Monetary policy committee flags the risks to growth

Rupa Rege | June 04, 2021

In line with the street expectations, the monetary policy committee (MPC) maintained status quo on policy rates and liquidity stance in its June policy highlighting increased risks to growth.

The rural sector that had played the economy's saviour in FY21 has come under stress in recent months with a significant rise in COVID-19 infections. The MPC points out that important rural demand indicators — tractor sales and two-wheeler sales — posted sequential declines in May. In the industrial sector, while mining and electricity segments have returned to their pre-pandemic level of activity, the manufacturing sector still lags behind.

The MPC has taken note that most high frequency indicators such as e-way bills generation, electricity output, railway freight traffic, port cargo, steel consumption, cement production, toll collections, etc. recorded sequential moderations in April-May, 2021. The moderation in manufacturing and services PMI was quite severe in May after several months of sustained expansion. This primarily reflects the impact of restrictions and localised lockdowns imposed by states, says the MPC.

Factoring in this acute slowdown and the future uncertain trajectory, the MPC revised downwards its real GDP growth projection for FY22 from 10.5 percent earlier to 9.5 percent. It has also stressed that at this juncture policy support from all sides, including fiscal and sectoral (and not only monetary), is essential to nurture recovery and expedite return to normalcy.

Surprisingly, despite a significant increase in inflationary risks on the back of rising global commodity prices and disruptions to supply chains, the MPC has just slightly revised its inflation projection for different quarters of FY22. For the year as a whole, it expects CPI inflation at 5.1 percent, which appears to be a gross underestimation.

To continue with its effective management of G-Sec yields so as to control the costs of borrowings for both government and the private sector, the RBI has announced another operation under G-SAP 1.0 to purchase government securities worth Rs 40,000 crore on June 17 and also announced G-SAP 2.0 for Q2, FY22 to conduct secondary market asset purchases worth of Rs 1.2 lakh-crore to support the market.

It has included State Development Loans (SDLs) in the G-SAP signalling its intent to make the SDLs an acceptable asset class in its liquidity operations. All these measures will support India's benign interest rate environment unless there is a high impact event in the form of global crude price or the US treasury yield movement.

Furthermore, the RBI has taken important sector-specific measures like on-tap liquidity window (of Rs 15,000 crore) for contact-intensive sectors such as hotels, restaurants, tourism, aviation ancillary services, etc. and enhanced its special liquidity facility to the SIDBI by Rs 16,000 crore to support the refinancing needs of the MSMEs.

The RBI has responded well to the newly-developed stresses in small manufacturing units due to the lockdown restrictions and their negative implications for the asset quality management (NPAs) of the lenders. To grant regulatory relief to lenders, it has expanded the coverage of borrowers under the resolution framework 2.0 and given permission to lenders to restructure loans of up to Rs 50 crore revising upwards its earlier threshold of Rs 25 crore. This loan restructuring is applicable to sectors that have again borne the brunt of the second wave such as the MSMEs, the non-MSME small businesses and individuals who had taken loans for business purposes.

To encourage investment by foreign portfolio investors (FPIs) in India's debt market, the RBI has granted permission to banks to place margins on behalf of their FPI clients for their transactions in government securities, state development loans, treasury bills, etc. within their credit risk management framework. This is expected to promote the ease of doing business for the FPIs.

To help regional rural banks (RRBs) in their short-term resource raising efforts, the RBI has given them permission to issue certificates of deposits (CDs). Further, they are allowed to buy back their CDs before maturity, subject to certain conditions. By facilitating higher flexibility to the RRBs in their liquidity management, the RBI has supported the short-term funding requirements of rural businesses.

To increase customer convenience in the current tough times, the RBI has decided to make available the services of National Automated Clearing House (NACH) on all days of the week. The NACH is a bulk payment system that facilitates one-to-many credit transfers such as payment of dividend, interest, salary, pension, etc. as also collection of payments for utilities (electricity, gas, water, etc).

To conclude, the intense nature of the COVID-19 second wave has prompted the RBI to increase its dovish hold and to do 'whatever it takes' to support economic recovery.

RUPA REGE is Group Chief Economist, L&T Financial Services. Views are personal.

Link: https://www.moneycontrol.com/news/opinion/monetary-policy-committee-flags-the-risks-to-growth-6988461.html