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A STUDY ON ROLE AND EFFECTS OF UNCONVENTIONAL MONETARY POLICY TOOLS USED BY RBI DURING COVID-19

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ABSTRACT

The world has been through the shock of what started as pneumonia in Wuhan which was later on called as Covid-19 or Coronavirus disease 2019. In the wake of rising infections, the virus got international attention when WHO declared it a major public health crisis of international importance on 30 January 2020, and a pandemic on 11 March. The virus which started off by affecting world's most populous country (China) traveled to the whole world i.e., around 180 countries and inflicted two shocks on them: a health shock and an economic shock. Among those India has been on the top 10 worst hit countries by this global pandemic. Since the disease turned out to be highly contagious, and there were no specific measures known to contain its spread and so the governments all around the world-imposed norms suggested by WHO like social isolation, isolation of self at home, shutting down of institutions and public facilities, limitations on mobility and a country-wide lockdown. Following the footsteps, the Indian government also imposed a countrywide lockdown on 25th march 2020 of 3 weeks which got extended 3 more times with the fourth phase being completed on 31 may 2020.This affected the macroeconomic aggregates which in turn halted the economic activity ultimately causing deceleration in GDP.

Keywords: *Monetary Policy, Covid-19, GDP, RBI, WHO.*

Introduction

In India, on the one end government announced various economic packages to safeguard the vulnerable sections and also provided counter cyclical measures to boost the consumption and investment as a part of fiscal stimuli while on the other end central bank i.e., The RBI devised and executed a variety of conventional and unconventional monetary policy tools to strengthen the system as well as the liquidity of certain sectors in order to satisfy credit requirements and reduce stress. Monetary policy and a country's economy are intermingled as it is concerned with interest rates, money supply and availability of credit which plays a major role in growth of an economy and that is why RBI governor SHAKTIKANTA DAS stated at his address in Bombay chamber of commerce and industry that "We will continue to assist the recovery process through the supply of adequate liquidity while preserving financial stability,"

Covid-19, Indian Government and RBI

In the last few years India as a country had gone through various structural and economic reforms. The introduction of GST and Demonetization served as major change in structure of how indirect taxes and shadow economy used to work. In the beginning it affected the market perception, consumption patterns and GDP numbers but with time indirect taxes collection started to increase and policies like Pradhan Mantri Jan Dhan Yojana started bringing more money into the system and then simultaneous introduction of economic reforms like Sagarmala project and development of freight corridors etc. and even globally the fall in crude oil prices improved our balance of payments as the crude oil import is an important component of current account and trade collectively gave hope of improvement.

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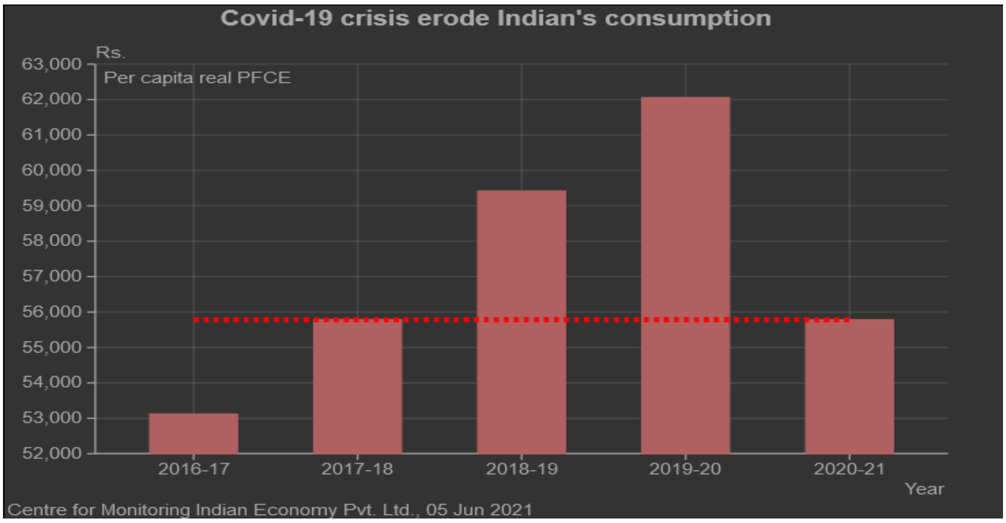
AS the world eyed towards growth the impact of 19 not only wiped out all these hopes for India but also of the world as it induced deceleration in GDP and trade all of the world. If we compare it with global financial crisis of 2008 the trends are contrasting, growth i.e., GDP globally is expected to have **shrunk** by **3.5%** in 2020 as compared to 0.1**%decline** recorded during the GFC.

To combat the virus's devastation, governments and central banks throughout the world deployed a variety of conventional and unorthodox assistance measures also called unconventional tools. In India just after few hours of the announcement of lockdown i.e 36 hours the finance minister unveiled a fiscal package of Rs. 1.7 lakh crore, accounting for around 5% of government expenditures and 1% of GDP. initial motive of which was to protect the vulnerable sections and then to counter attack with measures that can act as a driver to boost consumer perception and investor's reliability for resurrecting growth. But as we know in the first quarter of lockdown there was growth in savings of consumers so relying only on public spending can lead to more challenges like liquidity trap and so to work in tandem Central bank of India undertook several conventional and unconventional measures.



Apart from the Traditional measures long term Repo operations and Targeted long term repo operations were implemented by the central bank to improve systemic and sectoral liquidity to meet the sector's borrowing needs and reduce stress**,** special refinancing facilities have been made available to choose All Indian Financial Institutions (AIFIs), while a special mutual fund liquidity facility (SLF-MF) has been infused to reduce the rescue pressure. Other than the responses received by other central banks, the Reserve Bank's purchasing of assets did not compromise its balance sheet statement and therefore did not detract from the basic rules of central banking. These purchases were limited to government bonds which are considered risk free or sovereign bonds including government bonds issued by state only. The idea was to improve lending conditions without jeopardising financial stability. In addition, the future direction in the Reserve Bank's communications strategy became more important in order to achieve collaborative outcomes.

Unconventional Tools by RBI

Since received the central banks around the world have been constantly following the system of controlling inflation or formally called as targeting inflation as it affects the real income growth of the economy which can turn out to be domestic shock at the times of slowdown but the past has showed that too much focus on that keeps the eyes of the banks away from the asset prices, speculative markets like real estate and other unsustainable bubbles which became the cause of global financial crisis in 2008.The most common monetary policy instrument that has been used to target inflation rates i.e. retail as well as wholesale is interest rates specifically the short term rates, too much lowering of which by the central banks during the global financial crisis of 2008 made conventional tools ineffective and thus resulted in adoption of unconventional monetary policy tools or operation twist by the central banks to accelerate the economic activity. UMPTs, that helped the central banks throughout the GFC, were again redeployed when COVID-19 affected the world economies, to curtail its excruciated effects on the market, money supply which raised liquidity concerns for investors, consumer perception etc. ultimately bringing a halt on economic activity.

In terms of the kind of policy measures, their justification, the channels through which they operate, and the size of operations, unconventional monetary policy tools (UMPTs) differ significantly from conventional instruments. Following COVID-19, the reserve bank implemented a number of unconventional measures, including long-term repo operations (LTROs) to help with the process of monetary policy decisions which affect economic growth, prices and other aspects of the economy, demand in credit as well as targeted long-term repo operations (TLTROs) to pump cash into sectors and businesses that are facing monetary duress. Special OMOs(Operation Twists) which involves purchasing of long-term bonds and selling of short-term bonds as a part of open market operations to manage yields in the market were conducted to compress the termpremium, while express forward steering aided many UMPTs in regaining normality, alleviating monetary circumstances and preserving financial stability. Overall, these policies have laid the groundwork for future economic recovery. The unconventional monetary policy tools which are being used are negative rates of interest, emergency financing mechanism (term financing), asset purchasing and future direction or forward guidance. Apart from the negative interest rates, these programs of quotative easing are seldomly used by the RBI in the past to guide financial markets to work without hiccups.

Monetary Policy Response by RBI

The Covid-19 epidemic prompted central banks all over the world to act. The moving of the Monetary Policy Committee (MPC) meeting by1week by the RBI showed that it is took proactive measures in the face of the crisis.

The RBI was successful in communicating the message that is is cognizant of the magnitude of the pandemic through its decision and pronouncements made on March 27 2020. The stated monetary strategy prioritized guaranteeing liquidity, lowering credit costs, promoting transmission, and simplifying regulatory requirements.

So, these immediate announcements showed that rbi adopted wait and watch policy that how the market, the economy was going to respond to these announcements and also how hard the wave of pandemic was going to hit the economy. This showed accommodative stance of rbi.

Table 1: Monetary Policy Response by RBI during Covid 19 in India,2020

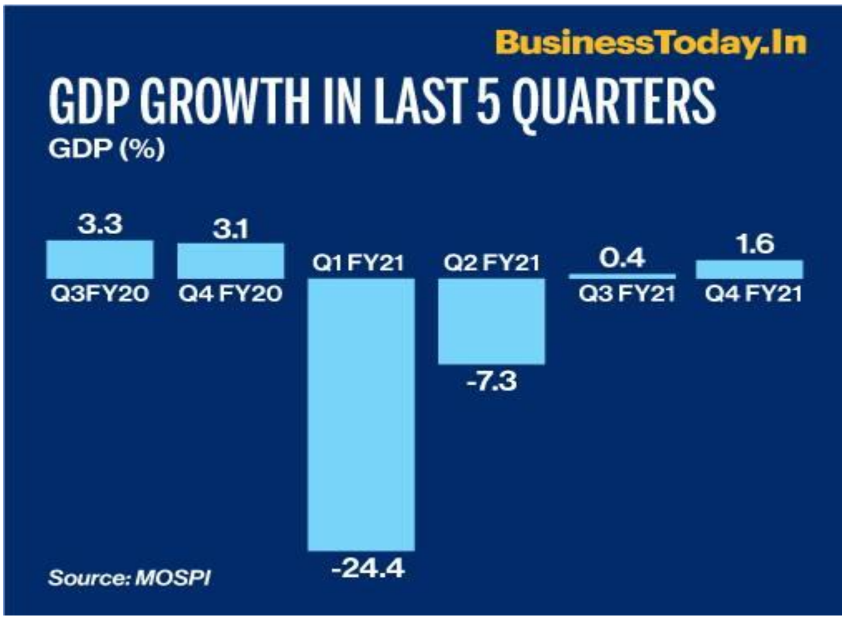
Monetary Policy Response	Changes in Policy	Impact by the Changes
Rates of Policy	Initially the repo rate was reduced by .75 bps making it to 4.4 %. Reverse repo was also brought down by .9 bps.	Keeping the inflation targets as same before i.e., 4 % makes the India near to a zero- interest rate.
Norms to Boost Liquidity	Reduction in cash reserve ratio by 100 bps making the rate top 3% Tenor of Targeted Long-Term Operations to 3 years. Increment in Marginal Standing Facility to 3% of SLR.	All these measures were to support injection of 3.74 lakh crore money supply in the economy.
MPC Corridor Widens	The monetary policy corridor also knows as the area between the reverse repo rate and MSF rate is raised to 0.65 from 0.5	This pushes the banks to lend more funds rather than parking funds with the Reserve Bank.
Easing in Regulations	Moratorium for a period of 3 months was provided on term loans and day to day capital i.e working capital loans Postponing the implementation of NSFR by 6 months.	Helps in easing the balance sheets of banks while forbearance of regulations provided relief to the borrowers

Source: RBI 2020, 7th Monetary policy statement of RBI and some related documents,2020

So, these were the proactive actions taken by RBI in 2020 after the first break of coronavirus in INDIA (TABLE 2). Now if we talk of current circumstances when the second wave of virus which hit the both rural and urban economy of our country, keeping that in focus RBI governor shakti anta das announced some of the emergency measures on MAY 5 2021 by addressing the media. He made many important announcements in this address which are as follows:

- He expressed the need of comprehensive and quick action and announced the special liquidity facility of 50000 crore for covid 19 related health facilities till march 2022. under this scheme banks will provide loan on easy installments to stakeholders like vaccine manufacturers, medical facility providers, hospitals and patients and logistic firms at **repo rate** for a period of **3 years.**

- The governor announced the targeted long term repo operation for small finance banks up to 1000 crore. The limit will be 10 lakhs per borrowing means it can be used for loans up to 10 lakhs per borrower.
- The states will be given an overdraft facility in which they will get concession. For this the period of overdraft facility has been increased to 50 days which was 30 days earlier.
- In view of current situation rbi governor also stated that changes were also been made in the KYC rules. KYC has now been approved via video and limited kyc will now be allowed until 1 December 2021.
- Individual small borrowers will be able to take advantage of onetime restructuring by 30thSeptember 2021. under this such borrowers up to 25 crore who had not availed loan restructuring facility earlier, will be able to avail loan restructuring this time.
- Under restructuring 1.0 moratorium period can be extended for 2 years. The second phase procurement of government securities of Rs 35000 crore under G-SAP 1.0 will be started by RBI on 20th may
- Small finance banks will now be able to lend to small microfinance institutions having assets of 500 crore.



With all these announcements RBI has circumferenced all the areas by giving them a boost. may it be the small individual borrowers which are being provided loan restructuring, increase in moratorium period or the small finance banks, the health providers or the states who are working hard to get away from the virus damage. Due to these frequent injections by the RBI, even after the second wave the impact on demand will be less visible as the businesses with the reliefs provided by the rbi have learned to emerge despite various restrictions imposed during corona and also these policy announcements by rbi have helped in strengthening of the agriculture sector which is instrumental of overall supply situation of the economy. Due to these adequate measures, there is ample liquidity in the domestic financial condition which will maintain ease in the domestic system.

Conclusion

The Indian economy was on the mend until the second wave of the Covid-19 outbreak hit the nation, according to GDP figures released during June2021 When the second wave hit in April and May, several high frequency indicators representing consumption and investment demand deteriorated.

In April and May of this year, the second wave of the pandemic had a negative influence on economic activity and consumption. The Purchasing Managers' Index (PMI), a key indicator of the manufacturing sector, fell to 50.8 in May from 55.5 in April. The PMI for the services sector fell in May as well. In April and May, other indications such as gasoline demand, automobile sales, and e-way bill production decreased significantly. However, since the second half of May, the crest of the second Covid wave looks to have been passed and also the emergency measures taken by rbi will do their magic again. Apart from the fact that GDP growth numbers saw a record deceleration of 24.4% of the April-June quarter of 2020-21 because of the lockdown imposed but due to the effective steps of the central bank the rate of inflation was kept under the targeted 4 percent. Monetary policy developments by RBI continuously infused capital into the system which even allowed the fiscal stimulus to do its work which was announced by the government.

From the three-year low of 5.1% till October 2020, loan growth of banks rose to 5.6% in year till march 2021 and seems to be aided further by liquidity support, low interest rates and the RBI'S growth enhancing steps. Even bank frauds of Rs 1 lakh and more fell by 25% in the previous fiscal and the central banks constant efforts reduced the volatility in the currency market and thus rupee gained by 3.5 percent.

Therefore, till now the monetary policy formulated has served towards normalcy of the economy to some extent just there were some disparities in service and industrial sector outcomes. Now the way ahead requires multi-indicator approach in monetary policy like not only concentrating on inflation but focusing on different other parameters too so that we can have a full-fledged picture. There is also a need to link cost of funds with market because to make the cost of funds flexible both deposit and lending rates are linked on externa benchmarks like Mumbai interbank offer rate. So as the RBI governor said in his report "of course not only us but for the whole world the road ahead is definitely full of dangers but INDIA'S destiny is not in the second wave but in the life beyond that ".

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