Volume XXI, Issue 18

Fact Sheet: Monetary Policy August 2021

RBI maintains accommodative stance, GDP growth estimate retained at 9.5% for 2021-22

- *The Monetary Policy Committee (MPC) unanimously voted to leave the repo rate unchanged at 4.0 percent in the monetary policy resolution announced on August 6, 2021. Consequently, the reverse repo rate under the LAF remained unchanged at 3.35 per cent, while the marginal standing facility (MSF) rate and the Bank Rate remained at 4.25 per cent*

- *The MPC also decided to continue with the accommodative stance of monetary policy for as long as necessary to sustain growth on a sustainable basis and continue to mitigate the impact of Covid-19 on the economy, while ensuring that inflation remains within the RBI's indicative target. However, this decision was based on a 5 to 1 majority.*

RBI Policy Action

Key rates	August 2020	October 2020	December 2020	February 2021	April 2021	June 2021	August 2021
Repo rate	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Reverse repo rate	3.35%	3.35%	3.35%	3.35%	3.35%	3.35%	3.35%
MSF	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%
CRR	3.00%	3.00%	3.00%	3.50% - Mar 27	3.50%	4.00%	4.00%
SLR	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%
Bank rate	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%

Snapshot of RBI's Projections (%YoY)

	Jun-21 MPC					Aug-21 MPC					
	FY22	**Q1 FY22**	**Q2 FY22**	**Q3 FY22**	**Q4 FY22**	**FY22**	**Q1 FY22**	**Q2 FY22**	**Q3 FY22**	**Q4 FY22**	**Q1 FY23**
CPI Inflation	**5.1**	5.2	5.4	4.7	5.3	**5.7**	-	**5.9**	**5.3**	**5.8**	**5.1**
GDP	**9.5**	18.5	7.9	7.2	6.6	**9.5**	**21.4**	**7.3**	**6.3**	**6.1**	**17.2**
Change in GDP growth estimate vis a vis previous policy	Downward revision	Downward revision	Downward revision	Upward revision	Upward revision	**Retained**	**Upward revision**	**Downward revision**	**Downward revision**	**Downward revision**	-

Reserve Bank of India's Growth Guidance

RBI retained GDP growth estimate for 2021-22 at 9.5%

GDP growth is projected at 21.4% in Q1, 7.3% in Q2, 6.3% in Q3 and 6.1% in Q4 of 2021-22

With the second wave of the pandemic now ebbing, economic activity has once again started to gain momentum. Rural demand and agricultural sector are likely to remain resilient, going forward. This will be supported especially with recent pick up in kharif sowing on the back of revival in monsoons. On the other hand, urban demand is likely to revive with a lag as non-contact services and manufacturing activity resume at a stronger pace. Acceleration in vaccination against covid-19 will lend support to a faster recovery. This coupled with buoyant exports, anticipated pick up in government expenditure, including capital component, and recent announcement of an economic package by the government will support consumption and growth.

However, risks emerging from elevated global commodity prices remain significant and can have a dampening effect. Alongside, volatility in financial markets also remains a potent downside risk to the growth forecast.

Reserve Bank of India's Inflation Guidance

The MPC's outlook on inflation trajectory is within the targeted band of 4% (+/- 2%); inflation is projected at 5.9% in Q2 2021-22 which is higher than the previous forecast of 5.2% for the same quarter. Inflation is likely to ease to 5.3% in Q3 2021-22 before rising once again to 5.8% in Q4 2021-22.

The RBI's inflation forecast for the entire fiscal 2021-22 was upwardly revised to 5.7% from the June 2021 review given the unexpected rise in price levels in the months of May and June. Furthermore, inflation is projected at 5.1% in Q1 2022-21.

Source: *RBI's Monetary Policy Statement, August 6, 2021*

Pick up in kharif sowing on the back of revival in southwest monsoons coupled with adequate food buffer stocks will cushion any pressures on cereal prices. Furthermore, some moderation is also being witnessed in the prices of edible oils and pulses after government intervened to augment domestic supply in July 2021.

Moreover, while input prices have been boiling across manufacturing and services segments driven by elevated commodity prices and industrial raw materials prices, the pass through of inflation has been tempered owing to weak demand conditions as well as cost cutting measures by companies.

The RBI suggested a calibrated reduction of indirect taxes on domestic fuel prices as it can substantially ease cost push inflationary pressures.

Reserve Bank of India's Liquidity Guidance

The months of June-July witnessed volatility in global financial markets in response to higher inflation numbers in several countries along with the fear of early policy normalization with skewed economic recovery in some advanced countries. These developments have also been factored in while considering the monetary policy review this time.

However, the RBI has maintained ample surplus liquidity through both, conventional as well as unconventional means since the onset of the pandemic to ensure easier financial conditions to support domestic demand.

Moreover, the efficacy of RBI's monetary policy measures and actions is reflected in the significant improvement in transmission during the current easing cycle. While the reduction in repo rate was to the tune of 250 basis points since February 2019, the subsequent transmission has been to the tune of 217 basis points in the weighted average lending rate (WALR) on fresh rupee loans. This implies significant reduction in domestic borrowing costs, including interest rates on market instruments like corporates bonds, debentures, CPs, CDs and T-bills.

- **14-day variable rate reverse repo (VRRR) auctions**

The MPC has decided to conduct fortnightly VRRR auctions of Rs. 2.5 lakh crore on August 13, 2021; Rs. 3.0 lakh crore on August 27, 2021; Rs. 3.5 lakh crore on September 9, 2021; and Rs. 4.0 lakh crore on September 24, 2021. RBI Governor clearly stated that these enhanced VRRR auctions should not be misread as a reversal of the accommodative policy stance.

- **Secondary market G-sec acquisition programme (G-SAP)**

The G-SAP has been successful in anchoring yield expectations while eliciting keen response from market participants. Therefore, the RBI announced to conduct two more auctions of Rs. 25,000 crore each on August 12 and August 26, 2021 under G-SAP 2.0. The RBI stated that it will continue to undertake such auctions and other operations like open market operations (OMOs) and operation twist (OT), among others, and calibrate them in line with the evolving macroeconomic and financial conditions.

Developmental & Regulatory Announcements

Liquidity Measures

On-tap TLTRO Scheme: Extension of Deadline

- The MPC has decided to extend the on-tap TLTRO scheme further by a period of three months, up to December 31, 2021, given the nascent and fragile economic recovery. The operating period of the scheme has been previously extended in phases till September 30, 2021.

Marginal Standing Facility (MSF): Extension in Period of Relaxation

- The relaxation which allowed banks to avail funds under the MSF by dipping into their Statutory Liquidity Ratio (SLR) up to an additional one percent of net demand and time liabilities (NDTL) has been extended for a further period of three months, i.e., up to December 31, 2021
- This facility will provide comfort to banks on their liquidity requirements, including meeting their Liquidity Coverage Ratio (LCR) requirement
- This dispensation provides increased access to funds to the extent of Rs. 1.62 lakh crore and qualifies as high-quality liquid assets (HQLA) for the LCR

Source: *RBI's Monetary Policy Statement, August 6, 2021*

Regulation and Supervision

LIBOR Transition-Review of Guidelines – Export Credit in Foreign Currency and Restructuring of Derivative Contracts

- The Reserve Bank has been engaging with banks and market bodies to proactively take steps to facilitate transition away from London Interbank Offered Rate (LIBOR). While this poses certain challenges for banks and the financial system, the Reserve Bank has issued advisories to ensure a smooth transition for regulated entities and financial markets.
- The MPC has amended the guidelines related to

(i) Export credit in foreign currency:

Banks have been permitted to extend export credit using any other widely accepted Alternative Reference Rate in the currency concerned in addition to current authorized dealers that extend Pre-shipment Credit in Foreign Currency to exporters

(ii) Restructuring of derivative contracts:

Banks are being advised that change in reference rate from LIBOR / LIBOR-related benchmarks to an Alternative Reference Rate will not be treated as restructuring. This is because the impending change in reference rate from LIBOR is a "force majeure" event.

Deferral of Deadline for Achievement of Financial Parameters under Resolution Framework 1.0

- The MPC has decided to defer the target date for meeting the specified thresholds in respect of the four operational parameters (Total Debt to EBIDTA ratio, Current Ratio, Debt Service Coverage Ratio and Average Debt Service Coverage Ratio) as required by resolution plans implemented under the Resolution Framework for COVID19 related stress to October 1, 2022 from March 31, 2022.
- This was done in view of the adverse impact of the second wave of COVID-19 and the resultant difficulties on revival of businesses and in meeting the operational parameters

FICCI's Comments

The Central Bank's indication yet again to continue with the accommodative stance until necessary to revive growth is encouraging. This is especially comforting when there was widespread expectation about the normalization of the monetary policy. The Central Bank has done a wonderful job through the pandemic period. We feel assured of RBI's full support in case we are hit by a third wave.

On the economic front although some uptick is being noted in demand, which was also indicated by the Central Bank Governor, we feel it is important that a stimulus is provided by the government to give a thrust to consumption. The timing of such measures will be apt at this juncture as the festive season is about to begin.

FICCI also welcomes the announcement on the extension of the on tap TLTRO Scheme until December 31, 2021, and the extension of the period of relaxation for banks to avail funds under the marginal standing facility by dipping into the Statutory Liquidity Ratio. However, the outreach of the TLTRO scheme has been very limited especially in case of NBFCs.

Also, the extension of deadline by six months to the meet the financial parameter requirements under the Resolution Framework 1.0 announced last year comes as a respite. However, given the way the covid situation has evolved some of the deeply stressed sectors may need a longer time period to be able to meet the financial parameters. We also feel that for such sectors the extant provisions of the RBI circular should be extended for one more year with invocation for such Resolution being allowed no later than 31st Dec 2021, and resolution plan implementation to be completed by 30th June 2022.

In addition, announcements pertaining to export credit in foreign currency and restructuring of derivative contracts amid the circumstance of transition away from the London Interbank Offered Rate are welcome. This is a landmark change that will have an impact on businesses throughout the world. We will look forward to further guidance on this from the Central Bank.

Source: *RBI's Monetary Policy Statement, August 6, 2021*