Monetary Sector Developments (In reference to financial year 2019-20)

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Abstract

Monetary policy as an instrument of economic policy has certain advantages. Monetary policy changes, unlike in the case of fiscal policy, can be made at any time during a year. Monetary policy has been operated with a view to ensuring a reasonable degree of stability consistent with the needs of economic development. The first and most important part of the monetary policy framework in a country is the task mandated to the monetary authorities. Monetary policy remained accommodative in 2019-20. The repo rate was cut by 110 basis points in four consecutive Monetary Policy Committee meeting in the financial year due to slower growth and lower inflation. Liquidity conditions were tight for initial two months of 2019-20.

In the present study an attempt has been made to examine the monetary sector developments in India during financial year 2019-20.

Keywords: Monetary Policy, Reserve Ratio, Liquidity, Economic Development.

I. Introduction

The Reserve Bank of India is mainly constituted as an apex authority for monetary management. Its primary function is to formulate and administer monetary policy. It seeks to control and regulate the flow of credit in the economy such that it can sustain the tempo of development and promote the maintenance of internal price stability. It uses quantitative controlling weapons, such as bank rate policy, open market operations and reserve ratio requirement. Since 1956, it has increasingly relied on and resorted to selective credit controls for accelerating the rate of growth and for checking inflationary spurts.

During the planning era, in its attempt to check inflation, the Government of India and the Reserve Bank have accorded a high priority to monetary control.

The monetary policy in the country is thus, prominently featured as antiinflationary. Indeed, it has been the major function of RBI to control and regulate the availability of credit, the cost of credit, and the uses of credit flow in the economy.

Over the period 1951-1990 and 1991-2018, the RBI has used a large number of traditional and non-traditional quantitative and qualitative weapons of credit control in the economy. From time to time, according to the need felt, all measures have been operated by the RBI in varying degrees of magnitude and effectiveness.

The basic objectives of the RBI's current monetary policy have been: - (i) To control inflation and bring about relative price stability,

(ii) To promote economic growth, and

(iii) To provide social justice in the allocation of bank credit.

II. Objective of the Study

1. To examine the working of quantitative monetary policy in India.
2. To understand monetary developments through various instruments of monetary policy and how they are interrelated.
3. The findings of the study will identify the role of RBI and government and how these policies can be executed in the Indian economy.

III. Research Methodology

The study is exploratory and quantitative in nature. The secondary information is used for the analysis of the problem. Sources for the secondary data are originated from the various sources like special investigation team report, newspaper and Reserve bank of India (RBI) websites.

IV. Monetary Developments

1. The Monetary Policy Committee (MPC) decided to cut the policy repo rate changing the stance of monetary policy from neutral to accommodative. Table 1.1 shows that the repo rate was reduced by 110 basis points from 6.00 per cent in

April 2019 to 5.15 per cent in October 2019. MPC's decision was guided by low inflation and the need to strengthen domestic growth by spurring private investment in the economy.

Table: 1.1 Revision in Policy Rates

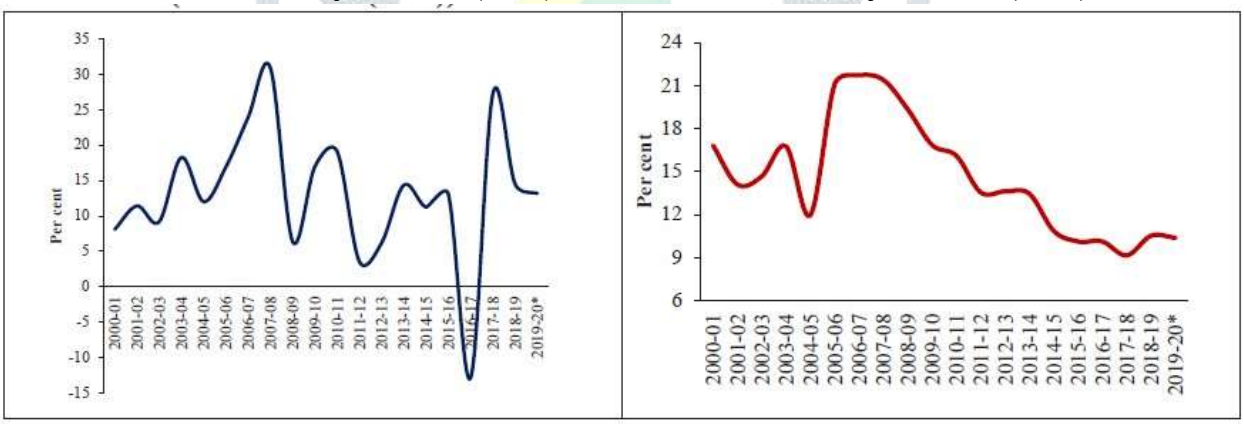
Effective Date	Repo Rate (per cent)	Reverse Repo Rate (per cent)	Bank Rate/ MSF Rate* (per cent)	Cash Reserve Ratio (per cent of NDTL)	Statutory Liquidity Ratio (per cent of NDTL)
04/04/19	6.00	5.75	6.25	4.00	19.25
07/08/19	5.40	5.15	5.65	4.00	18.75
05/12/19	5.15	4.90	5.40	4.00	18.50
04/01/20	5.15	4.90	5.40	4.00	18.25

Source: Reserve Bank of India
NDTL – Net Demand and Time Liabilities.
** Bank Rate was aligned to MSF rate with effect from February 13, 2012*

2. In Dec., 2019 MPC decided to keep the repo rate unchanged at 5.15 per cent, underlining the rising consumer price inflation as one of the reasons, MPC also signaled its intention to wait until effective monetary policy transmission happens. The real GDP projections were revised downwards to 5 per cent for 2019-20.

3. Due to demonetisation after experiencing unusual behaviour in 2016-17, the growth rates of monetary aggregates witnessed reversion to their long-term trend during 2018-19.

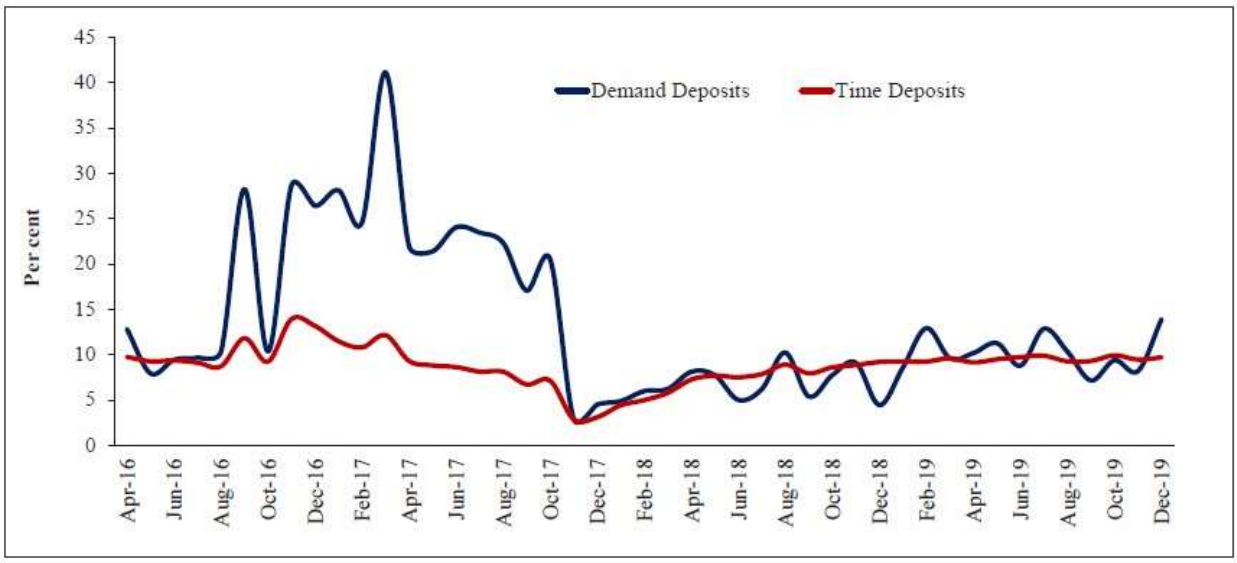
Chart- 1 Reserve Money Growth (YoY) Chart- 2 Broad Money Growth (YoY)



Source: Reserve Bank of India
**as on Dec.2019*

4. According to table-1.2 expansion in M0 during 2019-20 so far was contributed mainly by RBI's Net Foreign Assets (NFA) as against Net Domestic Assets (NDA) during the previous year. The growth of reserve money as on Dec. 2019 was 13.2 per cent. RBI's claims on banks decreased indicating surplus liquidity conditions in 2019-20.

Chart- 3 Deposits Growth (YoY)



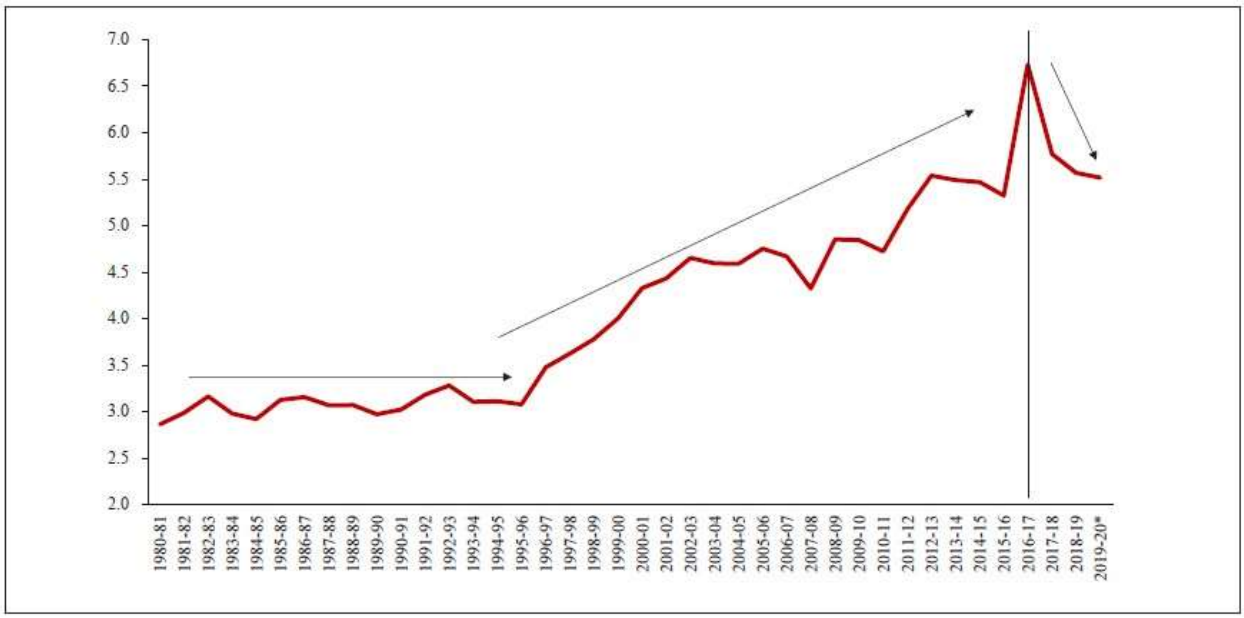
Source: Reserve Bank of India.

5. Broad money (M3) growth has been on declining trend since 2009. From the component side, the expansion in M3 so far during 2018-19 is attributable to aggregate deposits, which recoded a higher growth of 10.1 per cent as on Dec. 20,

2019 as compared with 9.2 per cent a year ago. On the source side, banks' credit to the government mainly contributed to M3 expansion.

6. The money multiplier, measured as a ratio of M3/M0 was mostly increasing; between mid-1990 to 2016-17. Money multiplier recorded a slight decline in 2019-20.

Chart- 4 Money Multiplier (M3/M0)



*Source: Reserve Bank of India. *As on Dec. 2019*

Table: 1.2 Year on Year (YoY) change in Monetary Aggregates as on end March of each year (per cent)

Items	2013-14	2014-15	2015-16	2016-17*	2017-18	2018-19	2019-20#
Currency in Circulation	9.2	11.3	14.9	-19.7	37	16.8	11.9
Cash with Banks	10.7	12.4	6.6	4.2	-2.1	21.4	15.8
Currency with the Public	9.2	11.3	15.2	-20.8	39.2	16.6	11.8
Bankers' Deposits with the RBI	34	8.3	7.8	8.4	3.9	6.4	17.1
Demand Deposits	7.8	9.8	11	18.4	6.2	9.6	13.1
Time Deposits	14.9	10.7	9.2	10.2	5.8	9.6	9.8
Reserve Money (M0)	14.4	11.3	13.1	-12.9	27.3	14.5	13.2
Narrow Money (M1)	8.5	11.3	13.5	-3.9	21.8	13.6	12.5
Broad Money (M3)	13.4	10.9	10.1	6.9	9.2	10.5	10.4

Source: Reserve Bank of India *****March 31, 2017 over April 1, 2016 (barring M0, CIC, and Bankers' Deposits with the RBI) #As on Dec.2019

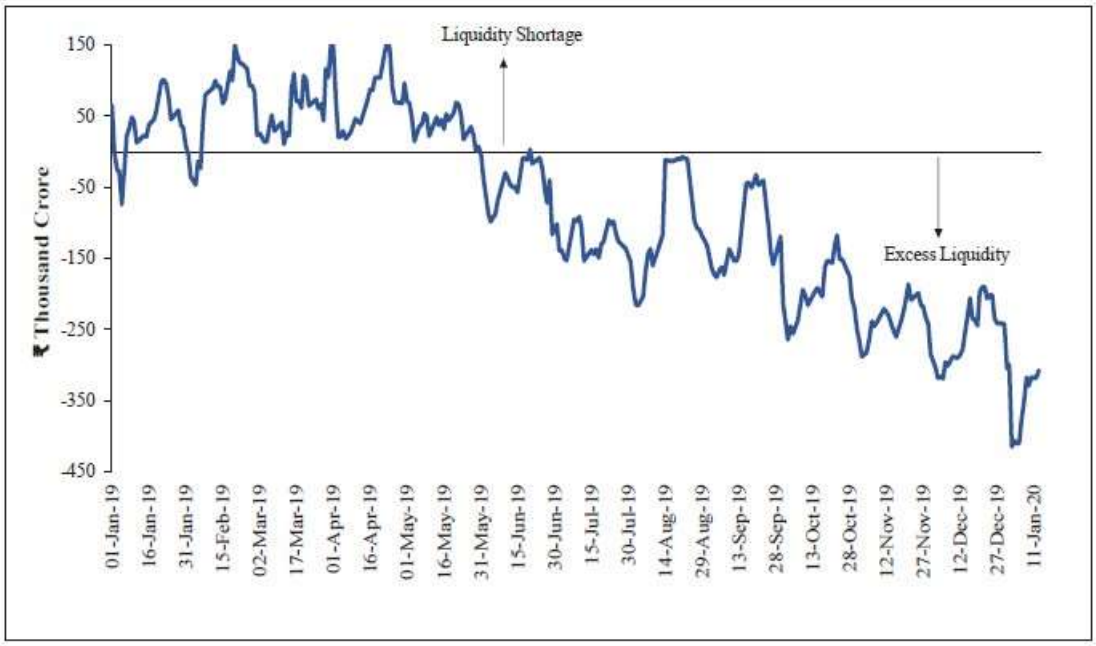
V. Liquidity Conditions and Its Management

The Reserve Bank's forex operations augmented the domestic rupee liquidity in contrast to absorption last year. Systematic liquidity in 2019-20 has been largely in surplus since June 2019. The Statutory Liquidity Ratio (SLR) has been reduced by 25

basis point each in four steps effective April 13, 2019 to January 4, 2020 respectively, to 18.25 per cent of Net Demand and Time Liabilities (NDTL) of banks, in accordance with the roadmap announced in Dec. 2018. Other factors crating surplus liquidity are modernisation in currency demand after two years of high demand following demonetisation.

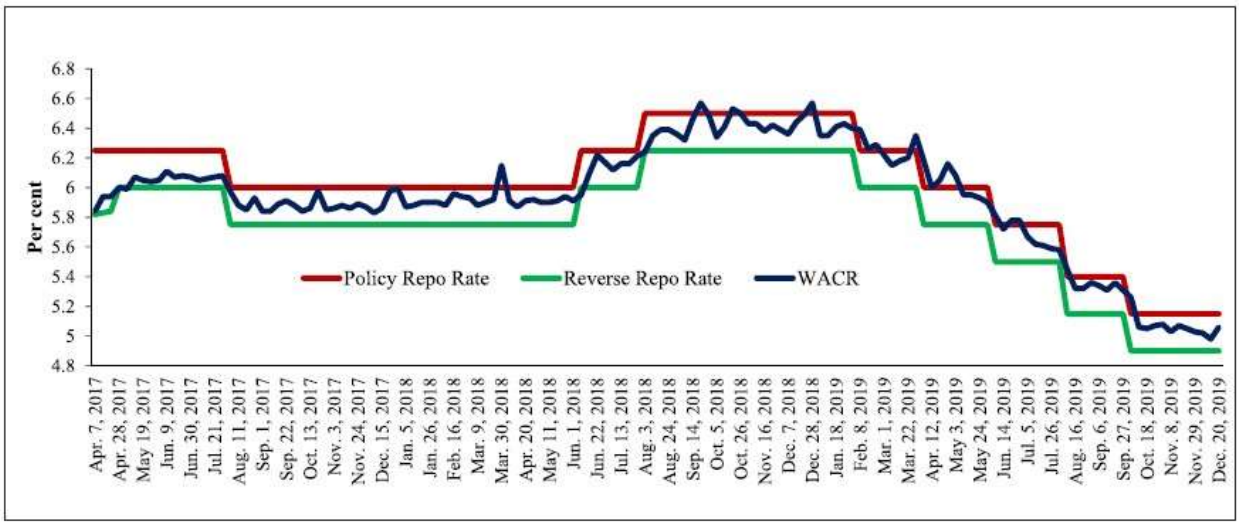
Due to restrained government spending and high demand for cash, liquidity was in deficit in April and May 2019. The unwinding of government of India cash balances, a regular feature every year in April, was much lower in the current year due to the imposition of the model code of conduct during elections restraining government spending.

Chart- 5 Daily Liquidity Management



Source: Net Liquidity injected data from Money Market Operation, RBI

Chart- 6 Policy Corridor and Call Rate



Source: Reserve Bank of India.

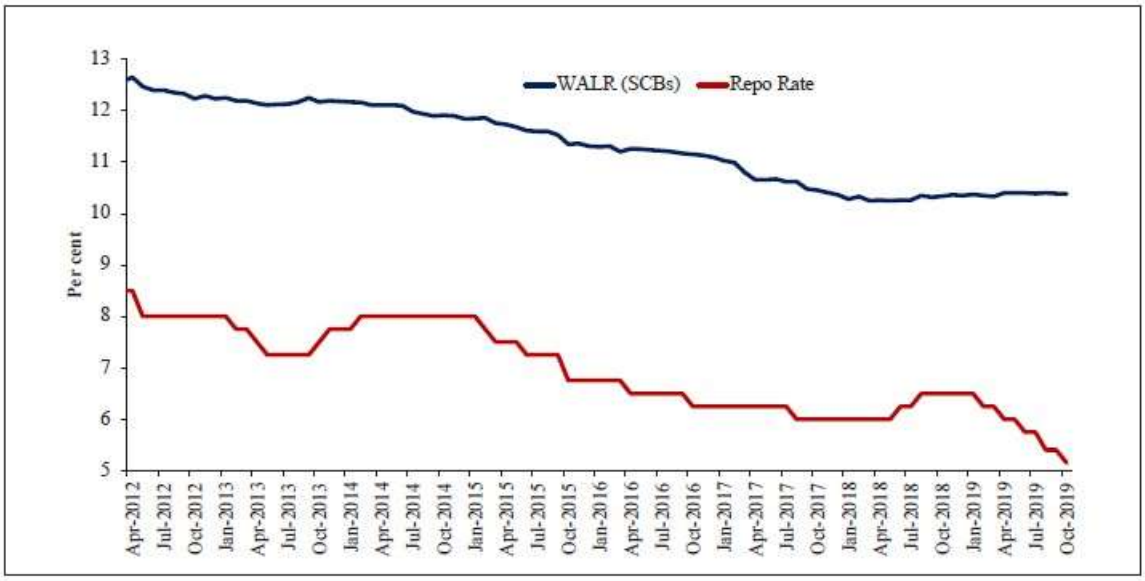
Comfortably liquidity situation is also evident in the Weighted Average Call Money Rate (WACR) being mostly been close to the repo rate within the Liquidity Adjustment Facility (LAF) corridor.

VI. Monetary Transmission

In 2019 the transmission of monetary transmission has been weak on all three accounts:

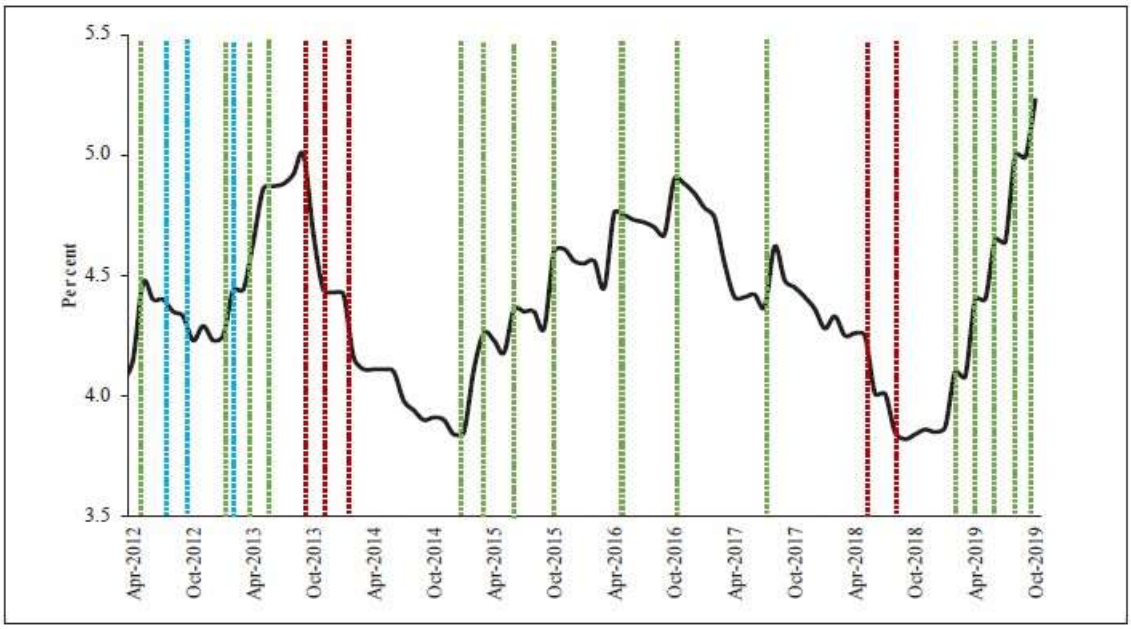
(i) Rate Structure: The monetary transmission has been slightly better for fresh loans. Weighted Average Lending Rate (WALR) of SCB's has not declined at all in 2019 despite reduction of repo rate by 135 basis point since January 2019. WALR on fresh loans of Public Sector Banks reduced by 47 bps and that of Private Sector Banks reduced by 40 bps from January to October 2019. However, even this has been much less than the repo rate cut of 135 basis point.

Chart- 7 Weighted Average Lending Rate on outstanding loans and Repo rate



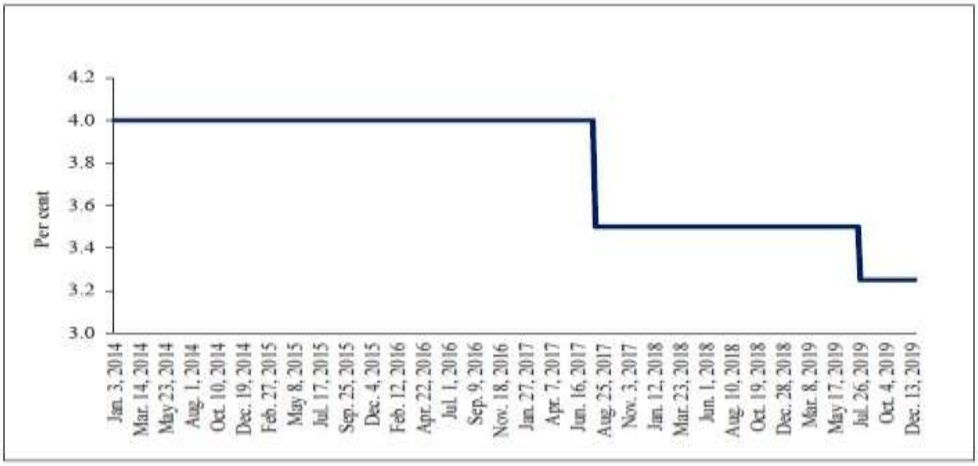
Source: Reserve Bank of India,

Chart- 8 Credit Spread



Source: Reserve Bank of India. Blue means CRR cut, Red Denotes Repo hike, Green denotes Repo cut. Credit spread is defined as difference between repo rate and WALR on outstanding loans. The difference between repo rate and WALR (Credit Spread) is at the highest level in this decade. WALR on outstanding loans of SCB's is 525 basis point higher than the repo rate. In 2014, the Weighted Average Term Deposit rate (WATDR) was same as Public Provident Fund (PPF), however the gap between them is 115 basis point at end October 2019.

Chart- 9 Saving Deposit Rate



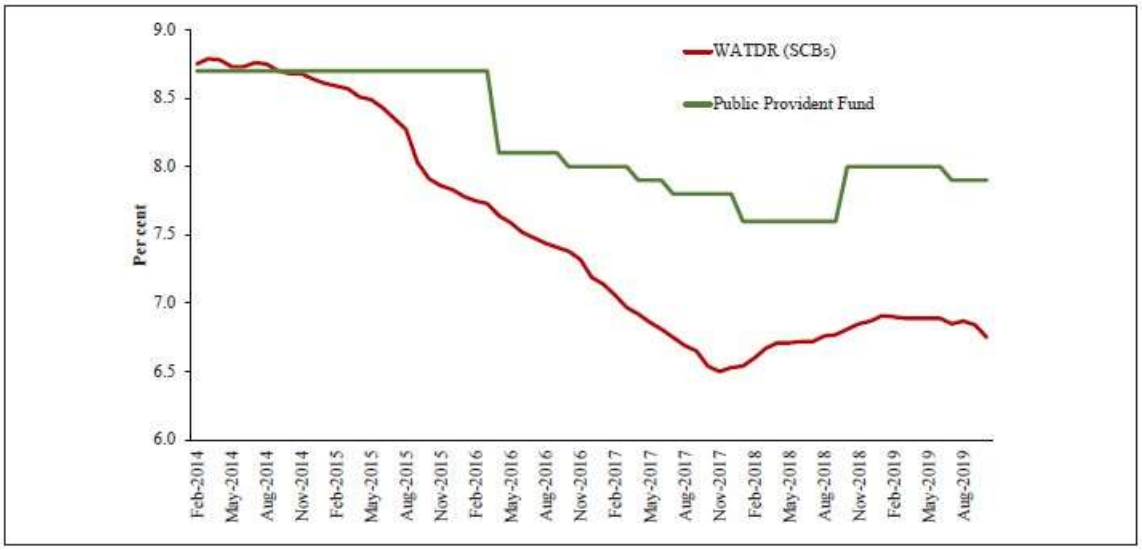
Source: Reserve Bank of India

It is unlikely that the term deposit rates can decline without a decrease in administered rates on schemes like these. There has reduction in the saving-deposit rate by 25 basis point in 2019. An important limiting factors seems to be the rate on small savings scheme like Public Provident Fund (PPF).

(ii) Term Structure: LAF liquidity and RBI's monetary easing has had some impact on short term interest rates. However, this impulse is not feeding through to longer term maturities.

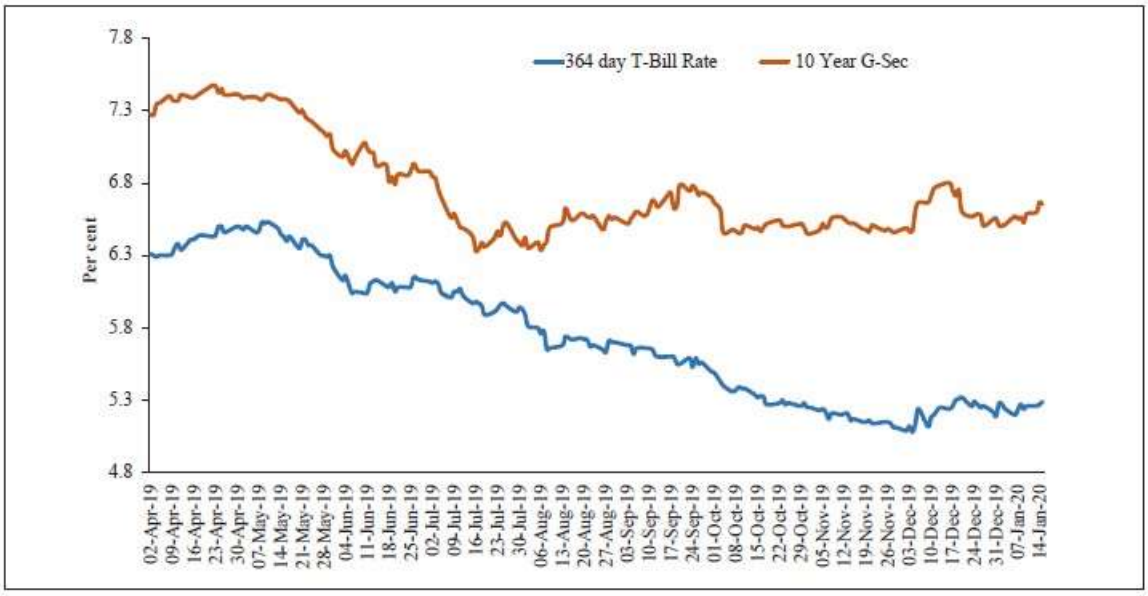
Since the beginning of the year, the yields on short term government securities (365 days) have declined much faster than that of long-term government securities (10 year).

Chart- 10 Term Deposit Rate of SCBs and rate of interest on Public Provident Fund



Source: RBI and Ministry of Finance.

Chart- 11 Bond yields (per cent)



Source: CCIL

(iii) Credit Growth: The credit growth (Year on Year) moderated from 12.9 per cent in April 2019 to 7.1 per cent as on Dec. 20, 2019. The moderation in credit growth was witnessed across all the major segments of non-food credit, except personal loans, which continued to grow at a steady and robust pace during 2019-20 so far. The moderation was led by a sharp deceleration in credit growth to the

Chart- 12 (a) Bank Credit Growth (YoY)

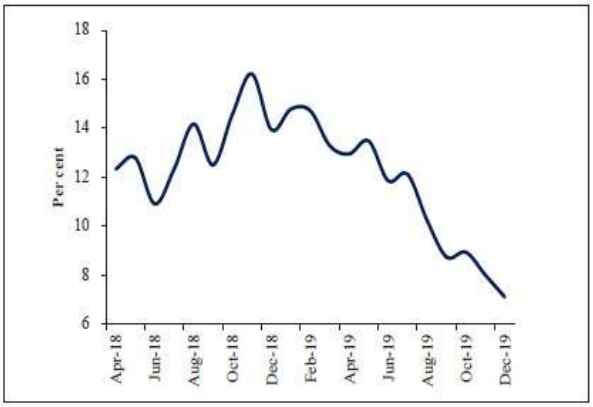
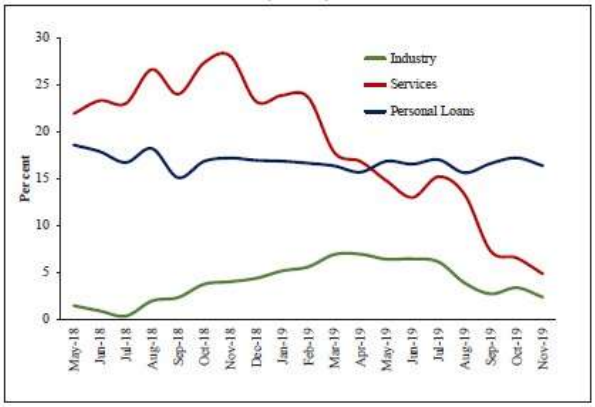


Chart- 12 (b) Sectoral Bank Credit Growth (YoY)



Source: Reserve Bank of India.

services sector. According to Table 1.3, The main contributor to this slowdown has been a negative growth of credit to Micro Small and Medium Enterprises and Textiles.

Table: 1.3 Growth I Industry-wise Deployment of Bank Credit b Major Sectors (YoY, per cent)

Items	Mar-15	Mar-16	Mar-17	Mar-18	Mar19	Nov-19#
Non-Food Credit	8.6	9.1	8.4	8.4	12.3	7.2
Industry	5.6	2.7	-1.9	0.7	6.9	2.4
Micro & Small	9.1	-2.3	-0.5	0.9	0.7	-0.1
Medium	0.4	-7.8	-8.7	-1.1	2.6	-2.4
Large	5.3	4.2	-1.7	0.8	8.2	3.0
Textiles	-0.1	1.9	-4.6	6.9	-3.0	-6.1
Infrastructure	10.5	4.4	-6.1	-1.7	18.5	7.0

Source: Reserve Bank of India (Data are provisional and relate to select banks which cover about 90 per cent of total non-food credit extended by all scheduled commercial banks.)

#as on November 22, 2019

Major Policy Changes

1. Permitting one-time restructuring of existing loans to MSMEs classified as standard as on January 1, 2019 without a downgrade in the asset's classification. The restructuring will have to be implemented by March 31, 2020.

2. It was decided to permit banks to lend to Infrastructure Investment Trusts, subject to certain safeguards which include a Board approved policy on exposures to trusts, assessment of all critical parameters including sufficiency of cash flows as trust level.

3. As the transmission of policy rate changes to the lending rate of the banks under the current MCLR framework was not satisfactory, guidelines were issued to banks on September 4, 2019 mandating bank (w.e.f. October 1, 2019) to link all new floating

rate personal or retail loans and floating rate loans to MSE to an external benchmark as under;

(i) Benchmarks: The banks are free to choose one of the several benchmarks from Repo Rate, 3 Months or 6 Months Treasury Bill yield and any other benchmark market interest rate published by the Financial Benchmark India Private Ltd (FBIL).

(ii) Spread: Banks are free to decide the spread over the external benchmark.

However, credit risk premium may undergo change only when borrower's credit assessment undergoes a substantial change, as agreed upon in the loan contract. Further, other components of spread including operating cost could be altered once in three years.

(iii) Reset of interest rates: The interest rate under external benchmark shall be reset at least once in three months.

Summary

1. Monetary policy remained accommodative in 2019-20.
2. The repo rate was cut in four out of five meetings held in 2019-20 (till December). The repo rate has been cut by 110 bps in 2019-20 so far.
3. Bank credit growth slowed down in 2019-20 and stands at 7.1 per cent (YoY) as of December 20, 2019, as compared to a growth of 12.9 per cent in April 2019. 4. The growth (YoY) of loans from NBFCs declined from 27.6 per cent in September 2018 and 21.6 per cent in December 2018 to 9.9 per cent at end September 2019.

5. Gross NPA ratio of SCBs remained unchanged at 9.1 per cent between March and September 2019.

6. Systemic liquidity has been largely in surplus in 2019-20. Weighted Average Call Money Rate remeined mostly close to repo rate within the Liquidity Adjustment Facility (LAF) corridor.

Reference

1. Various report of RBI Bulletin.

2. Economic Survey 2019-20 Volume-2

3. Report on Trend and Progress of Banking in India 2019-20