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INDUSTRY OUTLOOK

RBI MONETARY POLICY-FIRST CUT

04 December 2020

In conformity with the expectations of almost all market participants, the Reserve Bank of India (RBI) kept its key interest rates steady. As stressed by us on November 27 and again on December 2, 2020, the RBI held the Repo rate steady at 4 per cent, continued with the accommodative stance of monetary policy, reduced projected contraction of real GDP growth at (-) 7.5 per cent in 2020-21 and undertook extensive liquidity measures to revive activity by on tap TLTRO– Extension of Sectors and Synergy with Emergency Credit Line Guarantee Scheme (ECLGS 2.0). This will encourage banks to extend credit support to stressed sectors at lower cost and foster the fragile recovery, which is currently on.

High frequency indicators suggest a strengthening of the recovery process, with double digit growth in passenger vehicles and motorcycle sales, railway freight traffic, and electricity consumption in October.

GDP is expected to grow by 0.1 per cent in the October-December quarter and by 0.7 per cent in the following three months. Overall, the 2020-21 fiscal will end with a (-) 7.5 per cent degrowth.

"Under ECLGS 2.0, the corpus of ₹3.0 lakh crore of existing ECLGS 1.0 was extended to provide 100 per cent guaranteed collateral free additional credit to entities in 26 stressed sectors identified by the Kamath Committee of RBI plus health care sector with credit outstanding of above ₹50 crore and up to ₹500 crore as on 29.2.2020. Accordingly, in addition to the five sectors announced under the scheme on October 21, 2020, it is now proposed to bring the 26 stressed sectors identified by the Kamath Committee within the ambit of sectors eligible under on tap TLTRO. Banks are encouraged to synergise the two 2 schemes by availing funds from RBI under on tap TLTRO and seek guarantee under ECLGS 2.0 to provide credit support to stressed sectors.

Liquidity availed by banks under the scheme should be deployed in corporate bonds, commercial papers, and non-convertible debentures issued by the entities in specific sectors over and above the outstanding level of their investments in such instruments as on September 30, 2020. The liquidity availed under the scheme can also be used to extend bank loans and advances to these sectors. Investments made by banks under this facility will be classified as held to maturity (HTM) even above the 25 per cent of total investment permitted to be included in the HTM portfolio. All exposures under this facility will also be exempted from reckoning under the large exposure framework (LEF)".

The RBI has revised growth forecast in the light of Q2 GDP (-) 7.5 per cent in 2020-21 (from - 9.5 per cent earlier) : (+) 0.1 per cent in Q3:2020- 21 and (+) 0.7 per cent in Q4:2020-21; and 21.9 per cent to 6.5 per cent in H1:2021- 22, with risks broadly balanced.

Headline retail inflation at 7.6 per cent in October. CPI inflation for Q3 is estimated to be 6.8 per cent but this inflation could soften to 5.8 per cent in January-March. Inflation is projected to be in the range of 5.2 to 4.6 per cent in the first half of the 2021-22 fiscal.

While inflation will continue to be on the higher side, there could be some downward movement in the months ahead. As things stand now, both core and headline inflation has been on the higher side-well above the RBI's 2-6 per cent target band for seven months now. This unacceptable situation is largely attributable to higher commodity prices, lower labour availability, unseasonal rains, etc.

With growth picking up and inflation stubbornly breaching the RBI's comfort zone, there is limited scope for further rate cuts down the road.

The Governor also announced measures to deepen the corporate bond market and supervisory measures for the shadow banking sector.

There are important measures in the realm of regulation and supervision. Important measures relate to no dividend distribution by banks; formulate guidelines on dividend distribution by NBFCs; issue of Discussion Paper on Scale-based Regulatory Framework for NBFCs and strengthening Audit Systems of Supervised Entities (SEs): (i) issuance of guidelines to large UCBs and NBFCs on adoption of Risk Based Internal Audit (RBIA); (ii) harmonisation of guidelines on appointment of statutory auditors for commercial banks, UCBs and NBFCs; renewed thrust on financial literacy and education; and strengthening grievance redress mechanism in banks.

In an attempt to deepen financial markets, review of credit default swaps (CDS) guidelines, review of comprehensive guidelines on derivatives and comprehensive review of money market directions will be undertaken.

Welcome measures to enhance the export competitiveness of the country include direct dispatch of shipping documents, "write off" of unrealised export bills, set-off of export receivables against import payables and refund of export proceeds.

The RBI raised the limit of contactless card transactions to Rs 5,000 per usage from the current Rs 2,000, with effect from January 1.

Also, real-time gross settlement systems (RTGS) will be available 24x7 in the next few days.

This Policy was well received by the capital market inasmuch as India's stocks rose as benchmarks headed toward their longest weekly winning streaks since July after the RBI's professed strong commit to support languishing growth. The rupee strengthened 0.3 per cent to 73.7250 per U.S. dollar, while the yield on 10-year government bonds fell four basis points to 5.89 per cent.

It is welcome that the RBI is pursuing a data based and evidence driven policy.

This is the right policy in the evolving macro-economic scenario and the growth inflation dynamics.

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