Our Views

In RBI's inflation-growth balancing, growth is big winner in this round

Against the backdrop of an elevated inflation, RBI's focus on reviving growth on a durable basis and mitigating the impact of COVID-19 on the economy seems to be holding the catbird seat. The RBI re-stated its commitment to support growth by maintaining an accommodative stance and retaining status quo on the policy rates. The CPI inflation was 7.6% in October, 2020, and the RBI has also revised its outlook for inflation upwards from its previous guidance to 6.8% for Q3 and 5.8% for Q4, 2020. Normally, with this kind of elevated inflation scenario, the regulator would have treaded a more careful path. However, given the extraordinary situation, the RBI decided to give growth a priority over immediate price stability.

Is growth back on track?

RBI's estimate for the real GDP growth is at -7.5% for 2020-21. This implies that in the last two quarters of this fiscal year the economy should bounce back in the positive territory. If these estimates are a true reflection of things to come, we are certainly headed for a "v" shaped recovery. High frequency indicators, like a bumper agriculture production, double digit growth in passenger vehicles & motorcycle sales, increase in railway freight traffic, and higher electricity consumption in October, also point to a recovery gaining traction.

Liquidity support to targeted sectors

As a part of the on-tap TLTRO announced in Oct-20, which remains operational until March 31, 2021, only 5 sectors were eligible. Given that the success of this TLTRO was not very encouraging, RBI has now expanded its coverage to include other stressed sectors in synergy with the credit guarantee available under the Emergency Credit Line Guarantee Scheme of the Government. This will encourage banks to extend credit support under the ambit of on-tap TLTRO at a lower cost to 26 stressed sectors identified by the Kamath Committee and the healthcare sector.

Support to Regional Rural Banks (RRBs)

Even as the market is flushed with liquidity, the Regional Rural Banks (RRBs) are in need of liquidity support. To address this, for the first time, RRBs are being allowed to access the Liquidity Adjustment Facility (LAF) and Marginal Standing Facility (MSF) extended by RBI.

Robust payment and settlement systems

Followed by RBI's 'Statement on Developmental and Regulatory Policies' in October this year, the RTGS system will soon be made 24x7. This is likely to start from December 14, 2020. Once implemented, this will reduce settlement and default risk in the system and make the payments eco system more efficient. With this all payment settlements of AePS, IMPS, NETC, NFS, RuPay, and UPI transactions will happen on all days of the week. With the start of this new facility, India will become one of the very few countries such as Hong Kong and Australia to have a 24x7x365 large value real-time payment system.

Draft guidelines on Credit Default Swaps

The heads-up on the draft directions to facilitate the development and deepening of the credit derivatives market is quite welcome. It will go a long way in ensuring a vibrant market for corporate bonds, especially for lower rated issuers. However, it will be critical to ensure high standards of governance for efficient implementation.

Cash conservation of financial institutions

Another important announcement today was with regards to conservation of capital by banks. The RBI directed commercial banks and co-operative banks to retain the profits of the current year and not make any dividend pay-out from the profits pertaining to the current financial year.

Recognizing the importance of NBFCs, a similar extension is envisaged in the expected draft guidelines. It is expected to put in place a transparent criterion for declaration of dividends by various categories of NBFCs. This review is essential given the rapid development of NBFCs in the last few years, resulting in significant size and interconnectedness of this sector.

In conclusion

All things considered, the policy outlook is highly supportive of growth and is in-line with the street expectations. This is clearly visible in the equity markets' reaction with the BSE Sensex Index touching the 45,000 mark which has not been witnessed in this last year. Therefore, a positive GDP growth, low interest rates, liquidity & easy of financing, recovery of high frequency indicators, and a highly committed central bank has absorbed the extreme trepidation in the economy, driving hopes for a rapid and swift recovery.

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