

Significant Monetary Stimulus by the Reserve Bank of India

- The Reserve Bank of India announced a 75 bps cut to its benchmark repo rate to 4.40% and maintained an accommodative monetary policy stance. Various other measures were also introduced to alleviate financial stress.
- The monetary measures complement the government's fiscal relief package announced on March 26, yet more may be needed given the severity of the economic shock.

The Reserve Bank of India (RBI) unveiled substantial monetary stimulus on March 27. The monetary easing measures are intended to lessen the adverse impact of the COVID-19 pandemic, to revive economic growth, and to preserve financial stability. The monetary policy meeting was brought forward from March 31–April 3, reflecting the acuteness of the situation.

The RBI's measures have several dimensions. The bank cut the benchmark repo rate by 75 bps to 4.4% (chart 1) and maintained an accommodative policy stance. Prior to today's action, the key rate had been lowered by 135 bps between February and October 2019. The RBI also announced a series of measures to boost liquidity in the Indian financial system; targeted long-term repo operations, a boosted marginal lending facility, and a lower cash reserve ratio for all banks (cut by 100 bps to 3.0%) will inject a total of INR 3.74 trillion liquidity into the system. Moreover, the RBI reduced the reverse repo rate by 90 bps (i.e. more than the 75 bps cut to the repo rate), which results in a widening of the existing policy rate corridor. This measure aims to make it unattractive for banks to passively deposit funds with the RBI, underpinning lending to productive sectors of the economy. The central bank also announced a 3-month moratorium on loan repayments covering banks and non-bank financial companies.

The Indian economic outlook is turning increasingly negative as the coronavirus continues to spread rapidly. On March 25, Prime Minister Narendra Modi announced a 3-week nationwide lockdown to limit the spread of the virus. The curtailment of movement combined with an expected sharp deterioration in consumer and business confidence will lead to a substantial reduction in economic activity. In order to mitigate the impact, the government announced on March 26 a fiscal stimulus package worth INR1.7 trillion, equivalent to around 0.8% of GDP. The monetary and fiscal stimulus measures will complement each other, helping the economy recover once the virus outbreak stabilises. Nevertheless, as the persistence of the health crisis is uncertain, we note that further stimulus may be required over the coming weeks and months.

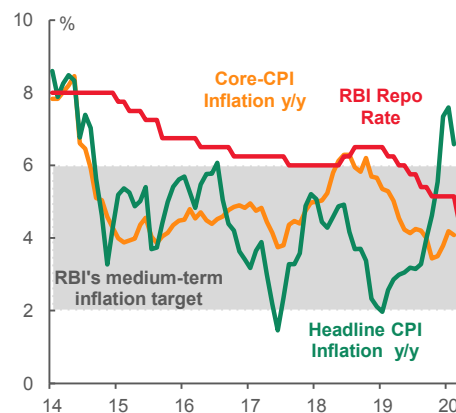
Given the severity of the situation, the RBI looked through India's high inflation and prioritised economic growth support. At 6.6% y/y in February (chart 1), headline inflation remains above the RBI's 2–6% target band. Nevertheless, price pressures eased from the January peak of 7.6% and will likely weaken further over the coming months on the back of lower oil prices and significantly softer demand-driven price pressures. Additionally, India's core inflation has remained more contained, hovering within the central bank's target. We expect headline inflation to return to the target fairly rapidly, paving the way for further monetary stimulus over the coming months.

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Chart 1

India's Inflation and Benchmark Interest Rate



Sources: Scotiabank Economics, Bloomberg.

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