Our View

RBI's policy announcement – hitting all the right chords!

During difficult times, as we are witnessing at present, people often have many expectations from the government and the regulator. It is also incumbent upon the regulators and policy makers to look after the interests of all their stakeholder in such tough times. Through today's credit policy, the Governor RBI has been able to provide something for everyone.

Putting to rest the debate on growth v/s inflation, the RBI has articulated its policy extremely well. Given the current situation, revival of the economy will be a priority for them. The MPC has decided to look through the current inflation hump as transient and address the more urgent need to revive growth and mitigate the impact of the pandemic on economy. However, they are keeping an eye on inflation and expect it to come down within the targeted range by Q3-Q4 of FY2021. Therefore, the overall policy announcements should be viewed in the context of focus on growth. Further, the central bank well knows that the Government does not have too much headroom on the fiscal front now given that the revenue is coming down and the expenditure is going up. Therefore, its important to support the economy through monetary policies rather than through fiscal stimulus.

To ensure better participation by banks in government borrowing program, the central bank has extended the facility of up to 22% SLR securities to be held on the Held to Maturity (HTM) basis. This extension up to March 31, 2022 will reduce the risk of mark-to-market for banks on such investments, enabling them to participate in the enhanced Government borrowing program. Additionally, the size of Open Market Operations (OMOs) will be increased to 20,000 crores which will further ensure liquidity in the system and reduce the pressure on the yield curve. Both these measures together should easily see through the government borrowing program for the rest of the year.

As we know, the State Government Finances are also extremely stretched. To facilitate the borrowing by the State Government, for the first time the Central Bank has announced OMOs in State Development Loans (SDLs). This is an extremely innovative method suggested by RBI which will also facilitate efficient pricing for the States.

To facilitate liquidity to sectors that require support, RBI has announced on-tap TLTRO with tenors of up to three years for a total amount of up to Rs. 1,00,000 crores at a floating rate linked to the policy repo rate. This scheme will be available up to March 31, 2021.

In a boost for the housing and real estate sector, RBI has changed the risk weights on housing loans to individuals. Under the current framework, differential risk weights are applicable to individual housing loans, based on the size of the loan as well as the loan-to-value ratio (LTV). RBI has now rationalized the risk weights for all new housing loans sanctioned up to March 31, 2022 and linked them to LTV ratio only. This will facilitate cheaper home loans and give a fillip to the real estate sector.

It is noteworthy that while being very focused on the immediate task of managing growth through monetary measures, RBI has not lost sight of long-term structural initiatives. While RBI had already introduced a 24x7x365 National Electronic Funds Transfer (NEFT) system, the proposal to implement Round-the-Clock Real Time Gross Settlement (RTGS) System will enable a swift and seamless payment in real-time for domestic businesses and institutions. This will make us one of few countries in the world to have this facility and will give a big boost to the ease of doing business. Apart from Hong Kong and Australia, which have a 24X7 equivalent of RTGS, even other major economies like the USA and UK do not have such an efficient system yet. Also, Hongkong's Faster Payments System (FSP) allows 24x7 payments but is not exactly equivalent to RTGS as there is a limit on payment. Of course, RBI will have to revise the framework to account for the impact of this facility on fund management by banks and their CRR.

Using monetary tools to boost growth and to address some of the immediate needs, and at the same time focusing on long-term strategic projects, the policy statement is indeed powerful.

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