Fact Sheet: Monetary Policy October 2020

RBI leaves repo rate unchanged, GDP to contract by 9.5% in 2020-21

- *The newly formed Monetary Policy Committee (MPC) unanimously voted to leave the repo rate unchanged at 4.0 percent in the monetary policy resolution announced on October 9, 2020*

- *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. It indicated that the stance would remain so at least during the current financial year and into the next year to mitigate the impact of COVID-19 and revive growth on a sustainable basis while ensuring that inflation remains within the RBI's indicative target.*

RBI Policy Action Since the Outbreak of the Pandemic

Key rates	Feb-2020	March-2020	April-2020	May-2020	August-2020	October-2020
Repo rate	5.15%	4.40%	4.40%	4.0%	4.0%	4.0%
Reverse repo rate	4.90%	4.00%	3.75%	3.35%	3.35%	3.35%
MSF	5.40%	4.65%	4.65%	4.25%	4.25%	4.25%
CRR	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
SLR	18.25%	18.25%	18.25%	18.0%	18.0%	18.0%
Bank rate	5.40%	4.65%	4.65%	4.25%	4.25%	4.25%

Key Monetary and Liquidity Measures since February 6, 2020	
LTRO	Rs 2,00,000 cr
Variable rate repo	Rs 1,75,000 cr
CRR cut	Rs 1,37,000 cr
MSF (dip by 1% in SLR)	Rs 1,37,000 cr
TLTRO	Rs 1,00,000 cr
TLTRO (2.0)	Rs 50, 000 cr
Net OMO purchases	Rs 50, 000 cr
Special liquidity facility for mutual funds	Rs 50, 000 cr
Refinance to NABARD,SIDBI,NHB and EXIM bank	Rs 75,000 cr
Special liquidity scheme for NBFCs	Rs 30,000 cr
56-day term repo	Rs 1,00,000 cr

Inflation Outlook

The MPC expects headline inflation to remain elevated at 6.8 per cent in Q2 2020-21 and thereafter moderate to around 5.4-4.5 percent in the second half of the fiscal. Inflation outlook for Q1 2021-22 was much lower at 4.3 percent

One year ahead inflation expectations of households suggest some softening in inflation from three months ahead levels. Selling prices of firms remain muted, reflecting the weak demand conditions.

Factors that may put downward pressure on inflation

- Good kharif sowing
- Softer international crude oil prices
- Weak pricing power of firms in the face of weak demand
- Prices of key vegetables such as potatoes, tomatoes and onions are likely to ebb in the coming quarters with fresh kharif arrivals

Factors that may put upward pressure on inflation

- Prices of pulses and oilseeds are likely to remain firm due to elevated import duties
- Domestic pump prices may remain elevated as the roll back of taxes seems unlikely given already large revenue shortfalls for both central and state governments
- While progressive unlocking of economic activity is underway, possibility of cost-push pressures on inflation due to supply side disruptions remain

Source: *RBI's Monetary Policy Statement, October 9, 2020*

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Growth Outlook

RBI has projected GDP growth to contract by 9.5% in 2020-21
GDP growth to turn positive by Q4 2020-21: (-)9.8 per cent in Q2:2020-21; (-)5.6 per cent in Q3; and 0.5 per cent in Q4

Upsides to Growth

- Recovery in the rural economy is expected to strengthen further. Job creation under the Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA) has provided incomes and employment in rural areas
- Manufacturing firms expect capacity utilisation to recover in Q3 2020-21 and increased activity from Q4 onwards
- Improved soil moisture conditions, healthy reservoir levels have brightened the outlook for the rabi season
- Migrant labour is returning to work in urban areas, and factories and construction activity is picking up

Downside to Growth

- Contact-intensive services sector will take time to regain pre-COVID levels
- With infections rising once again, turnaround in urban demand is likely to be lagged in view of social distancing norms
- Private investment and exports are likely to be subdued, especially as external demand is still anaemic

Three Speed Recovery Likely depending on sector-specific realities

Front Runners: Agriculture and allied activities; fast moving consumer goods; two wheelers, passenger vehicles and tractors; drugs and pharmaceuticals; and electricity generation (especially renewables)

Sectors to 'Strike Form' Gradually: would comprise sectors where activity is normalising gradually

Slog Overs : These are sectors that are most severely affected by social distancing and are contact-intensive. Aviation, Tourism, Hospitality, Entertainment etc

Regulatory & Developmental Announcements

Liquidity Measures and Financial Markets

On Tap TLTRO

- On tap TLTRO with tenors of up to three years for a total amount of up to Rs. 1,00,000 crore at a floating rate linked to the policy repo rate to be conducted to support sector specific revival; Scheme will be available up to March 31, 2021
- Liquidity availed by banks under the scheme has to be deployed in corporate bonds, commercial papers, and non-convertible debentures issued by entities in specific sectors over and above the outstanding level of their investments in such instruments as on September 30, 2020

SLR Holdings in Held to Maturity Category

- Dispensation of enhanced Held to Maturity (HTM) limit of 22 percent extended till March 31, 2022 (for securities acquired between September 1, 2020 and March 31, 2021) to foster orderly market conditions & congenial financial costs

Open Market Operations (OMOs) in State Development Loans (SDLs)

- OMOs to be conducted in SDLs as a special case during the current financial year to improve secondary market activity and rationalize spreads of SDLs over central government securities of comparable maturities

***Source:** RBI's Monetary Policy Statement, October 9, 2020, FICCI Research*

Regulatory & Developmental Announcements

Support to Exports

- System-based automatic caution-listing has been discontinued; RBI will henceforth undertake caution-listing on the basis of case-specific recommendations of the Authorised Dealer banks

Regulatory Measures

Revised Regulatory Limits for Retail Portfolio of Banks

- In order to expand credit flow to small businesses, threshold of all fresh as well as incremental qualifying exposures has been increased to Rs. 7.5 crore from Rs 5 crore

Rationalization of Risk Weights on Individual Housing Loans

- To provide a fillip to the real estate sector, risk weights for all new housing loans sanctioned up to March 31, 2022 to be rationalized and linked to loan-to-value ratios only

Financial Inclusion

Review of the Co-origination Model

- Framework for co-origination of loans to be extended to all NBFCs, including HFCs, in respect of all eligible priority sector loans. Greater operational flexibility to the lending institutions will also be allowed. Earlier only a category of NBFCs had this facility subject to certain conditions

Payment and Settlement Systems

- In December 2019, RBI made available the National Electronic Funds Transfer (NEFT) system on a 24x7x365 basis. Now, the RTGS system will also be available round the clock on all days from December 2020. This will facilitate innovations in the large value payments ecosystem and promote ease of doing business.
- Authorisation for all PSOs (new applicants as well as existing PSOs) will now be granted on a perpetual basis, subject to certain conditions, as compared to a limited period of five years earlier. This will obviate licensing and business uncertainty for PSOs, reducing compliance costs and creating a climate conducive for investment activities, increased employment, and infusion of new talent as well as technologies into value chains.

FICCI's Comments

Given the evolving growth-inflation dynamics, a clear focus on reviving growth was the need of the hour. FICCI feels encouraged with the MPC signaling more supportive measures to energize growth. While the policy repo rate remained unchanged, several other measures that were announced should help lowering interest rates in the market.

The announcement to have on tap TLTRO, enhancing the amount under open market operations, laying out the plan to conduct open market operations in state development loans, giving banks further flexibility with regard to their SLR investments and extending the provision with regard to hold to maturity till March 2022 are all positive measures and should help improve liquidity in the system. In addition, banks would now be able to manage liquidity without facing much friction, given the government's own borrowing requirements.

***Source:** RBI's Monetary Policy Statement, October 9, 2020*

FICCI's Comments

Another major announcement in the policy pertains to the housing sector where the lenders have been given greater flexibility as the risk weight attached to housing loans will be determined by the loan to value ratio only. FICCI has on many occasions suggested the need to focus on the housing and construction sector as any positive movement here can have a large multiplier impact on the growth of several other sectors.

We have also noted the decision to increase the exposure limits on individual retail loans from Rs 5 crore to Rs 7.5 crore. This would benefit both individuals and small businesses that are currently gasping for liquidity support to keep themselves afloat.

On extension of the co-lending model to all NBFCs and HFCs, while FICCI welcomes this move, we feel that there is a need to simultaneously address some of the larger challenges that are being faced by the NBFC and HFC sector and enable them to support the economic revival process.

The decision to discontinue the automatic caution listing system comes as a big relief to exporters and will certainly benefit them. FICCI has on several occasions brought this issue up with the RBI and we are happy to see a positive move in this direction.

Source: *RBI's Monetary Policy Statement, October 9, 2020, FICCI Research*