Governor's Statement - Seventh Bi-monthly Monetary Policy Statement, 2019-20, March 27, 2020-Analysis and Comments

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1. Why this Policy?

The covid-19 pandemic has truly been a game-changer across the development spectrum in terms of the hit to the global economy, domestic economies and several segments and sectors of the domestic economy. The scale of devastation wreaked by this medical-cum-economic emergency wreaked by this crisis can be gauged by the fact that the United Nations Conference on Trade and Development (UNCTAD) estimated a $1 trillion hit to the global economy. There have also been extremely disconcerting parallels drawn with the global financial meltdown of October 2008 and even the Great Depression of 1928.

The latest Moody's report clearly brings out that the coronavirus outbreak across the world will lead to a further slowdown in global economic activity, especially in the first half of the year. Moody's Global Macro Outlook 2020–2021 has revised the baseline growth for all the G20 economies in the year 2020. The countries are now expected to grow at 2.1 per cent in 2020, which is 0.3 percentage point lower than the previous forecast. India has already been witnessing an economic slowdown with its Gross Domestic Product (GDP) falling to 4.7 per cent in the third quarter of the fiscal year 2019–20.

It is commonly observed that the coronavirus is a classic supply shock starkly reflected in the first-round effects of disruption in global value chains in industrial production, particularly electronics and pharmaceuticals. Clearly, there are also larger issues of free multilateral trade, rising protectionism, collapse of the OPEC agreement and the free fall in the oil price in the coronavirus narrative. But it is not so commonly realised — much less felt — that supply and demand are not silos and a supply shock can trigger its own lack of demand. Similarly, a pandemic can — and does have — demand effects in these uncertain times because of a complete lockdown across countries.

In the case of India, the economy has been in the midst of a pronounced macro-economic slowdown with the impact being pronounced on MSMEs, the unorganized sector, exports and manufacturing. This global crisis, which has severely damaged the large domestic market, local supply chains and a disruption of global value chains, is estimated by the UNCTAD to set the Indian economy by $348 Million with sectors like the airline and hospitality sectors on the verge of a virtual collapse. Infact, there are many economists, planners, thinkers and policy-makers-even those at the helm of affairs, who justifiably maintain that given the scale of the damage caused to the domestic economy, the UNCTADs' estimate of $348 Million to the Indian economy may be an under-estimate. Several susceptible sections of society, for example, the poor, the marginalised and vulnerable sections of society-what Mahatma Gandhi called the 'teeming millions of India' have been devasted by this medical-cum-economic emergency.

2. Policy Measures

Against this backdrop, the overall scenario is characterized by the debilitating impact on the GDP growth for Q4 19-20 and FY 20-21, weakening of aggregate demand and uncertain and negative future outlook.

Given the stress on the financial markets and fact that they require steps by the central bank for market stability and revival of economic growth, the RBI announced a reduction in the Repo rate by 75 basis points to 4.4% and a reduction in the Rev repo by 90 basis points to 4%, three-month moratorium on payment of instalments of Term Loan outstanding and deferment of interest on WC facilities

by 3 months. It is extremely welcome that such deferment will not to be considered for computation of NPAs and revised DP calculations will be done by reassessing WC cycle. All these measures will not affect the credit history of the borrower.

The CRR has been slashed by 100 basis points to 3% for year. This measure would release 1.37 lakh crores to the banking system. The requirement of minimum daily CRR balance has been reduced from 90% - 80% till June 30, 2020. Thus, a liquidity of Rs, 3.74 lakh crore has been injected into the system. The total liquidity injection works out to 3.4% of GDP.

Essentially, there are four measures to help the Indian economy – measures to expand the liquidity in the market, steps to reinforce monetary transmission, ease financial stress by relaxing repaying pressures, improve the functioning of markets in view of high volatility. The RBI further said it was maintaining its "*accommodative stance, and would keep its position as long as necessary*"' to revive growth, while ensuring inflation remained within target.

3. Comments

These extraordinary measures, which would help to partially alleviate the pain and suffering caused by the Caronavirus, are of considerable contextual significance not just for leveraged sectors and companies but also for the larger macro-economy. What makes this set of measures covering all aspects of the economy by taking system-wide measures both through liquidity, rates and regulatory forbearance (retail and industry), and also targeted measures to manage the corporate bond markets particularly welcome is the fact that historically the RBI has been known for taking gradual, calibrated measures-sometimes dubbed 'baby-steps'. But this time, by going the whole hog, thereby redeeming its promise to 'do whatever it takes, the RBI is ahead of the curve. As the Governor aptly said, "*worthwhile to remember that tough times never last, only tough people and institutions do*"'. RBI has shown that it is tough.

The issue of delayed and inadequate transmission of rate cuts into the credit market, specifically bank lending, despite improved monetary transmission in sectors with new floating rate loan linkage to the external benchmark, strengthened

the case for hefty cuts across the board-both in terms of the Repo Rate, CRR, moratorium on payment of instalments of Term Loan outstanding and deferment of interest on WC facilities. But there would now be a renewed thrust on banks to ensure much greater transmission of the rate cuts than in the past. Further, banks need to prudent; otherwise, at the end of the three-month moratorium, there could be a surge in non-performing assets.

In conjunction with the sweeping measures announced by the Finance Minister in the economic stimulus package-with a distinct possibility of some more measures to come, the economy would receive a shot in the arm in its rehabilitation attempt. This combination of moratoriums, liquidity enhancing measures and the steep repo rate cut would prevent a freeze in credit/debt market as also a crisis of confidence. Hence, in sum, the Governor took the right call in these difficult Caronavirus times.

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