Monetary Policy: RBI

Why in News

Recently, the **Monetary Policy Committee** (MPC) of the **Reserve Bank of India** (RBI) has left the **repo rate unchanged** and **maintained an accommodative policy stance** as it prioritised support for the economy's recovery over inflation amid the **Covid-19 pandemic.**

- It has also announced various other **liquidity management measures** and steps to **improve regulatory oversight** of the financial system.
- The MPC is a **statutory and institutionalized framework** under the **RBI Act 1934,** for maintaining price stability, while keeping in mind the objective of growth. It **determines the policy interest rate** (repo rate) **required to achieve the inflation target** (4%).

Key Points

- **Repo Rate:**
    - The MPC has kept the RBI's key lending rate, the **repo rate, steady at 4%** and **reverse repo rate** at **3.35%.**
        - The **repo rate,** also known as the **policy rate,** is the interest rate at which the RBI provides loans to banks.
        - The **reverse repo** is the rate at which commercial banks park their money with the central bank.
    - It has left key policy rates **unchanged for the third time in a row** in the wake of persistently high retail inflation, even as it pointed to the economy, which contracted in the last two quarters, showing signs of early recovery.
    - The central bank has **slashed the repo rate by 115 basis points** (bps) **since late March** to cushion the economy from the fallout of the Covid-19 and the resultant **lockdowns.**

        Generally, **a low repo rate translates into low cost loans** for the general masses.

- **GDP Projections:**
  - The real **Gross Domestic Product** (GDP) for FY 2020-21 has been projected at **-7.5%.**
    - **Real GDP** is an **inflation-adjusted measure** that reflects the value of all goods and services produced by an economy in a given year.
  - However, with the country gradually opening up after the lockdown and the improvement in activity in the second quarter, GDP is expected to **expand by 0.1% in the December quarter** and **0.7% in the March quarter.**
    - **GDP growth contracted by 23.9%** in the Q1 of 2020 compared to the same period (April-June) in 2019.
- **Inflation:**
  - **Inflation** still remains a concern for policymakers as the **supply-side bottlenecks had fuelled inflation and large margins were being charged** to the consumer.
  - **Cost push pressure or cost push inflation** continue to impinge on core inflation, which has not changed much and could firm up as economic activity normalises and demand picks up.
    - **Cost-push Inflation:** Spurt in production prices of certain commodities also causes inflation as the price of the final product increases.
    - **Core Inflation:** It **excludes volatile goods** from the basket of commodities tracking **Headline Inflation.** These volatile commodities mainly comprise **food and beverages** (including vegetables) and **fuel and light (crude oil).**
  - RBI **projected retail inflation to average 6.8% in Q3,** before moderating to 5.8% in Q4 and 5.2% to 4.6% in the first half of the fiscal year 2021-22, with risks broadly balanced.
  - This **constrains monetary policy at the current juncture from using the space available to act in support of growth.** At the same time, the signs of recovery are far from being broad-based and are dependent on sustained policy support.
  - **Consumer Price Inflation** (CPI) at a **six-year high of 7.6% in October,** which is well above its medium target level of 4% within a band of plus/minus 2%.
- **Accommodative Stance:**
  - The MPC had decided to **continue with the accommodative stance** as long as necessary, at least during the current financial year and into the next financial year, to **revive growth on a durable basis and mitigate the impact of Covid-19** on the economy.

- **Risk-based Internal Audit Norms:**
  - RBI has announced the introduction of **risk-based internal audit norms** for large **Urban Cooperative Banks** (UCBs) and **Non-Banking Financial Companies** (NBFCs), as part of measures aimed at **improving governance and assurance functions** at supervised entities.
  - The RBI also moved to harmonise the guidelines on the **appointment of statutory auditors** for commercial banks, UCBs and NBFCs in order **to improve the quality of financial reporting.**
  - It had been decided **to put in place transparent criteria for the declaration of dividends by different categories** of NBFCs.
  - With a view to deepening financial markets, **regional rural banks** would be allowed to access the **Liquidity Adjustment Facility** (LAF) and **Marginal Standing Facility** (MSF) of the RBI, as also the call/notice money market.
    - **LAF** is a tool used in monetary policy by the RBI, that allows banks to borrow money through repurchase agreements (repos) or for banks to make loans to the RBI through reverse repo agreements.
    - **MSF** is a window for scheduled banks to borrow overnight from the RBI in an emergency situation when interbank liquidity dries up completely. Under interbank lending, banks lend funds to one another for a specified term.
- **Digital Payment Security Controls Directions:**
  - To significantly improve the ecosystem of digital payment channels with robust security and convenience for users, the RBI has **proposed to issue Digital Payment Security Controls directions for the regulated entities.**
  - These directions will **contain requirements for robust governance, implementation and monitoring of certain minimum standards** on common security controls for channels like Internet and mobile banking and card payments.

- **Targeted Long-Term Repo Operations:**
  - RBI has decided to **bring the 26 stressed sectors identified by the Kamath Committee within the ambit of sectors eligible under on tap Targeted Long-Term Repo Operations** (TLTRO), providing **more liquidity** to the slowdown-hit economy.
    - The RBI had announced the TLTRO on Tap scheme in **October 2020,** which will be available up to **31st March 2021.**
    - Accordingly, it was decided to conduct on tap TLTRO with **tenors of up to three years for a total amount of up to Rs. 1 lakh crore** at a floating rate linked to the policy repo rate with flexibility to enhance the amount and period after a review of the response to the scheme.
  - Under TLTRO, banks can **invest in specific sectors through debt instruments** like **corporate bonds, commercial papers and non-convertible debentures** (NCDs) to push the credit flow in the economy.
  - As part of the **Aatmanirbhar Bharat Package 3.0**, the Centre launched the **Emergency Credit Line Guarantee Scheme 2.0** (ECLGS 2.0).
    - Under it, the corpus of Rs. 3 lakh crore of existing ECLGS 1.0 was extended to provide 100% guaranteed collateral-free additional credit to entities in 26 stressed sectors identified by the Kamath panel.
  - According to the RBI, **banks are encouraged to synergise the two schemes by availing funds from RBI under on tap TLTRO and seek guarantee under ECLGS 2.0** to provide credit support to stressed sectors.

Source: TH