RBI MONETARY POLICY - AUGUST 2021

Announcement

- Repo Rate: Unchanged at 4.00% with an accommodative stance.
- Reverse Repo Rate: 3.35%
- CRR 3.50%

RBI's Assessment

- Since the MPC's meeting during June 2-4, 2021 the pace of global recovery appears to be moderating with the resurgence of infections in several parts of the world, especially from the delta variant of the virus.There has been a slowing of momentum in global trade volumes in Q2:2021, with elevated shipping charges and logistics costs posing headwinds.
- There has been a considerable hardening of commodity prices, particularly of crude oil. The latest agreement within the (OPEC) plus to raise oil production for a likely restoration of output to the pre-pandemic levels by September 2022 imparted transient softening to spot and future crude prices from the recent peak in early July.
- On the domestic front, economic activity picked up pace in June-July as some states eased pandemic containment measures. As regards agriculture, the south-west monsoon regained intensity in mid-July after a lull; the cumulative rainfall up to August 1, 2021 was one per cent below the long-period average. The pace of sowing of kharif crops picked up in July along with some high frequency indicators of rural demand, notably tractor and fertiliser sales.
- Reflecting large base effects, industrial production expanded in double digits year-on-year (y-o-y) in May 2021 on top of the massive jump in April, but it was still 13.9 per cent below its May 2019 level. The manufacturing purchasing managers' index (PMI) that had dropped into contraction to 48.1 in June for the first time in 11 months, rebounded well into expansion zone with a reading of 55.3 in July. High-frequency indicators–posted strong growth in June/July, reflecting adaptations to COVID related protocols and easing of containment. Services PMI remained in contractionary zone due to COVID-19 related restrictions, though the pace eased to 45.4 in July from 41.2 in June 2021. Initial quarterly results of non-financial corporates for Q1:2021-22 show healthy growth in sales, wage growth and profitability led by information technology firms.
- Headline CPI inflation plateaued at 6.3 per cent in June after having risen by 207 basis points in May 2021. Food inflation increased in June primarily due to an uptick in inflation in edible oils, pulses, eggs, milk and prepared meals and a pick-up in vegetable prices. Fuel inflation moved into double digits during May-June 2021 as inflation in LPG, kerosene, and firewood and chips surged. After rising sharply to 6.6 per cent in May, core inflation moderated to 6.1 per cent in June.
- System liquidity remained ample, with average daily absorption under the LAF increasing from ₹5.7 lakh crore in June to ₹6.8 lakh crore in July and further to ₹8.5 lakh crore in August so far (up to August 4, 2021). Auctions for a cumulative amount of ₹40,000 crore in Q2:2021-22 so far under the secondary market (G-SAP) evened liquidity across illiquid segments of the yield curve. As on July 16, 2021, money supply (M3) and bank credit by commercial banks grew by 10.8 per cent and 6.5 per cent, respectively. India's foreign exchange reserves increased by US$ 43.1 billion in 2021-22 (up to end-July) to US$ 620.1 billion.

Announcements - Statement on Developmental and Regulatory Policies - Liquidity Measures

- **On Tap TLTRO Scheme** - Given the nascent and fragile economic recovery, it has now been decided to extend the On Tap TLTRO scheme further by a period of three months, i.e., till December 31, 2021.

- **Marginal Standing Facility (MSF)** - On March 27, 2020 banks were allowed to avail of funds under the marginal standing facility (MSF) by dipping into the Statutory Liquidity Ratio (SLR) up to an additional one per cent of net demand and time liabilities (NDTL), i.e., cumulatively up to 3 per cent of NDTL. It has now been decided to continue with the MSF relaxation for a further period of three months, i.e., up to December 31, 2021.

- **LIBOR Transition - Review of Guidelines**

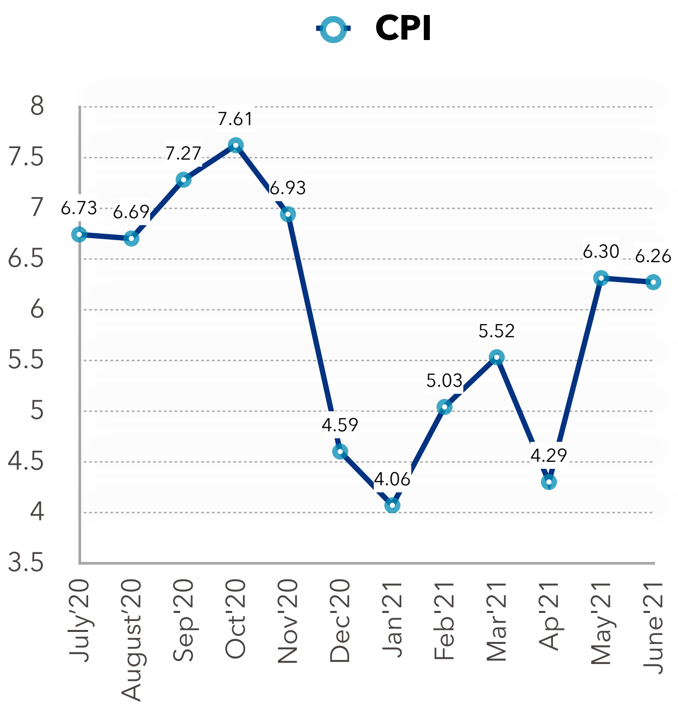
(i) Export Credit in Foreign Currency – Benchmark Rate - Authorized dealers are currently permitted to extend Pre-shipment Credit in Foreign Currency (PCFC) to exporters for financing the purchase, processing, manufacturing or packing of goods prior to shipment at LIBOR / EURO-LIBOR/ EURIBOR related rates of interest.

(ii) Prudential Norms for Off-balance Sheet Exposures of Banks – Restructuring of Derivative Contracts - Since the impending change in reference rate from LIBOR is a "force majeure" event, 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

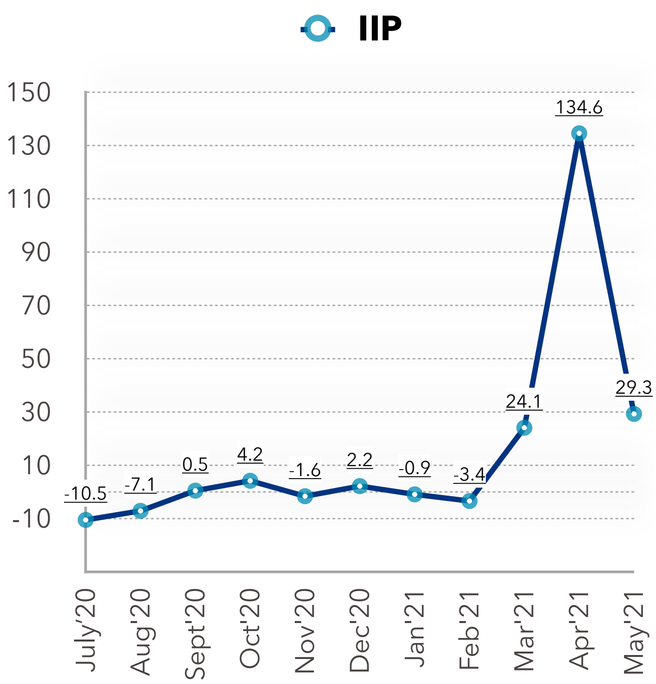
(iii) Deferral of Deadline for Achievement of Financial Parameters under Resolution Framework 1.0 - The resolution plans implemented under the Resolution Framework for COVID-19 related stress announced on August 6, 2020 are required to meet the sector specific thresholds notified in respect of five financial parameters, four of which are related to the operational performance of the borrowing entity, viz. Total Debt to EBIDTA ratio (Total Debt/EBIDTA), Current Ratio, Debt Service Coverage Ratio and Average Debt Service Coverage Ratio, by March 31, 2022. Recognising the adverse impact of second wave of COVID-19 on revival of businesses, and the difficulty it may pose in meeting the operational parameters, it has been decided to defer the target date for meeting the specified thresholds in respect of the above parameters to October 1,2022. As regards the parameter Total Outside Liabilities/Adjusted Total Net Worth (TOL/ATNW), this ratio reflects the revised capital structure (i.e., debt-equity mix) as required under the implementation conditions for the resolution framework and was expected to be crystallised upfront as part of the resolution plan. Accordingly, the date for achieving the same remains unchanged, i.e. March 31, 2022.

CPI/GROWTH OUTLOOK: CPI inflation is now projected at 5.7 per cent during 2021-22: 5.9 per cent in Q2; 5.3 per cent in Q3; and 5.8 per cent in Q4 of 2021-22, with risks broadly balanced. CPI inflation for Q1:2022-23 is projected at 5.1 per cent. Projection for real GDP growth is retained at 9.5 per cent in 2021-22 consisting of 21.4 per cent in Q1; 7.3 per cent in Q2; 6.3 per cent in Q3; and 6.1 per cent in Q4 of 2021-22. Real GDP growth for Q1:2022-23 is projected at 17.2 per cent.

Outlook: In-House



The Governor's speech focused on liquidity management with respect to yield curve and other market risks. RBI introduced VRRRs fortnightly of a higher quantum (increased from INR 2Tn to INR 4Tn in a calibrated manner) and this is an early step towards normalisation. RBI will continue to support the markets with OMOs/GSAP going forward with no rush to tighten policy. Inflation will be continued to be monitored. However, RBI Governor said that the withdrawal of surplus liquidity should not be read as a reversal of accommodative policy. The central bank will continue to buy bonds via various operations to ensure a liquid bond yield curve, he said.



Inflation risks have largely been driven by supply shocks and a low base effect. Going forward we expect inflation to moderate well within RBI's target range with expectations of a good monsoon and the pick-up in kharif sowing. Elevated food stocks should help to control cereal price pressures. Crude oil prices at elevated levels and global commodity prices pose as risks. A reduction in the tax of domestic oil prices by the Centre and states can help to lessen cost pressures. We do not see a policy rate hike until January 2022.

Sources: Reserve Bank of India, Reuters.

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