RBI keeps Repo Rate unchanged at 4% and sets out various developmental and regulatory policy measures

- The Monetary Policy Committee (MPC) met on 4th, 5th and 6th August 2021. Based on an assessment of the evolving domestic and global macroeconomic and financial conditions and the outlook, the MPC voted unanimously to keep the **policy repo rate unchanged at 4 per cent.** The MPC also decided on a 5 to 1 majority to **continue with the accommodative stance** as long as necessary 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 marginal standing facility (MSF) rate and the bank rate remain unchanged at 4.25 per cent. The **reverse repo rate also remains unchanged at 3.35 per cent.**

- Domestic economic activity has started normalising with the ebbing of the second wave of the virus and the phased reopening of the economy. High-frequency indicators suggest that (i) consumption (both private and Government), (ii) investment and (iii) external demand are all on the path of regaining traction.

- External demand remained buoyant during Q1:2021-22 and was reflected in increasing exports, lending critical support to aggregate demand. Strong external demand is an opportunity for India and further policy support should help in capitalising on this. Global commodity prices and episodes of financial market volatility, together with vulnerability to new waves of infections are, however, downside risks to economic activity.

- Taking all these factors into consideration, projection of 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.

- Headline CPI inflation edged up sharply to 6.3 per cent in May driven by a broad-based pick-up across all major groups on adverse supply shocks, sectors specific demand-supply mismatches and spillovers from rising global commodity prices. It remained at 6.3 per cent in June; however, core inflation registered an appreciable moderation. Taking into consideration all these factors, 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.

- The Reserve Bank through its market operations, both conventional and unconventional, has maintained ample surplus liquidity since the onset of the pandemic to ensure easing of financial conditions in support of domestic demand. Buoyed by the renewed vigour of capital inflows and the Reserve Bank's purchase of government securities in the secondary market, total absorption through reverse repos surged from a daily average of ₹5.7 lakh crore in June to ₹6.8 lakh crore in July 2021 and further to ₹8.5 lakh crore in August 2021 so far (up to August 4).

- Under the revised liquidity management framework announced on February 06, 2020, the Reserve Bank has been conducting 14-day variable rate reverse repo (VRRR) auctions as its main liquidity operation. With the commencement of normal liquidity operations, the VRRR, which was temporarily held in abeyance during the pandemic, has been re-introduced since January 15, 2021 and the initial absorption of ₹2 lakh crore has been rolled over in the subsequent fortnightly auctions. In parallel, access to the fixed rate overnight reverse repo has been kept open. Markets have adapted and even welcomed the VRRR in view of the higher remuneration it offers relative to the fixed rate overnight reverse repo. Fears that the recommencement of the VRRR tantamounts to liquidity tightening have been allayed. We have seen higher appetite for VRRR in terms of the bid-cover ratio in the auctions. Considering all these aspects, it has now been decided to conduct fortnightly VRRR auctions of ₹2.5 lakh crore on August 13, 2021; ₹3.0 lakh crore on August 27, 2021; ₹3.5 lakh crore on September 9, 2021; and ₹4.0 lakh crore on September 24, 2021. These enhanced VRRR auctions should not be misread as a reversal of the accommodative policy stance, as the amount absorbed under the fixed rate reverse repo is expected to remain more than ₹4.0 lakh crore at end September 2021. Needless to add that the amount accepted under the VRRR window forms part of system liquidity.

- The Reserve Bank's secondary market G-sec acquisition programme (G-SAP) has been successful in anchoring yield expectations while eliciting keen response from market participants. RBI proposed to conduct two more auctions of ₹25,000 crore each on August 12 and August 26, 2021 under G-SAP 2.0. RBI will continue to undertake these 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.

- After the onset of the pandemic, the Reserve Bank has announced more than 100 measures to mitigate its impact. Going forward, RBI's endeavour would be to continue the monitoring of measures which are still in operation to ensure that the benefit of all RBI's measures percolate down to targeted stakeholders. Against this backdrop and based on RBI's continuing assessment of the macroeconomic situation and financial market conditions, certain additional measures are being announced today.

- The scope of the on-tap TLTRO scheme, initially announced on October 9, 2020 for five sectors, was further extended to stressed sectors identified by the Kamath

Committee in December 2020 and bank lending to NBFCs in February 2021. The operating period of the scheme was also extended in phases till September 30, 2021. 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.

- 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. To provide comfort to banks on their liquidity requirements, including meeting their Liquidity Coverage Ratio (LCR) requirement, this relaxation which is currently available till September 30, 2021 is being extended for a further period of three months, i.e., up to December 31, 2021. This dispensation provides increased access to funds to the extent of ₹1.62 lakh crore and qualifies as high quality liquid assets (HQLA) for the LCR.

- The transition away from London Interbank Offered Rate (LIBOR) is a significant event that poses certain challenges for banks and the financial system. The Reserve Bank has been engaging with banks and market bodies to proactively take steps. The Reserve Bank has also issued advisories to ensure a smooth transition for regulated entities and financial markets. In this context, it has been decided to amend the guidelines related to (i) export credit in foreign currency and (ii) restructuring of derivative contracts. Banks will be permitted to extend export credit in foreign currency using any other widely accepted Alternative Reference Rate in the currency concerned. Since the change in reference rate from LIBOR is a "force majeure" event, banks are also being advised that change in reference rate from LIBOR/ LIBOR related benchmarks to an Alternative Reference Rate will not be treated as restructuring.

- The resolution plans implemented under the Resolution Framework for COVID19 related stress announced on August 6, 2020 require sector specific thresholds to be met in respect of certain financial parameters. Of these parameters, the thresholds in respect of four parameters relate to operational performance of the borrowing entities, viz. Total Debt to EBIDTA ratio, Current Ratio, Debt Service Coverage Ratio and Average Debt Service Coverage Ratio. These ratios are required to be met by March 31, 2022. Recognizing the adverse impact of the second wave of COVID-19 and the resultant difficulties on revival of businesses and in meeting the operational parameters, it has been decided to defer the target date for meeting the specified thresholds in respect of the above four parameters to October 1, 2022.

Please find the attached documents on the same for your kind reference.

Please contact for any query related to this mail to Mr Rishabh, Research Associate at rishabh@phdcci.in, with a cc to Dr S P Sharma, Chief Economist | DSG at spsharma@phdcci.in and Ms Kritika Bhasin, Research Officer at kritika.bhasin@phdcci.in, PHD Chamber of Commerce & Industry.

Warm Regards,

Dr S P Sharma

Chief Economist | DSG
PHD Chamber of Commerce and Industry
PHD House, 4/2 Siri Institutional Area
August Kranti Marg, New Delhi-110016, India
Tel: +91 49545454
Fax: +91 11 26855450
Email: spsharma@phdcci.in
Website: www.phdcci.in
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PHD House, 4/2 Siri Institutional Area, August Kranti Marg, New Delhi - 110 016 (India) • Tel. : +91-11-2686 3801-04, 49545454, 49545400
Fax : +91-11-2685 5450, 49545451 • E-mail : phdcci@phdcci.in • Website : www.phdcci.in, CIN: U74899DL1951GAP001947

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