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EVALUATION OF RBI's MONETARY POLICY DURING COVID-19

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Abstract: The unprecedented shocks from the COVID-19 pandemic jeopardized the global economy and created an environment of Knightian uncertainty all around. The 2020 pandemic caused worldwide contagion and the precipitous loss of lives and livelihood. By the end of 2021, several advanced economies may have reached or exceeded pre-pandemic levels of output, but middle-income emerging economies have suffered large losses of output, with the heaviest burden falling on low-income countries. This pandemic is also noteworthy for the unprecedented policy response mounted by governments and central banks. The IMF estimates that since March 2020 and up to October 2021, US$16.9 trillion or 16.4 per cent of global GDP had been pledged as fiscal support in response to the pandemic, with US $ 14.5 trillion provided by advanced economies (AEs) and US $ 2.4 trillion provided by emerging market economies (EMEs), including the least developed countries. The total monetary support was US$19.0 trillion or 18.4 per cent of global GDP, US$ $ 16.1 trillion by AEs and US$ 2.9 trillion by EMEs. This study evaluates the impact of the monetary policy responses initiated by the Reserve Bank of India (RBI) to mitigate the cascading effect of the pandemic on the Indian Economy. The study uses a combination of exploratory and analytic approaches for evaluating the monetary policy responses initiated since January 2020. The actions of RBI are analysed under four headings namely Policy Rate Cuts, Liquidity Provisions and Credit Supports, Asset Purchases, and Regulatory Easing. It is observed that RBI has responded on all four fronts successfully which is evident through the availability of sufficient liquidity and easy credit in the market for all the stakeholders like central and state governments, large corporates, MSMEs and individuals. RBI must maintain the momentum of policy response till the return of normalcy in the economy. It should also be ensured that no adverse effect appears after the withdrawal of the stimulus extended as a policy response against the pandemic.

***Index Terms* - COVID*-19, Analytic approach, Impact analysis, Liquidity provisions, Asset purchases, Regulatory easing*.**

INTRODUCTION

The worldwide impact of the COVID-19 pandemic on human lives and their livelihood was so sudden and deeper that even advanced economies felt helpless to limit the damage during the first wave. After the viral outbreak in China on December 31, 2019, the first cross-country infection got reported on January 13, 2020, in Thailand. India identified its first case on January 27, 2020. On February 11, 2020, Dr Tedros (DG of WHO) nomenclature it as COVID-19 but underestimated the gravity of the problem and took one more month to announce it as a pandemic (on March 11, 2020). By this time, the situation had worsened in so many advanced countries and even India registered its first death on March 10, 2020. Most of the countries declared lockdown to prevent the spread of the disease but it adversely affected their economy. The abruptness and momentum of economic deterioration combined with blinding uncertainty about the degree of impact of the pandemic created an environment of Knightian uncertainty all around. Forecasting became so challenging that some advanced economy's central banks (Federal Reserve, Bank of Canada, Bank of England) suspended their forecast in the initial phase of the COVID shock. Financial markets faced another unique problem of lower money multiplier effect and liquidity challenge arising out of 'dash for cash' behaviour. It was a widespread agreement that Monetary policy has a critical role along with Health and Fiscal Policies in driving the economy out of recession. The extensive research and multifaceted policy reaction during the Global Financial Crisis (GFC) has given the confidence to handle the present situation effectively. Thus, monetary authorities responded at their earliest with a range of tools to address overlapping challenges. India, an emerging market, and faster-growing economy minimized the life loss during its first wave of COVID spread by timely and stringent implementation of the nationwide lockdown however, not able to avoid the deep dent in the economy. GDP growth contracted sharply in the first quarter of 2020-21 (-24.4%) and finally registered an average negative growth of 7.3% for the complete financial year. However, the second wave of the pandemic in the beginning of 2021-22 created heavy casualties and blow to the incipient signs of economic recovery. This led the RBI to take the initiative of doing changes in their monetary policy in order to maintain the financial order in the country.

This research paper is based on the critical analysis of the various policy measures took place during the pandemic era based on the secondary research from the reports published for the same.

Monetary authorities of emerging markets, like that of advanced economies, responded quickly and reduced their policy rates substantially as shown in Fig-1 below.

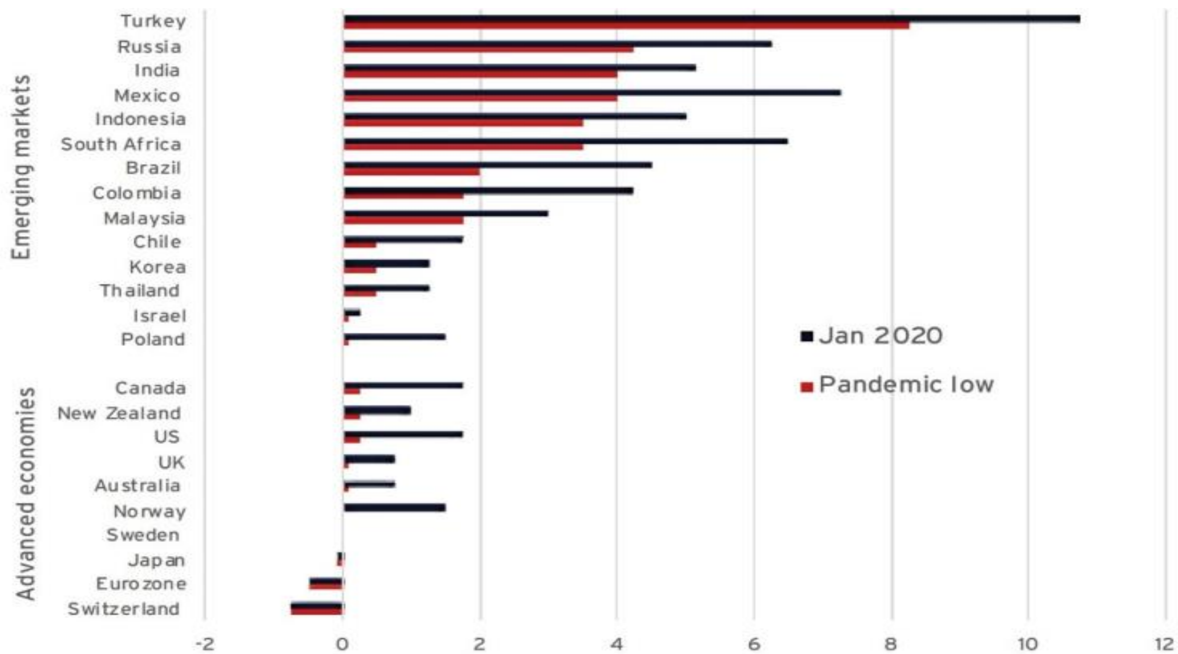
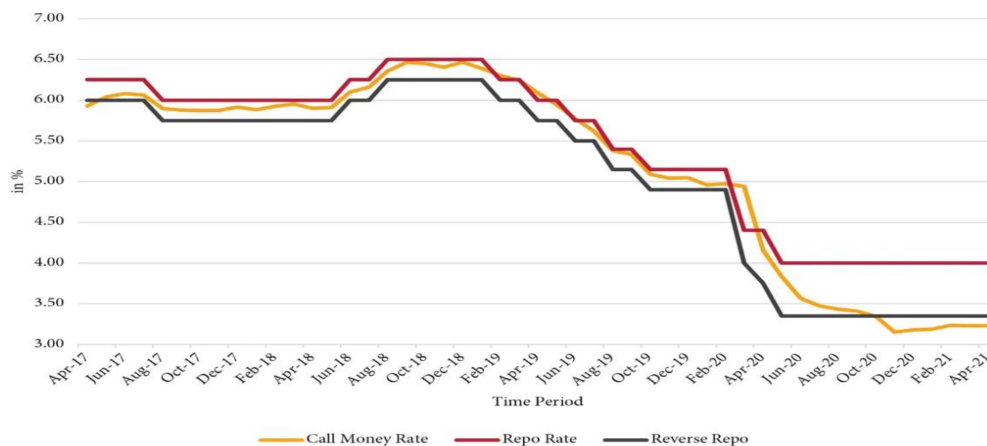


Fig-1: Central Bank Policy Rates: Pre-Covid to Pandemic Low
***Source*: Bloomberg.**

The RBI acted very quickly in March 2020 and convened the Monetary Policy Committee (MPC) on March 24, a week earlier than its previously scheduled date. The decisions taken were intended to "(a) mitigate the negative effects of the virus; (b) the revive growth; and above all, (c) preserve financial stability" (RBI 2020). Starting from the aggressive policy actions taken in this meeting, the RBI reduced the policy repo rate from 5.15% to 4.0% over the year. the monetary policy interest-rate corridor has been expanded significantly from 50 basis points to 90 basis points

Figure 1: Repo, reverse repo and call money rate (nominal)



Source: Reserve Bank of India.

METHODS AND DATA

The study is based on secondary data collected from various news reporting, press releases, and published reports of the World Health Organization (WHO), World Trade Organization (WTO), World Bank, World Economic Forum (WEF), International Labour Organization (ILO), IMF, and RBI during this pandemic period and various other research articles published so far. The policy responses for the study are considered from February 2020 to June 2021. However, for ease of comparison, the annual data for 2020-21 and 2021-22 is compared with the previous financial year 2019-20.

POLICIES OVERVIEW

RBI controls the economy of India through various monetary policy tools and these includes qualitative tools and quantitative tools. Under quantitative tools, it includes various policy rates like repo rate, reverse repo rate, marginal standing facility(MSF), Cash reserve ratio(CRR), Statutory liquidity ratio(SLR) Open market operations(OMO) and Bank rates, whereas in qualitative tools it includes Moral suasion, direct action, Loan to value(LTV), selective credit control and Priority sector lending(PSL). During the pandemic period, RBI went through various policy changes through these tools in order to curb the attack of coronavirus on the Indian economy.

Policy Rate Provisions

In 2020, Feb CRR Exemption was made for 5 years, depending on loans. In 2020, in March RBI announced 100 basis points (bps) (=1%) cut in CRR. So Earlier 4%-1%=3%. This will increase the loanable funds available to the banks. In 2021 when India was moving towards economic recovery, enough loanable funds in banks were available so, RBI ordered the restoration/increase of CRR in two phases: 3.5% (2021: March2May) to 4% (2021-May). In 2019, repo was in the range of 5-6%. Then, in 2020 due to Corona, Atmanirbhar Bharat RBI's monetary policies from Mar-April-May-2020 made the Repo Rate decrease to 4% keeping the accommodative stance. By 2020, March banks parked ₹~3 lakh crores in RBI in Reverse Repo. So, RBI has drastically reduced the reverse repo rate to discourage such laziness of banks. The statutory Liquidity Ratio (SLR) decreased from 18.25% to 18% on April

11, 2020. The easing of limits of commercial banks' overnight borrowing under the Marginal Standing Facility (MSF) and targeted three-year repo operations to alleviate the pressures on non-banking finance companies (NBFCs) and Microfinance institutions (MFIs) by RBI, stimulated the private borrowings through corporate bonds and debentures in FY 2020- 21 [1]

Credit Support and Liquidity Provisions

The operating framework of monetary policy aims at aligning the operating target – the weighted average call rate (WACR) – with the policy repo rate through proactive liquidity management. The Reserve Bank maintained surplus liquidity in the banking system during 2021-22 in consonance with the accommodative stance of monetary policy. In response to the second wave of the pandemic, the Reserve Bank announced additional liquidity measures amounting to ₹3.61 lakh crore during 2021-22, taking the total announced amount of primary liquidity offered since February 2020 to ₹17.2 lakh crore (8.7 per cent of nominal GDP of 2020-21). Across the world, US$16.9 trillion or 16.4 per cent of global GDP was pledged as fiscal support and US$19.0 trillion or 18.4 per cent of global GDP as monetary support. RBI pumped ₹ 11.1 trillion till the end of the first quarter of 2020-21 which increased the overall liquidity in the market and stabilized the bond yield. Usually, Repo loans are for short-term borrowing from overnight to 14 days. But, in 2020-Feb, RBI announced to conduct Long Term Repo Operations (LTROs) of 1 yr. & 3 years tenors where RBI loan total ₹ 1,00,000 crore, in various rounds through E-Kuber platform with Interest rate prevailing repo rate and Interest rate will be compounded annually. Which will increase loanable funds with banks so that economic growth can be revived. Targeted Long Term Repo Operations (TLTRO) launched with a tenure of 3 years with interest rate floating rate linked with repo rate. In the First round 1.0, ₹1 lakh crore was utilized and in round 2.0, ₹50,000 crore was utilized

Table 1: India's Unconventional Lending Operations during COVID-19

Lending Operations	Announced Amount (₹ crore)			
	2019-20	2020-21	2021-22	Total
1	2	3	4	5
I. LTRO/TLTROs/SLTROs[4]	2,25,000	2,25,000	10,000	4,60,000
II. Lending to Mutual Funds/ NBFCs	-	80,000	-	80,000
III. Lending to Emergency Health Services/ Contact-intensive Sectors	-	-	65,000	65,000
IV. Refinancing to AIFIs	-	75,000	66,000	1,41,000
Total	2,25,200	3,80,000	1,41,000	7,46,200

Source: RBI.

Note: 1. FY stands for Financial Year

Sector-specific tap window liquidity facility was started by the RBI where whenever Banks want, they can buy a specific amount based on interest rate same as the repo rate for the tenure of 3 years. A notable feature of India's pandemic response is the special liquidity support provided by the Reserve Bank to All India Financial Institutions (AIFIs) in the face of acute risk aversion among banks hindering the on-lending of central bank liquidity to pandemic-affected entities. These lines of credit were channelised to more than 500 financial intermediaries/entities (as on March 31, 2022), including cooperative banks, regional rural banks (RRBs), housing finance companies (HFCs), microfinance institutions (MFIs) and small finance banks (SFBs).[5] Moreover, taking advantage of the Reserve Bank's special liquidity schemes of ₹65,000 crores for emergency health and contact-intensive services, banks deployed their own funds to the tune of ₹15,663 crore during 2021-22 towards COVID-19 related emergency health services and contact-intensive sectors, which effectively expanded bank credit to the economy at a time when credit growth was subdued.

Easing Operations

RBI increased the state Government's short-term liquidity credit under the Ways and Means Advance (WMA) to enable them for their fiscal management. The maximum number of days of Overdraft (OD) in a quarter is being increased from 36 to 50 days and the number of consecutive days of OD from 14 to 21 days for the period till September 30, 2021. Also, RBI launched an operation twist. It increased the LTV from 75% to 90%. The reforms were also made in the PSL norms as the weaker section increased from 10% to 12%, Agriculture farmers decreased from 10% to 8%, marginal farmers increased from 8% to 10%, small and medium enterprises from 4.50% to 2.50%, Urban Cooperative Banks from 40% to 75%. Less Cash Economy / Digital Payment / Fraud Prevention

(1) Scheme of Offline Retail Payments Using Cards and Mobile Devices

(2) Online Dispute Resolution (ODR) for Digital Payments

(3) Positive Pay Mechanism for Cheques.

The implementation of the Net stable funding ratio (NSFR) and the last stage of the phased-in implementation of the Capital Conservation Buffers (CCB) of 0.625% which was due on April 1, 2020, are finally deferred till October 01, 2021.

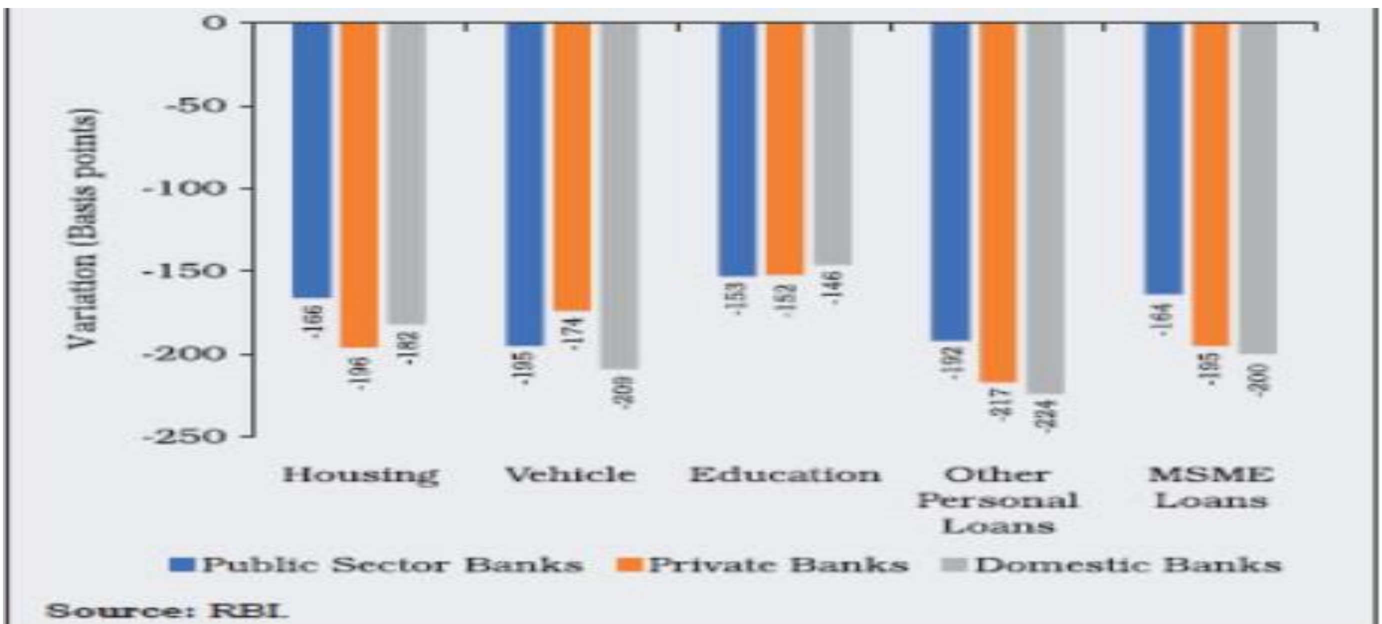


Chart: Transmission of WALR to MSMEs

FINDINGS AND OBSERVATION

Overall, the RBI, in cooperation with the Government of India, has succeeded in achieving its broad objective of keeping financial intermediaries, financial markets and the financial system as a whole sound, liquid, and functioning smoothly. It has maintained financial stability despite initial conditions of the Indian financial intermediaries being stressed as a consequence of legacy problems. But very significant challenges remain as this crisis unfolds further in both India and the rest of the world. It has also protected households as well as small and large businesses from experiencing acute financial stress for the time being, but stresses will emerge once regulatory forbearance is lifted.

Transmission of the highly accommodative monetary policy, and the corresponding liquidity management, has been largely successful. Interest rates have fallen across the board and g-sec yields are at almost record lows, with most real interest rates now being in negative territory. However, the RBI's liquidity injection has been so large that there was an almost consistent systemic liquidity surplus of about ₹6 trillion (about 3% of GDP) that needed to be absorbed by the RBI on a daily basis. In India, because of constrained fiscal response, the RBI had to do much of the heavy lifting. Its policy actions since February 2020 have put it at par to any central bank of advanced economies. RBI has carried out more policy actions than any other EME central banks. Examining the overall actions of RBI, since February 2020, it may be concluded that the monetary authority of India adopted multipronged strategies to minimise the adverse macroeconomic impact of the Covid pandemic and the associated lockdowns. Effective transmission of monetary policy impulses to the targets/beneficiaries along with preserving financial stability without disturbing the proper functioning of financial markets and financial institutions was a challenge but RBI did it successfully. Adequate liquidity at affordable rates is always maintained in the market to keep financial system robust. Commercial banks are encouraged to extend credit on easy terms specially to households for stimulating the demand and to MSMEs for supply side. RBI has made a smart move in which at one hand excess liquidity is sucked for the short period through variable rates reverse repo, and on other side injected the liquidity for longer period which results into compressing the 'term-premia' and normalising the curve. The impact is clearly noticed through the reduced yields on Government securities like 6% for the 10-year G-Sec, 5.6% for 5-year G-Sec and around 4.85% for 3-year G-Sec. The key economic indicators witnessed the V shaped recovery in the month of May 2020 onwards due to quick and collective efforts of monetary and fiscal responses.

CONCLUSION

In the hallowed tradition of central banks, the RBI as an institution shuns the glare of the limelight, preferring to remain unglorified and grounded. Yet when the chips are down and crises loom, it rises up from the depths that it inhabits and flings itself at the gathering storm. When the job is done, the recovery secured and macroeconomic and financial stability ensured, it falls back, usually unsung, but always on guard. The pandemic continues to shape the future, but the RBI remains armed and battle ready. Continuously evaluating highly volatile and uncertain conditions and remaining prepared to protect the economy from shocks, the RBI has committed all its instruments to this objective, using conventional measures and fashioning new ones, as the pandemic experience

showed. The lessons of the pandemic will be imbibed and the RBI will emerge stronger and more resilient than before, and committed to its mandate of price stability, keeping in mind the objective of growth. Monetary policy plays an important role in price stability, economic growth, job creation and social justice in any economy. But its efficacy is low for the Indian economy, because of the various economic issues. However, both RBI and the Government of India have been making attempts to address it through various reforms for fixing the bad loan/NPA problem in the banking sector, developing the infrastructure & promoting the ease of doing business, financial inclusion and a less-cash economy. In the upcoming time, these reforms will help improve the impact of Monetary policy in India's economic growth and human development. Regulatory easing across jurisdictions facilitated the flow of financial resources to the economy and effectively prevented the amplification of the shock. In the light of recently passed second wave of the pandemic and in the shadow of the expected third wave which might be more dangerous, RBI should continue its policy presence for maintaining the financial equilibrium till the return of normalcy. Further, for universal vaccination, production capacity has to increase many folds where RBI may play a vital role through easy credit extension and regulatory support.

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