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RBI MONETARY POLICY

JUNE 2021

HIGHLIGHTS

MPC holds rates, indicates prolonged pause despite slightly higher inflation

RBI's Second Bi-monthly Monetary Policy Review: 2021-22

The MPC unanimously held rates and retained its accommodative stance – adding that it would seek to revive and sustain growth on a durable basis, given the second wave effects while ensuring that inflation remains within target going forward.

Policy Actions

Repo, Reverse repo, MSF & Bank rate also kept steady, CRR held constant at 4%

GROWTH-INFLATION DYNAMICS

RBI revised its inflation projection slightly higher at 5.1% for FY22, with Q1 retained at 5.2%, Q2 at 5.4% vs 5.2% previously Q3 at 4.7% from 4.4% previously and Q4 at 5.3% from 5.1% previously.

Risks from higher global commodity prices and logistics costs were noted.

The MPC called for GOI to reduce taxes on fuel as well as measures to address food supply chain constraints and ramp up vaccination.

Due to the prolonged second wave, the MPC revised GDP growth for FY22 to 9.5% from 10.5% earlier, with limited downside risks seen from the second wave.

This follows from better adaptability of COVID protocols, favourable financing conditions and strong global recovery – and is corroborated by incoming data showing a much milder contraction than the last year.

LIQUIDITY AND EXTERNAL SECTOR

FY22 opened with very comfortable liquidity, but limited government spending and restoration of CRR to 4% led the surplus reduce. The RBI attempted to offset this through G-SAP, but was unable to fully offset lower intervention.

RBI is expected to continue to keep liquidity conditions surfeit through various tools in its kit.

Global economy has been gaining momentum, propelled by extraordinary fiscal and monetary stimulus in the DMs.

The EM recovery appears uneven, with subsequent waves of COVID and limited policy space for higher stimulus.

Inflation has been firming up on higher global food and commodity prices - this has led to a noticeable impact on inflation expectations.

POLICY STANCE AND GUIDANCE

The MPC indicated an accommodative stance as long as it is necessary to revive and sustain growth and mitigate the impact of pandemic on the economy while ensuring inflation remains within target.

Governor Das also said that the central bank would use all possible tools in its command and support growth- indicating that any eventual normalization is many months away.

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order since lockdown.

Date	Measures Announced
March 27, 2020	• Repo Rate cut by 75 basis points to 4.4%; • Reverse Repo Rate cut by 90 basis points to 4%; • Cash Reserve Ratio (CRR) cut by 1% to 3% for a period of 1 year. • TLTRO (Targeted Long-Term Operations) for Rs 1 tn, for upto 3 years • MSF window extended to 3% from 2% of NDTL, • 3-month moratorium on payment of interest of all term loans, • 3-months deferment of interest on working capital facilities, • NFSR implementation delayed by 6 months and banks permitted to trade in NDF from 30 June.
March 27, 2020	First TLTRO for Rs. 250 bn
April 3, 2020	Second TLTRO for Rs. 250 bn
April 7, 2020	RBI increased tenor allowed for states/UTs overdraft to 21 consecutive working days from 14 days previous, and to 50 working days in a quarter from 36 days previous
April 9, 2020	Third TLTRO for Rs. 250 bn
April 17, 2020	• Reverse repo cut by 25 bps to 3.75%; • TLTRO 2.0 of Rs 500 bn, for small and mid-sized NBFC and MFIs; • LCR requirements of SCBs cut from 100% to 80%, • Special refinance of Rs 500 bn to NABARD, SIDBI and NHB, • Hike in WMA (Ways & Means Advances) limit for states by 60% over and above the levels as on 31 Mar until 30 Sep. • NPA classification will exclude 3-month moratorium period till May end • NBFCs' loans to delayed commercial real estate projects can be extended by a year without restructuring;
April 20, 2020	RBI enhances WMA limit for remaining part of H1-FY21 to Rs 2 trillion.
April 27, 2020	Announces special 90-day repo liquidity facility for MFs up to Rs 500 bn.
May 22, 2020	• Repo Rate cut by 40 basis points to 4%; • Reverse Repo Rate cut by 40 basis points to 3.35%; • Extends moratorium on term loan repayments for 3 months. • To support exports/imports, RBI has increased pre and post-shipment credit facility and extended line of credit for Rs 150 bn to EXIM bank for 90 days. • Rs 150 bn facility created for SIDBI to be extended by another 90 days. • Permits banks to extend margins on working capital facilities to original levels by 31 March 2021 and group exposures of banks to be increased from 25% to 30% of eligible capital base by 30 June, 2021.

KEY MEASURES ANNOUNCED BY THE RBI

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Date	Measures Announced

August 6, 2020	• Policy Rates Unchanged
	• Rs. 10,000cr at repo rate to NABARD and NHB
	    • Rs. 5,000cr to NHB to support HFCs (after the Rs. 10,000cr already given),
	    • Rs. 5,000cr to NABARD (after the Rs. 25,000cr already given) to refinance small NBFCs and MFIs
	• The RBI to amend priority-sector lending guidelines to remove regional disparity -- a higher weight would be accorded to districts with lower credit flows.
	• To provide a window under the 'prudential framework on resolution of stressed assets' dated 07 June 2019 to enable lenders to implement a resolution plan for eligible corporate exposures (without change in ownership) and personal loans, while classifying such loans as standard and subject to specific conditions.
	• Restructuring MSME debt so that stressed MSMEs can utilise this provided their accounts with the concerned lender were classified as standard as on 01 March 2020 but this will have to be implemented by 31 March 2021. (Already in place if account was standard as on 01 Jan 20).
	• Maximum loan-to-value of loans sanctioned by banks against gold ornaments & jewellery for non-agricultural purposes, which is currently 75%, has been increased to 90%.
	• Banks investment in debt MFs and debt ETFs will be treated consistently with direct debt investments in terms of capital allocation.

October 9, 2020	• Policy Rates Unchanged • WMA limit for the Centre has been kept at Rs.1.25 lakh crore compared to Rs.35,000 crore in H2FY20. The 60% WMA limit for states has been extended till March 31, 2021. • RBI to up the size of the OMO Purchases to Rs.20,000 crore from Rs. 10,000 crores. • To conduct on tap TLTRO with tenors upto 3 years for upto Rs.1 Lakh crore at floating rate linked to policy rate available up to March 31, 2021. • TLTRO funds availed by banks to be deployed in corporate bonds, commercial papers and non convertible debentures issued by entities in specific sectors. • To conduct OMOs in State Development Loans (SDL) to rationalize spreads over G-sec.

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October 9, 2020	• Enhanced SLR holdings in HTM category (increased from 19.5% to 22% in September 2020) of NDTL of banks, acquired between 1st September 2020 to 31st March 2021, will be applicable till 31st March 2022.
	• To discontinue system-based automatic caution listing of Exporters.
	• Allowed banks to increase exposure to retail individuals or small business (with turnover of upto Rs 50 crore) from Rs.5 crore to Rs.7.5 crore.
	• To rationalise the risk weights and link them to LTV ratios only for all new housing loans sanctioned up to March 31, 2022.
	• To extend scheme for Co-lending to all NBFCs including HFCs.
	• Other Measures
	  • Round-the-clock availability of RTGS on all days from December 2020.
	  • To grant authorisation for all PSOs (new applicants as well as existing PSOs) on a perpetual basis from earlier limited periods of up to five years.

December 4, 2020	• On Tap TLTRO - will be expanded to cover other stressed sectors in synergy with the credit guarantee available under the Emergency Credit Line Guarantee Scheme (ECLGS 2.0). • Regional Rural Banks (RRB) will be allowed to access the Liquidity Adjustment Facility (LAF) and Marginal Standing Facility (MSF) of the RBI; and also the Call money market. • Scheduled commercial banks & cooperative banks shall not make any dividend pay-out from the profits of FY20. • Formulate guidelines on dividend distribution policy by NBFCs. • Issue guidelines to large UCBs, NBFCs for adoption of Risk-Based Internal Audit. • Harmonise guidelines on appointment of statutory auditors for commercial banks, UCBs and NBFCs. • Proposed to issue Reserve Bank of India (Digital Payment Security Controls) Directions, 2020 for regulated entities to set up a robust governance structure and implement common minimum standards of security controls for channels like internet, mobile banking, card payments, among others. • Revised draft directions to be issued for credit default swaps. • Revides draft guidelines for derivatives to be issued. • Discussion paper on supervision of NBFCs based on size to be issued in January.

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Measures announced in chronological order since lockdown.

Date	Measures Announced
February 5, 2021	• TLTRO on Tap scheme extended to NBFCs for incremental lending to the specified stressed sectors. • Restoration of CRR in two phases beginning March 2021 (increase to 3.5% on March 27 and 4% on May 22, 2021) • Additional 1% of NDTL dispensation given on statutory liquidity ratio (SLR) for availing funds under the marginal standing facility (MSF) extended by 6 months to end September 30, 2021. • Extension of HTM limits (upto 22% of NDTL) upto March 31, 2023 from March 31, 2020 (to include securities acquired between April 1, 2021 and March 31, 2022). • Defer the implementation of last tranche of the Capital Conservation Buffer (CCB) of 0.625 per cent and also defer the implementation of Net Stable Funding Ratio (NSFR) by another six months from April 1 to October 1, 2021. • Retail investors are being allowed to open gilt accounts with RBI. • Encouraging foreign portfolio investments in defaulted bonds by exempting these investments from short term limit and the minimum residual maturity requirement.
April 7, 2021	• To conduct VRRR auctions of longer maturity. The amount and tenor of these auctions will be decided based on the evolving liquidity and financial conditions • To purchase Rs.1 lakh crore of G-secs under G-SAP in Q1 • Extension of the deadline for the TLTRO scheme by 6 months to September 30. • Fresh lending of Rs.50,000 crore to all Indian financial institutions like NABARD, NHB and SIDBI to maintain a continuous flow of credit. • Extended the use of central payment systems like RTGS and NEFT to non-banking service providers like PPIs and trade platforms regulated by the RBI. • Maximum end-of-day balance for payments banks increased from Rs.1 lakh to Rs.2 lakh. • Committee will be formed to review the working of ARCs • Enhancing ways & means advance (WMA) limit to Rs.47,010 crore, up 46% from current limit of Rs.32,225 crore • Bank lending to NBFCs for on-lending to PSL will be extended till September 30, 2021.

KEY MEASURES ANNOUNCED BY THE RBI

Measures announced in chronological order since lockdown.

Date	Measures Announced
May 5, 2021 (Measures announced outside MPC meeting)	• On-tap liquidity window of ₹50,000 crore with tenors of up to three years at the repo rate is being opened till march 31, 2022 to ease access to emergency health services. • SLTRO of ₹10,000 crore at repo rate for the SFBs, to be deployed for fresh lending of up to ₹10 lakh per borrower till October 31, 2021. • SFBs are now being permitted to reckon fresh lending to smaller MFIs (with asset size of up to ₹500 crore) for on-lending to individual borrowers as priority sector lending up to March 31, 2022. • Credit disbursed to MSME borrowers (upto 25 lakh) up to the fortnight ending October 1, 2021 extended till December 31, 2021. • Individuals, small businesses and MSMEs having aggregate exposure of upto ₹25cr eligible under Resolution Framework 2.0 for restructuring. • Individual borrowers, small businesses who have availed restructuring of their loans under Resolution Framework 1.0 can increase the moratorium and/or extending the residual tenor up to a total of 2 years. • Banks are allowed to utilise 100% of floating provisions/ countercyclical provisioning buffer held ason Dec 31,2020 for making specific provisions for NPA with prior approval of their board is permitted up to Mar 31,2022. • The max no. of days of OD in a qtr is being increased from 36 to 50 and the no. of consecutive days of OD from 14 to 21 for state govts.
June 4, 2021	• On-tap liquidity window for Contract-intensive sectors (tourism, travel agents, tour operators, adventure/heritage facilities, aviation ancillary services) to the tune of Rs. 15,000 crores with tenors of up to 3 years at repo rate until March 31, 2022. Banks can park their surplus liquidity upto the size of the loan book created under the scheme with RBI under reverse repo window at 40 bps higher than the reverse repo rate. • Special Liquidity facility to SIDBI to an extent of Rs. 160,000 crores to facilitate short and medium-term credit needs of MSMEs. • Enhancement of aggregate exposure for restructuring under Resolution Framework 2.0 to Rs. 50 crores as against Rs. 25 crores earlier. • Permitted Authorised Dealer banks to place margins on behalf of their FPI clients for their transactions in G-secs (including SDL and Treasury Bills), within the credit risk management framework of banks. • Permitted Regional rural banks to issue CDs to eligible investors. Banks have been allowed to buy back issued CDs ahead of the redemption date to ensure greater flexibility in liquidity management. • NACH will be available all days of the week.

IMPACT ON THE MUTUAL FUND INDUSTRY:

Liquid Funds:

These schemes will continue to generate returns around the operating rate due to their portfolio composition i.e. being invested at the shorter end of the money market segment. Liquid funds have low average maturity as they concentrate more on high quality papers including CPs, CDs and other debt securities with residual maturity of upto 3 months.

Ultra Short Term / Low Duration / Money Market Funds (Maturity Up to 1 Year):

These schemes predominantly invest in below 1 year maturity paper. The strategy adopted by these schemes is to hold the paper till maturity and capitalize on the running yield. Hence, returns in this category will continue to remain relatively attractive depending on the positioning of the fund.

Short Duration Funds:

Schemes in this category are predominantly invested in Corporate Bonds, CPs and CDs while a few of them also have some exposure to G-Secs. We continue to remain bullish at the shorter end of the curve. Investors may consider these funds (with the investment horizon commensurate with the maturity profile of such funds) and gain from current accruals.

Medium Duration Funds:

Given the current steepness in the curve there are reasonable opportunities in the intermediate duration (3-5 years) segment. Till the time RBI is managing the yield curve, the steepness of the curve may provide cushion even if there are mark-to-market losses. Investors may consider those funds with high quality portfolios and where the investment horizon is commensurate with the maturity profile of the fund and also gain from current accruals.

Credit Risk Funds:

We remain cautious on Credit Risk Funds as there could be further erosion of NAVs and hence returns due to a mark-to-market impact (timing mismatches, further possible downgrades, etc). It will also depend on the liquidity conditions in the market and redemption pressure on these funds. Thus, we think there is an elevated systemic risk in the market within the credit space. Hence, it makes sense for one to stay away from these funds at the current juncture till the dust settles or risks in the credit markets shows signs of waning.

IMPACT ON THE MUTUAL FUND INDUSTRY:

Long Term Income Funds / Gilt Funds / Dynamic Bond Funds:
Bonds continued their positive performance since the last policy, albeit the curve witnessed some steepening bias as the market participants pushed back the possibility of RBI's exit from the extra-ordinary accommodative measures to late 2021 due to the onset of second Covid-19 wave. Additionally, Rs.1 trillion OMO purchase (GSAP 1.0) announced by the MPC for Q1FY22 was taken positively by the market. Cancellation of the 5 year and 10-year auctions triggered short covering rallies and announcement of Rs. 100 billion operation twist on top of the GSAP 1.0 purchase program boosted the market sentiment. The RBI's GSAP auctions and the continuing implicit yield curve control strategy has kept the benchmark 10y sovereign bond yield anchored around 6% in the recent period.
In the wake of the pandemic, Mr Das in an unscheduled meeting in first week of May listed a number of liquidity boosting measures. He also added that the RBI will continue monitoring the emerging situation and deploy the necessary resources to mitigate the impact of the second wave. The MPC has unanimously decided to keep the rates unchanged while maintaining an 'accommodative stance' as long as necessary to mitigate the impact of the COVID-19 pandemic. The forecast of a normal south-west monsoon, the resilience of agriculture and the farm economy, the adoption of COVID compatible operational models by businesses, and the gathering momentum of global recovery are factors that can provide tailwinds to revival of domestic economic activity when the second wave abates. On the other hand, the spread of COVID-19 infections in rural areas and the dent on urban demand poses downside risks. Ramping up the vaccination drive and bridging the gaps in healthcare infrastructure and vital medical supplies can mitigate the pandemic's devastation.
The central bank, which were expecting the economy to expand by 10.5% in the current fiscal, has lowered their projections to 9.5% for FY22 after a slew of recent high-frequency indicators showed a hit to economic activity. It's current reading is underpinned by expectations of a normal monsoon, a return of pent-up demand once lockdowns end and an improved pace of vaccination. Additionally, with external demand strengthening, a rebound in global trade is taking hold and should support India's export sector.
The Central bank said CPI inflation trajectory is likely to be shaped by uncertainties impinging to both upside and downside pressures. The rising trajectory of international commodity prices (esp. crude), together with logistics costs, pose upside risks to the outlook. Food inflation trajectory is likely to get help from the normal south-west monsoon season and coordinated reduction of domestic taxes on petroleum products shall help ease the input cost pressure.

IMPACT ON THE MUTUAL FUND INDUSTRY:

With declining infections, restrictions and localised lockdowns across states could ease gradually and mitigate disruptions to supply chains, reducing cost pressures. Liquidity normalization is likely to be delayed given the emerging threats to the economic activity due to COVID-19 second wave. This has so far been reflected by the lack of any longer term VRRR auctions as well as liquidity infusions so far, neutralizing the impact of the unwinding of the CRR reduction. The fall in bond yields in India could also be due to a decline in the US Treasury yields. Going forward the RBI may have to do a fine balancing act between the economic growth, yield management along with managing inflation.
The yield curve is already very steep, even if the 10y point (which has been suppressed by a combination of OMOs, auction cancellations and devolvements) is taken as a spread over the 1y point. This is to be expected going into a recovery, but will likely steepen further if the full extent of supply is left to the markets and the turning of the cycle becomes imminent. The RBI is likely to limit movements in this yield for a time, until conditions are more certain. Even then, the 10y yield is likely to be allowed to rise only gradually (or evolve in an orderly fashion). The bond yields may remain in a tight range in the near future supported by the RBI's bond purchases and over the medium term, inflation and potential monetary policy normalization will play a more important role. Beyond the near - term pandemic concerns, we believe that we are at the fag-end of the interest rate cycle. Given the high uncertainty over the interest rate trajectory, it would be prudent to remain constructive on the shorter end of the yield curve. With the economies healing in India and the world over, growth should continue to pick up (albeit a bit unevenly), and accordingly inflationary expectations and interest rate cycle will need to be recalibrated. It is expected that the RBI shall take requisite measures going forward to support growth and ensure surplus liquidity in the banking system, with a dual objective of improving the financial conditions and managing the yield curve.
(P.S.: The 10 Year benchmark were trading in a tight range of 5 bps since last policy. Today (5.85% GS 2030) is up by 3 bps to 6.0272% at the close).

Conservative Hybrid Funds-CHF *(Erstwhile: Monthly Income Plans (MIPs)*: With between 10% to 25% allocation to equity, returns of CHFs are largely determined by the vagaries of the equity markets as against the debt markets. These funds are therefore suitable for investors who have a reasonably long time horizon & are comfortable with taking exposure to equities.

OUTLOOK

IMPACT ON THE MUTUAL FUND INDUSTRY:

We take away from the policy a strong bias towards looking through current supply-side, transient inflation, with vigilance towards any signs of demand pull inflation coming in.

Governor Das clarified that there was no thinking around normalisation yet, and yields would be allowed to evolve only in an orderly fashion. The level of the 10y yield has also become somewhat of a signaling mechanism for the policy stance and will likely be allowed to rise sometime before eventual normalization - though this appears to be many months away. RBI communication is amply clear on rates, including the use of G-SAPs, and tactical auction flexibility to convey its use on an ongoing basis.

We remain constructive on the shorter end of the yield curve. **Medium Duration funds, Short Duration funds, Corporate Bond funds, Banking & PSU Debt funds, Low Duration funds, Money Market funds and Ultra Short Duration funds** can be considered by investors with an investment horizon commensurate with the maturity and duration of the schemes. Having said that, one should consider aspects such as exit load, capital gains tax and asset allocation amongst others while evaluating their investment options.

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