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INDUSTRY OUTLOOK

RBI'S OCTOBER MONETARY POLICY - RIGHT CALL

31 October 2020

I. PERSPECTIVE

The position of the Indian economy continues to be difficult with the macro-economic situation deteriorating from twin balance sheet crisis to four balance sheet crisis: banks, infrastructure projects, real estate and NBFCs. Subramanian, et al (2019) cogently argued *"India is now facing a Four Balance Sheet challenge—the original two sectors, plus NBFCs and real estate companies—and is trapped in an adverse interest-growth dynamic, in which risk aversion is leading to high interest rates, depressing growth, and generating more risk aversion. Standard remedies are unavailable: monetary policy is stymied by a broken transmission mechanism; large fiscal stimulus will only push up already-high interest rates, worsening the growth dynamic. The traditional structural reform agenda—land and labour market measures—are important for the medium run but will not address the current problems. Addressing the Four Balance Sheet problem decisively will be critical to durably reviving growth. Raising agricultural productivity is also high priority. And even before that, a Data Big Bang is needed to restore trust and enable better policy design."*

II. POLICY BACKDROP

This Policy was formulated against a difficult backdrop, which was characterized by a likely contraction in GDP of global economy in 2020 by 4.4 per cent and the Indian economy by 10.3 per cent (as estimated by the IMF) and uncertain and uneven global scenario (IMF, 2020, a; IMF, 2020, b). Domestically, there are issues of India's GDP shrinking by 23.9 per cent in April-June, 8 per cent contraction in industrial production in August, the possibility of this year ending with 8-10 per cent contraction, spike in Covid-19 cases and limping businesses. There are also the issues of disrupted supply, demand destruction, free fall in investment, debilitated consumption demand, low corporate credit appetite, job losses and salary cuts across the board.

To be sure, food grain production is likely to reach record highs. There are also emerging green shoots as manifested in surging variables, viz., power consumption; rising petrol use, moderating diesel decline; spike in retail payments by UPI, IMPS; e-way bill & toll collection; railway freight, passenger car sales, manufacturing PMI, exports, aviation and GST collections.

The Department of Economic Analysis' (DEA's) monthly September report revealed steadily improved high frequency indicators, viz., 5.3 per cent export growth, recovery in rail freight together with rural demand growth reflected in registration of 2/3 wheelers, passenger vehicles and tractor sales. Rising GST collection (Sept. Rs 95,000 crore), fertiliser sales, manufacturing PMI, peak power consumption are welcome.

There are also other positive indicators, viz., negative interest rates in major markets, huge forex reserves, ample liquidity and surging FDI. All these events and developments are strongly suggestive of India's recovery gaining traction. With festival season, growth should gain further strength. But the position of non-oil non gold imports, C-D ratio, new capex, hotels, restaurants, tourism, FMCG, etc. indicate that the growth is yet to be broad based. Further, the issues of high unemployment rate, stressed debt rising, conspicuous absence of investment cycle in corporate credit, sputtering consumption engine and weakened balance sheets of banks force us to look at the future with some trepidation.

India's services sector, which accounts for 55 per cent of GDP and one third employment improved with Nikkei/IHS PMI rising from 41.8 in Aug. to 49.8 in Sep. India's services sector is gaining strength but persisting concerns remain on India's pathways to growth. While gazing into the crystal ball reveals a long and difficult ascent, it could perhaps justifiably be maintained that that the worst is behind us. Gerry Rice, Director, IMF held that PM Modi's call for an "Aatmanirbhar Bharat" (self-reliant India) has supported the Indian economy and mitigated significant downside risks, job losses (Money control, 2020) and COVID 19 concerns persist necessitating flattening of the curve.

Contrary to what had become a defining feature of the Indian economy, the post COVID period has been characterized by a substantial balance-of-payments (BoP) surplus. This situation stems from both short-term factors and long-term factors. Short-term factors include surge in foreign currency reserves, sluggish imports triggered by severe macro-economic contraction and rise in exports because of fiscal stimuli in the developed world and a rapid output revival in China. Structural shifts relate to low energy prices, thrust on Atmanirbhar Bharat (self-reliant India) and the concerted attempt to move up the global export value chains.

Disruptive demonetisation, rolling out of the Goods and Services Tax (GST) and COVID 19 influences, ubiquitous smartphones, e-wallets and UPI technology have facilitated fin tech startups on-boarding and integrating. This is welcome because rapid digitization of India is the way to go.

The banking sector is a microcosm of the economy. Hence, the case for repositioning banks has to be situated in a proper historical and comparative perspective. There are the issues of modest capital buffers for most PSBs, mounting NPAs, higher credit costs, weaker earnings because of interest reversals and lower fee income and subdued growth prospects.

Bank deposits surged to Rs 143 lakh crore (Rs 6.8 lakh crore rise post March). Advances fell by Rs 1.4 lakh crore to Rs 102 lakh crore. Widened C-D gap of Rs 8.2 lakh crore is met by G-Sec investment. These aspects are suggestive of heightened risk aversion, what Dr. Rakesh Mohan, the then Deputy Governor of the RBI called "lazy banking" .

III. POLICY ACTION

The MC decided to

> Keep the Policy Repo Rate under the Liquidity Adjustment Facility (LAF) unchanged at 4 per cent.

> Consequently the Reverse Repo Rate under the under the LAF remained unchanged at 3.35 per cent and the Marginal Standing Facility (MSF) rate and the Bank rate also remained unchanged at 4.25 per cent.

The RBI pressed the pause button on the Policy Rate in view of evolving growth and inflation concerns. The RBI, however, indicated greater easing by continuing "with the accommodative stance of monetary policy for as long as necessary at least through the current financial year and next year". This is important because the RBI forecasted the economy to contract by 9.5 per cent in this financial year. The six-member Monetary Policy Committee (MPC) unanimously decided to retain the benchmark Repurchase or Repo rate at 4 per cent.

The RBI had slashed the Repo rate by 115 basis points (bps) and the Reverse Repo rate by 155 bps post March to support languishing growth. The RBI Governor said the economic growth, which slumped to a negative 23.9 per cent in the April-June quarter, will turn positive only in the final January-March quarter. Barring the risk of a second wave of infections, the economy appeared poised for a recovery. With macro indicators pointing to a recovery, "GDP growth may break out of contraction and turn positive by Q4 (January-March)".

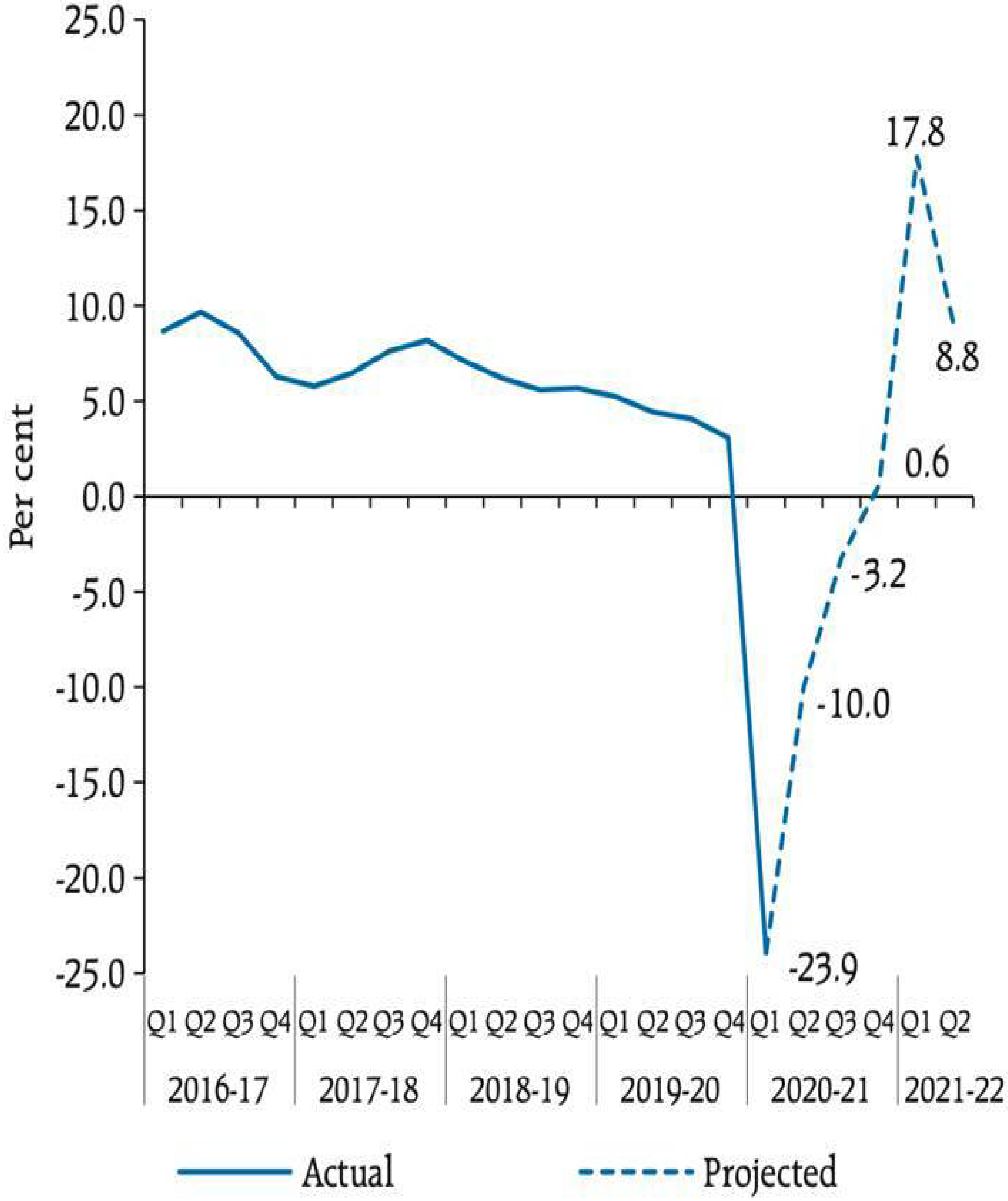
IV. GROWTH

RBI's GDP forecast revealed a contraction at 9.5 per cent for FY21 with downside risks. With the economy continuing to be in a fragile state, recovery in growth is of paramount importance. The MPC said the real GDP growth in 2020-21 is expected to be negative at (-) 9.8 per cent in the second quarter of 2020-21, (-) 5.6 per cent in the third quarter and 0.5 per cent in the fourth quarter.

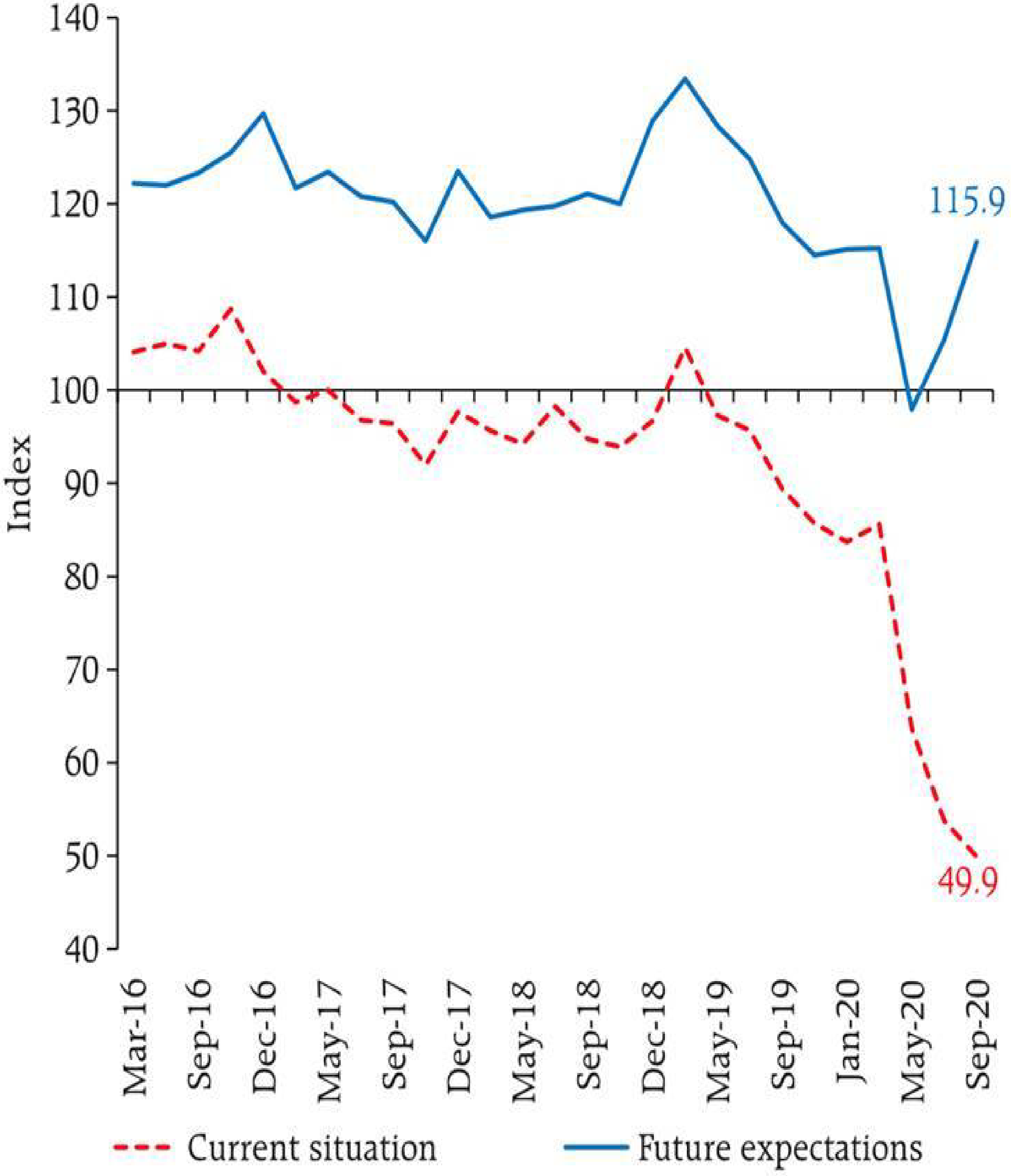
"For the year 2020-21 as a whole, therefore, real GDP is expected to decline by 9.5 per cent, with risks tilted to the downside". If the current momentum of upturn gains ground, a faster and stronger rebound is eminently feasible. *"GDP growth may break out of contraction and enter positive zone by Q4 of current fiscal... Modest recovery in first half of the year could further strengthen in the second half... Economic activity will gain traction in Q3"*. The Governor stressed *"by all indications, the deep contractions of Q1 2020-21 (April-June) are behind us; silver linings are visible in the flattening of the active case load curve across the country"*. The focus must, therefore, shift from containment to reviving economy, particularly because India could swiftly rebound to 8.8 per cent in 2021. The MPC assessed, *"real GDP growth for the first quarter 2021-22 is placed at 20.6 per cent"*. But synchronized efforts are required to enhance growth with an accent on growth and distributive equity.

GDP at Constant (2011-12) Prices in Q1 of 2020-21 is estimated at Rs 26.90 lakh crore, as against Rs 35.35 lakh crore in Q1 of 2019-20, showing a contraction of 23.9 percent as compared to 5.2 percent growth in Q1 2019-20. Quarterly GVA at Basic Price at Constant (2011-12) Prices for Q1 of 2020-21 is estimated at Rs 25.53 lakh crore, as against Rs 33.08 lakh crore in Q1 of 2019-20, showing a contraction of 22.8 percent (NSO, 2020).

The RBI also released its second Monetary Policy Report (MPR) of 2020. The MPRs are released biannually in April and in October and provide a clear idea of the macro-economic landscape. The RBI's professed aim of propping up the economy despite rising inflation is soothing. Professional forecasters' poll in the September 2020 round of the RBI's survey suggested an uptick in India's real GDP growth. The steep pick up in the first quarter of the next financial year is driven by 23.9 per cent contraction in GDP in Q1 of the current financial year (Chart 1).



Source: Survey of Professional Forecasters, RBI and National Statistical Office.



Source: Consumer Confidence Survey, RBI.

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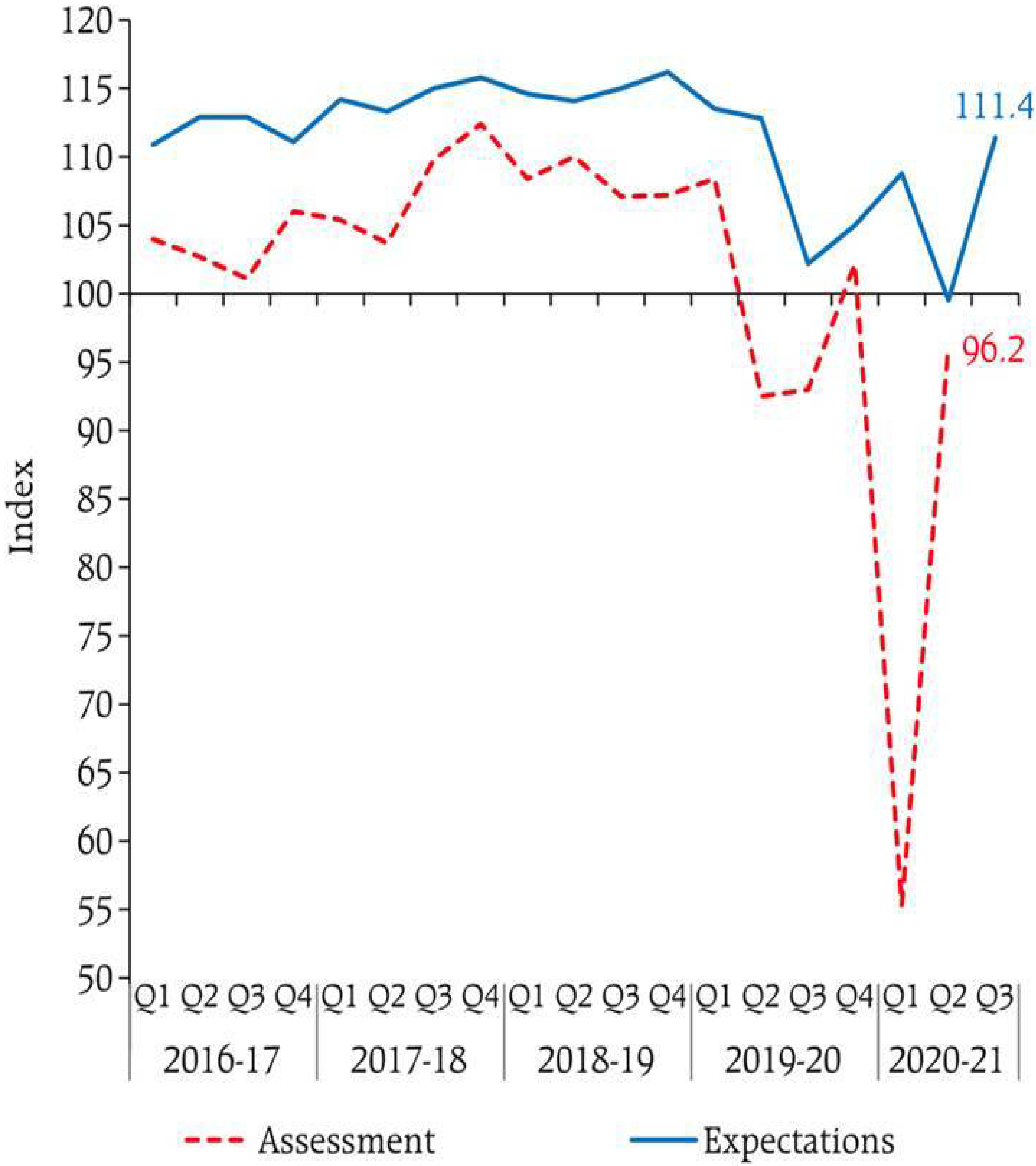
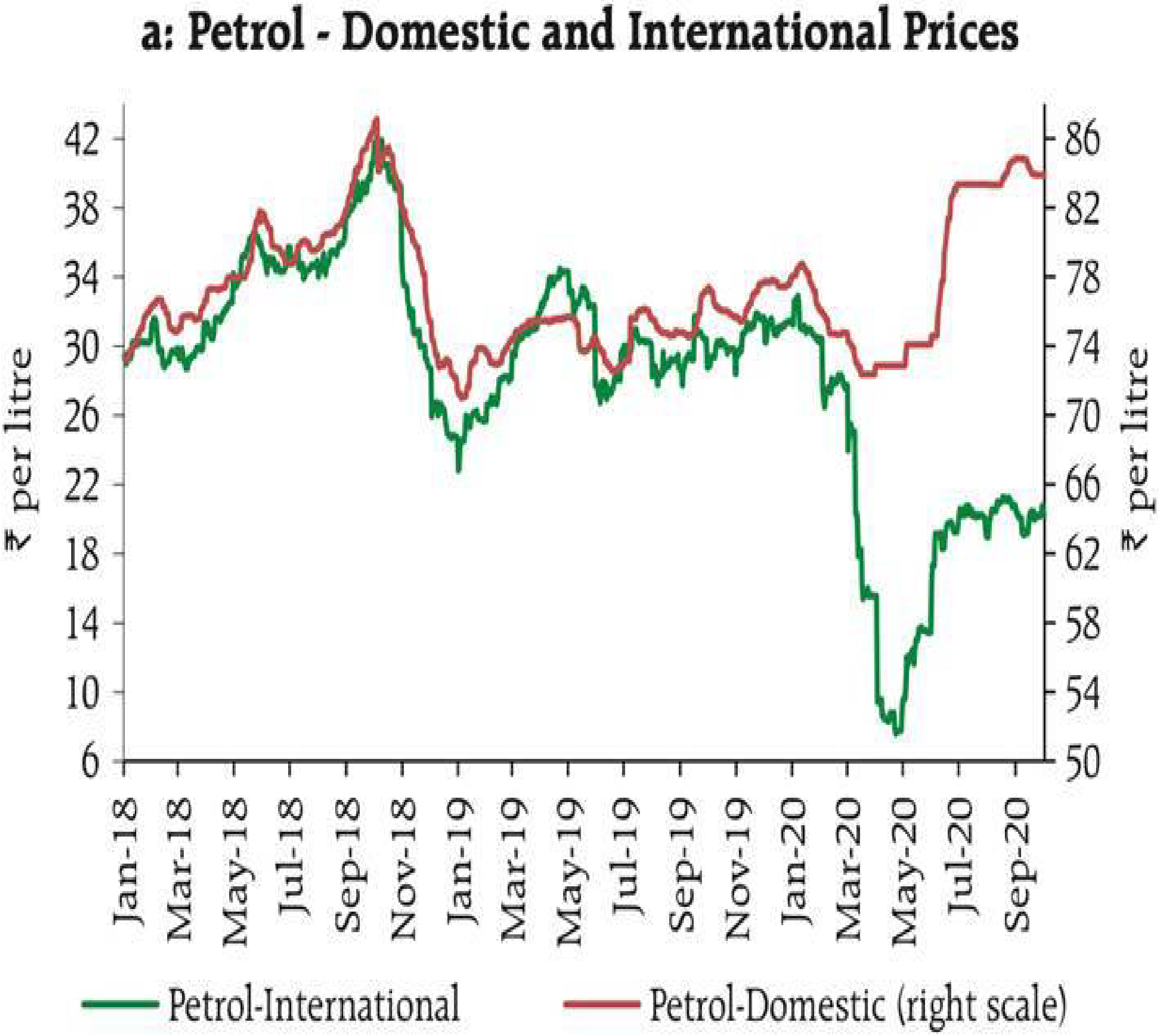
While the current the consumer confidence index fell to an all-time low in September, for the year ahead, consumer confidence improved in the September 2020 round, "driven by improved sentiments on the general economic situation, the employment scenario and income" (Chart 2).

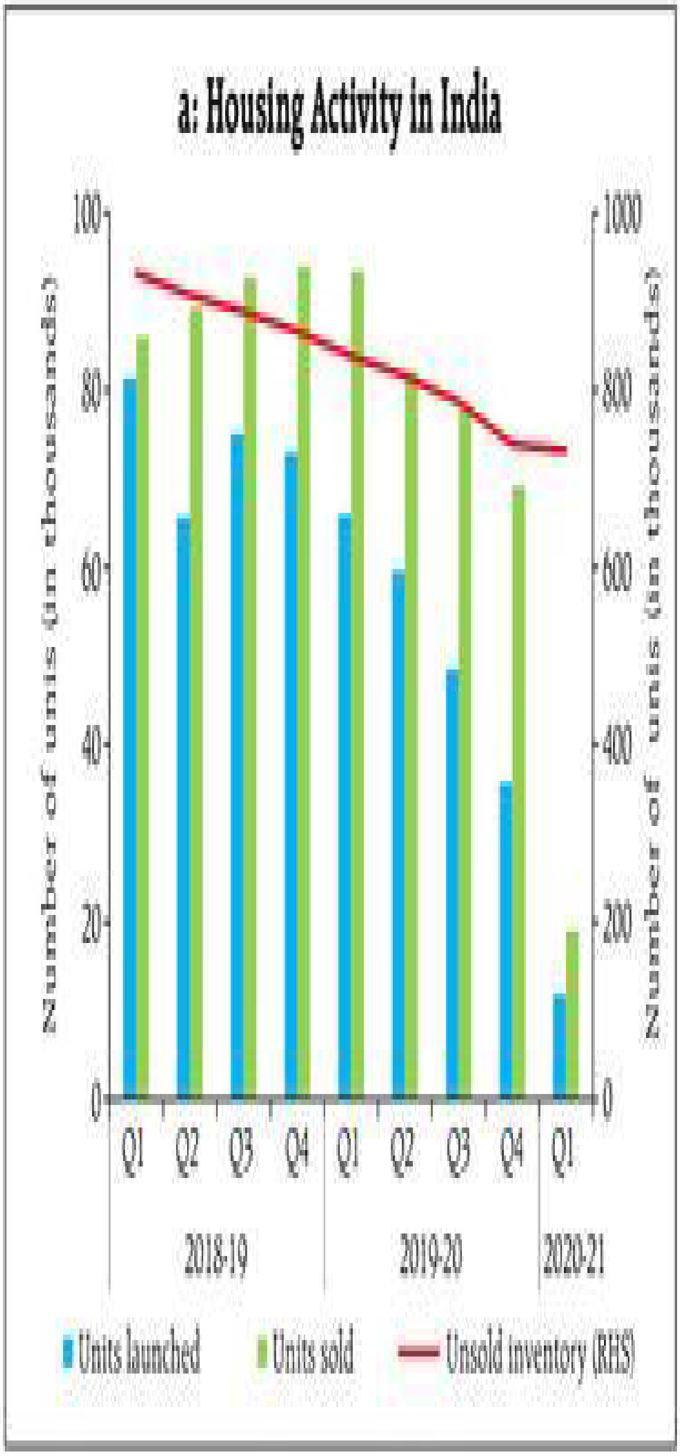


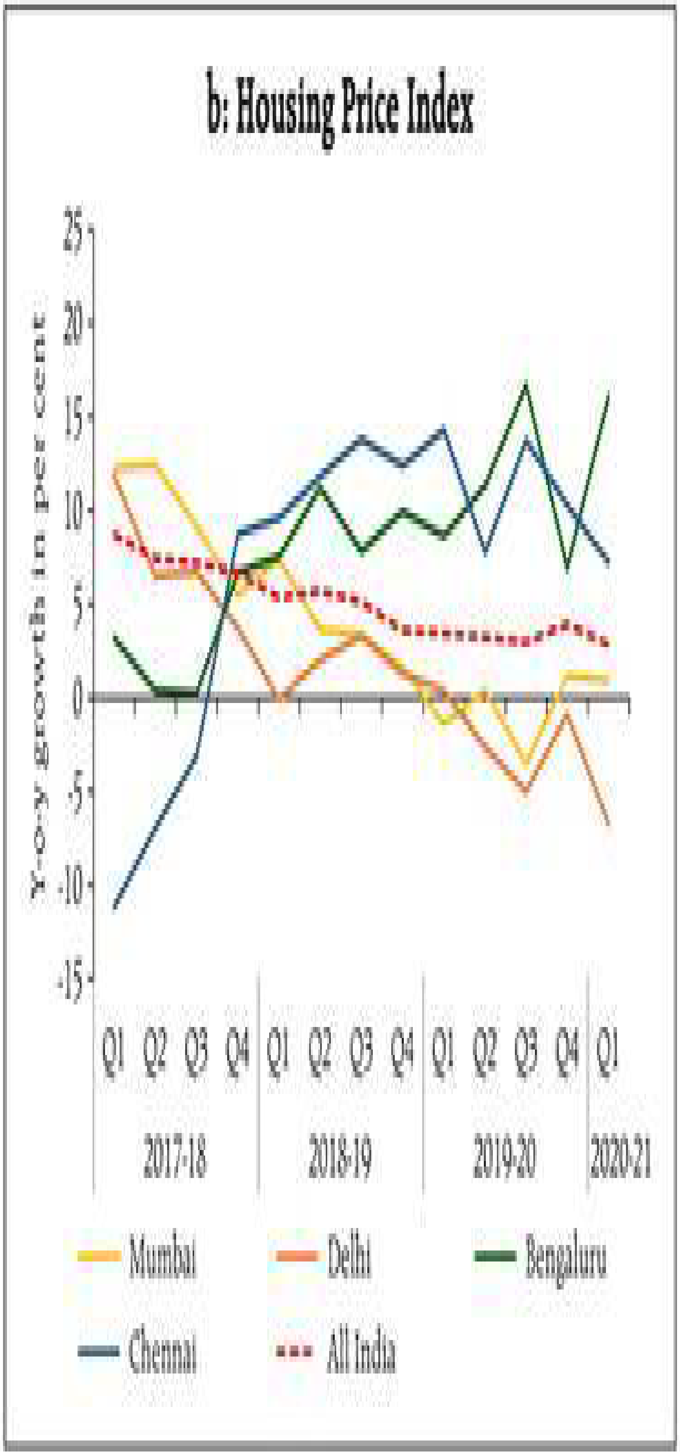
Source: Industrial Outlook Survey, RBI.

RBI's Industrial Outlook Survey reflects optimism as the expectations (blue line) for the quarter ahead moved into the expansion zone (above 100) (Chart 3).



The wide divergence between domestic and international fuel prices, which causes concern, has hampered the decline in inflation and inflationary expectations and the consequent downward bias of the interest rate (Chart 4).





Source: PropTiger and RBI staff estimates.

Rising housing inventory has been accentuated by COVID 19. While the regulatory and funding challenges intensified in the housing industry and consumer demand declined, the overall price index (red dotted line in the last chart) also reduced with the only exception being Bengaluru (Charts 5 and 6).

With the economy continuing to be in a fragile state, rehabilitation of the growth process becomes utmost important. The RBI marshalled and dissected macroeconomic and industry data to demonstrate that the worst is behind us. The RBI's assurances to market participants to undertake further measures to facilitate liquidity and easy finance conditions and provide access to easier credit to smaller businesses are welcome. However, more steps are needed to revive the economy and for India's recovery to gain traction, Special dispensation for HTM holding extended until March 2022 with a provision to buy Government securities until March 2021 and hold these in HTM to 22 per cent of NDTL is welcome. OMO amount increased to 20000 crore per auction, TLTROs made an on-tap facility and end-use is sector specific with thrust towards NBFCs. The creative and unconventional announcement of OMO Purchases of State Development Loans will ensure the states' borrowing program is non-disruptive and the cost remains anchored to broader market realities.

V. INFLATION

The current inflation hump is seen to be transient. The RBI projected inflation easing close to the targeted band of 4 per cent, plus or minus 2 per cent, in the fourth-quarter ending March. It is, however, likely to stay above the tolerance level at 6.8 per cent for the quarter ended September 2020.

The RBI projected Consumer Price Index (CPI) inflation at 6.8 percent for Q2FY21, at 5.4-4.5 percent for second half of FY21 and 4.3 percent for Q1FY22, with risks broadly balanced. Subsequently, large favourable base effects are expected to reduce it to 5.4 per cent in Q3, and 4.5 per cent. Confidence intervals for headline inflation in Q4 of 2020-21 are 3.2-5.9 per cent and 2.4-6.6 per cent, respectively. "For 2021-22, assuming a normalisation of supply chains with the availability of effective vaccines against COVID-19, a normal monsoon, and no major exogenous or policy shocks, structural model estimates indicate that inflation will move in a range of 4.1-4.4 per cent".

Given the present ground realities, this estimate may seem overly optimistic. But some of the Governor's optimism is grounded in people's expectations. In the September 2020 round of the RBI's survey, households expected inflation to decline modestly over the next three months, suggestive of ameliorating supply chains. "Other surveys, also conducted in September, indicate that consumer confidence is turning upbeat on the general economic situation, employment and income over a one year ahead horizon". He held "our projections indicate that inflation would ease closer to the target by Q4 of 2020-21". "Our assessment is that inflation will remain elevated in September but ease gradually towards the target over Q3 and Q4. Our analysis also suggests that supply disruptions, and associated margins and markups are the major factors driving up inflation".

While inflation exceeded the tolerance band for several months, the MPC evaluated that the underlying factors are essentially supply shocks which should dissipate with gradual unlocking of the economy, restoring supply chains, and normalizing activity. While there are encouraging signs of recovery, the emerging form and substance of recovery is unclear. With the economy recovering and supply lines restoring, retail inflation should ease, but flattening of the curve continues to be of utmost importance.

The RBI expected that the economic recovery will be a 3-speed recovery, with variation across sectors, depending on sector-specific realities.While manufacturing firms may see capacity utilisation in Q3, agriculture, consumer goods, power, and pharmaceutical sectors are likely to see quicker recovery. The Governor asserted "against all odds, we shall strive and revive". Towards this end, he announced several unconventional measures to boost liquidity and support economic activity while ensuring the government's record borrowing programme goes through smoothly.

Retail inflation has consistently breached the RBI's mandated level mostly since December 2019. With supply disruptions and associated margins/mark-ups getting restored, these wedges should dissipate. There was, therefore, a case for the MPC holding the repo rate. In other words, with inflation expected to fall within RBI's comfort band — that is, 4 per cent, +/- 2 percentage points — in the second half of the year, there could be a repo rate cut in the coming months. The RBI expected the economy to contract by 9.5 per cent in the current financial year.

The RBI's projections indicated that inflation would ease closer to the target by the fourth quarter of 2020-21. In the September 2020 round of the RBI's survey, households expected inflation to decline modestly over the next three months, indicative of hope that supply chains are mending.
The Monetary Policy Report identified that 80 per cent of the inflation deviation from target was attributable to a supply shock in food and the elevated taxes on fuel, and that the MPC intends to look through this period of high inflation. Banks or other bond investors that refrained from purchasing government bonds because of market perception that the RBI would increase interest rates at some point to comply with its legal mandate would find this communication reassuring.

VI. LIQUIDITY

Given the large banking-system surplus liquidity, the RBI kept bond yields contained through OMOs (open market operations) or Operation Twist. Over the past few months RBI had declined to accept bids at a government bond auction for the fourth time in seven weeks as it strove to cool benchmark yields in excess of 6 per cent. A well-defined framework on the size and length of the quantitative programs supportive of government borrowing helps in reducing the uncertainty causing an upside bias in bond yields despite surplus liquidity.
The RBI reiterated the non-disruptive conduct of the government borrowing programme. To this effect, the OMO amounts have also been increased to Rs 20,000 crore. RBI's willingness to look through the current phase of high CPI and future expectation of CPI coming closer to the RBI's target should work as a strong anchor for bond yields. This would provide a pre-Diwali cheer to bond markets.
The announcement of OMO (including OMO for SDL) and on tap LTRO will facilitate greater liquidity infusion and check interest rates. The RBI is willing to take further liquidity measures. Accordingly, the Governor announced Rs 1 lakh crore of targeted long-term funds with tenors of 3 years from the RBI to banks for investing only in corporate bonds, aimed at easing cash crunch at firms. The RBI will buy bonds issued by state governments as a special case and also extended till March 31, 2022, its permission to banks to hold more government bonds without marking to market.

VII. RETAIL

The increased exposure to retail and small borrowers up to Rs 7.5 crore and rationalising risk weights for all new housing loans till March 31, 2022 will help the real estate sector, particularly borrowers of higher value loans, enhance credit to borrowers and thus generate employment and economic activity. But banks need to shore up their credit appraisal processes to reduce the risks of defaults and delinquencies.
The RBI Governor announced a 'Co-Lending Model' to improve the credit flow to the unserved and underserved sectors of the economy. In terms of the new model, all non-banking finance companies (NBFCs), including housing finance companies (HFCs) will be allowed to collaborate with banks to undertake priority sector lending. This "Co-Lending Model" is expected to collaboratively leverage the comparative advantages of banks and NBFCs. In 2018, the RBI had introduced a framework on the co-origination of loans by banks, and only a certain category of NBFCs were allowed to partner with banks for lending to the priority sector subject to certain conditions. However, with the new rules, this has been extended to all the NBFCs (including HFCs), to make all priority sector loans eligible for the scheme and provide greater operational flexibility to the lending institutions. This is important because in the process of national unlocking, NBFCs were hit by a constellation of factors, including regional lockdowns, the uncertainty of business resumption and a hazy macroeconomic scenario.

VIII. REVISED LTV NORMS

The RBI's rationalization of risk weights on home loans till 31 March 2022 will marginally reduce home loan rates and thus boost the sagging fortunes of the housing sector to a limited extent. It would also make available capital for lending.

Regulatory norms require banks to set aside capital for loans to cover defaults. Home loans by banks are calculated on the basis of the amount of loan disbursed, and the percentage of the loan against the property value, i.e., loan-to-value (LTV) ratio. Banks will now only consider the LTV ratio in computation of the risk weight, and the size of the loan will be rendered inconsequential. All loans, irrespective of the amount, with an LTV of 80 per cent or less, will have a risk weight of 35 per cent. Similarly, the risk weight will be 50 per cent for all loans with a LTV between 80 per cent and 90 per cent.

Existing regulations cap the LTV ratio for various loan sizes. For loans below Rs 30 lakh, a lender can finance up to 90 per cent of the property value, and between Rs 30 lakh and Rs 50 lakh, it can offer an LTV of up to 80 per cent. While these will remain constant, for loans above Rs 75 lakh, the RBI permits financing up to 75 per cent of the property value. The rationalization of risk weight for this segment will provide an impetus to housing loan disbursals from a supply-side perspective by bringing about greater capital efficiency for lenders in housing loan disbursal. Rationalizing of risk weight will not have a direct impact on home loan borrowers. With banks required to set aside lesser capital for higher-ticket loans, this would boost both liquidity and enhance liquidity.

IX. LOAN MORATORIUM EXTENSION

The RBI advised the Supreme Court that continuation of the loan moratorium period beyond six months already granted may affect overall credit discipline, and small borrowers will eventually feel the pinch. The RBI also urged the Supreme Court to lift its interim order staying declaration of accounts as NPAs because this will have *"huge implications for the banking system, apart from undermining"* its *"regulatory mandate"*. The RBI averred *"a long moratorium exceeding six months can also impact credit behaviour of borrowers and increase the risks of delinquencies post resumption of scheduled payments. It may result in vitiating the overall credit discipline which will have a debilitating impact on the process of credit creation in the economy. It will be the small borrowers which may end up bearing the brunt of the impact as their access to formal lending channels is critically dependent on the credit culture". A more "durable solution" is provided by the RBI's Resolution Framework for Covid-19 related Stress (August 6), which "enables the lenders to implement a resolution plan in respect of personal loans as well as other exposures affected due to Covid-19, subject to the prescribed conditions, without asset classification downgrade. The framework, inter alia, permits extension of the moratorium by a maximum of two years".*

The Union Finance Ministry had told the Supreme Court that the government had decided to waive interest on interest in respect of MSMEs and other personal loans up to Rs 2 crore during the six-month moratorium period. The RBI maintained *"continuation of temporary moratorium"* beyond the six month period already allowed *"would not even be in the interest of borrowers. It may not be sufficient in addressing deeper cash flow problems of the borrowers and in fact exacerbate the repayment pressures for the borrowers". On September 3, the Supreme Court had directed that accounts which have not been declared as NPAs as of August 31 should not be declared so until further orders. The RBI urged the court to "immediately" lift this "across the board stay" because if this is not done "it shall have huge implications for the banking system, apart from undermining" its "regulatory mandate" The RBI said it "has taken a balanced view, taking into account the interest of the depositors, borrowers, real sector entities and banks.On September 3, the Supreme Court had directed that accounts which have not* *been declared as NPAs as of August 31 should not be declared so until further orders. The RBI urged the court to "immediately" lift this "across the board stay" because if this is not done "it shall have huge implications for the banking system, apart from undermining" its "regulatory mandate" The RBI said it "has taken a balanced view, taking into account the interest of the depositors, borrowers, real sector entities and banks.*

The RBI stressed that as per the Resolution proposal, only those borrower accounts, which were classified as standard, but not in default for more than 30 days with any lending institution as on March 1, 2020, shall be eligible for resolution. It may inter alia include rescheduling of payments, conversion of any interest accrued or to be accrued into another credit facility, or, granting of moratorium, based on assessment of income streams of the borrower for two years. The RBI disagreed that accounts, which were standard but overdue beyond 30 days as on March 1, 2020, should also be considered eligible for the Resolution as they too may have been impacted on account of Covid-19. The RBI held *"this is a classic fallacy of composition which presumes that the accounts paying on time can be equated with accounts paying with a considerable delay. An account which was impacted by pandemic as well as had a pre-existing financial has a different risk profile as compared to an account without pre-existing stress and to treat both borrowers on equal footing would be gross suspension of economic sensibilities".*

Some petitioners had sought directions to RBI to announce sector-specific reliefs.

But the RBI countered *"such prayers deliberately obfuscate the fact that Resolution Framework gives complete discretion to lending institutions and borrowers to arrive at resolution plans which are tailored to the specific requirements of the sector subject to the prudential boundaries specified therein".*

The K V Kamath Committee recommended *"sector specific thresholds to the mandatory financial parameters, which are more liberal than normal lending financial benchmarks, that need to be considered in the financial projections while designing the resolution plans"*. The RBI circular of September 7, 2020 provides for *"separate thresholds for 26 sectors including power, real estate and construction. Even under the power sector, separate thresholds have been prescribed for generation, transmission and distributions sectors. Similarly, separate thresholds have been prescribed for residential and commercial real estate sectors".*

"Sectors such as power and real estate were already stressed even before the pandemic on account of various factors pertain to sector-specific problems," the central bank said, adding that *"the travails of the real sector cannot be solved through banking regulations. The banking regulations of RBI cannot substitute the addressal of structural problems of the real sector". "In any case, projects under implementation which are affected due to the fallout of Covid-19 can be restructured under an already existing framework. This extant framework allows for extension of timeline for completion of the projects by 2 years in case of non-infra projects, including real estate projects, and by 4 years for infrastructure projects without downgrading to NPA," it said.*

The government had also initiated several measures to address some of the sectoral problems, including creation of a Special Window for Completion of Affordable and Mid-Income Housing (SWAMIH Investment Fund) to provide priority debt financing for the completion of stalled housing projects.

X. E-TRANSACTIONS

A key measure includes linking risk weight for home loans to LTVs and making RTGS (Real Time Gross Settlement) system a 24x7 payment system on the same lines of NEFT. In December last year, RBI had made available the National Electronic Fund Transfer (NEFT) system on a 24x7x365 basis.

XI. EXPORTS

For exporters hit by the pandemic, the RBI discontinued the system-based automatic caution-listing to allow them to realise export proceeds.

XII. TRANSMISSION MECHANISM

The yawning chasm between the repo rate and the average lending rate of banks is attributable to (a) the gap between the deterministic RBI repo rate and the borrowing rate of the Indian government (the G-Sec yield) and (b) the gap between the G-Sec yield and the borrowing rate of individuals or private firms. While the latter reflects manifests risk aversion in the financial system and inadequate capacity, the former, i.e., the "term premium" can be influenced by the RBI's actions.

The RBI has not gone the whole hog in directly influencing the term premium for the sake of its credibility and independence. However, unless the borrowing rate of the government reduces (i.e., the "risk free rate" because the government cannot default, at least not on local currency borrowings), high borrowing costs for the whole economy will persist. There is a compelling case for a paradigm shift and capital infusion in PSBs. The RBI's Working Paper cogently argued for capital infusion in PSBs to enhance real sector credit flow and smoother policy transmission. The thesis that higher NPAs hamper transmission and lower growth rate has been well substantiated in the literature on banking development (RBI, 2020).

Usually there is a significant difference in the borrowing level across banks and in the language of risk management; one-size does not fit all. However, generally speaking, banks at present are not borrowing significantly because there is not much credit off-take and surplus funds are parked in G-Secs.

However, there two conflicting thoughts here: the Repo Rate has increasingly emerged as a signalling mechanism and banks are expected to move in this direction. In a deregulated environment, however, banks take their individual call on the basis of their financial position, cost and yield, level of NPAs, etc. Any reduction in the lending rate requires a concomitant reduction on deposits to protect spreads and margins. But the rate of interest on government deposits acts as a floor. If banks drastically reduce their deposit rates, their deposits would flow to competing instruments. Hence this leads to a dilemma.

XIII. FUTURE RATE CUTS

Given the expectations of falling inflation in coming months with strong Kharif crops, brightened rabi outlook, restored supply chains and resilient rural economy, the incompatibility of a severe GDP contraction with demand side inflation pressures and the RBI maintaining its support in terms of liquidity and using several non-interest tools to revive economy, there is space for another 25-50 bps rate cut. This cut could conceivably occur in February 21, but is possible even in December 20.

While maintaining accommodative stance without any rate cut, the RBI announced several additional liquidity and regulatory measures including on tap TLTRO, creative open market operations (OMO) in state development loans, rationalisation of risk weights on housing loans and extension of held to maturity limits till March 2022. These measures are likely to un-stress financial conditions further and provide support to key sectors of the economy.
The RBI's assurance of continuing *"with the accommodative stance as long as necessary-at least during the current financial year and into the next financial year"* in conjunction with liquidity commitments and bond-supportive measures will ensure greater policy transmission across markets (money, bonds, bank lending), despite unchanged policy rates.

XIV. ANCHORING RATES

A modest repositioning of growth was justified because of the consideration of inflation as transitory. The bond markets also received an impetus by several liquidity measures — both for the Centre and (debut) state development loans — helping to cap risk-free yields. Most policy easing expectations now are a function of the inflation trajectory, which depends on both cost-push and supply-side disruptions. With the economy recovering and reducing slack in demand conditions, there could conceivably be an inflationary spiral. But the thrust on anchoring rate and inflationary expectations, with a careful consideration of the available policy room vis-à-vis price momentum is contextually significant.

Despite downward rigidity in the benchmark rates, policymakers could anchor rates at prevailing levels for quite some time by various mechanisms, e.g.,
> Keeping the policy rate constant a la (post- global financial crisis phase from 2Q09 to February 2010) (despite an apparent uptick in growth because of base effects) to surmount the problems of weak capacity utilisation, sluggish labour market and inadequate deleveraging process by key economic agents.
> Negative gap in demand conditions should allow surplus liquidity without an obsessive concern with consumption-led price pressures. Reduced lending rates could also facilitate enhanced lending to the real economy.
> Role of the bond markets, e.g., doubling the size of the weekly OMO, easing HTM limits for banks, and innovative special liquidity support for state development loans.
> Direct debt monetisation is certainly a distinct possibility but there is a sense of dread because of the past saga of difficult eventual withdrawal reminiscent of the popular phrase *"if you ride a tiger, you dare not dismount"*. This mechanism was gradually debilitated by the introduction of the FRBM Act and the RBI stressing its inflation targeting objective.

The Indian economy has customarily been confronted with the twin fiscal and current account deficits. But the consideration of asset purchases, given the extent of concurrent borrowing and debt with attendant macro implications is fraught with difficulties. Hence, while markets hope for direct intervention, there is a clear possibility of mobilizing secondary market purchases.

XV. CONCLUSION

These are trying times for the global economy in general and the Indian economy in particular. Macro demand destruction and sluggish investment in India post COVID 19 necessitate breaching of mandated fiscal deficit, remunerative prices for agriculture, cash infusion by burgeoning public sector, construction intensive activities and rehabilitation of MSMEs by an enabling ecosystem, viz., timely and adequate credit, marketing support and wage cost subsidization. Rising infections and stress in state finances also cause concern.

The RBI's assurances to market participants to carry forward the process of liquidity infusion and easy finance conditions and provide access to easier credit to smaller businesses are welcome. While more steps are needed to revive the economy, the RBI’s operationally dovish policy would foster development of the broader economy. Such measures, however, ought not to be seen in isolation, in silo but be considered as an integral part of the series of measures announced in unison by the RBI and the Government of India’s stimulus package. It is thus part of a continuum to address emerging concerns. There is, therefore, a need for optimism about our inherent dynamism and resilience.

The RBI also announced some measures to boost credit growth. The targeted refinancing operations (TLTRO) should help to reduce borrowing rates in the targeted industries. Other measures like the counter-cyclical changes in risk weights for home loans, higher single-borrower limits for small borrowers and expansion of the co-origination model (where banks and non-banking firms jointly lend to borrowers) may have limited impact. But the use of these instruments shows that the RBI is alive and conscious of the evolving situation.

The decision to hold rates steady would help to protect net interest margins (NIMs) of Banks as a majority of the loan book is linked to the Repo or other floating benchmarks. The policy measures provide an explicit recognition of the growth risk to the macro-economy and the consequent need to ensure adequate liquidity as clearly manifested in recent measures and the cut-offs in auctions.

Good monsoon, favourable high-frequency indicators, pent-up demand, and the Oktoberfest of the Navratri festival season augur well for the economy to gain steam. In the context of the overarching COVID 19 pandemic, reconciling conflicting objectives & trade-offs is difficult but doable. The holding of the Policy Rate steady in view of evolving growth and inflation concerns in this era of incipient, uncertain and uneven growth makes this a judicious policy at the present juncture. The Policy did well to ensure that money remained affordable for governments, corporate borrowers and individuals and facilitated an enabling ecosystem for larger ground level disbursement of credit- both at the corporate and retail levels. The moves to hold bigger auctions for open market operations (OMO), special OMOs for state governments and easier terms for bank's bond portfolios and relief for small borrowers with the threshold exposure level being raised to Rs 7.5 lakh crore from Rs 5 crore are some other welcome features of this Policy.

Going ahead, the economic challenges are unlikely to go away in a hurry, the financial system still needs a major overhaul, and the domestic demand is not yet fully resurrected. This requires both the RBI and the MPC to stay the course for some more time for a discernible and sustained macro-economic position. This is a difficult time but there is light at the end of the tunnel. This too shall pass. We shall overcome.

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Statement 1: Quarterly Estimates of GVA at Basic Prices in Q1 (April-June) of 2020-21 (at 2011-12 Prices)

(₹ in crore)

Industry	April-June (Q1)				
	2018-19	2019-20	2020-21	Percentage Change Over Previous Year	
				2019-20	2020-21
1. Agriculture, Forestry & Fishing	4,27,177	4,39,843	4,54,658	3.0	3.4
2. Mining & Quarrying	88,634	92,807	71,209	4.7	-23.3
3. Manufacturing	5,61,875	5,78,936	3,51,396	3.0	-39.3
4. Electricity, Gas, Water Supply & Other Utility Services	74,998	81,628	75,877	8.8	-7.0
5. Construction	2,49,913	2,62,828	1,30,750	5.2	-50.3
6. Trade, Hotels, Transport, Communication & Services related to Broadcasting	6,09,330	6,30,860	3,34,284	3.5	-47.0
7. Financial, Real Estate & Professional Services	7,57,850	8,03,322	7,60,491	6.0	-5.3
8. Public Administration, Defence & Other Services	3,87,589	4,17,483	3,74,656	7.7	-10.3
GVA at Basic Prices	**31,57,366**	**33,07,707**	**25,53,320**	**4.8**	**-22.8**

Statement 2: Quarterly Estimates of Expenditures on GDP in Q1 (April-June) of 2020-21 (at 2011-12 Prices)

(₹ in crore)

Item	April-June (Q1)				
	2018-19	2019-20	2020-21	Rates of GDP (%)	
				2019-20	2020-21
1. Private Final Consumption Expenditure (PFCE)	18,89,008	19,92,967	14,61,164	56.4	54.3
2. Government Final Consumption Expenditure (GFCE)	3,93,709	4,18,249	4,86,636	11.8	18.1
3. Gross Fixed Capital Formation (GFCF)	10,82,670	11,32,195	5,99,192	32.0	22.3
4. Change in Stocks (CIS)	64,131	67,328	53,336	1.9	2.0
5. Valuables	41,080	51,347	4,645	1.5	0.2
6. Exports	6,86,695	7,08,546	5,67,961	20.0	21.1
7.Imports	8,08,933	8,25,788	4,92,286	23.4	18.3
8. Discrepancies	10,803	-9,576	8,908	-0.3	0.3
GDP	**33,59,162**	**35,35,267**	**26,89,556**	**100.0**	**100.0**
GDP (Percentage change over previous year)		5.2	-23.9		

Statement 3: Quarterly Estimates of GVA at Basic Prices in Q1 (April-June) of 2020-21 (at Current Prices)

(₹ in crore)

Industry	April-June (Q1)				
	2018-19	2019-20	2020-21	Percentage Change Over Previous Year	
				2019-20	2020-21
1. Agriculture, Forestry & Fishing	6,55,799	7,12,222	7,52,768	8.6	5.7
2. Mining & Quarrying	98,202	1,04,945	61,586	6.9	-41.3
3. Manufacturing	6,64,844	6,94,993	4,21,746	4.5	-39.3
4. Electricity, Gas, Water Supply & Other Utility Services	1,13,836	1,24,751	1,18,150	9.6	-5.3
5. Construction	3,24,955	3,50,920	1,70,611	8.0	-51.4
6. Trade, Hotels, Transport, Communication & Services related to Broadcasting	7,58,987	8,06,915	4,24,739	6.3	-47.4
7. Financial, Real Estate & Professional Services	9,74,229	10,56,866	10,10,899	8.5	-4.3
8. Public Administration, Defence & Other Services	5,65,871	6,37,682	6,05,507	12.7	-5.0
GVA at Basic Price	**41,56,723**	**44,89,292**	**35,66,006**	**8.0**	**-20.6**

Statement 4: Quarterly Estimates of Expenditures on GDP in Q1 (April-June) of 2020-21 (at Current Prices)

(₹ in crore)

Item	April-June (Q1)				
	2018-19	2019-20	2020-21	Rates of GDP (%)	
				2019-20	2020-21
1. Private Final Consumption Expenditure (PFCE)	26,52,987	28,77,927	21,72,892	58.5	57.1
2. Government Final Consumption Expenditure (GFCE)	5,52,100	6,04,299	7,26,278	12.3	19.1
3. Gross Fixed Capital Formation (GFCF)	13,18,447	14,22,545	7,41,057	28.9	19.5
4. Change in Stocks (CIS)	76,913	84,723	69,854	1.7	1.8
5. Valuables	47,431	55,479	5,740	1.1	0.2
6. Exports	8,70,374	9,26,505	7,68,037	18.8	20.2
7.Imports	10,63,713	11,20,793	6,89,734	22.8	18.1
8. Discrepancies	96,685	67,544	14,070	1.4	0.4
GDP	**45,51,224**	**49,18,228**	**38,08,193**	**100.0**	**100.0**
GDP (Percentage change over previous year)		8.1	-22.6		

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