

Reserve Bank of India begins policy normalisation

India's central bank left main policy interest rates unchanged but raised the cash reserve ratio for banks by 50 basis points. Even though this signals towards the end of the easing cycle, we don't think a rate hike will be on the table anytime soon



Reserve Bank of India
Governor Shaktikanta
Das

Source: Shutterstock

3.50%

Cash reserve ratio for banks

After 50bp hike today

Higher than expected

RBI policy normalisation begins

The Reserve Bank of India unanimously voted to leave the key policy rates, the repurchase rate and the reverse repurchase rate, unchanged at 4.00% and 3.35% respectively. There was no change to the accommodative policy stance that has been in place since the outbreak of

Covid-19 and will be maintained as long as necessary.

However, policymakers caught the markets off guard as they decided to raise the cash reserve ratio for banks by 50 basis points to 3.50% effective 27 March - the first of the two-phase normalisation of the 100 bp cut implemented at the onset of Covid-19 outbreak in March 2020.

But it doesn't come as a complete surprise, though in that the cut was earmarked for one year. The second phase of 50bp CRR hike to 4.00% is set for 22 May. While CRR hike typically drains out banking system liquidity, RBI's Governor Shaktikanta Das sees it as opening space for injecting additional liquidity.

The cash reserve ratio normalisation opens up space for variety of market operations of the central bank to inject additional liquidity. - RBI Governor Shaktikanta Das

Among other measures announced today included an exemption for banks from maintaining cash reserves against loans made to new small borrowers; extension of relaxation of the marginal standing facility (MSF) for banks for six more months until the end of September; and, easier availability of funds to non-bank finance companies for lending to stressed sectors.

Direct online access for retail investors to government bond market via gilt accounts with the central bank was also proposed in a drive to deepen financial markets, as well as an integrated ombudsman scheme for customer grievances redressal to be rolled out by June 2021.

Where is the economy headed?

The governor's [statement](#) struck an optimistic cord on the recovery of the economy from a record Covid-induced slump, particularly noting significant fiscal thrust, improved capacity utilisation in the manufacturing sector, surging direct and portfolio investment, and improving flows of financial resources to the commercial sector.

The central bank sees the country's GDP bouncing by 10.5% in the fiscal year 2021-22, which starts in April. This is to be led by a front-loading of recovery with as much as a 26% surge in the first half of the year followed by an estimated -7.7% contraction in the current fiscal year.

It is our strong conviction, backed by forecasts, that in 2021-22, we would undo the damage that COVID-19 has inflicted on the economy - RBI Governor Das.

On inflation, the central bank sees it hovering near the top end of its 2-6% target zone throughout the first half of FY21-22 and subsequently easing to 4.3% in 3Q. The inflation optimism rests on food inflation trajectory, which the RBI expects to be shaped favourably by bumper harvest and softer poultry demand amid worries of avian flu.

What do we make of all this?

We think the central bank's decision to leave main policy rates unchanged but raise the cash reserve ratio by 50bp comes as a clear signal that the central bank's monetary easing cycle has run its course. While this reflects the central bank's confidence in a V-shaped economic recovery in FY21-22, which also aligns with the government's view of 11% growth in the next fiscal year. That said, we think the recovery will continue to face strong headwinds from both local and external factors, and this is likely to leave growth short of the official projections.

Our GDP growth forecasts are -9.8% contraction in FY20-21, followed by an +8.1% growth next year.

Even as the phased normalisation of CRR goes ahead, we don't think the hike in the policy rates will be on the table anytime soon.

We also view the move to normalise policy as an acknowledgement of the persistent inflation risk ahead. Inflation might have drifted back within the RBI's 2-6% policy target zone in December, after a year of remaining above-target, though but we don't think the risk has completely disappeared just yet. The ample banking system liquidity together with expansionary fiscal policy and potential pass-through of rising global oil prices to domestic fuel prices should keep inflation elevated this year.

The higher cash reserve ratio may draw out some excess liquidity but not a whole lot given policy remains supportive of the banking system liquidity in a bid to push growth higher. Even as the phased normalisation of CRR goes ahead, we don't think the hike in the policy rates will be on the table anytime soon, at least not in 2021.

Indeed, the government bond market remains at the receiving end of such a macro policy mix. The yields have been under upward pressure since January and the pressure is intensified sharply following the announcement of FY21-22 budget earlier this week.

The central bank's decision didn't give any respite to the bond market, anyway. If sustained, the higher yields will add to the servicing cost of already high public sector debt. The announcement, however, buoyed sentiment towards the Indian rupee initially, though the currency pared gains in subsequent trading hours.

Author

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan
min.joo.kang@asia.ing.com

Coco Zhang
ESG Research
coco.zhang@ing.com

Jan Frederik Slijkerman
Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind
Senior Economist, Services and Leisure
Katinka.Jongkind@ing.com

Marina Le Blanc
Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

Franziska Biehl
Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne
Senior Editor and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl

Oleksiy Soroka, CFA
Senior High Yield Credit Strategist
oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek
Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma
Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Rico Luman
Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier
Head of Corporates Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter
Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen
Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer
Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante
Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klok
Senior Economist, Netherlands
marcel.klok@ing.com

Piotr Poplawski
Senior Economist, Poland
piotr.poplawski@ing.pl

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com