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The RBI maintains focus on economic growth revival, sticks to targeted policy steps for providing additional support

- As expected, the Reserve Bank of India (RBI) retained the status quo on key policy rates and maintained the accommodative stance “as long as necessary to revive and sustain growth on a durable basis”.
- With a continued focus on growth revival and the need for relief to affected segments, the RBI stuck to a targeted approach while extending policy support.
- Supplementing its measures announced on May 5, 2021, the RBI expanded the coverage under resolution framework 2.0 by increasing the maximum aggregate exposure threshold from Rs 25 crore to Rs 50 crores for small borrowers.
- The central bank introduced an on-tap liquidity window of Rs 15,000 crores for certain contact intensive sectors and additional liquidity support of Rs 16,000 crores to the Small Industries Development Bank of India (SIDBI) for on-lending/refinancing to benefit MSMEs.
- The RBI also announced the secondary market G-sec acquisition programme (G-SAP) 2.0 for Q2 FY22 worth Rs 1.2 lakh crore, which is 20% higher compared to Q1 FY22, to support governments’ borrowing programme while also helping with an ordering evolution of the yield curve.
- The RBI revised its economic growth forecast downward to 9.5% YoY for FY22 from 10.5% earlier, driven primarily by the impact of the second COVID wave and associated virus containment measures on Q1 FY22 growth.
- The central bank also revised its inflation forecast marginally higher but noted that projected inflation of 5.1% YoY for FY22 remains within the target range of 2% to 6%.
- The RBI governor also stated that talks of normalization of policy stance are premature and that the Monetary Policy Committee (MPC) is presently not considering it. We believe that the accommodative policy stance could continue at least till Q3-FY22, and a repo rate hike is off the table for the rest of the year.

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RBI continues to proactively lend support to the economy

The RBI continues to focus on economic growth revival, overlooking likely future inflation pressures. As expected, the RBI kept policy rates unchanged and maintained the accommodative stance "as long as necessary to revive and sustain growth on a durable basis" in its policy meeting today. With a continued focus on growth revival and the need to provide relief to affected segments, the RBI stuck to a targeted approach while extending policy support. Recognizing the renewed impact of the second COVID wave on the economy, the RBI expanded the coverage of the resolution framework 2.0 to include a larger number of small borrowers, introduced an on-tap liquidity window for certain contact intensive sectors, and provided additional liquidity support to SIDBI for on-lending to MSMEs. The RBI also announced G-SAP 2.0 with a higher quantum for Q2 FY22 compared to Q1 FY22, which is likely to support governments' borrowing programme while also helping with an ordering evolution of the yield curve. The RBI has, so far, announced liquidity measures over Rs 17 lakh crore since February last year and is likely to continue supporting growth despite some firming up of prices going ahead.

Liquidity Measures since February 06, 2020 (as on June 4, 2021)

Measures	Announced Amount (in cr)
LTRO	2,00,000
Variable rate repo	2,25,000
SLF for PDs	7,200
CRR cut	1,37,000
MSF (dip by 1% in SLR)	1,37,000
TLTRO	1,00,000
TLTRO (2.0)	50,000
Net OMO purchases	1,50,000
Special liquidity facility for mutual funds	50,000
Refinance facilities to AIFIs	1,41,000
Special liquidity scheme for NBFCs	30,000
56-day term repo	1,00,000
On Tap TLTRO	1,00,000
On Tap Liquidity window	65,000
GSAPs 1.0	1,00,000
GSAPs 2.0	1,20,000
SLTRO (State Finance Banks)	10,000
Total	**17,22,200**

Source: RBI

RBI continues to prioritize growth revival over inflation

As expected, the Monetary Policy Committee (MPC) kept policy rates unchanged at their respective levels - Repo rate at 4%, Reverse repo rate at 3.35%, Marginal Standing Facility rate, and Bank rate at 4.25%. The MPC also decided to maintain its state-based accommodative stance *"as long as necessary to revive and sustain growth on a durable basis"*. There was a minor tweak in the guidance to include the word "revive" in addition to "sustain", as it recognized the impact of the second COVID wave on the economy. The RBI governor also stated that talks of normalization of policy stance are premature and that the MPC is presently not considering it. We believe that the accommodative policy stance could continue at least till Q3-FY22, and the repo rate hike is off the table for the rest of the year.

The current accommodative policy stance is supported by a downward revision to RBI's economic growth projection for FY22 due to the impact of the second COVID wave, while inflation projections have been revised slightly upward, even as pressures are not seen as persistent. The RBI noted, in its economic assessment, the impact of the second COVID wave and associated virus containment measures in terms of sequential decline in economic activity, including rural and urban demand indicators, in April-May'21 but mostly lesser as compared to last year. However, the RBI views this impact to be mostly felt in Q1 FY22, noting the spread of COVID-19 infections in rural areas and the dent in urban demand posing downside risks. Considering these factors, the MPC revised its growth forecast downward to 9.5% YoY for FY22 from 10.5% earlier, with the revisions primarily illustrative in Q1 FY22 (Q1 FY22 growth was revised lower to 18.5% YoY from 26.2% YoY earlier). This resonates well with our forecast of ~16% YoY for Q1 FY22 and 9.9% YoY for FY22 as we expect the impact of the second wave to be mostly felt in the first quarter of the fiscal year before the economy resumes its sequential recovery in the subsequent quarters. In line with our assessment, the RBI indicated the forecast of a normal monsoon, the resilience of agriculture and the farm economy, the adoption of COVID-compatible operational models by businesses, and the gathering momentum of global recovery, as factors that can provide tailwinds to economic revival as the second wave abates. Moreover, the vaccination drive is expected to gather steam in the coming months, which should help with the faster normalization of economic activity. The central bank also highlighted that ~$600 billion foreign reserves provide the central bank great confidence to combat challenges from global spillovers.

On the inflation outlook, the MPC revised its forecast for inflation numbers marginally upward for upcoming quarters (Q2-Q4 FY22), incorporating the rising cost pressures due to logistical constraints from localized lockdowns and increasing global commodity prices. However, the RBI continues to prioritize growth as demand conditions remain weak and inflation is not seen as persistent. Moreover, a favourable base effect in the near term is likely to keep inflation pressure under control and within the RBI's upper target boundary of 6%, with Consumer Price Index (CPI) inflation being forecasted at 5.1% for the full year FY22, which should allow space for additional policy measures if needed.

RBI Growth and CPI Forecasts

RBI MPC Growth Forecasts (%YoY)					
	Q1 FY 2022	Q2 FY2022	Q3 FY2022	Q4 FY2022	FY2022
April 2021 Policy	26.2	8.3	5.4	6.2	10.5
June 2021 Policy	18.5	7.9	7.2	6.6	9.5
RBI MPC CPI Forecasts (%YoY)					
April 2021 Policy	5.2	5.2	4.4	5.1	-
June 2021 Policy	5.2	5.4	4.7	5.3	5.1

Source: RBI

RBI increases coverage of credit support to vulnerable segments while introducing fresh support for contact intensive sectors

Having announced policy steps in April and May 2021, in response to the evolving second COVID wave situation, the RBI announced additional policy measures today. The RBI continued to maintain its calibrated approach as it offered targeted policy support to vulnerable segments of the population while also trying to increase coverage and extend reach to more beneficiaries of its existing schemes. Supplementing its proactive measures announced on May 5, 2021, the RBI expanded coverage under resolution framework 2.0 by increasing the maximum aggregate exposure threshold from Rs 25 crore to Rs 50 crores for small borrowers - MSMEs, non-MSME small businesses, and loans to individuals for business purposes. This is likely to increase the number of borrowers who can avail restructuring.

The RBI also extended a special liquidity facility to SIDBI for Rs 16,000 crores at the prevailing policy repo rate for a period of up to one year for on-lending / refinancing through novel models and structures (including double intermediation, pooled bond/loan issuances, etc) to increase the coverage of credit support to the more credit deficient and aspirational regions. It remained open to an extension of the facility depending on the usage. This facility is in addition to the Rs 15,000 crore support to SIDBI, which the RBI had announced in the April'21 policy meeting. In regard to rural and regional banks (RRBs), RBI permitted RRBs to issue certificates of Deposits (CDs) to facilitate flexibility in raising short-term funds and thereby helping liquidity management (in addition to permitting the RRBs access to RBI's liquidity windows and the call/notice money market in Dec'20). Moreover, it has also been decided that all issuers of CDs will be permitted to buy back their CDs before maturity to provide issuers with greater flexibility in liquidity management.

In addition to increasing the coverage and reach of credit support to the more vulnerable segments - the RBI also extended support for certain contact intensive sectors that have been among the most impacted given the pandemic restrictions / social distancing measures. The RBI provided an on-tap liquidity window of Rs 15,000 crores, wherein banks can provide fresh lending support to hotels and restaurants; tourism – travel agents, tour operators, and adventure/heritage facilities; aviation ancillary services, etc., and classify these loans in a separate COVID loan book under the scheme. A similar scheme was announced with an on-tap liquidity window of Rs 50,000 crores in May this year to boost healthcare infrastructure and services in the country. The facility announced today will remain open till March 31, 2022, and available for tenors of up to three years at the repo rate. To create an incentive for banks to lend under this scheme, banks will be eligible to park their surplus liquidity up to the size of the COVID loan book with the RBI under the reverse repo window at a rate that is 40 bps higher than the reverse repo rate. The central bank extended this incentive to banks which will deploy their own resources without availing funds from the RBI under the scheme for lending to the specified segments.

RBI to complement fiscal policy through continued liquidity and lower borrowing costs

The RBI continued to complement the fiscal policy by supporting the demand for the high government borrowing programme and by keeping interest rates anchored, especially at the longer end of the curve. The RBI announced the third leg of the secondary market G-sec acquisition programme (G-SAP) 1.0 of Rs 40,000 crores (to be conducted on June 17, 2021, thereby completing its Rs 1 lakh crore target for Q1 FY22). Recognizing the increased strains on fiscal positions of state governments that find themselves at the forefront of the COVID battle again - Rs 10,000 crores (of Rs 40,000 crores) was accorded for state development loans (SDLs). The RBI also introduced the G-SAP 2.0 for Q2 FY22 that was 20% higher at Rs 1.2 lakh crore compared to Q1 FY22. These measures are likely to support the borrowing programme of both the center and state governments that have come under renewed stress with revenue collections getting impacted due to the advent of the second COVID wave. The Ministry of Finance has already proposed additional market borrowing to the tune of Rs 1.58 lakh crores to compensate states for the Goods and Services Tax (GST) shortfall, similar to last year. As such, the G-SAP measures are likely to ease borrowing costs of both the center and state governments and complement other support measures such as increasing the Ways and Means Advances, and overdraft limits introduced by the RBI for state governments. During the current year so far, the RBI has undertaken regular Open Market Operations (OMOs) and injected additional liquidity to the tune of Rs 36,545 crore by the end of May in addition to Rs 60,000 crore under G-SAP 1.0. These steps have helped the Gsec 10-year to trade around 6%, supporting the government borrowing programme as well as policy transmission to credit markets.

The RBI also announced other measures as listed below.

Placement of Margins for Government Securities Transactions on behalf of Foreign Portfolio Investors (FPIs)

- To promote ease of doing business and ease operational constraints faced by FPIs, Authorized Dealer banks have been permitted to place margins on behalf of their FPI clients for their transactions in Government securities (including State Development Loans and Treasury Bills), within the credit risk management framework of banks.

Availability of National Automated Clearing House (NACH) on all days of the week

- In order to further enhance customer convenience, and to leverage the 24x7 availability of Real Time Gross Settlement (RTGS), NACH, which is currently available on bank working days, is proposed to be made available on all days of the week, effective from August 1, 2021.

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