MPC's accommodative stance expected to continue till economy recovers: Brickwork Ratings

Brickwork Ratings, Bengaluru, 7 April 2021: The Reserve Bank of India (RBI), in its first bi-monthly Monetary Policy Committee (MPC) meeting for the current fiscal year announced today, maintained a status quo and an accommodative policy stance. Both the decisions of the MPC are in line with BWR expectations. On the GDP guidance, the RBI continued to maintain its forecast of 10.5% growth for FY22. On the inflationary side, the RBI sees a softening trend in prices in Q3 FY22 (4.4%) and maintained the 5.2% inflation forecast for H2 FY22. The expectation of inflation moving within the MPC's target provides scope for the continuation of the accommodative policy stance for the near term. Overall, the tone of the MPC remained dovish, while supporting growth recovery, and financial stability concerns continue to remain the central focus of the RBI.

The hope generated by the vaccination drive has been offset by the growing number of new Covid cases recently. The second wave of Covid infections has created renewed uncertainty, and recovery in most sectors of the economy has again been disrupted due to the imposition of partial lockdowns in various parts of the country. Hence, the RBI continued with the accommodative policy stance through announcing regulatory and liquidity easing measures to ensure smooth borrowing and lending activities. To address the stress in financial conditions, the RBI governor announced additional regulatory policy measures on (i) liquidity management and support to targeted sectors, (ii) regulation and supervision, (iii) debt management, (iv) payment and settlement systems, (v) financial Inclusion, and (vi) external commercial borrowings in its accompanying **"Statement on Developmental and Regulatory Policies".** Following are the announcements:

- TLTRO on tap scheme: Extension of the deadline by a period of six months, i.e., till 30 September 2021.
- Liquidity facility for All-India Financial Institutions (AIFIs): To extend fresh support of Rs 50,000 crore to AIFIs for new lending in 2021-22, NABARD will be provided a Special Liquidity Facility (SLF) of Rs 25,000 crore for a period of one year to support agriculture and allied activities, the rural non-farm sector and Non-Banking Financial Companies- Micro Finance Institutions (NBFC-MFIs). An SLF of Rs 10,000 crore will be extended to NHB for one year to support the housing sector. To meet the funding requirements of Micro, Small and Medium enterprises (MSMEs), SIDBI will be sanctioned Rs 15,000 crore under this facility for a period of up to one year. All these three facilities will be available at the prevailing policy repo rate.

- The enhancement of the limit of the maximum balance per customer at end of the day from Rs 1 lakh to Rs 2 lakh for payments banks.
- Constitution of a committee for Asset Reconstruction Companies (ARCs): Proposed to constitute a committee to undertake a comprehensive review of the working of ARCs in the financial sector ecosystem and recommend suitable measures for enabling such entities to meet the growing requirements of the financial sector.
- Permitting banks to on-lend through NBFCs: With a view to ensure the continued availability of credit to these sectors to aid faster economic recovery, the RBI has decided to extend the PSL classification for lending by banks to NBFCs for 'on-lending' to specified priority sectors (Agriculture/MSME/Housing) for six months, i.e., up to 30 September 2021.
- Priority Sector Lending (PSL) guidelines - Enhancement of loan limit against eNWR/NWR: To encourage farm credit to individual farmers against the pledge/hypothecation of agricultural produce and leverage the inherent safety of Negotiable Warehouse Receipts (NWRs)/electronic-NWRs(eNWRs) issued by the warehouses registered and regulated by the Warehousing Development and Regulatory Authority (WDRA), the RBI has been decided to enhance the loan limit from Rs 50 lakh to Rs 75 lakh per borrower against the pledge/hypothecation of agricultural produce backed by NWRs/(e-NWRs) issued by warehouses registered and regulated by the WDRA.
- Review of Way and Means Advances (WMA) limits for state governments/UTs: An overall revised limit of Rs 47,010 crore for all states, as against the current limit of Rs 32,225 crore (fixed in February 2016).
- Financial inclusion index: The FI Index will be published annually in July for the financial year ending previous March.
- Centralised Payment Systems (CPS), viz., RTGS and NEFT- Membership for entities other than banks: To encourage the participation of non-banks across payment systems, it is proposed to enable, in a phased manner, payment system operators, regulated by the Reserve Bank, to take direct membership in CPSs.
- Interoperability of Prepaid Payment Instruments (PPIs), and increase in account limit to Rs 2 lakh: Proposed to make interoperability mandatory for full-KYC PPIs and for all acceptance infrastructure. To incentivise the migration of PPIs to full-KYC, it is proposed to increase the limit of outstanding balance in such PPIs from the current level of Rs 1 lakh to Rs 2 lakh.
- Permitting cash withdrawal from full-KYC PPIs issued by non-banks: Proposed to allow the facility of cash withdrawal, subject to a limit, for the full-KYC PPIs of non-bank PPI issuers as well.

- Relaxation in the period of parking for External Commercial Borrowing (ECB) proceeds in term deposits: In view of the difficulty faced by borrowers in utilising already drawn down ECBs due to the Covid-19-pandemic-induced lockdown and restrictions, it has been decided to relax the above stipulation as a one-time measure, with a view to provide relief. Accordingly, unutilised ECB proceeds drawn down on or before 1 March 2020 can be parked in term deposits with AD Category-I banks in India prospectively up to 1 March 2022.

Says Dr M Govinda Rao, Chief Economic Advisor, Brickwork Ratings, "The decision to hold the policy rates by the MPC is on expected lines. While maintaining the status quo, the committee has continued with an accommodative policy stance. It has not provided guidance for the future, but has clearly stated that the accommodative stance will continue until the economy recovers. The tone of the policy was dovish and accommodative, and the statement that the RBI will do whatever it takes towards recovery clearly shows that the focus is to help in sustaining growth recovery and financial stability. Although there was no clear forward guidance on the recovery front, the RBI maintained its FY22 growth forecasts at 10.5%, highlighting renewed concerns owing to the second wave of Covid infections. The decision to purchase government securities amounting to Rs 1 lakh crore is to ensure adequate liquidity to keep the yields in check. The RBI's CPI forecast too is well within the upper band of the flexible target. We expect the RBI to continue with its current policy stance for H1 FY22 and possibly gradually start the withdrawal of liquidity later in the year".

The announcement of G-sec Acquisition Programme (GAP) to purchase G-secs amounting to Rs 1 lakh crore in Q1 FY22 is mainly to help keep the yield curve low and ease the government's fund raising programme. The extension of on tap TLTRO for another six months ensures ample liquidity available to the productive sectors of the economy.

Says R Rajee, Chief Ratings Officer, Brickwork Ratings, "In line with BWR expectations, RBI has kept rates unchanged and retained its accommodative stance till growth is secured. Extending the TLTRO for six months, introducing secondary market G-sec Acquisition Program 1.0 and the Rs 50,000 crore liquidity injection to the financial institutions, which includes Rs 10,000 crore to NHB, are positive developments. These are expected to sustain a balanced liquidity and keep the borrowing momentum buoyant in the markets. Given the renewed uncertainty in the economy, the MPC announcements provide the reassurance of preserving adequate liquidity, protecting financial markets from external vulnerabilities and preventing the hardening of yields in the bond market. Providing state-based guidance rather than time-based guidance, given the current scenario, is practical. The formation of a committee to review the functioning of ARCs and recommend measures to enable the realisation of their full potential to meet the growing requirements of the financial sector has come at the right time. We expect the RBI to continue with the current stance till the economy recovers from the instability caused by the pandemic".

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