A swift response to the COVID-19 second wave

Rupa Rege | April 07, 2021

With a second COVID-19 wave taking hold in India, the Reserve Bank of India (RBI) has optimally scaled up its monetary policy response by focusing more on the durable economic recovery. The recent surge in coronavirus cases across major states and the consequent semi-lockdowns and restraints have again clouded the growth outlook. According to the April 7 policy document, "Consumer confidence has dipped with the recent surge in COVID infections in some states imparting uncertainty to the outlook".

In spite of this, the monetary policy committee (MPC) has not revised downwards the growth outlook either for Q4, FY21 or for FY22. Yet the RBI has taken every possible measure to keep liquidity and borrowing costs in a comfortable zone to protect the investment sentiment. For example, for FY22, the RBI has decided to put in place a secondary market G-Sec acquisition programme (G SAP 1.0) to enable an orderly evolution of yield curve amid comfortable liquidity conditions. It has even announced the OMO calendar (responding to the bond traders' long-pending demand) of Rs 1 trillion in Q1, FY22 under the G SAP 1.0 programme.

Additionally, it has extended the targeted long-term repo operations for specific sectors by six months and further increased liquidity support to All India Financial Institutions such as NABARD, SIDBI, NHB and EXIM Bank by Rs 500 billion for fresh lending during FY22. These measures along with other announcements such as permission to banks to on-lend through the NBFCs, enhancement of the loan limit under Priority Sector Lending backed by Negotiable Warehouse Receipts and the extension of priority sector tag for the NBFC loans, etc. would protect the borrowing momentum in the system. Here, the RBI explicitly recognises the key role played by the NBFCs in making credit available to the last mile.

Another growth-supportive measure taken by the RBI is the enhancement of the borrowing limit for state governments under Ways & Means Advances (WMA) by 46 percent and continuation for another six months the higher limits announced last year. This will facilitate state governments to meet their prior spending commitments in the absence of expected revenue generation and likely increase in their ad hoc spending due to the resurgence of the pandemic.

To provide relief to pandemic-hit companies that had borrowed from the overseas markets but could not use the proceeds due to lockdown, the RBI has given them permission to park the proceeds (drawn down before March 1, 2020) in term deposits with banks in India prospectively up to March 1, 2022. This 'relief' is given as a one-time measure.

Interestingly, the April 7 MPC document is more vocal on risks to inflation than to economic growth. According to its assessment, inflation risks have been originating from high international commodity prices, increased logistics costs and rising inflation expectations of urban households. However, even after taking into consideration all these risk factors, the MPC has not revised much of its inflation projections between the February policy and the April policy.

As regards liquidity management operations, the RBI has decided to conduct Variable Rate Reverse Repo (VRRR) auctions of longer maturity (greater than the existing 14-day) as recommended by its revised liquidity management framework. According to fixed income experts, this may put pressure on the shorter end of the curve but is not expected to shift the overnight rates above the reverse repo rate of 3.35 percent at least in the coming six months.

The Governor too clarified in the press meet that this measure should not be read as liquidity tightening. In fact, by paying a higher rate of interest on liquidity absorptions through the VRRR auctions, the RBI is indirectly expanding liquidity.

All in all, to balance the conflicting trajectories of inflation (with an upside bias) and economic growth (with a downside bias), the RBI has relied on smart management of liquidity to keep the costs of borrowings low for both the government and the private sector. It has refrained from giving any revised projections on growth and inflation despite the warning signals given by a few high-frequency data indicators, as rising Covid infection rates and restrictions have again clouded the economic outlook. At this stage, the RBI's role as a "lender of the last resort" has become critically important.

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