COVID-19 IMPACT

26 March 2020

Pandemic to stunt global growth, delay India's recovery

With complete lockdown, ~70% of economic activity — investment, exports and discretionary consumption — has come to a halt. Only essential goods and services are operational. The government has announced stimulus of Rs 1.7tn (0.8% of GDP) to cushion the impact. More will follow. China's model of quarantine and social distancing has aided a quick return to normalcy and India is on course to achieve that. Though difficult to estimate, we believe GDP growth is likely to be ~1.5% lower from our earlier estimate of 5.5% in FY21.

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Global economies in turmoil: Economic growth worldwide will be severely affected in H1CY20 as Covid-19 exacts a heavy toll on supply chains, tourism, travel, consumption and investment. China has reported a 21% YoY decline in retail sales, 14% drop in industrial activity and 25% contraction in fixed asset investments in Feb'20. While the country is gradually returning to normal, other parts of the world including India are now entering into lockdown mode to halt the rampant spread of the virus. With major economies downing shutters, global growth may drop to levels last seen during the 2008-09 financial crisis.

India's FY21 growth to be lower by ~1.5%: We lower the FY21 GDP growth estimates set in our Feb'20 **India's Road to Recovery** report sharply downwards by ~1.5%. This is due to lower consumption of discretionary goods and services (28% of GDP) and lower capex spending (30% of GDP) amid Covid-19 restrictions. Services such as restaurants and hotels, recreation, education and transport will be the hardest hit. The Indian economy will also be buffeted by disruptions in global supply chains and lower global growth, with repercussions for exports (20% of GDP) as well as imports (22% of GDP) that will delay recovery.

Rs 1.7tn package announced, RBI to cut policy rates: Government announced a package of Rs 1.7tn (0.8% of GDP) covering provision of food and DBT to marginal households. We expect more measures which implies higher fiscal deficit and borrowings. Next set of measures will be announced by RBI on 3 April 2020 including a 50bps reduction in repo rate along with forbearance on existing loans and enhanced liquidity support. These steps would be in-line with measures taken by other Central Banks. In our view, global backdrop of sharp decline in oil prices and prospects of dismal growth provide room to RBI to undertake measures to ensure financial stability is maintained when ~70% of the economy is in a lockdown.

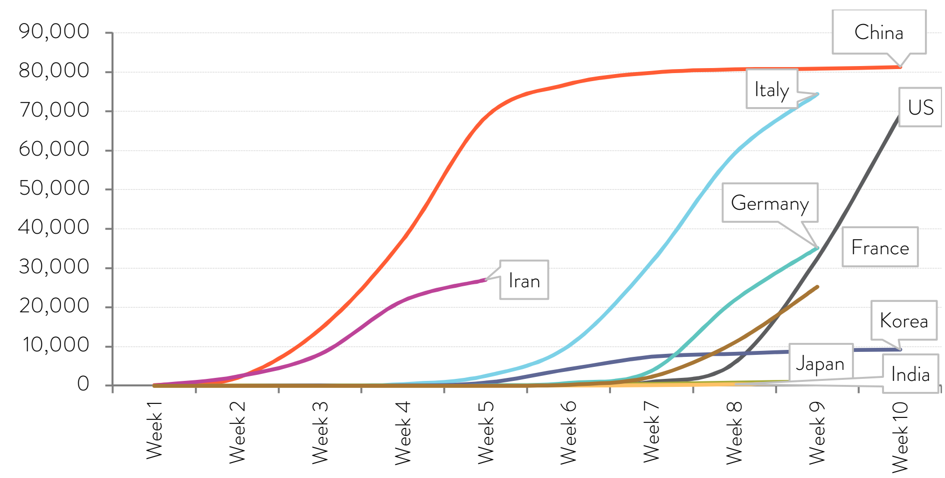
KEY HIGHLIGHTS

- Global growth expected to shrink at least 1ppt due to Covid-19 outbreak
- India's FY 21 GDP growth estimated to be lower by ~1.5% compared with 5.5% estimated earlier.
- RBI expected to cut rates by 50bps in upcoming policy meet

Covid-19 and the global economic fallout

Since the coronavirus outbreak early this year, growth estimate for large economies compared to last year has been revised down by anywhere between 0.8% and 1.3%. While China now appears to be recovering from the outbreak, Europe and the US are in the throes of partial to complete lockdowns. If quarantine is extended, global growth may be at the same level as 2009 when it had fallen by 0.1% from 3% in 2008. In India too, the central government has announced a complete lockdown for 3 weeks starting from 24 Mar 2020.

FIG 1 – COVID-19 CASES HAVE SURGED GLOBALLY



Source: Bloomberg, Bank of Baroda Research | Data as of 26 Mar 2020

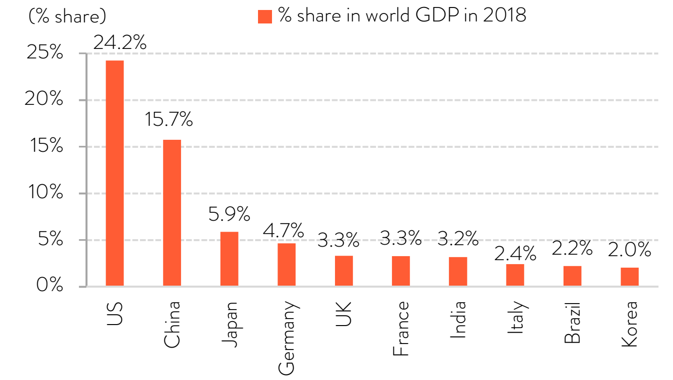
Restrictions on travel and closure of commercial establishments will drive down consumption demand. Disruptions in global – and especially China-led – supply chains alongside lower consumption will have a cascading impact on world economic growth, as manufacturing trade constitutes 32.1% of global GDP and services trade 13.4%. The volatility in financial markets and rising credit spreads also suggest funding to firms will suffer. On the whole, global growth is expected to be at least 1ppt lower than OECD's growth estimate of 2.9% for CY19 with significant downside risks.

Disruptions in China supply chain

Following the coronavirus outbreak, China's retail sales for the month of Feb'20 plunged more than 20% YoY, industrial production contracted 13.5% and fixed asset investments dropped 24.5%. China alone constitutes 15.7% of global GDP. With the large downshift in its production and economic activity, consensus estimates show a decline in China's Q1CY20 GDP growth to 3% (vs. 6% in the preceding quarter), followed by partial recovery to 5.3% in Q2.

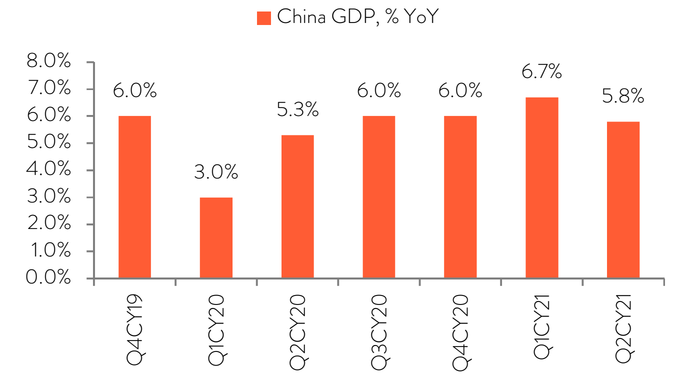
We note that production capacity in the country is currently showing signs of stabilisation as China has been able to contain the virus. The pandemic has now moved to Europe, with Italy and France in complete lockdown. Italy constitutes 2.4% of global GDP and France 3.3%.

FIG 2 – CHINA CONTRIBUTES ~16% OF GLOBAL GDP



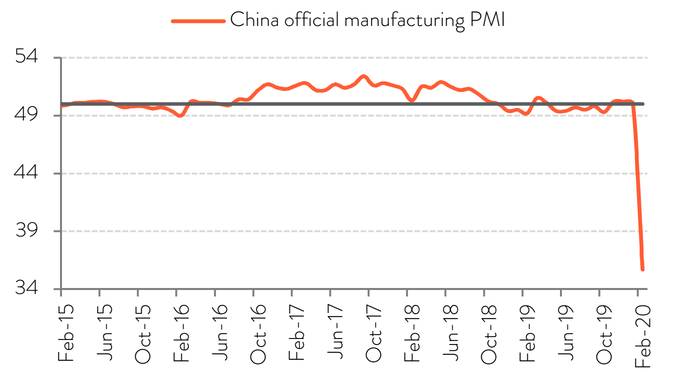
Source: IMF, World Economic Outlook Database Oct 2019, Bank of Baroda Research

FIG 3 – CHINA'S GDP GROWTH TO FALL TO 3% IN Q1



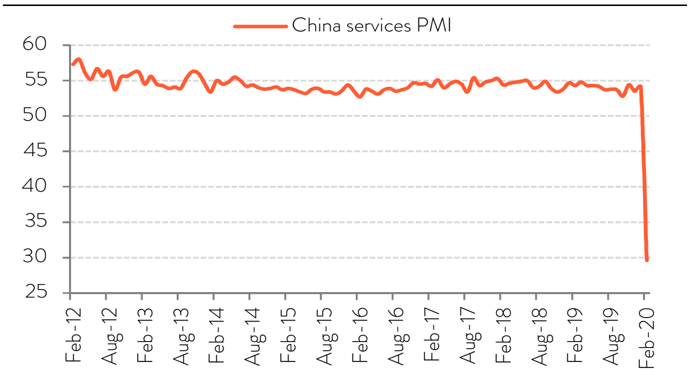
Source: Bloomberg consensus estimates (23 Mar 2020), Bank of Baroda Research

FIG 4 – CHINA'S MANUFACTURING PMI PLUNGED TO ALL-TIME LOW OF 35.7 IN FEB'20…



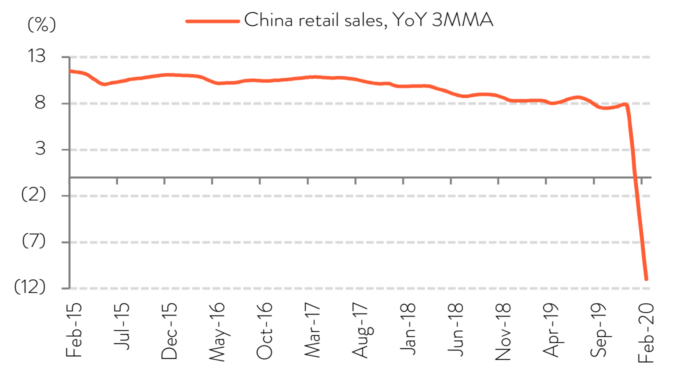
Source: National Bureau of Statistics China, Bank of Baroda Research

FIG 5 – …SIMILAR TREND VISIBLE IN SERVICES PMI AT 29.6



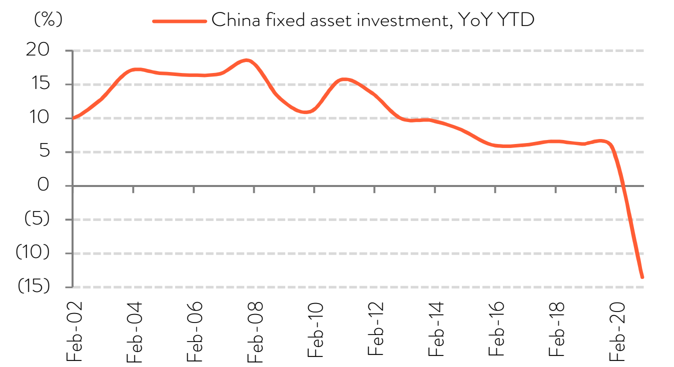
Source: National Bureau of Statistics China, Bank of Baroda Research

FIG 6 – RETAIL SALES FELL 20.5% YOY



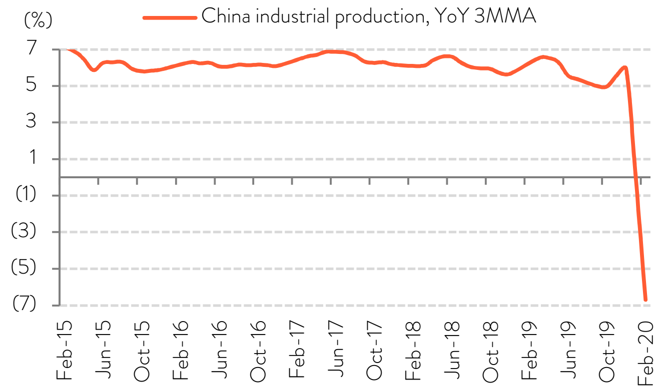
Source: Bloomberg, Bank of Baroda Research

FIG 7 – FIXED ASSET INVESTMENT DOWN 24.5% YOY



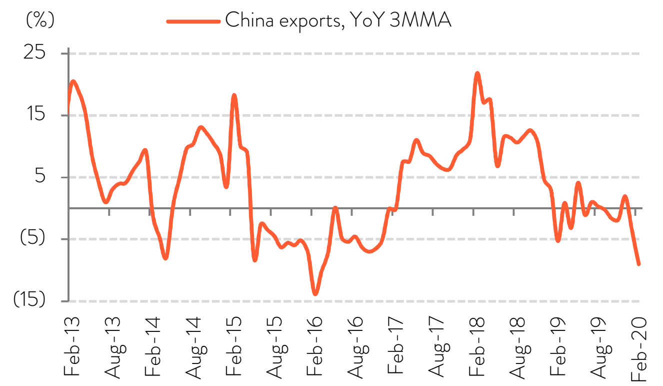
Source: Bloomberg, Bank of Baroda Research

FIG 8 – INDUSTRIAL PRODUCTION GROWTH PLUMMETED TO 13.5% YOY



Source: Bloomberg, Bank of Baroda Research

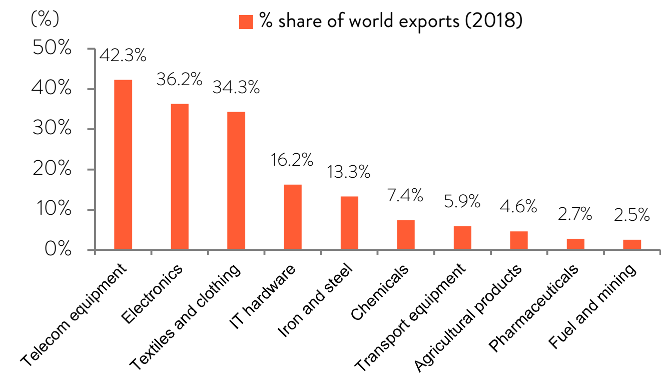
FIG 9 – EXPORTS GROWTH FELL 17.5% YOY



Source: Bloomberg, Bank of Baroda Research

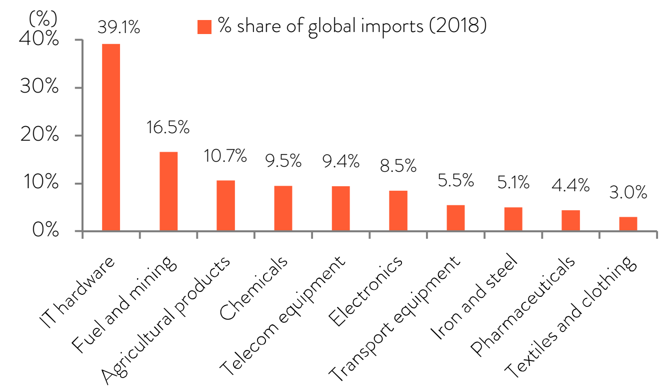
China's exports have slid 17.5% YoY in Jan-Feb'20 amid factory shutdowns and curtailed global demand. Its share in global exports stands at 12% (compared with 15.7% of global GDP), but rises to as high as 34-42% in categories such as telecom equipment, electronics and apparel. These sectors will continue to experience supply disruptions in coming months. China's imports of IT hardware, crude oil and agri products, among others, are also expected to come off.

FIG 10 – CHINA LEADS IN GLOBAL TELECOM AND ELECTRONICS EXPORTS



Source: WTO, Bank of Baroda Research

FIG 11 – CHINA IMPORTS INTERMEDIATE INPUTS FOR FURTHER PROCESSING



Source: WTO, Bank of Baroda Research

Global tourism industry a major casualty

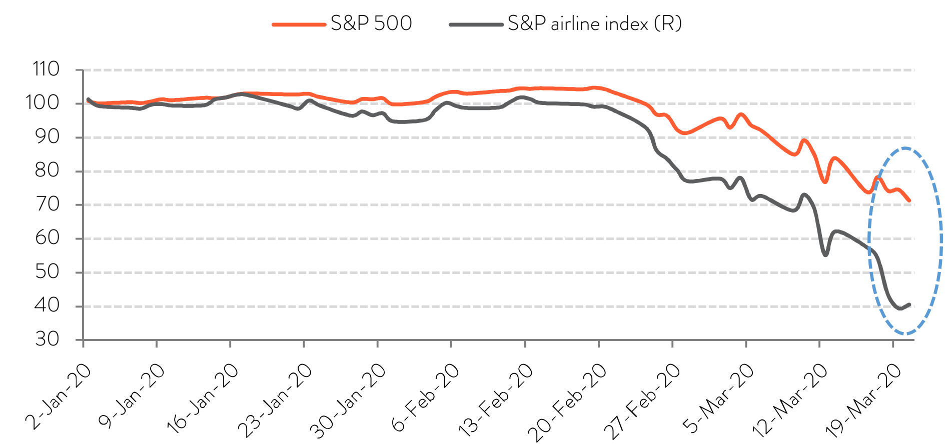
With domestic and international travel restrictions imposed across several countries together with softer demand, UN WTO estimates that international tourist arrivals will decline by 1-3% in CY20 vs. an increase of 3-4% estimated earlier – this translates to potential losses of US$ 30bn-50bn in international tourism receipts. Given the growing number of countries imposing quarantines, the impact could be far higher.

INTERNATIONAL TOURISM RECEIPTS & REMITTANCES TO FALL

Country (2018)	International tourism receipts (US$ bn)	Personal remittances, received (US$ bn)
US	256.1	6.7
UK	48.5	4.4
India	29.1	78.8
Italy	51.6	9.9
Japan	45.3	4.4
Korea	19.9	7.1
China	40.4	24.3
Euro Area	416.2	87.6
World	**1649.3**	**637.4**

Source: World Bank, Bank of Baroda Research

FIG 12 – AIRLINE STOCKS HAVE NOSEDIVED WORLDWIDE



Source: Bloomberg, Bank of Baroda Research | As of 20 Mar 2020

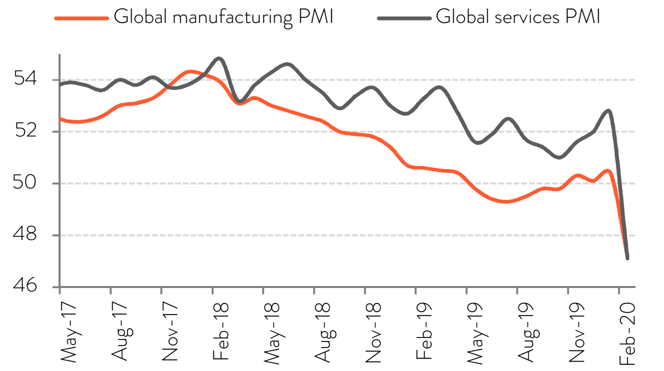
Asia and the Pacific regions are expected to be the most affected with an expected decrease of 9-12% in international tourist arrivals in CY20 vs. an increase of 5-6% estimated in Jan'20. Notably, international tourism receipts account for about 1.9% of global GDP and thus this will impact global growth as well. Travel restrictions are likely to get stricter in the coming days and hence global tourism industry will suffer further.

Widespread economic shocks

With a slowdown expected in more than 60% of the world economy, we expect growth in CY20 could be at least 1ppt lower than last year's 2.9% (as per OECD estimates). If the Covid-19 restrictions continue beyond Q1CY20, the impact will be even higher. Some estimates suggest that global growth could fall to levels last seen during the financial crisis in 2008-09 when it fell by 0.1% in 2009 from 3% in 2008. Further, some countries could see more severe shocks than that projected for the world economy.

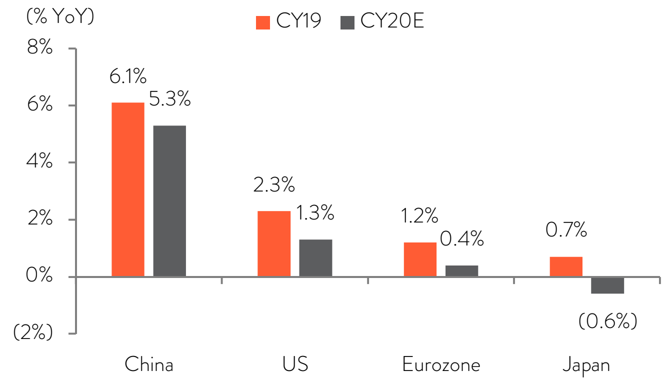
Latest Bloomberg consensus estimates indicate that economic growth for CY20 is likely to be 0.8% lower than last year in China and Eurozone and 1% lower in the US. Japan could be the worst off as growth is estimated to move from +0.7% to (-)0.6% due in part to a recent increase in VAT.

FIG 13 – GLOBAL PMI DOWN SHARPLY IN FEB'20



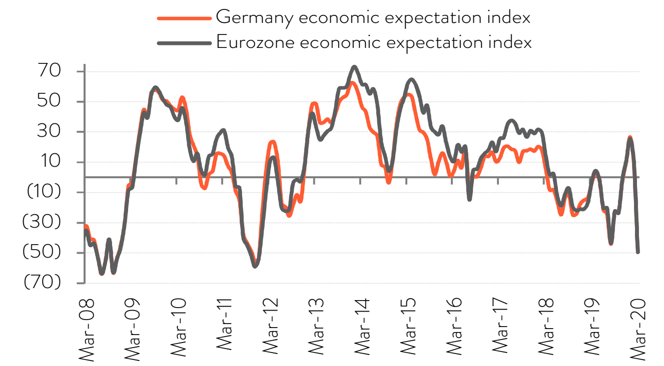
Source: Bloomberg, Bank of Baroda Research

FIG 14 – MAJOR ECONOMIES TO SLOW DOWN IN CY20



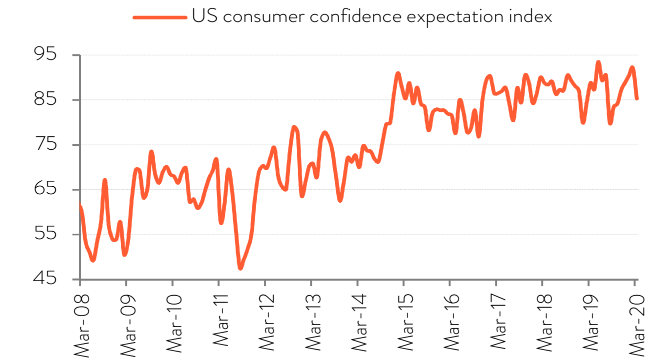
Source: Bloomberg consensus estimates (24 Mar 2020), Bank of Baroda Research |*Data for India pertains to financial year ending 31 March and is based on Bank of Baroda Estimates

FIG 15 – ECONOMIC SENTIMENT INDEX IN EUROZONE AND GERMANY SLUMPS IN MAR'20



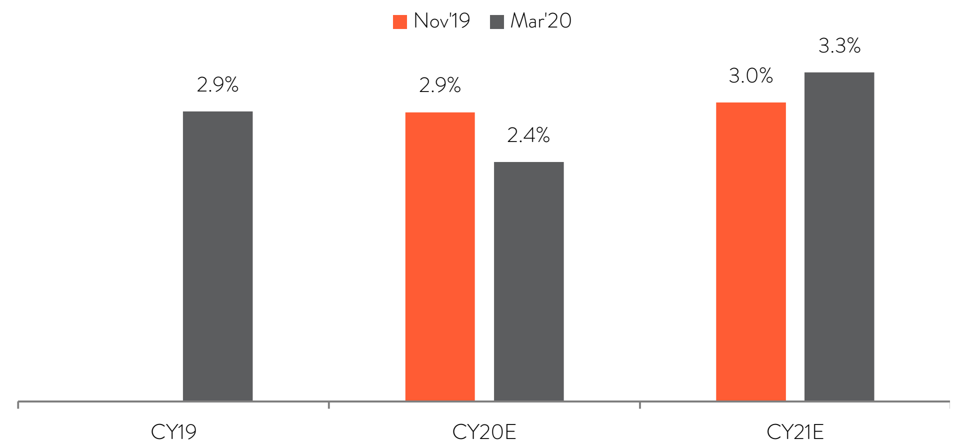
Source: Bloomberg, Bank of Baroda Research

FIG 16 – US CONSUMER CONFIDENCE ALSO DROPS



Source: Bloomberg, Bank of Baroda Research

FIG 17 – OECD CUTS GLOBAL GDP GROWTH FORECAST FOR CY20, GLOBAL ECONOMY LIKELY TO SHRINK IN H1CY20



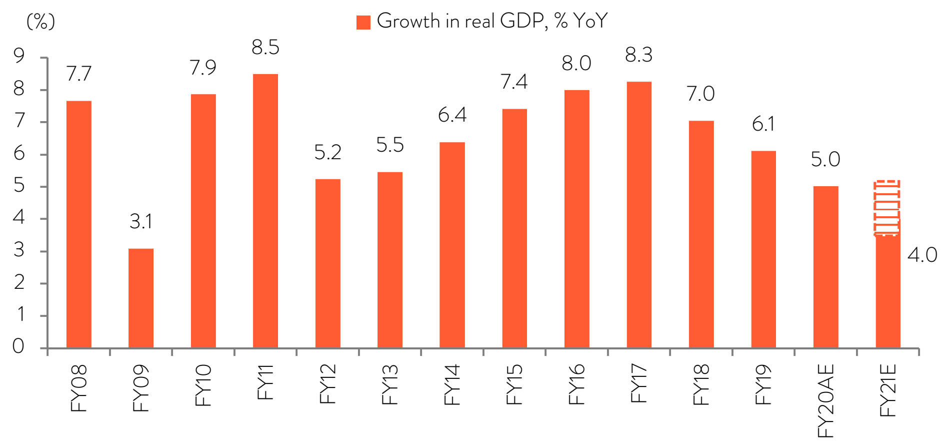
Source: OECD, Bank of Baroda Research

India – Revival delayed beyond FY21

With a complete nationwide lockdown in India, GDP growth is estimated to be lower in FY21. We see GDP growth to be lower by ~1.5% from our estimate of 5.5%. Apart from weaker discretionary consumption of both goods and services amid Covid-19 restrictions (estimated at 28% of GDP), investment activity (30% of GDP) too will take a huge hit from the lockdown. Further the impact will be spread across Q4FY20 and Q1FY21 with a gradual recovery visible only in Q2FY21. Given that the situation is still evolving, we estimate GDP growth to be ~1.5% lower than our earlier estimate of 5.5% for FY21. Notwithstanding this, risks to the outlook remains tilted to the downside on the back of higher than estimated slowdown in global growth and extension of the lockdown beyond early Apr'20.

Services that will be hit the hardest, viz. restaurants and hotels, recreation, education and transport, comprise 14% of GDP, while the share of discretionary and non-discretionary goods is 27.6%. Investment spending which constitutes almost 30% of the GDP is also expected to come to a halt. Apart from this external headwinds are also increasing in the form of disruption in global supply chains and lower global growth, ratcheting up pressure on both exports as well as imports.

FIG 18 – WE EXPECT GDP GROWTH TO BE 1.5% LOWER THAN OUR EALRIER ESTIMATE OF 5.5%

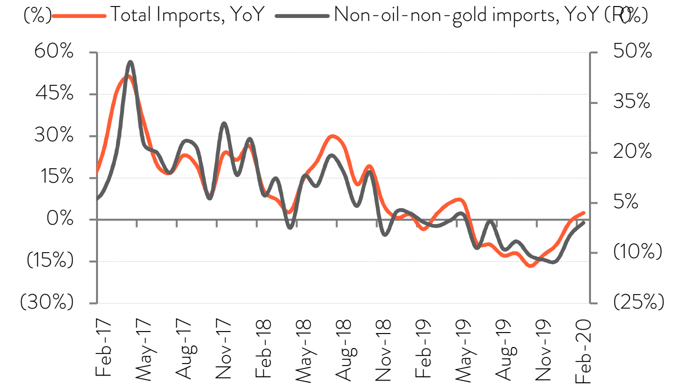


Source: CEIC, Bank of Baroda Research | AE-Advance estimate, E-Bank of Baroda Estimate

Epidemic to derail budding consumption pick-up

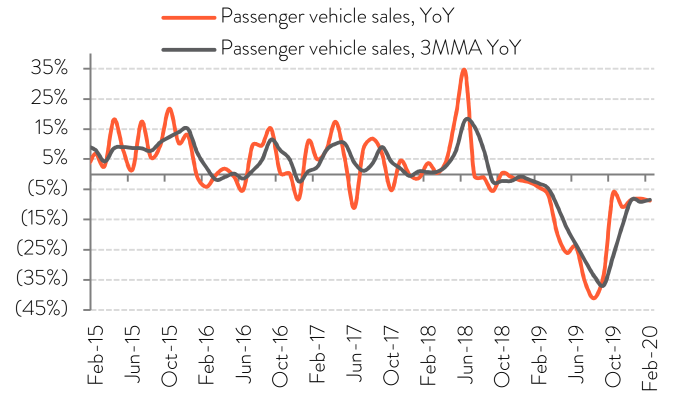
Broad indicators such as vehicle sales and non-oil, non-gold imports were stabilising somewhat in India after a prolonged period of deceleration. Non-oil, non-gold imports, for instance, fell by only 2.8% in Jan-Feb'20 compared with the 6.4% decline seen in Apr-Dec'19. Passenger vehicle sales also showed similar improvement, leading us to believe that growth had bottomed out in FY20 (read our Feb'20 report **India's Road to Recovery**). However, with the coronavirus outbreak, we expect demand to weaken as discretionary consumption is postponed.

FIG 19 – INDIA'S NON-OIL, NON-GOLD IMPORTS PICKED UP IN JAN-FEB'20



Source: CEIC, Bank of Baroda Research

FIG 20 – PASSENGER VEHICLE SALES TOO SEEMED TO HAVE STABILISED

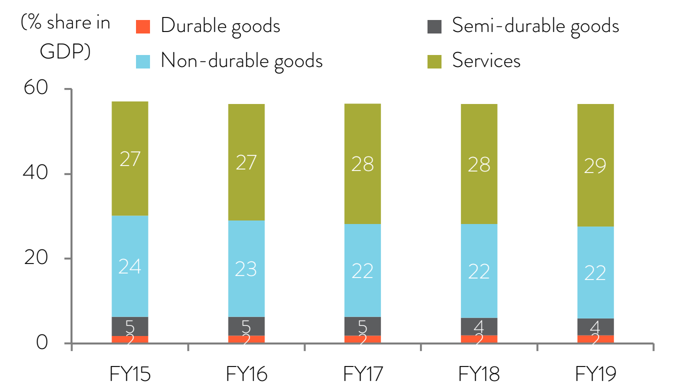


Source: CEIC, Bank of Baroda Research

Consumption demand forms 57% of India's GDP, of which 29% is for services and the remaining for goods. Within services, health and telecom are unlikely to be affected. However, the transport, restaurant, recreation and education sectors which constitute 14% of GDP will see a slowdown. In addition, while certain essential goods will attract higher demand, demand for durable and semi-durable goods is likely to decelerate.

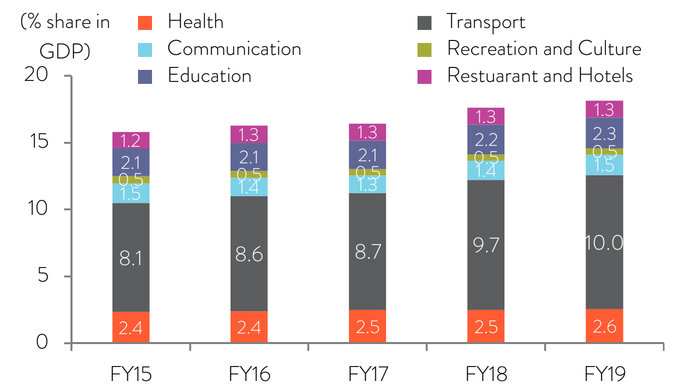
With the closure of malls, theatres and market areas, the retail industry is likely to bear a brunt of the economic impact. We note that India's top eight cities have 126 malls extending over 61mn sq ft. For now, we expect a negative impact in Q1FY21 and normalisation thereafter.

FIG 21 – CONSUMPTION OF SERVICES ACCOUNTS FOR 29% OF GDP



Source: CEIC, Bank of Baroda Research

FIG 22 – CONSUMPTION SPENDING ON SERVICES LIKELY TO BE MUTED LED BY TRANSPORT



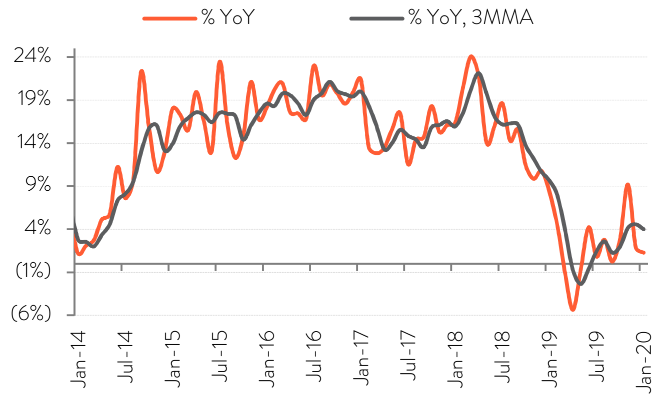
Source: CEIC, Bank of Baroda Research

Tourism and domestic travel sectors also see a dip

India's tourist industry is also staring at heavy losses. The country had 8.8mn international arrivals during Apr'19-Jan'20. This was before the Indian government imposed restrictions on international inbound and outbound travel in March, besides discouraging domestic movement as well.

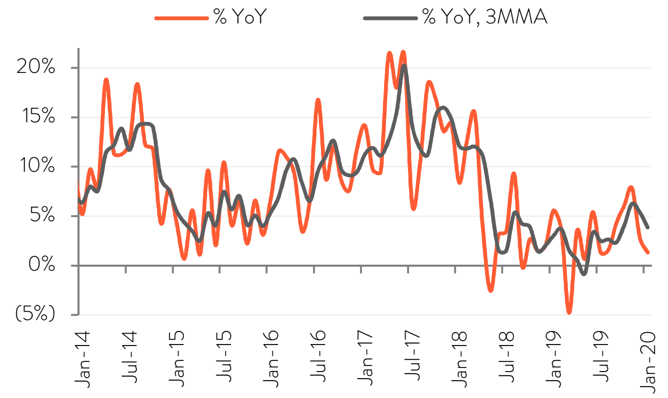
In line with the global slowdown, international tourism receipts for India (US$ 29.1bn in 2018) are likely to be lower. Remittances too will be lower as oil prices have fallen. Together these contribute about 4.9% of GDP. Domestic passenger traffic growth has fallen by 1.3% in Apr-Jan'20 vs. a growth of 1.7% in FY19. This is also likely to falter with rail and road traffic now being shut in the entire country.

FIG 23 – DOMESTIC PASSENGER TRAFFIC GROWTH IN INDIA LIKELY TO DECLINE



Source: CEIC, Bank of Baroda Research

FIG 24 – FOREIGN TOURIST ARRIVALS WILL ALSO REDUCE



Source: CEIC, Bank of Baroda Research

Lower Chinese imports to hurt several sectors

India's imports from China totalled US$ 72bn in FY19, forming 13.7% of its total import basket. Categories that are heavily reliant on imports and hence will be the most affected by ongoing supply disruptions are electronic and capital goods, chemicals, auto parts and plastics. Exports to China (5% share) will also slow, affecting sectors such as minerals, footwear, agri products, textiles and chemicals. India's export growth has remained sluggish in FYTD20 and the situation is likely to worsen due to muted external demand.

FIG 25 – INDIA'S MAJOR EXPORTS TO CHINA

% share	FY00	FY05	FY10	FY15	FY19
Ores, Slag and Ash	31.1	78.3	83.7	52.2	66.3
Parts of footwear	33.9	53.1	45.1	56.9	62.4
Vegetable fats & oils	12.3	13.9	31.2	28.1	36.1
Minerals	11.1	17.1	25.0	31.7	30.5
Copper and articles	0.4	6.9	30.2	56.3	24.4
Textile fibres woven fabrics	0.3	0.1	12.9	22.7	23.0
Cotton	2.4	3.9	27.4	29.5	22.7
Vegetable plating materials	2.3	6.7	52.8	43.2	21.5
Musical instruments and parts	1.8	1.7	4.5	4.9	21.1
Organic chemicals	4.9	10.0	6.8	8.7	17.8
Total exports to China	**1.5**	**6.7**	**6.5**	**3.8**	**5.1**

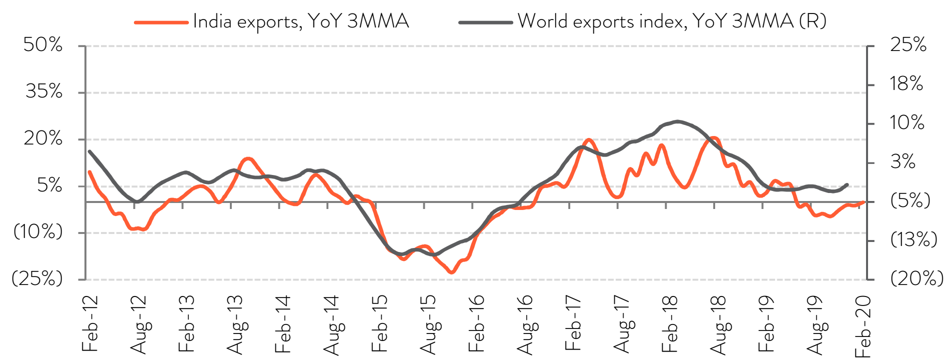
Source: CEIC, Bank of Baroda Research

FIG 26 – INDIA'S MAJOR IMPORTS FROM CHINA

% share	FY00	FY05	FY10	FY15	FY19
Electrical machinery	5.3	19.9	43.8	50.5	50.53
Capital goods	3.5	10.9	25.7	32.0	30.5
Organic chemicals	14.3	19.7	32.0	35.7	38.4
Plastics and articles	1.3	5.9	9.4	14.6	17.9
Fertilizers	0.3	0.3	6.7	49.4	30.8
Articles of iron and steel	6.4	10.8	30.7	35.0	34.1
Optical, photographic, cinematographic	1.8	4.7	10.1	17.3	16.5
Vehicles	0.3	1.8	15.3	24.0	24.7
Iron and steel	1.8	3.8	9.2	22.0	11.3
Miscellaneous chemical products	2.4	7.2	12.4	19.0	21.6
Total imports from China	**2.6**	**6.4**	**10.7**	**13.5**	**13.7**

Source: CEIC, Bank of Baroda Research

FIG 27 – INDIA'S EXPORTS DECLINING IN LINE WITH GLOBAL EXPORTS



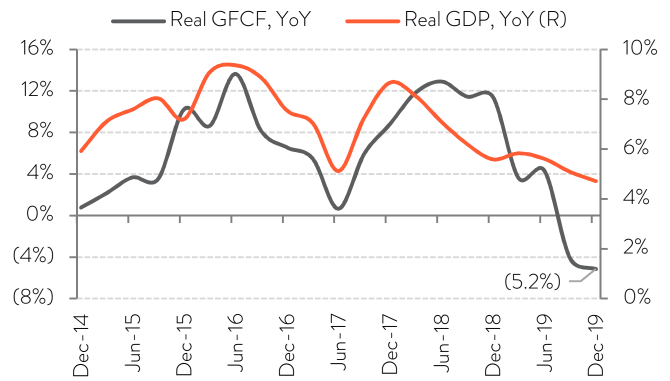
Source: CPB Netherlands Bureau for Economic Policy Analysis, CEIC, Bank of Baroda Research

Investment spending postponed

Investment or GFCF spending in the economy contracted by (-) 5.2% in Q3FY20. While capital imports were seeing an improvement in Jan-Feb'20 with an increase of 7.1% compared with a decline of 10.7% during Apr-Dec'19, the entire recovery will be postponed as the country is now in a lockdown.

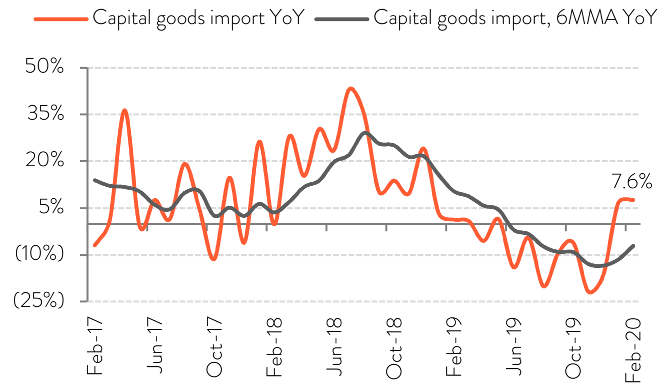
An important element of investment spending is construction (7.8% of GDP) which will come to a complete halt in the period of lockdown. On an overall basis, investment spending constitutes 30% of GDP and the lockdown implies sharp decline in investment spending in Q1FY21. However, we expect activity to normalise from Q2FY21 onwards.

FIG 28 – INDIA'S GFCF GROWTH FELL TO 5.2% IN Q3FY20



Source: CEIC, Bank of Baroda Research

FIG 29 – CAPITAL GOODS IMPORTS STABILISED IN JAN-FEB'20, SET TO DECLINE IN Q1FY21



Source: CEIC, Bank of Baroda Research

Global central banks in easing mode

In March, as many as 20 global central banks have reduced policy rates to cushion their economies against Covid-19. The US Fed has cut rates by 150bps and also announced QE measures – as did the ECB – to provide added liquidity to banks. This apart, global commodity prices have fallen led by crude oil (down 41.5%), which bodes well for India's inflation outlook and fiscal health (the govt. has raised excise duty on petrol & diesel by Rs 3/litre). In our view, the accommodative global backdrop and growth deceleration gives RBI room to reduce policy rates by 50bps in Apr'20 and also introduce further measures to support durable liquidity.

Policy cuts, stimulus packages to cushion growth

A total of 43 central banks have lowered policy rates since the beginning of the year (20 in March alone). China began the easing cycle via liquidity injections and interest rate cuts. The US Fed has responded with a 150bps reduction in interest rates and is also proposing a large infusion of liquidity through the purchase of bonds worth US$ 700bn, besides a US$ 2tn stimulus package to spur demand and spending.

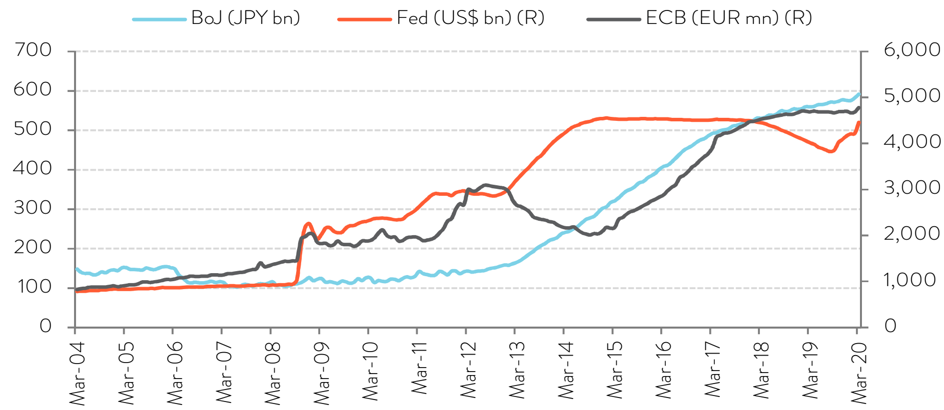
ECB has announced measures to support banks through an asset purchase program by launching an emergency stimulus package worth US$ 817bn. BoJ has also announced expansion of its asset buying program. The Australian and Italian governments have rolled out packages worth US$ 11.4bn and US$ 28.3bn respectively. IMF has pledged US$ 50bn and World Bank will deploy up to US$ 12bn to cushion the global economy against the pandemic.

FIG 30 – MAJOR CENTRAL BANKS HAVE ALREADY CUT RATES

Country	Current Inflation rate	Current Policy rate	Change in CY19 (bps)	Change in CYTD20 (bps)	Direction of policy rate in CYTD20
Germany	1.7	0	0	0	-
India	6.6	5.15	(135)	0	-
Japan	0.4	(0.1)	0	0	-
China	5.2	4.35	0	0	-
Russia	2.3	6	(150)	(25)	↓
Korea	1.1	0.75	(50)	(50)	↓
Australia	1.8	0.25	(75)	(50)	↓
Indonesia	2.98	4.5	(100)	(50)	↓
Thailand	0.74	0.75	(50)	(50)	↓
Malaysia	1.3	2.50	(25)	(50)	↓
UK	1.7	0.1	0	(65)	↓
Mexico	3.7	6.5	(100)	(75)	↓
Brazil	4.01	3.75	(200)	(75)	↓
Philippines	2.6	3.25	(75)	(75)	↓
US	2.3	0.25	(75)	(150)	↓
Turkey	12.37	9.75	(1200)	(225)	↓

Source: Bloomberg, Bank of Baroda Research

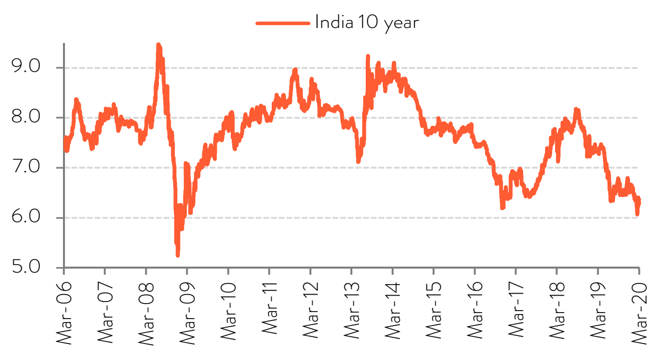
FIG 31 – BALANCE SHEETS OF GLOBAL CENTRAL BANKS EXPANDING AGAIN



Source: Bloomberg, Bank of Baroda Research

As a result of worsening global outlook and the resulting global risk-off, yields have been falling across the world, led by the US where the ten-year (10Y) yield has dropped more than 100bps in the current year. Bond yields have also softened in Europe, India and China. Owing to a muted demand outlook, global commodity prices have plunged, led by oil prices which have fallen ~59% in CYTD20. Global equity markets too have seen sharp declines on the back of risk-off trades and EM currencies have taken a hit amid continued FPI outflows.

FIG 32 – INDIA'S 10Y YIELD: ▼25BPS IN CYTD20

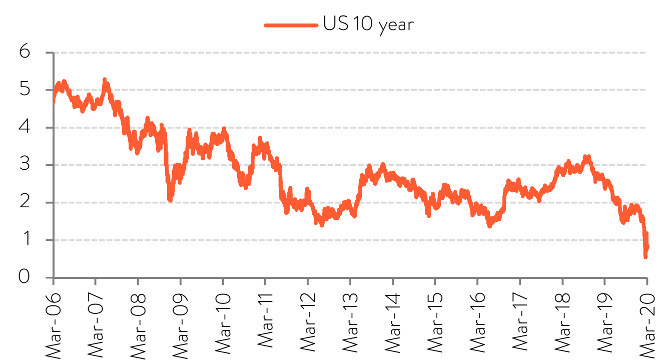


Source: Bloomberg, Bank of Baroda Research | As of 25 Mar 2020

FIG 33 – CHINA'S 10Y YIELD: ▼52BPS IN CYTD20

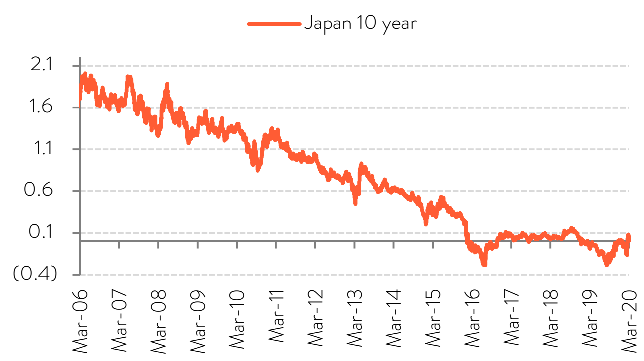
Source: Bloomberg, Bank of Baroda Research | As of 25 Mar 2020

FIG 34 – US 10Y YIELD: ▼105BPS IN CYTD20



Source: Bloomberg, Bank of Baroda Research | As of 25 Mar 2020

FIG 35 – JAPAN'S 10Y YIELD REMAINS LOW

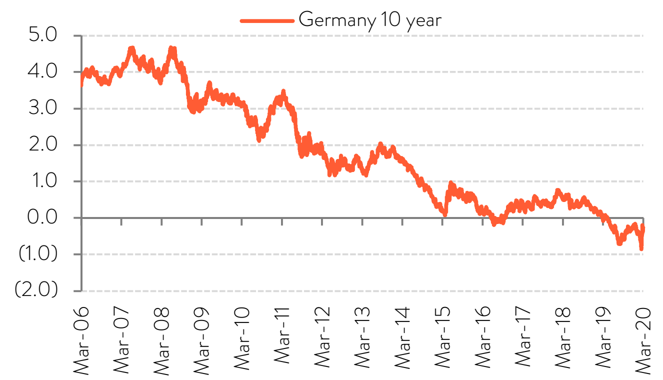


Source: Bloomberg, Bank of Baroda Research | As of 25 Mar 2020

FIG 36 – UK 10Y YIELD: ▼38BPS IN CYTD20

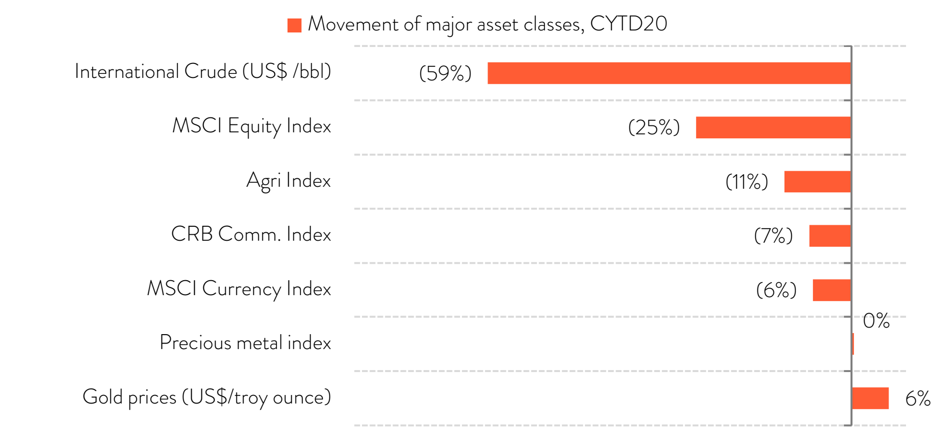
Source: Bloomberg, Bank of Baroda Research | As of 23 Mar 2020

FIG 37 – GERMANY 10Y YIELD: ▼8BPS IN CYTD20



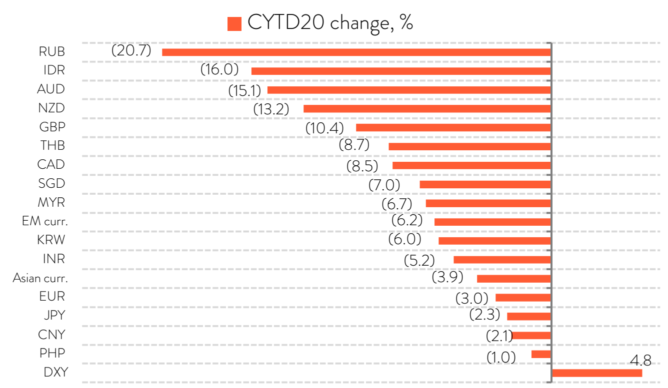
Source: Bloomberg, Bank of Baroda Research | As of 23 Mar 2020

FIG 38 – GOLD PRICES UP (SAFE HAVEN), OIL PRICES DOWN SHARPLY



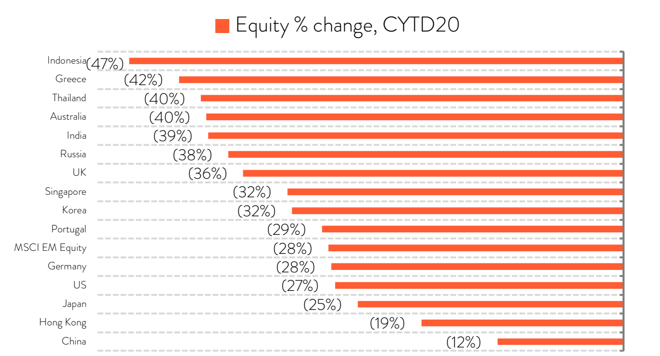
Source: Bloomberg, Bank of Baroda Research | As of 25 Mar 2020

FIG 39 – GLOBAL CURRENCIES DOWN IN CYTD20



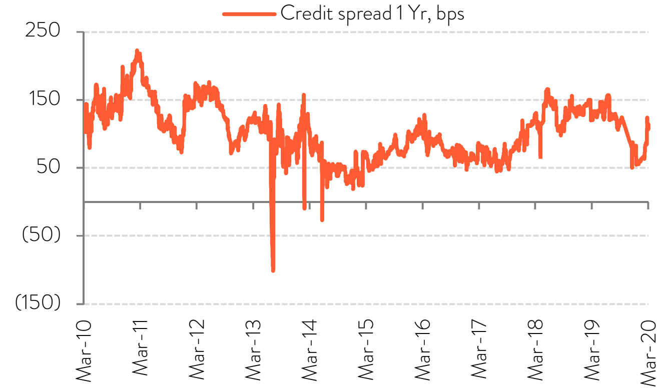
Source: Bloomberg, Bank of Baroda Research | As of 25 Mar 2020

FIG 40 – GLOBAL EQUITY MARKETS ALSO PLUNGED



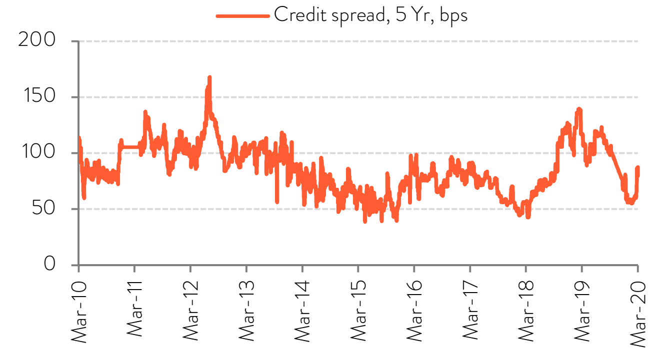
Source: Bloomberg, Bank of Baroda Research | As of 25 Mar 2020. Indices in constant US$ currency terms

FIG 41 – INDIA'S 1YR CREDIT SPREAD HAS WIDENED TO 114BPS



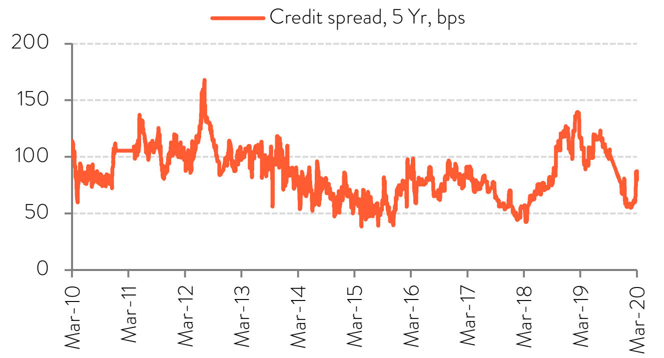
Source: Bloomberg, Bank of Baroda Research | As of 25 Mar 2020

FIG 42 – 3YR CREDIT SPREAD HAS WIDENED TO 115BPS



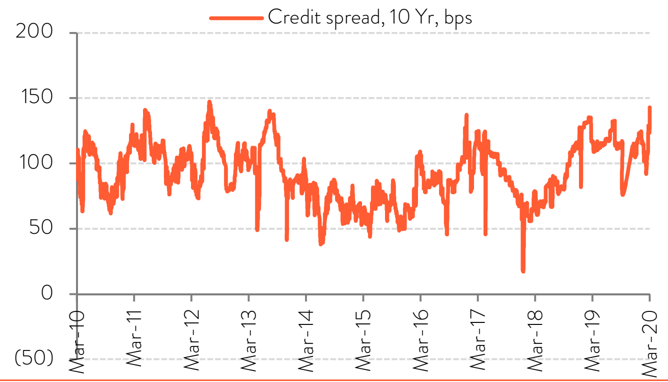
Source: Bloomberg, Bank of Baroda Research | As of 25 Mar 2020

FIG 43 – 5YR CREDIT SPREAD HAS WIDENED TO 87BPS



Source: Bloomberg, Bank of Baroda Research | As of 25 Mar 2020

FIG 44 – 10YR CREDIT SPREAD HAS WIDENED THE MOST TO 143BPS



Source: Bloomberg, Bank of Baroda Research | As of 25 Mar 2020

Fiscal measures to supplement

Apart from monetary easing, governments across the world have stepped up fiscal spending to boost growth. US has been leading the front with an estimated ~US$ 2tn (9% of GDP) stimulus package which includes US$ 500bn in direct payments to citizens and US$ 500bn to support businesses impacted by lockdown. Apart from this, the package also provides support to SMEs and US$ 50bn bailout for the airline industry.

Along similar lines, Germany is looking at providing support of € 50bn to SMEs and also extending borrowing to stressed sectors. It is setting up a € 500bn bailout fund to buy stakes in critical industries. Recently, UK announced stimulus worth US$ 37bn covering tax cut for retailers and cash transfers to small businesses. Italy too announced a US$ 28bn package for SMEs and workers facing layoffs. Japan is also opting for cash pay-outs to households at an estimated cost of US$ 503bn (10% of GDP).

India too today announced first set of measures to support the economy. The total economic cost of the package announced is Rs 1.7tn (0.8% of GDP). The economic package comprises providing food (cereals and pulses) through PDS for next three months to marginal households and cash transfers to farmers, pensioners, women and construction workers. Other measures announced include increase in minimum wages under MNREGA and free LPG cylinders to Ujwala scheme beneficiaries. Limit for collateral free loan for women SHGs has been enhanced to Rs 0.2mn from Rs 0.1mn earlier. For organised sector workers, the GoI will pay EPF contribution for three months.

We expect more measures to be announced specifically for SMEs and stressed sectors such as automobiles, hotels, airlines and restaurants to cushion the impact of the current lockdown.

RBI's liquidity infusion measures to aid better transmission

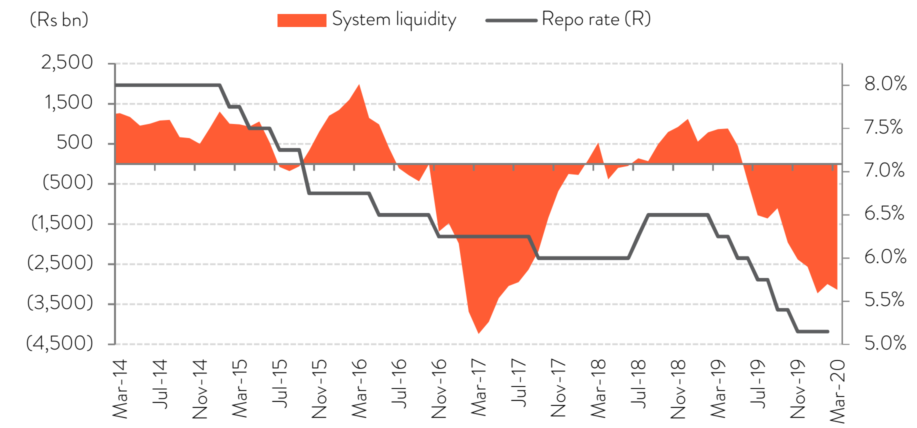
In CY19, RBI cut policy rates by a cumulative 135bps as inflation remained well below target and domestic growth was below potential. More importantly, in order to ensure transmission, the central bank ensured that system liquidity moved into surplus from deficit by taking a series of measures, outlined in Fig 43 below.

FIG 45 – RBI MEASURES TO IMPROVE LIQUIDITY

Feb'19	Apr'19	Jun'19	Aug'19
• RBI starts monetary easing cycle with 25bps repo cut to 6.25% • Policy stance changed from calibrated tightening to neutral • Measures announced to improve credit flow o risk weightage for NBFCs changed to external rating-based	• Policy rate cut by 25bps to 6% • Neutral stance maintained • To improve lending, banks permitted to reckon an additional 2% G-sec within the mandatory SLR requirement as FALLCR for the purpose of computing LCR	• Policy rate cut by 25bps to 5.75% • Monetary policy stance changed from neutral to accommodative	• Policy rate cut by unconventional 35bps • Accommodative stance maintained • Measures to boost credit demand o banks' exposure limit to a single NBFC raised to 20% of tier-I capital from 15% o risk weight for consumer credit (ex-credit card receivables) reduced to 100% from 125%
Oct'19	**Dec'19**	**Feb'20**	**Mar'20**
• Policy rate cut by 25bps • Total quantum of cuts now at 135bps	• Policy rate unchanged • First tranche of simultaneous OMO purchase/sale • Under this scheme, RBI purchased Rs 400bn of long-end bonds and sold Rs 253bn of short-end bonds • This was along the lines of the US Fed's 2011-12 'Operation Twist' to bring down long-end yields	• Policy rate unchanged • Liquidity management framework altered via long-term repo operations (LTRO) – LTRO of Rs 1tn upto 3 years issued • Ceiling of bank borrowing from RBI (1% of NDTL) removed • Comprehensive measures announced to incentivise lending to auto, residential real estate, MSME • MSME loan restructuring extended • External benchmark loans extended to medium enterprises	• US$ 4bn sell/buy swap to maintain dollar liquidity amid virus outbreak and ensuing volatility in global financial markets • Earlier, in Mar/Apr'19 a US$ 10bn buy/sell swap was conducted to provide rupee liquidity • Additional Rs 1tn LTRO to inject durable liquidity and improve transmission • OMO purchase worth Rs 400bn announced

Source: RBI, Bank of Baroda Research

FIG 46 – SURPLUS LIQUIDITY TO KEEP RATES LOWER



Source: CEIC, Bank of Baroda Research

The impact of all these measures is visible in transmission in the bond markets where yields declined 114bps in the financial year, compared with credit markets where one-year MCLR has fallen by 55bps as against repo rate cuts of 135bps.

FIG 47 – MCLR RATES HAVE ALSO EDGED LOWER

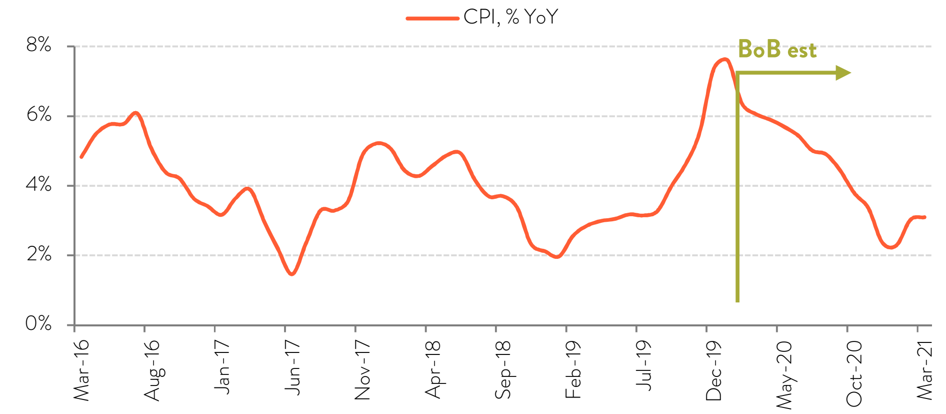
1Y MCLR (Median %)	Feb'19	Mar'19	Apr'19	May'19	Jun'19	Jul'19	Aug'19	Sep'19	Oct'19	Nov'19	Dec'19	Jan'20	Feb'20
Public Sector Banks	8.75	8.68	8.65	8.68	8.65	8.60	8.50	8.40	8.35	8.35	8.30	8.28	8.20
Private Sector Banks	9.28	9.38	9.38	9.45	9.45	9.45	9.40	9.25	9.23	9.18	9.18	9.13	9.10
Foreign Banks	8.68	8.70	8.62	8.60	8.52	8.41	8.28	8.14	7.95	7.70	7.90	7.59	7.40
Scheduled Commercial Banks	8.80	8.75	8.74	8.75	8.70	8.60	8.50	8.45	8.35	8.31	8.30	8.25	8.21

Source: RBI, Bank of Baroda Research

Room for further rate cuts

RBI's policy meet is due on 3 April 2020 when we expect a further cut in interest rates. While inflation has been trending up on the back of higher food prices, the trend has reversed in Feb'20 with inflation falling to 6.6% from 7.6% in Jan'20. Further, oil prices have nosedived 59% from a high of US$ 68.9/bbl in Jan'20. This will ease inflationary pressure in the coming months. While inflation is above RBI's target of 4%, we see it reaching targeted levels in Q2FY21 now instead of Q3 earlier – this will give RBI the headroom to cut policy rates by 50bps in Apr'20 and also to take further liquidity measures to support the economy.

FIG 48 – CPI INFLATION TO COOL OFF…



Source: CEIC, Bank of Baroda Research

FIG 49 – …LED BY LOWER FOOD INFLATION

(%)	Q4FY20E	Q1FY21E	Q2FY21E	Q3FY21E	Q4FY21E
CPI	6.6	5.3	4.4	3.1	2.7
CPI: Food	11.3	8.3	6.0	2.5	1.5
Core CPI	4.1	4.1	4.1	4.3	4.2

Source: Bank of Baroda Research

Businesses and self-employed and even employed individuals will face liquidity stress which calls for forbearance/ moratorium on existing loans. A scheme will be in order. Specifically, we expect RBI to provide additional liquidity support measures given there will be a cash flow mismatch with businesses right now. Notably, in 2008 RBI operationalised two liquidity facilities:

1. The special refinance facility under Section 17(3B) of the Reserve Bank of India Act, 1934 introduced on November 1, 2008 under which all scheduled commercial banks (excluding RRBs) were provided refinance from the Reserve Bank equivalent to up to 1.0 per cent of each bank's NDTL as on October 24, 2008 at the LAF repo rate up to a maximum period of 90 days.

2. RBI announced additional liquidity support to SCBs under special term repo facility on 15 October 2008 for enabling banks to meet the funding requirements of MFs, NBFCs and HFCs through LAF upto 1.5% of NDTL through relaxation in maintenance of SLR norms.

We believe such steps are in order and will be duly required to put the economy back on track.

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