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INDUSTRY OUTLOOK

RBI MONETARY POLICY: HOLDING THE RATE STEADY- CONTEXTUALLY SIGNIFICANT POLICY

June 2021

RBI'S JUNE 2021 POLICY

In line with our expectations and infact most market participants, the Reserve Bank of India (RBI) kept the Repo rate unchanged and retained the accommodative stance. The six-member MPC unanimously held the Repo rate unchanged at 4 per cent. This was the seventh consecutive time since May 22, 2020- when it was reduced from 4.4 per cent to 4 per cent on May 22, 2020-that the RBI kept the Repo rate unchanged at 4 per cent as also the Reverse Repo rate unchanged at 3.35 per cent. The Marginal standing facility (MSF) rate and the bank rate remained unchanged at 4.25 per cent. The Governor pointed out "the MPC was of the view that at this juncture, policy support from all sides is required to regain the momentum of growth that was evident in H2:2020-21 and to nurture the recovery after it has taken root".

Why did we say status quo? The case for a status quoist policy stemmed from the compelling need for macro-economic stability in the wake of widespread devastation caused to lives and livelihoods, continued uncertainty triggered by the second wave of covid 19, decelerated growth prospects and sticky inflation.

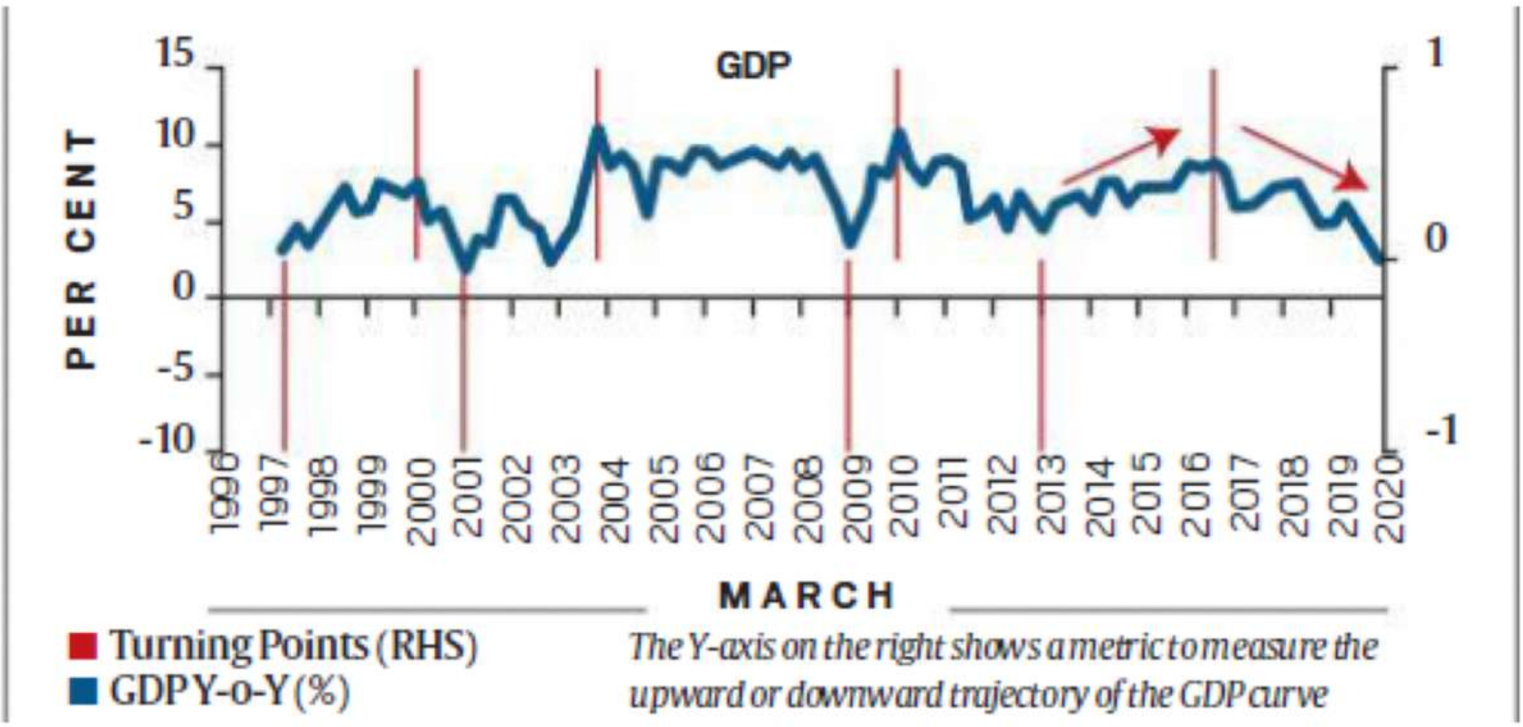
In a strong and unambiguous message, "the MPC also decided unanimously to continue with the accommodative stance as long as necessary to revive and sustain growth on a durable basis and continue to mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward". The continuation of accommodative stance till the Indian economy recovers on a durable and sustainable basis from the impact of Covid 19 pandemic is reassuring. The Policy suggests that though the rates are at historic lows, further rate cuts down the road are not completely ruled out. Let us attempt to highlight, which are of considerable contextual significance in the light of the RBI's monetary policy.

1. GDP Growth

The issue of the growth and the composition of the GDP has always evoked considerable debates and discussions across the development spectrum. It is, therefore, important to cut the clutter and connect the dots. It is disconcerting to note that the pandemic induced recession caused India's GDP to shrink by 7.3 per cent in FY 21 with Q4 growing by 1.6 per cent, up from 0.5 per cent in Q3 because of extensive lockdowns and stopped most economic activities.

Data released by Ministry of Statistics and Programme Implementation (MOSPI) 0n 31 May 2021, shows that for the entire year 2020-21, the economy contracted by minus (-) 7.3 per cent as compared to 4.0 percent in 2019-20. Real GDP in 2020-21 is now estimated to attain a level of ₹135.13 lakh crore, as against the First Revised Estimate of GDP for the year 2019-20 of ₹145.69 lakh crore, previously released on 29th January 2021. The quarterly GDP growth stood at 1.6 per cent (end-March'2021 quarter).

To place matters in perspective, it is important to realize that the economy grew by 4 per cent in FY 20 and shrank by 5.2 per cent in FY 80. It is widely agreed that extensive restrictions and partial lockdowns could act as headwinds to growth.



Key indicators, viz., industry and business activities are still very vulnerable given the low vaccination levels among the larger, younger population. At the individual and household level, public fear and anxiety this time are deeper. Such fears have thus debilitated consumption and demand. The RBI, which has kept its monetary policy loose while boosting liquidity to the economy highlighted that growth prospects will, inter-alia, be a function of quick check on infections.

Compared to other emerging market developing economies (EMDEs), India is a laggard in GDP growth. But modest current account surplus and rising levels of foreign exchange reserves remain some bright spots.

Table 1: The macro comparison (April 2021)

India's economic metrics look worse than those of other emerging (figures in %) economies on four out of five counts.

Sl No.	Countries	GDP growth	Annual Inflation	Fiscal Deficit/GDP	Government Debt/GDP	Current A/C as % of GDP
1	Bangladesh	3.8	5.6	-5.5	38.9	-1.5
2	Brazil	-4.1	3.2	-13.4	98.9	-0.9
3	Indonesia	-2.1	2.0	5.9	36.6	-0.4
4	Russia	-3.0	3.4	-4.0	19.0	2.2
5	South Africa	-7.0	3.3.	12.2.	77.1	2.2
6	Thailand	-6.1	-0.8	-4.7	49.6	3.3
7	Turkey	1.8	12.3	-5.4	36.8	5.1
8	India	-7.3*	6.2	-9.3**	89.6	1.0
9	Average EMDEs	-2.2	5.1	-7.7	63.4	0.6

Source: IMF World Economic Outlook April 2021 database.
*Earlier projection was minus (-8) per cent. ** earlier projections was -12.3 per cent.

The RBI's Annual Report FY 21 (27 May) highlighted that private consumption expenditure was negative in FY 21, and showed a gradual decline since FY 20. Almost all parameters, viz., total consumption expenditure-private, government; gross fixed capital formation-fixed investment, change in stocks, valuables; net exports; GDP showed declining trends in recent years.

Chart 2: Macroeconomic Parameters Trends (in per cent)

(Per cent)

Component	2016-17	2017-18	2018-19	2019-20	2020-21
1	2	3	4	5	6
I. Total Consumption Expenditure	**7.8**	**7.1**	**7.4**	**5.9**	**-7.1**
Private	8.1	6.2	7.6	5.5	-9.0
Government	6.1	11.9	6.3	7.9	2.9
II. Gross Capital Formation	**3.7**	**10.8**	**9.7**	**2.3**	**-12.9**
Fixed Investment	8.5	7.8	9.9	5.4	-12.4
Change in Stocks	-48.8	68.3	27.2	-39.7	-3.5
Valuables	-18.6	40.2	-9.7	-14.2	-38.0
III. Net Exports					
Exports	5.0	4.6	12.3	-3.3	-8.1
Imports	4.4	17.4	8.6	-0.8	-17.6
IV. GDP	**8.3**	**6.8**	**6.5**	**4.0**	**-8.0**

Fiscal deficit is 9.3 per cent of the revised GDP, lower than 9.5 per cent estimated in revised Budget estimates. Google mobility and other high-frequency data, (3rd week May 2021), suggest decline in activity on all fronts including retail, grocery, transit stations and toll collections as compared to March and April.

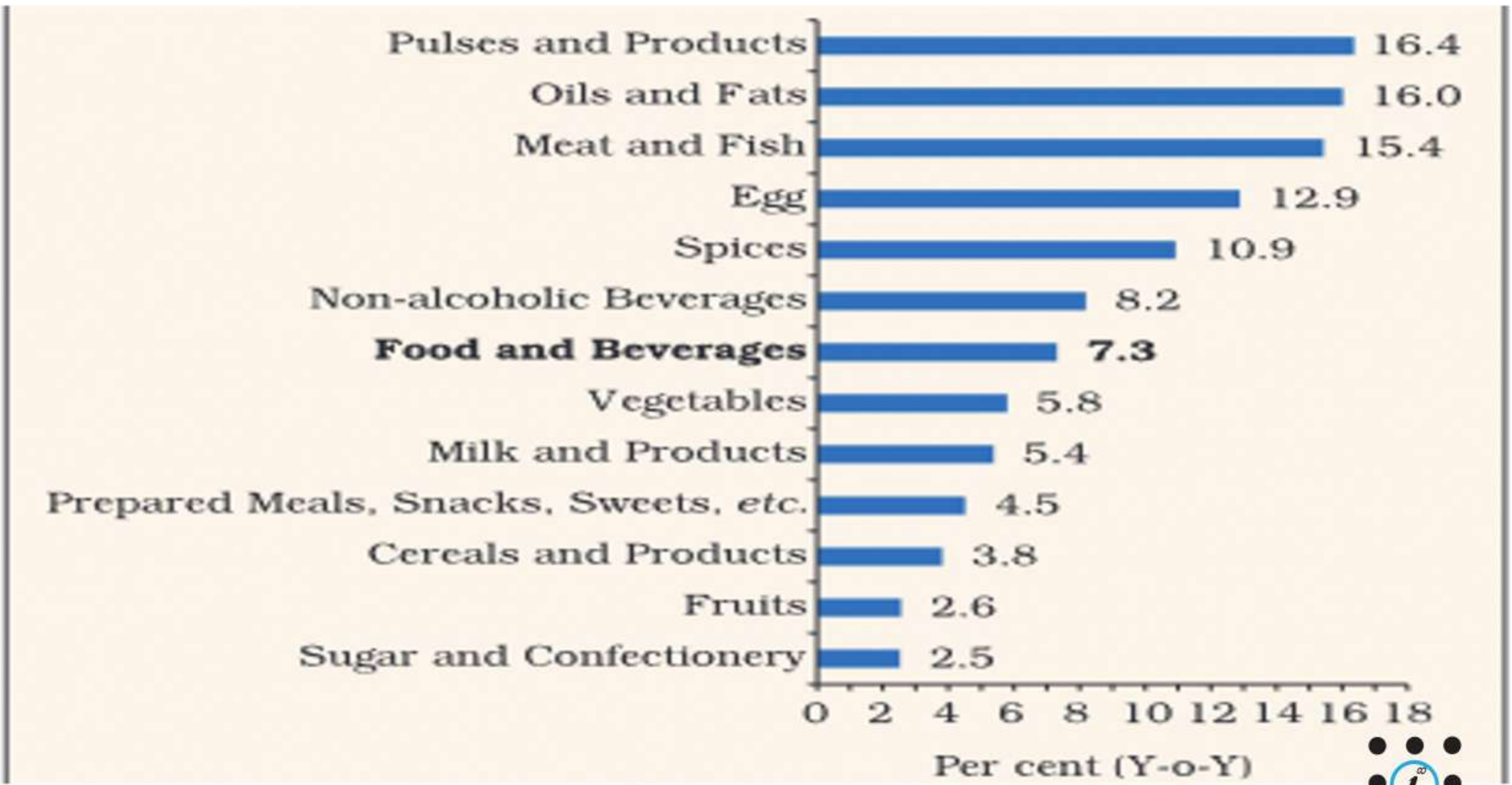
FICCI (May 2021) Business Survey, Overall Business Confidence Index plunged to 51.5 in the current survey round. Demand conditions deteriorated substantially. Lower household savings due to higher health expenditure incurred in the second wave and fear of a third wave is restricting growth in private consumption. There has also been permanent impairment to income for many households, which have lost jobs or faced deaths. Global demand is recovering more rapidly than the domestic market. Key export markets for India (e.g., US) are experiencing relatively better economic momentum, boosted by the $1.9 trillion US stimulus programme & a sharp drop in covid-19 infections. The U.K. government is accelerating its vaccination drive. OECD raised its 2021 global GDP growth forecast to 5.8 per cent, but warned that "too many headwinds persist" as not enough COVID vaccines are reaching emerging economies, making the world vulnerable to variants.

Growth outlook has decelerated further since May's policy announcements, with greater evidence that inflation headwinds may remain persistent going into H2 (July-December) 2021.Should there be some relief on the COVID 19 front, economic normalcy could return. However, while the pace of economic recovery in FY 21 turned out to be faster than anticipated, the outlook is marked by several uncertainties and would depend upon the evolving trajectory of infections & vaccinations. The RBI rightly maintained "a durable recovery will be dependent on continued policy support". Given the speed, scale and severity of the second wave of COVID 19 infections, the RBI reduced the growth prospects for this FY from 10.5 per cent to 9.5 per cent. This reduction in the growth prospects was in conformity with our assessment and infact most market players had already factored in the reduced GDP growth prospects.

2. Inflation-What Lies Ahead?

The retail inflation, i.e., the CPI eased to a three-month low of 4.29 per cent in April from 5.52 per cent in March, mainly on account of easing of prices of kitchen items like vegetables and cereals. Supply-demand imbalances may continue to exert pressure on food items like pulses and edible oils, prices of cereals may soften with bumper food-grains production in 2020-21.

Chart 3: Inflation in 2020-21 (in per cent year-on-year)



But the surge in wholesale inflation to 10.5 per cent in April from 7.39 per cent in March causes concern. The cognizable dilemma here is to check the inflationary spiral while shoring up languishing growth in the aftermath of the rising dreaded Coronavirus. While the evolving retail/ CPI inflation trajectory is likely to be subjected to both upside and downside pressures, the RBI's raising of the inflation forecast by 10 bps to 5.1 per cent is realistic because of supply-side disruptions. The RBI visualized retail inflation at "5.2 per cent in Q1; 5.4 per cent in Q2; 4.7 per cent in Q3; and 5.3 per cent in Q4 of 2021-22, with risks broadly balanced". Three contemporarily significant facts are:

Food inflation path will critically depend on the temporal & spatial progress of the south-west monsoon in 2021.

"Some respite from the incidence of domestic taxes on petroleum products through coordinated action by the Centre & States could provide relief, although international crude oil prices continued to be volatile".

"A combination of high international commodity prices & logistic costs may push up input price pressures across manufacturing & services".

The Government retained inflation target at 4 % with the lower & the upper tolerance band of 2 % & 6%, respectively, for the next 5 years (April 21-March 26).

3. Liquidity and Financial Market Guidance

The RBI has consistently attempted "to create conducive financial conditions so that financial markets and institutions keep functioning normally. Accordingly, adequate system level liquidity has been ensured and targeted liquidity to stressed institutions and sectors has been provided. Hence, borrowing costs and spreads have been reduced to historic lows. This has incentivised a record private borrowing through corporate bonds and debentures in FY2020-21. Reserve money rose by 12.4 per cent (y-o-y) as on May 28, 2021, while money supply (M3) grew by 9.9 per cent (y-o-y) (as on May 21), and bank credit by 6.0 per cent (y-o-y) (as on May 21)". The Policy scheduled another operation under G-SAP 1.0 of ₹ 40000 crore on June 17, 2021.

Of this, ₹10,000 crore constituted purchase of state development loans (SDLs). Bond purchases were raised by 20 per cent to ₹1.20 lakh crore to support the market. Enhancing the GSAP-2 from ₹ One lakh crore in Q1 to ₹1.20 lakh crore is a welcome move for the Bond markets.

4. Surplus liquidity

It is expected that possibly starting in the October-December 2021 quarter, when the proportion of population vaccinated reaches critical mass, the RBI may start lowering surplus liquidity, raising the reverse repo rate, and change its stance to neutral.

5. Rate Transmission

An analysis across banks reveals that the transmission to banks' deposit and lending rates improved significantly on the back of surplus liquidity conditions and the mandated external benchmark system of the pricing of loans for specified sectors.

5. Future Policy Direction-Where Do we Go from Here?

The RBI's annual report brought into focus "the conduct of monetary policy in 2021-22, would be guided by evolving macroeconomic conditions, with a bias to remain supportive of growth till it gains traction on a durable basis while ensuring inflation remains within the target".

6. Conclusion

The RBI is conscious of the need of a multi-speed economic recovery. Contextual issues include well-calibrated economic policies and strategies to improve access to health care and education, support and retrain displaced workers, and strengthen public investment in green projects and digital infrastructure. There is a compelling need to build more inclusive economies, while ensuring macroeconomic stability.

On the basis of an objective analysis of the macro-economic landscape and emerging policy prescriptions, the RBI did well not to change the Repo Rate because of the evolving growth-inflation dynamics and the heightened macro-economic concerns caused by the second wave of COVID 19, which has caused widespread devastation to lives and livelihoods. The RBI has slashed the Repo rate by 115 bps cumulatively since March 2020 to reduce the blow from the pandemic. Measures, such as, on tap liquidity window for contact intensive sectors like hotels and transport, fresh liquidity facility of Rs. 50,000 crore to NABARD, NHB and SIDBI, enhanced exposure thresholds are welcome and timely. Equally welcome are the assurance of adequate liquidity and availability of the same for needy segment on equitable basis, enhanced coverage of borrowers under the one-time debt resolution framework by enhancing the maximum exposure limit from Rs. 25 crore to Rs. 50 crore for MSMEs, small businesses and business loans to individuals.

Given the widespread uncertainties caused by the second wave of the Coronavirus, the thrust on macro-economic stability and the slew of measures relating to MSMEs, on tap liquidity window for contact intensive sectors, enhanced exposure thresholds are contextually significant in the process of rehabilitation of the Indian economy. The Governor's well-founded stress on ramping up the vaccination drive and bridging the gaps in healthcare infrastructure to mitigate the pandemic's devastation is fully justified and needs to be pursued with a sense of urgency. Given the macro-economic constraints and the challenges to policy making in this volatile and turbulent world, this is an excellent policy, which would be well-received by all stake-holders.

Annexure

Statement 1: Provisional Estimates of National Income and Expenditures on GDP, 2020-21

(At 2011- 12 Prices) (₹ crore)

S.No.	Item	2018-19	2019-20	2020-21	Percentage change over previous year	
		(2nd RE)	(1st RE)	(PE)	2019-20	2020-21
	Domestic Product					
1	GVA at Basic Prices	1,27,44,203	1,32,71,471	1,24,53,430	4.1	-6.2
2	Net Taxes on Products	12,59,114	12,97,797	10,59,310	3.1	-18.4
3	GDP (1+2)	1,40,03,316	1,45,69,268	1,35,12,740	4.0	-7.3
4	NDP	1,23,92,839	1,28,22,882	1,18,74,000	3.5	-7.4
	Final Expenditures					
5	Private Final Consumption Expenditure (PFCE)	78,84,423	83,21,701	75,60,985		
6	Government Final Consumption Expenditure (GFCE)	14,29,055	15,41,742	15,86,745		
7	Gross Fixed Capital Formation (GFCF)	44,86,205	47,30,416	42,20,508		
8	Change in Stocks (CIS)	2,62,639	1,58,385	1,54,276		
9	Valuables	1,91,704	1,64,527	1,67,784		
10	Exports	29,23,273	28,26,639	26,94,386		
11	Imports	33,43,220	33,17,165	28,65,827		
12	Discrepancies	1,69,236	1,43,023	-6,117		
13	GDP	1,40,03,316	1,45,69,268	1,35,12,740		
	Rates To GDP					
14	Private Final Consumption Expenditure (PFCE)	56.3	57.1	56.0		
15	Government Final Consumption Expenditure (GFCE)	10.2	10.6	11.7		
16	Gross Fixed Capital Formation (GFCF)	32.0	32.5	31.2		
17	Change in Stocks (CIS)	1.9	1.1	1.1		
18	Valuables	1.4	1.1	1.2		
19	Exports	20.9	19.4	19.9		
20	Imports	23.9	22.8	21.2		
21	Discrepancies	1.2	1.0	-0.05		
22	GDP	100.0	100.0	100.0		
	National Products					
23	GNI	1,38,50,857	1,44,27,632	1,33,84,612	4.2	-7.2
24	NNI	1,22,40,380	1,26,81,246	1,17,45,872	3.6	-7.4
	Per Capita Income, Product and Final Consumption					
25	Population* (in million)	1327	1341	1355		
26	Per Capita GDP (₹)	1,05,526	1,08,645	99,694	3.0	-8.2
27	Per Capita GNI (₹)	1,04,377	1,07,589	98,749	3.1	-8.2
28	Per Capita NNI (₹)	92,241	94,566	86,659	2.5	-8.4
29	Per Capita PFCE (₹)	59,415	62,056	55,783	4.4	-10.1

* Relates to mid-financial year

RE: Revised Estimates; PE: Provisional Estimates

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