Mr. Vipin Malik,
(Chairman, Infomerics Ratings)

Dr. Manoranjan Sharma
(Chief Economist)

RBI'S OCTOBER 2021 MONETARY POLICY-FIRST CUT

08 October 2021

INTRODUCTION

The COVID 19 pandemic caused widespread devastation to lives and livelihoods all across the world but thankfully post-pandemic, growth is gaining traction. The COVID19 has highlighted issues of disparate demand and supply divergence, patchy access to countries with low production costs and irregular vaccination necessitating synchronized measures with a sense of immediacy.

I. OCTOBER POLICY HIGHLIGHTS

In conformity with our policy expectations, the RBI, despite high inflation, held the rates steady in October's bimonthly policy. Accordingly, the policy repo rate remains unchanged at 4 per cent; the reverse rate unchanged at 3.35 per cent, the marginal standing facility (MSF) rate and the bank rate unchanged at 4.25 per cent.

II. STATUS QUO ON RATES

The accommodative policy stance continues to remain "to revive and sustain growth on a durable basis and continue to mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward". The case for unchanged repo rate and accommodative stance stemmed from the fact that "calibrated reversal of indirect taxes on fuel to contain cost-push inflation could contribute to a sustained lowering of inflation, inflationary expectations".

What is welcome that in view of the devastation to lives and livelihoods in the wake of COVID 19 pandemic, this is the eighth consecutive time that the MPC maintained a status quo in rates. The RBI had last revised its policy repo rate or the short-term lending rate on May 22, 2020, in an off-policy cycle to perk up demand by cutting interest rate to a historic low. The Governor disclosed that the policy rate decision was unanimous, stance decision was 5:1.

III. GDP GROWTH

The GDP growth for FY 22 is seen at 9.5 per cent. There has been no revision in the GDP forecast in the October policy. The RBI has pegged Q2FY22 GDP growth at 7.9 per cent compared to 7.3 per cent earlier; Q3FY22 GDP growth at 6.8 per cent against 6.3 per cent earlier and retained the GDP growth at 6.1 per cent for Q4FY22.

The emerging process and pattern of the growth Indian economy is broad-based and resilient as clearly manifested in the fact that "almost all components of GDP grew year-on-year in Q1 despite the destructive impact of the second wave of Covid-19".

Factors, such as, ebbing infections and improving consumer confidence are likely to bolster private consumption. Pent-up demand and festival season should give further fillip to urban demand in Q2.

Against this macro-economic backdrop, the RBI is expected to help the government enhance growth with the required broad-based policy support. Given the compelling need to strengthen growth, the conduct of monetary policy is required to nurture a nascent and hesitant recovery.

High frequency domestic growth indicators have improved quickly post the second wave and early signs of recovery broadening with improvement in service-related indicators. But contact-intensive sectors are likely to struggle because of the persisting fear of a potential third wave. The coming festival season should, however, push demand and accelerate recovery.

IV. BANK CREDIT

Bank credit is yet to gain steam. With better operational efficiency and robust deposit growth, banks did well in Q1. Despite stress in retail loans, asset deterioration contained, recovery improved, restructuring manageable and incremental provision reduced. But risk aversion, stringent underwriting and credit to MSMEs causes concern.

On a year-on-year (y-o-y) basis, non-food bank credit growth stood at 6.7 per cent in August 2021 as compared to 5.5 per cent in August 2020.

V. FINANCIAL POSITION OF BANKS

There has to be a sustained improvement in financial position of banks. CRAR of SCBs rose to 16.03 per cent and provision coverage ratio to 68.86 per cent in March 2021. Macro stress tests reveal that GNPAs of SCBs could rise from 7.48 per cent in March 21 to 9.8 per cent in March 22 (baseline scenario) and 11.22 per cent (severe stress scenario). There is a need to bolster capital and liquidity of banks.

Disruptive changes necessitate banking transformation. Banking will remain but banks may not survive the onslaughts of Amazon's presence in financial services, Walmart's and Google's entry into financial services business, UPI's disruption of payment services, etc. Fasten your seat belts, turbulent times ahead!

We cannot solve today's challenges with yesterday's mindset. A paradigm shift is needed in the banking sector to reorient with the VUCA times and stay ahead of the curve. The task ahead is difficult but doable.

VI. CPI INFLATION

The RBI lowered its FY22 CPI Inflation target to 5.3 per cent from the earlier 5.7 per cent. It also saw July-September CPI inflation at 5.1 per cent compared to the 5.9 per cent earlier. The October-December CPI Inflation is estimated at 4.5 per cent compared to the 5.3 per cent earlier.

VII. LIQUIDITY MEASURES

The Governor stressed that in the absence of further borrowing under GST and an increase in government spending, further expansion of the GSAP operations was not warranted. He maintained "the RBI will remain ready to undertake GSAP as and when warranted by liquidity conditions and will continue to undertake other liquidity management operations like Twist and OMOs". The 14-day variable rate reverse repo has been the key instrument under the liquidity framework and the potential liquidity overhang was over Rs 13 lakh crore, as the economy gradually recovered from the COVID-19 pandemic. The Governor placed matters in perspective, when he said "RBI has maintained ample surplus liquidity since the beginning of the pandemic for India's speedy recovery, with surplus increasing further during September under reverse repo".

Overall liquidity injected during the first six months of this year comprising GSAP amounted to Rs 2.7 lakh crore as compared to Rs 3.1 lakh crore during FY21. The GSAP process "has to be gradual, calibrated, and non-disruptive. GSAP has been successful, coupled with other liquidity measures that made recovery conducive".

VIII. SURGING DIGITIZATION

The RBI increased the daily limit of immediate payment service (IMPS) to Rs 5 lakh from current Rs 2 lakh. Introduced in 2010, IMPS is a 24X7 service to transfer money real-time. It allows transferring of funds instantly within banks across India, which is not only safe but also economical.

The framework for retail digital payments in offline modes would be announced soon all over India in line with a similar scheme announced in August last year to "further expand the reach of digital payments and open up new opportunities for individuals and businesses".

To encourage online payments, the RBI has proposed to introduce a plan for utilising geo-tagging to capture the exact location information on existing and new payments acceptance (PA) infrastructure – Point of Sale (PoS) terminals, Quick Response (QR) codes, etc. This would complement the Reserve Bank's Payment Infrastructure Development Fund (PIDF) framework in ensuring deployment of PA infrastructure in more and more geographies.

In addition to its cohorts on 'Retail Payments', 'Cross Border Payments', and 'MSME Lending', the RBI has announced a cohort on 'Prevention and Mitigation of financial frauds' to provide further impetus to the emerging fintech scene in India.

IX. CONCLUDING OBSERVATIONS

The RBI's well-considered move to hold all the rates steady would provide an impetus to the incipient growth impulses. But high inflation, accommodative monetary policy, unchanged rates and incipient growth could lead to stagflationary concerns. An accent on calibrated approach to absorb excess liquidity and the renewed thrust on maintaining a vigil on the inflationary price spiral are of contextual significance. The issue of employment also continues to be a major and persisting concern in the overall growth and transformation saga.