Syllabus subtopic: Indian Economy and issues relating to Planning, Mobilization of Resources, Growth, Development and Employment.

Prelims and Mains focus: about the steps taken by the MPC and their implications; repo rate; CRR; MPC; CPI

News: The Reserve Bank of India (RBI) stepped in to do the heavy lifting to revive the economy, after the Union budget appeared to have few measures to spur credit growth and boost demand.

About the RBI's move

The central bank introduced a direct incentive framework to boost credit growth, even as the six-member monetary policy committee (MPC) kept benchmark rates unchanged because of uncertainty in the inflation outlook. The repo rate, the rate at which banks borrow from RBI, remained unchanged at 5.15%.

What steps has it taken?

- To improve credit flow, RBI temporarily removed the cash reserve ratio (CRR)—which requires banks to set aside 4% of their deposits—for every new retail loan made to finance automobiles, homes, and to small businesses. This move, while making it attractive for banks to lend to retail and small businesses, essentially translates into a short-term cut in cash reserve ratio. This scheme will be available for new loans given till 31 July.

- In addition, the central bank will now conduct one-year and three-year term repo auctions to inject up to Rs.1 trillion into the banking system, giving lenders the opportunity to raise money at current rates. When viewed in the context of elevated headline inflationary pressures, this is another incentive for banks to lock medium-term funding at current low rates.

- This should encourage banks to undertake maturity transformation smoothly.
Observations made by the RBI committee on inflation

- Given the uncertainty, MPC pegged consumer price inflation for the first half of FY21 at 5-5.4% as compared to 3.8-4% earlier. For the third quarter of FY21, the forecast stands at 3.2% with risks broadly balanced. According to the committee, the recent increase in prices of milk, pulses and crude oil are likely to weigh on inflation.

- MPC also noted that the inflation trajectory will be determined by several factors, including the pass-through of telecom charges, increase in prices of drugs and pharmaceuticals and the impact of new emission norms.

- MPC projected economic growth for fiscal 2021 at 6%—in the range of 5.5-6% in the first half and 6.2% in the third quarter. This is in line with its past GDP growth projections and that of the Economic Survey, which has pegged growth at 6-6.5%. The committee noted that the economy continues to be weak and the output gap remains negative.