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भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA

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May 22, 2020

Monetary Policy Statement, 2020-21
Resolution of the Monetary Policy Committee (MPC)
May 20 to 22, 2020

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) at its meeting today (May 22, 2020) decided to:

- reduce the policy repo rate under the liquidity adjustment facility (LAF) by 40 bps to 4.0 per cent from 4.40 per cent with immediate effect;
- accordingly, the marginal standing facility (MSF) rate and the Bank Rate stand reduced to 4.25 per cent from 4.65 per cent; and
- the reverse repo rate under the LAF stands reduced to 3.35 per cent from 3.75 per cent.
- The MPC also decided to continue with the accommodative stance as long as it is necessary to revive growth and mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target.

These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 per cent within a band of +/- 2 per cent, while supporting growth.

The main considerations underlying the decision are set out in the statement below.

Assessment

Global Economy

2. Since the MPC met in March 2020, global economic activity has remained in standstill under COVID-19 related lockdowns and social distancing. Among the key advanced economies (AEs), economic activity contracted in the US, Euro area, Japan and the UK in Q1:2020. Among emerging market economies (EMEs), the Chinese economy went into a pronounced decline and data on high frequency indicators suggest that activity may have also shrunk in other EMEs such as Brazil and South Africa.

3. Global financial markets calmed after a turbulent period in March, and volatility ebbed as swift and large fiscal and monetary policy responses helped to soothe sentiment. Equity markets recovered some lost ground, while government bond yields

remained range-bound, although somewhat elevated in some EMEs due to country-specific factors. Portfolio flows to EMEs revived in April and the rush to safe havens eased. With the US dollar weakening, major EME currencies, which had experienced persistent downward pressure, traded with an appreciating bias. Crude oil prices firmed up modestly as oil producing countries (OPEC *plus*) agreed to cut production, and prospects for revival in demand improved on expectations of imminent easing of lockdowns. Gold prices remained elevated on hedging demand. CPI inflation remained subdued across major AEs and EMEs primarily due to a collapse in oil prices and compression in demand amidst lockdowns, while food inflation picked up due to supply disruptions.

Domestic Economy

4. Domestic economic activity has been impacted severely by the lockdown which has extended over the past two months. High frequency indicators point to a collapse in demand beginning March 2020 across both urban and rural segments. Electricity consumption has plunged, while both investment activity and private consumption suffered precipitous declines, as reflected in the collapse in capital goods production and the large retrenchment in the output of consumer durables and non-durables in March. High frequency indicators of service sector activity such as passenger and commercial vehicle sales, domestic air passenger traffic and foreign tourist arrivals also experienced sizable contractions in March. The only silver lining was provided by agriculture, with the summer sowing of rice, pulses and oilseeds in the country progressing well, with total area sown under the current *kharif season* up by 43.5 per cent so far, and the *rabi* harvest promising to be a bumper as reflected in record procurement.

5. Retail inflation, measured by the consumer price index, moderated for the second consecutive month in March 2020 to 5.8 per cent after peaking in January. This was mainly due to food inflation easing from double digits in December 2019 – January 2020. In April, however, supply disruptions took a toll and reversed the softening of food inflation, which surged to 8.6 per cent from 7.8 per cent in March. Prices of vegetables, cereals, milk, pulses and edible oils and sugar emerged as pressure points[1].

6. The Reserve Bank remained in pro-active liquidity management mode, expanding its array of measures, both conventional and unconventional, to augment system-level liquidity as also to channel liquidity to specific sectors facing funding constraints. Systemic liquidity remained in abundance, with average daily net absorptions under the liquidity adjustment facility (LAF) increasing to ₹5.66 lakh crore in May 2020 (up to May 20) from ₹4.75 lakh crore in April. During 2020-21 (up to May 20), ₹1,20,474 crore was injected through open market operation (OMO) purchases and ₹87,891 crore through three targeted long-term repo operation (TLTRO) auctions and one TLTRO 2.0 auction. In order to distribute liquidity more evenly across the yield curve, the Reserve Bank

[1]All India headline CPI was not released for April 2020 in view of limited transactions in non-food items due to the lockdown; data were released only for the food and housing groups.

conducted one ‘operation twist’ auction involving the simultaneous sale and purchase of government securities for ₹10,000 crore each on April 27, 2020. Furthermore, the Reserve Bank has provided ₹22,334 crore as refinance to National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI) and National Housing Bank (NHB) so far (as on May 21, 2020) and ₹2,430 crore to mutual funds through a special liquidity facility (SLF) with a view to easing liquidity constraints and de-stress financial markets. Since February 6, 2020 the Reserve Bank has announced liquidity augmenting measures of ₹9.42 lakh crore (4.6 per cent of GDP).

7. Reflecting the various liquidity management measures, domestic financial conditions have eased appreciably as reflected in the narrowing of liquidity premia in various market segments. Yields on government securities, commercial paper (CP), 91-day treasury bills, certificates of deposit (CDs) and corporate bonds have softened. The weighted average lending rates on fresh rupee loans of commercial banks declined by 43 bps in March 2020 alone. Though credit growth remains muted, scheduled commercial banks’ investments in commercial paper, bonds, debentures and shares of corporate bodies in this year so far (up to May 8) increased sharply by ₹66,757 crore as against a decline of ₹8,822 crore during the same period last year. There were net inflows into various schemes of mutual funds in April in contrast to large outflows in March.

8. In the external sector, India’s merchandise trade slumped in April 2020, with exports shrinking by 60.3 per cent and imports by 58.6 per cent (y-o-y), respectively. While imports contracted in all 30 commodity groups in April, exports contracted in 28 out of 30 groups. The trade deficit narrowed in April 2020 – both sequentially and on a year-on-year basis – to its lowest level in 47 months. On the financing side, net foreign direct investment inflows picked up in March 2020 to US$ 2.9 billion from US$ 0.8 billion a year ago. In 2020-21 so far (till May 18), net foreign portfolio investment (FPI) in equities increased to US$ 1.2 billion from US$ 0.8 billion a year ago. In the debt segment, however, there were portfolio outflows of US$ 3.8 billion during the same period as compared with outflows of US$ 1.4 billion a year ago. By contrast, net investment under the voluntary retention route increased by US$ 0.7 billion during the same period. India’s foreign exchange reserves have increased by US$ 9.2 billion in 2020-21 so far (up to May 15) to US$ 487.0 billion – equivalent to 12 months of imports.

Outlook

9. The inflation outlook is highly uncertain. As supply lines get restored in the coming months with gradual relaxations in the lockdown, the unusual spike in food inflation in April is expected to moderate. The forecast of a normal monsoon also portends well for food inflation. Given the current global demand-supply balance, international crude oil prices are likely to remain low although they may firm up from the recent depressed levels. Soft global prices of metals and other industrial raw materials are likely to keep input costs low for domestic firms. Deficient demand may hold down pressures on core inflation (excluding food and fuel), although persisting supply dislocations impart uncertainty to the near term outlook. However, volatility in financial markets could have a

bearing on inflation. These factors, combined with favourable base effects, are expected to take effect and pull down headline inflation below target in Q3 and Q4 of 2020-21.

10. Turning to the growth outlook, economic activity other than agriculture is likely to remain depressed in Q1:2020-21 in view of the extended lockdown. Even though the lockdown may be lifted by end-May with some restrictions, economic activity even in Q2 may remain subdued due to social distancing measures and the temporary shortage of labour. Recovery in economic activity is expected to begin in Q3 and gain momentum in Q4 as supply lines are gradually restored to normalcy and demand gradually revives. For the year as a whole, there is still heightened uncertainty about the duration of the pandemic and how long social distancing measures are likely to remain in place and consequently, downside risks to domestic growth remain significant. On the other hand, upside impulses could be unleashed if the pandemic is contained, and social distancing measures are phased out faster.

11. The MPC is of the view that the macroeconomic impact of the pandemic is turning out to be more severe than initially anticipated, and various sectors of the economy are experiencing acute stress. The impact of the shock has been compounded by the interaction of supply disruptions and demand compression. Beyond the destruction of economic and financial activity, livelihood and health are severely affected. Even as various measures initiated by the Government and the Reserve Bank work to mitigate the adverse impact of the pandemic on the economy, it is necessary to ease financial conditions further. This will facilitate the flow of funds at affordable rates and revive animal spirits. With the inflation outlook remaining benign as lockdown-related supply disruptions are mended, the policy space to address growth concerns needs to be used now rather than later to support the economy, even while maintaining headroom to back up the revival of activity when it takes hold.

12. Accordingly, all members voted for a reduction in the policy repo rate and maintaining the accommodative stance as long as it is necessary to revive growth and mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target.

13. Dr. Pami Dua, Dr. Ravindra H. Dholakia, Dr. Janak Raj, Dr. Michael Debabrata Patra and Shri Shaktikanta Das voted for a reduction in the policy repo rate by 40 bps, while Dr. Chetan Ghate voted for a reduction by 25 bps.

The minutes of the MPC's meeting will be published by June 5, 2020.

(Yogesh Dayal)
Chief General Manager

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