GDP Revival Forecast: RBI

Why in News

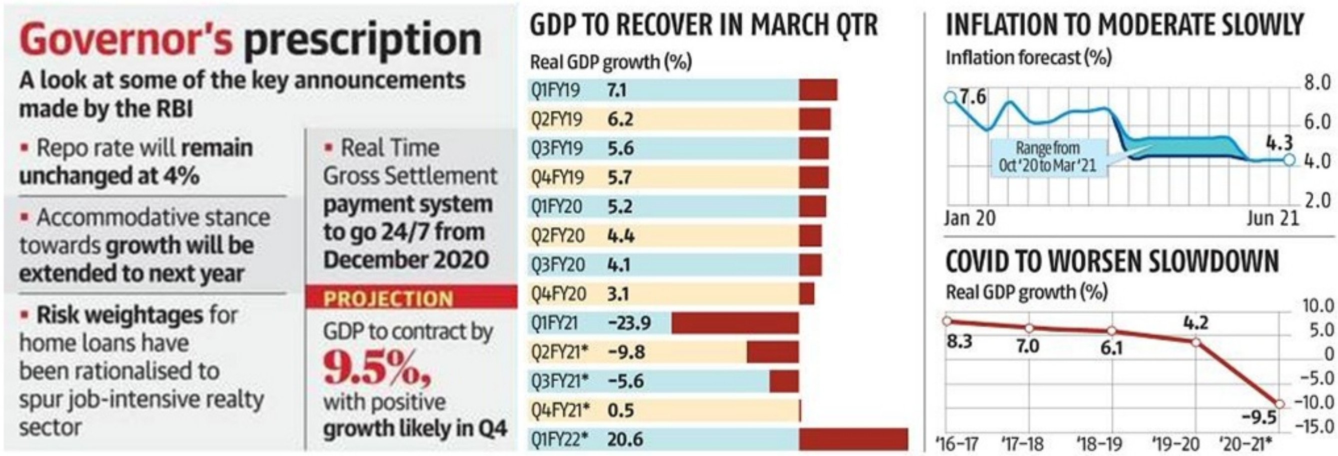
The **Monetary Policy Committee** of the **Reserve Bank of India (RBI)** has announced the **extension of its accommodative policy stance** for the rest of this year as well as 2021-22 and forecasted a GDP revival in coming months.

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

Key Points

Decisions:

- RBI has kept **key policy rates unchanged to revive growth** of the economy and mitigate the economic impact of Covid-19 pandemic.
  - The **Repo and reverse repo rate unchanged** at 4% and 3.35% respectively because of **high inflation.**
- **Risk weights,** i,e, the capital required to be set aside on individual home loans, have been relaxed and the **loan limit** for retail and small business borrowers have been raised.
  - This would give a boost to the **job-intensive real estate sector** that has been suffering in the pandemic.
- **Real-Time Gross Settlement (RTGS)** will be available round the clock.
- **Targeted Long Term Repo Operations (TLTRO)** of Rs 1,00,000 crore for the revival of specific sectors, and **Open Market Operations (OMOs)** for **State Development Loans (SDLs)** have been announced.
  - This will assure market participants of **access to liquidity and easy finance conditions.**
  - Long Term Reverse Repo Operation (LTRO) is a mechanism to **facilitate the transmission of monetary policy** actions and the flow of credit to the economy. This helps in **injecting liquidity in the banking system.**
  - Open Market Operations (OMO) is one of the **quantitative** monetary policy tools which is **employed by the central bank of a country to control the money supply in the economy.**
  - OMOs are conducted by the RBI by way of **sale or purchase of government securities (g-secs)** to adjust money supply conditions.
  - The central bank sells g-secs to commercial banks to remove liquidity from the system and buys back g-secs to infuse liquidity into the system.



Forecasts:

- **GDP Revival**
  - **Real gross domestic product (GDP)** in FY21 will fall by 9.5%.
  - GDP growth may break out of contraction and **enter a positive zone by Q4** of the current fiscal year (2020-21)
  - Starting from a modest recovery the economic activity is expected to gain traction in Q3.
  - The real GDP growth in 2020-21 is expected to be negative at -9.8% in Q2 of 2020-21,-5.6% in Q3 and 0.5% in Q4.
  - Real GDP is likely to grow by 20.6% in the Q1 of 2021-22.
- **Decline in Inflation:**
  - Inflation is expected to decline in the next 3 months and is likely to ease to the projected target of around 4% (within a band of +/- 2%) by Q4 of FY'21.
  - Supply chain disruptions is the major factor driving up inflation. As supply chains are restored, the inflation would come down.
  - The **retail inflation growth was 6.69%**, as of **August 2020.**
- **Restart of Economy**
  - The economy is likely to witness a three-speed recovery i.e. individual sectors showing varying paces with **fastest, modest and slowest** recovery rates.
  - Apart from agriculture, sectors such as fast-moving consumer goods, automobiles, pharma and power would revive first.

Monetary Policy Committee

- 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.
- The **Governor of RBI** is **ex-officio Chairman** of the committee.
- The committee comprises **six members (including the Chairman)** - three officials of the RBI and three external members nominated by the Government of India.
- Decisions are taken by majority with the Governor having the **casting vote in case of a tie.**
- The MPC determines the policy interest rate (repo rate) required to achieve the inflation target (4%).
- An RBI-appointed committee led by the then deputy governor Urjit Patel in 2014 recommended the establishment of the Monetary Policy Committee.

Repo Rate and Reverse Report Rate

- It 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.
- It is used by monetary authorities to **control inflation.**
  - In the event of inflation, central banks increase the repo rate as this acts as a disincentive for banks to borrow from the central bank. This ultimately reduces the money supply in the economy and thus helps in arresting inflation.
  - The central bank takes the contrary position in the event of a fall in inflationary pressures.
- Ideally, a low repo rate **should translate into low-cost loans for the general masses.** When the RBI slashes its repo rate, it expects the banks to lower their interest rates charged on loans.
- **Reverse repo rate** is the rate at which the RBI borrows money from commercial banks within the country.

Source: TH