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INDUSTRY OUTLOOK

MONETARY POLICY STATEMENT, MAY 22, 2020-A PERSPECTIVE

23 May 2020

In a yet another unscheduled off-cycle monetary policy meeting (well ahead of the scheduled meeting in early June), the RBI Governor made some important policy and operational announcements. This Policy was formulated in the context of testing domestic and global conditions. These conditions are starkly reflected in a complete collapse of the global economic activity post the COVID 19 new normal of ubiquitous lockdowns and social distancing. There has been an economic deceleration in the key advanced economies (AEs), viz., the US, Euro area, Japan and the UK in Q1:2020. In the case of the emerging market economies (EMEs), the Chinese economy went into a pronounced decline and high frequency data indicators are suggestive of a shrinkage in Brazil and South Africa. In sum, Covid 19 has crippled the global economy and activities across the world have stalled.

Private consumption, which accounts for 60 per cent of domestic demand, has been severely hit. India is witnessing a collapse of demand; electricity and there has been a dip in petroleum product consumption. The combined impact of demand compression and supply disruption will depress economic activity in the first half of the current fiscal. The Governor said, "Assuming that economic activity gets restored in a phased manner in the second half of this year and taking in consideration favourable base effect, it is expected that combined fiscal, monetary and administrative measures currently undertaken by both the government and RBI create conditions for gradual revival of activities in the second half of 2020-21".

In the case of the Indian economy, there are grave risks seen with a free fall in the GDP growth plunging to the negative territory for the first time in over four decades with some pick up in the second half. "Simultaneous fiscal, monetary and administration measures will create conditions for a gradual revival of activity in the second half of 2020-2021." Both urban and rural segments have taken a severe drubbing because of a massive demand shock in the wake of the Coronavirus pandemic. As the RBI governor Shaktikanta Das said, "domestic economic activity has been impacted severely by the 2 months lockdown. The top 6 industrialised states that account for about 60 per cent of industrial output are largely in red or orange zones".

Industrial production shrank by close to 17per cent in March with manufacturing activity down by 21per cent. Output of core industries contracted by 6.5per cent. But India's foreign exchange reserves increased by 9.2 billion during 2020-21 from 1st April onwards. So far, up to 15th May, foreign exchange reserves stand at 487 billion US dollars.

This process and pattern of ongoing deceleration has taken a toll on fiscal revenues. The biggest blow from COVID-19 stemmed from a slump in the private consumption with consumer durables production slipping by 33 per cent in the month of March. What is of greater concern is that things do not seem to be improving any time soon. The agriculture and allied activities have, however, raised hope for the country as also the normal south-west monsoons this year.

In this overarching macro-economic setting, the six-member Monetary Policy Committee (MPC) decided to cut the repo rate by 40 bps to 4per cent with five members voting for such a cut and one — Chetan Ghate — voting for a 25 bps cut. The reverse repo rate was simultaneously reduced to 3.35 per cent. Accordingly, the marginal standing facility (MSF) rate and the Bank Rate stand reduced to 4.25 per cent from 4.65 per cent.
The MPC also "decided to continue with the accommodative stance as long as it is necessary to revive growth and mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target," the policy statement read.

The food inflation, which had eased from the January peak in February and March has now surged to 8.6 per cent in April 2020 with the price of vegetables, oilseeds, and milk emerging as pressure points. The MPC held that headline inflation rate in the first half of 2020 will remain intact but by the third quarter and fourth quarter, it may fall below the target of 4 per cent. Inflation outlook has become complicated by the release of partial and incomplete data by the National Statistics Organisation (NSO).

While there is scope for improvement, the monetary policy transmission has improved and improvement in passing lower rate to the borrowers has been noticed across various segments.

Some important points, which emerged from the RBI Governor's address include:

1. The RBI supplemented the interest rate cut by extending by three months the permission given to all banks to give a three-month moratorium on payment of monthly instalments on all outstanding loans, providing relief to home and auto buyers as well as real estate sector where construction activities are already at a standstill. The three-month moratorium allowed on term loans and working capitals has been further extended by another 3 months from June 1 to August 31, making it a six-month moratorium. Also, interest accumulated for the six-month moratorium period can be converted into a term loan.
2. The Group Exposure Limit of banks has been hiked to 30 per cent from 25 per cent for enabling the corporates to meet their funding requirements from banks. The RBI had set the 25 per cent limit in June 2019 and had capped lenders' exposure to a single party at 20 per cent. This welcome move will allow lenders to give larger loans to companies. The increased limit will be applicable up to June 30, 2021.
3. As part of the developmental and regulatory policies, the RBI also announced help to Small Industries Development Bank of India (SIDBI) on the refinance front through the rollover of a three month, Rs 15,000-crore facility announced earlier to provide additional liquidity support to the beleaguered MSME sector. "In order to provide greater flexibility to SIDBI in its operations, it has been decided to roll over the facility at the end of the 90th day for another period of 90 days".
4. The RBI announced a Rs 15,000-crore line of credit to the Export-Import Bank of India, to help the sagging foreign trade. The RBI said Export-Import Bank of India (EXIM Bank) depends on foreign currency borrowings for its operations and as a result of the COVID-19 pandemic, it is unable to raise the resources, due to which the facility is being extended. "It has been decided to extend a line of credit of Rs 15,000 crore to the EXIM Bank for a period of 90 days from the date of availment with rollover up to a maximum period of one year so as to enable it to avail a US dollar swap facility to meet its foreign exchange requirements," RBI Governor Das said.
5. The country's export-import trade has suffered because of external demand crippling owing to the pandemic and decline in import of essential goods and services. Among other measures, the RBI has also decided to increase the maximum permissible period of pre-shipment and post-shipment export credit sanctioned by banks from the existing one year to 15 months, for disbursements made up to July 31, 2020.
6. On the imports front, the time period for completion of remittances against normal imports into India (except in cases where amounts are withheld towards guarantee of performance) was extended from six months to 12 months from the date of shipment for imports made on or before July 31, 2020. This will provide greater flexibility to importers in managing their operating cycles in a COVID-19 environment.
7. For the financial markets, in view of the difficulties reported by the Foreign Portfolio Investors and custodians for adhering to the condition of investing at least 75 per cent of allotted limits are invested in three months, the RBI granted an additional three months to fulfil this requirement.

CREDIT DISPENSATION-SHIFTING PARADIGMS

These measures like the reduction in the policy repo rate under the liquidity adjustment facility (LAF) by 40 bps to 4.0 per cent from 4.40 per cent and reduction in the reverse repo rate under the LAF stands to 3.35 per cent from 3.75 per cent. are of considerable contextual significance. Historically, there were three effective credit channels for the Indian economy -banks, NBFCs and the bond market. But in the aftermath of the IL&FS crisis, the NBFCs ceased to be an important player in the market for credit dispensation and has been relegated to the position of an also ran. In the last five years, the banks have been severely hit by the double whammy of slow growth in business and mounting NPAs and consequently exponentially rising provisioning requirements. This together with the fear of the dreaded 4 Cs-the CVC, CBI, Courts and the CIC, have made banks increasingly risk-averse. The clear failure of the objective of the RBI conducting auctions of targeted term repo operation (TLTRO 2.0) of up to three years tenor for a total of up to Rs. 50,000 crore ($6.54 billion) at the policy repo rate is starkly reflected in the fact that the banks are parking over Rs 8 lakh crore, over $100 billion in the reverse repo with RBI. What is interesting is that the banks continue to do this even though the use of this window gets them a return of only a measly 3.75 per cent. This further reduction of 40 bps together with the clear downward bias of the interest rate spelt out by the RBI would nudge the banks to move forward in the direction of greater lending to the productive sectors of the economy.

It is however, important, to view the issue of banks parking funds with the RBI in a proper historical and comparative perspective. The issue of bankers becoming risk averse is quite complex and multilayered and defies a naïve and simplistic solution. A detailed discussion would involve aspects like Asset Quality Review (AQR), absence of deterrent action against wilful defaulters, policy paralysis because of the humongous 2 G, 3G and 4G issues, the fear of the 4 Cs-CVC, CBI, CIC and the Courts and the use of several dreaded words in the commercial banking segment. Some such words are accountability, due diligence, fixing of responsibility, systems and procedures, vigilance angle, reopening NPA cases even after a gap of 10-15 years. Hence, we cannot have a simplistic solution to a complex multidimensional issue.

The RBI is the liquidity provider of last resort. But who is the risk-taker of the last resort? This is a fundamental question in the overarching setting of greatly enhanced risk aversion across the development spectrum. There is an unfortunate tendency among all the participants, banks, mutual funds, NBFCs to pass the buck and play safe.

CONCLUDING OBSERVATIONS

The Governor explained that the measures announced today can be divided into four categories: to improve functioning of markets, to support exports and imports, to ease financial stress giving relief on debt servicing and better access to working capital and to ease financial constraints faced by state governments.

Rules governing withdrawal from Consolidated Sinking Fund (CSF) have been relaxed while at the same time, ensuring depletion of fund balance is done prudently. This will enable states to meet about 45per cent of redemption of their market borrowings which are due in 2020-21.

There is no doubt that at the present juncture, the MPC took the right call in slashing the policy rate. But of late, searching questions have been raised about the timeliness, adequacy and cost of credit and the role of the fiscal policy in resuscitating the Indian economy. While in the long run, both the monetary and fiscal policy must move in tandem, the fiscal policy has to play a more active role. The role of the   monetary policy has to be basically supportive in achieving the avowed objective of development.

The Governor assured the country that the RBI is ready to use all its instruments to address the concerns of the unknown future. The RBI has been constantly monitoring the situation and has taken policy measures in the past 2-3 months. The RBI will be vigilant in battle readiness to address dynamics of unknown future and will preserve financial stability

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