Towards Gradual Policy Normalisation

Brickwork Ratings, Bengaluru, 08 April 2022: The Reserve Bank of India (RBI) has maintained a status quo on policy rates and has continued the accommodative policy stance in its Monetary Policy Committee (MPC) decision announced today. Both these decisions of the MPC are in line with Brickwork Ratings' (BWR's) expectations.

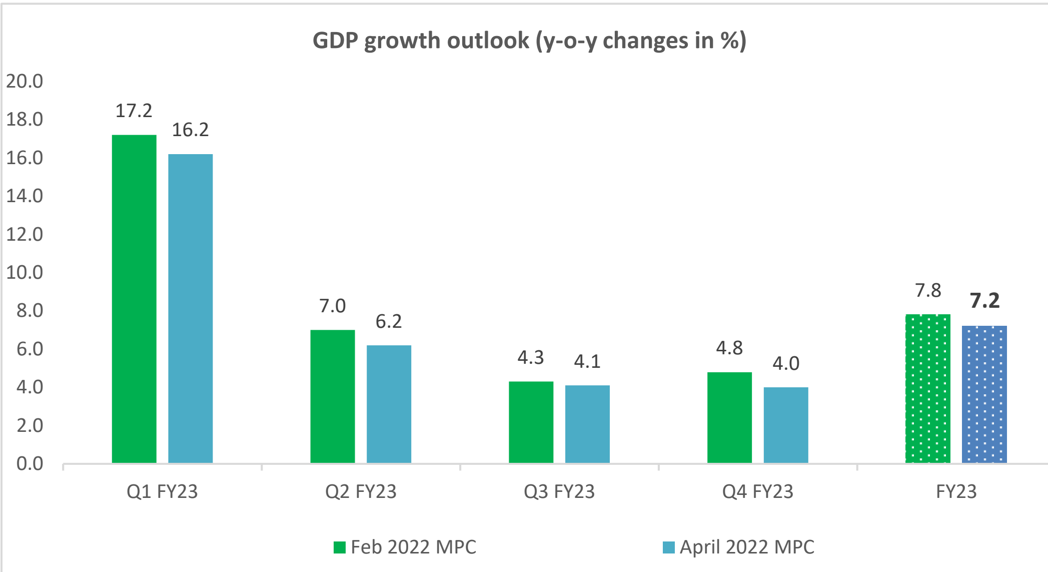
Key takeaways from MPC's announcements

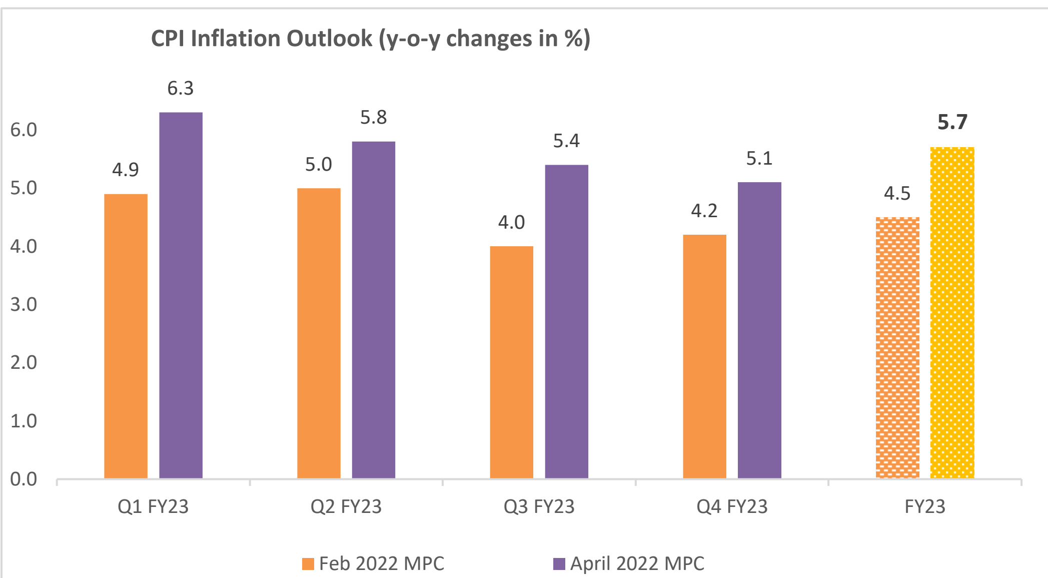
- No change in the key policy rates; repo rate retained at 4%, but a little bullish approach even while maintaining the reverse repo rate at 3.35%, and MSF rate at 4.25%.
- Narrowed the LAF corridor to 50 bps by introducing the Standing Deposit Facility (SDF) as the floor of the LAF corridor. The SDF rate will be 25 bps below the policy rate, at 3.75% which will be applicable to overnight deposits.
- Unanimous decision by MPC members to retain the accommodative stance, while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.
- Downward revision in GDP growth projections for FY23 to 7.2% from 7.8% growth estimated in the MPC's February meeting. Quarterly growth outlook also revised downwards.
- CPI inflation outlook for FY23 revised upwards to 5.7% from the February forecast at 4.5%. Greater concern expressed on the inflation outlook attributed mainly to the geo-political factor.
- Variable Rate Repo (VRR) and Variable Rate Reverse Repo (VRRR) auctions to remain as the main liquidity management tools.
- Fully restore the liquidity management framework instituted in February 2020, albeit with some refinements to enhance its effectiveness.
- To restore the size of the liquidity surplus in the system to a level consistent with the prevailing stance of monetary policy in a gradual and calibrated and non-disruptive manner over a multi-year time frame.
- Restore the opening time for financial markets regulated by the RBI to the pre-pandemic timing of 9:00 am with effect from 18 April 2022, without any change in their closing time prevailing at present.

Other Major Announcements

- **Individual Housing Loans – Rationalisation of Risk Weights**: The risk weights for individual housing loans were rationalised in October 2020 by linking them only with loan to value (LTV) ratios for all new housing loans sanctioned up to 31 March 2022. To facilitate higher credit flow for individual housing loans, RBI has decided to extend the applicability of these guidelines till 31 March 2023.
- **SLR holdings in HTM category:** With a view to enable banks to better manage their investment portfolio during FY23, RBI has decided to enhance the present limit under Held to Maturity (HTM) category from 22% to 23% of Net Demand and Time Liabilities (NDTL) till 31 March 2023. It has also been decided to allow banks to include eligible SLR securities acquired between 1 April 2022 and 31 March 2023 under this enhanced limit. The HTM limits would be restored from 23% to 19.5% in a phased manner starting from the quarter ending 30 June 2023.
- To facilitate better understanding and assessment of the potential impact of climate-related financial risks by Regulated Entities, a Discussion Paper on Climate Risk and Sustainable Finance will be published shortly for feedback.
- Proposed to set up a committee to examine and review the current state of customer service in the RBI Regulated Entities, adequacy of customer service regulations and suggest measure to improve the same.
- Proposed to make card-less cash withdrawal facility available across all banks and ATM networks using the UPI.
- To facilitate greater penetration of bill payments through the Bharat Bill Payment system (BBPS) and to encourage participation of a greater number of non-bank Bharat Bill Payment Operating Units in the BBPS, RBI has proposed to reduce the net worth requirement of such entities from Rs 100 crore to Rs 25 crore.
- To ensure payment systems remain resilient to conventional and emerging risks, specifically those relating to cyber security, RBI has proposed to issue guidelines on Cyber Resilience and Payment Security Controls for Payment System Operators.

Revision in GDP and Inflation Outlook for FY23: Growth down, Inflation up





Source: April 2022 Monetary Policy Statement, BWR Research

Says Dr M Govinda Rao, Chief Economic Advisor, Brickwork Ratings, "The decision to hold policy rates by the MPC is on expected lines. Both the downward revision in GDP projections and an upward revision to the inflation outlook are due to the uncertainties and potential risks emanating from the ongoing geopolitical developments. On the GDP guidance, the RBI forecasts 7.2% growth for FY23, which is notably lower than the 7.8% growth estimated in its previous MPC. The RBI is caught between the dilemma of decelerating growth and accelerating inflation. Growth concerns continue to warrant the RBI to maintain the policy rate stable at current levels while there is little scope left to continue with an accommodative stance due to increasing inflationary worries. The continued global supply bottlenecks, in addition to sharp rise in international commodity prices, particularly crude oil prices exacerbate inflation risks. The RBI has revised its inflation forecasts to 5.7% for FY23 from 4.5% estimated in the February MPC, and the H1 FY23 estimates exceed the MPC's upper tolerance level of 6% with Q1 and Q2 estimates at 6.3% and 5.8%, respectively. In the first two months of the Q4FY22, inflation already crossed above the upper tolerance level of RBI. The chances of inflation remaining above 6% levels continuously for three quarters may pose challenges for the inflation-targeting framework of RBI. Considering this, the RBI stated in its MPC note that it will remain accommodative, while focussing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth. While, the forecast for inflation is largely dependent on domestic factors such as demand and supply situation, international commodity prices, and monsoon. We expect the RBI to continue to focus on inflation with appropriate monetary measures such as gradual withdrawal of liquidity, without destabilising economic recovery".

Says Rajee R, Chief Ratings Officer, Brickwork Ratings, "In line with BWR's expectations, RBI remained accommodative by reiterating that despite economic recovery and aggregate demand gaining traction, continued policy support is warranted to support domestic growth, primarily due to challenges emerging at the external sector. However, the focus has shifted to gradual withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth. Introduction of the Standing Deposit Facility (SDF) and normalization of the LAF corridor to 50 bps along with announcement of withdrawal of excess liquidity from the system over a multi-year time frame indicate this shift in RBI's stance. Upward revision in inflation forecast and downward revision in GDP growth forecast for FY23, mainly due to increase in commodity and other input costs arising out of geopolitical tensions in Europe and rising Covid cases in China indicate that RBI may have to tread cautiously to keep inflation within stipulated limit while continuing to support growth in FY23. Extension of rationalized risk weights for housing loans till 31 Mar 2023 will facilitate higher credit flow for individual housing loans. The proposal to set up a committee to review the current state of customer service in the RBI Regulated Entities, adequacy of customer service regulations and identify improvement measures are expected to increase customer satisfaction and trust towards the RBI regulated institutions. Introduction of cardless cash withdrawal at all bank branches and ATMs via UPI would enhance the ease of transactions and help prevent frauds".

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