover, under the June 7, 2019 circular, RBI has now extended restructuring facilities for all corporate loans, and not only limited to MSMEs. This is aimed at maintaining long term viability of otherwise robust borrowers, while at the same time taking care of overall financial stability. The extension of this forbearance would also be beneficial for the banking sector in its recognition of NPAs.

Recognising the large quantity of gold assets primarily in the form of jewellery held with the average Indian household, the central bank has increased the permissible loan to value ratio against pledge of gold ornaments and jewellery, for non-agricultural purposes. This is aimed at helping the retail borrowers to tide over the economic impact of the crisis. Other than this, additional measures in the form of addressing regional disparities in the flow of priority sector credit and extension of priority sector lending to cover start-ups are welcome moves as well.

In conclusion, MPCs continued focus on inflationary targeting is welcome as it helps maintain its credibility, and is in line with the respect and prestige of the institution it represents. Moreover, focus on the stress visible in the real economy, including small businesses, NBFCs, other corporates and the individual household are steps in the right direction. Notwithstanding the adverse reaction in the bond markets due to the lack of demand inducing measures from RBI, the current leadership and the overall construct of RBI would give markets the overall confidence in handling this crisis. This is particularly important from a financial stability perspective, and in this respect, the weakening dollar and the huge BOP surplus expected this year would keep Indian markets in good stead.