Practice affecting Monetary policy committee

Why in news?

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The Reserve Bank of India’s Monetary Policy Committee (MPC) is set decide its policy stance in the coming days.

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What were the outcomes of the previous meet?

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- The monetary policy committee decided to increase the repo rate by 25 basis points to 6.5%.
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- However, the RBI has maintained fairly a **neutral policy stance**.
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- This means that RBI has made only a marginal increase which is proportionately lesser to the inflation projections.
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- This was to help accommodate the domestic and external uncertainties like oil price rise, currency wars, US rate trajectory etc.,
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Why there is a possibility of a rate hike now?

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- U.S. Federal Reserve recently raised interest rates by 0.25%, which triggers concerns on outflow of portfolio investments from emerging markets.
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- Hence the RBI would be expected to increase benchmark borrowing costs in India to prevent heightened outflows of portfolio capital.
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- The rupee’s depreciation of more than 12% against the dollar in 2018 made imports costlier.
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- Added with that, crude oil’s continuing upward march raised the risk of imported inflation.
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- While headline CPI inflation eased appreciably in August to 3.69%, core inflation, which exclude the food, fuel and light groups, was still running higher at 5.59%.
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- Food prices could also start hardening once the impact of the higher minimum support price for kharif crops kicks in.
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- MSP hike may have a direct impact on food inflation and eventually on headline inflation (CPI).
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- This will make things difficult for inflation-targeting mandate of RBI and will demand a tight policy (higher rates).
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- All these factors make the argument for a rate hike even more compelling.
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Why there is a possibility of reducing the repo rate?

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- RBI recently has enhanced the "Facility to Avail Liquidity for Liquidity Coverage Ratio (**FALLCR**)" from the existing 11% to 13% of their deposits.
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- The move follows RBI’s concerns over tight liquidity conditions and banks’ unwillingness to lend to NBFCs, following defaults by the IL&FS group.
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- Liquidity Coverage Ratio refers to highly liquid assets which are held by financial institutions to meet short term obligations.
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- The LCR promotes short-term resilience of banks to potential liquidity disruptions by ensuring that they have sufficient high quality liquid assets (HQLAs) to survive an acute stress scenario lasting for 30 days.
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- Presently, the assets allowed as Level 1 High Quality Liquid Assets (HQLAs) for the purpose of computing LCR of banks include government securities in excess of the minimum SLR requirement.
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- Within the mandatory SLR requirement, Government securities to the extent allowed by RBI under Marginal Standing Facility (MSF) currently stands at 2% of the bank's NDTL and under FALLCR is at 11% of the bank's NDTL.

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- Now, banks will be permitted to reckon as Level 1 HQLAs, government securities held by them up to **another 2% of their NDTL** under FALLCR within the mandatory SLR requirement.
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- It will take the total carve-out from SLR (statutory liquidity ratio) available to banks to 15% of bank's NDTL.
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- SLR is currently at 19.5%, which is the percentage of deposits that banks have to mandatorily invest in government and state government securities.
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- The tweak to the LCR norms is expected to free up close to Rs. 2.5 lakh crore in additional liquidity to the banks.
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- Out of that, Rs. 1.25 lakh crore becomes available to the banking system at the more affordable repo rate of 6.5%.
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- Thus RBI is keen to reduce any risks to the availability and cost of short-term credit from any unforeseen financial market volatility.
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- RBI has also conducted open market operations in successive weeks recently.
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- It has provided a liberal infusion of liquidity through term repos in addition to the usual provision via the Liquidity Adjustment Facility.
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- Thus, in order to mitigate tighter liquidity conditions on the domestic front, RBI might look forward to reduce the repo rates.
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Source: The Hindu, Business Line

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