RBI Monetary Policy 2021

Why in News

Recently, the **Reserve Bank of India (RBI)** has forecasted that real **Gross Domestic Product (GDP)**, hit by the **Covid pandemic** in 2020-21, is expected to grow by **10.5% in 2021-22.**

RBI had previously introduced a number of measures in its **Monetary Policy Report** for dealing with the **Covid-19 induced economic setback.**

Key Points

- **GDP Forecast:**

  The **10.5% real GDP growth in 2021-22** forecasted by RBI will move in the range of 26.2 to 8.3% in the first half and 6% in the third quarter of 2021.

  - Hit by **lockdown** and closures of industries, GDP had contracted by **23.9% in the June quarter of 2020-21** and **fell by 7.5% in the September quarter of 2020-21.**
  - **Real GDP** is a measurement of economic output that accounts for the effects of inflation or deflation.

    The **difference between nominal GDP and real GDP** is the adjustment for inflation. Since nominal GDP is calculated using current prices, it does not require any adjustments for inflation.

- **Reasons for a Positive Outlook:**
  - **Rural demand is likely to remain resilient** on good prospects of agriculture.
  - **Urban demand** and demand for contact-intensive services is **expected to strengthen with the substantial fall in Covid-19 cases and the spread of vaccination.**
  - Consumer **confidence is reviving,** and business expectations of manufacturing, services and infrastructure remain upbeat.
  - The fiscal stimulus under **AtmaNirbhar 2.0 and 3.0 schemes** of the government will likely accelerate public investment.
  - The **Union Budget 2021-22**, with its thrust on sectors such as health and well-being, infrastructure, innovation and research, etc. should help accelerate the growth momentum.
- **Unchanged Policy Rates:**
  - The RBI has kept the **repo rate** under the **Liquidity Adjustment Facility (LAF)** unchanged at 4%.
  - The **reverse repo rate under the LAF remains unchanged at 3.35%** and the **Marginal Standing Facility (MSF)** rate and the **Bank Rate at 4.25%.**
- **Other Decisions:**
  - **Cash Reserve Ratio (CRR):**
    - The RBI has decided to restore the **CRR** in a non-disruptive manner from 3% to 4% in two stages by May 2021.
  - **Direct Retail Investment in Government Securities (G-Sec):**
    - The RBI has proposed to **allow small investors direct access to the G-Sec platform.**
      - A **G-Sec** is a **tradable instrument** issued by the Central Government or the State Governments and is considered to be the **safest form of investment.**
- **Accommodative Stance:**
  - The **Monetary Policy Committee (MPC)** of the RBI also decided to continue with the **accommodative stance** as long as necessary to revive growth on a durable basis and mitigate the impact of Covid-19 on the economy, while ensuring that inflation remains within the target going forward.
  - These decisions are in consonance with the objective of achieving the medium-term target for **Consumer Price Index (CPI)** inflation of 4% within a band of +/- 2 %, while supporting growth.
    - The CPI **calculates the difference in the price of commodities and services** such as food, medical care, education, electronics etc, **which Indian consumers buy for use.**
    - The **CPI has several sub-groups** including food and beverages, fuel and light, housing and clothing, bedding and footwear.

Monetary Policy Committee

- **About:**
  The Monetary Policy Committee is a **statutory and institutionalized framework under the Reserve Bank of India Act, 1934,** for maintaining price stability, while keeping in mind the objective of growth.
- **Formation:**
  An RBI-appointed committee led by the then deputy governor **Urjit Patel** in 2014 recommended the establishment of the Monetary Policy Committee.
- **Chairman:**
  The **Governor** of RBI is **ex-officio Chairman of the committee.**
- **Members:**
  The **committee comprises six members** (including the Chairman) - **three officials of the RBI and three external members nominated by the Government of India.**
- **Decisions :**
  Decisions are taken by majority with the Governor having the casting vote in case of a tie.
- **Function:**
  The MPC determines the policy interest rate (repo rate) required to achieve the **inflation** target (4%).

Key Terms

- **Repo and Reverse Repo Rate:**
  - **Repo rate** is the rate at which the central bank of a country (Reserve Bank of India in case of India) lends money to commercial banks in the event of any shortfall of funds. Here, the **central bank purchases the security.**
  - **Reverse repo rate** is the rate at which the RBI borrows money from commercial banks within the country.
- **Liquidity Adjustment Facility (LAF):**
  It 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.
- **Bank Rate:**
  It is the **rate charged by the RBI for lending funds to commercial banks.**
- **Marginal Standing Facility (MSF):**
  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.
- **Cash Reserve Ratio (CRR):**
  Banks are required to hold a certain proportion of their deposits in the form of cash. This minimum ratio (that is the part of the total deposits to be held as cash) is stipulated by the RBI and is known as the CRR.

Source:IE