MONETARY POLICY REVIEW

27 March 2020

RBI takes a bold move, more to follow

With 70% of economy in lockdown, MPC members reduced repo and reverse repo rate by 75bps and 90bps respectively. RBI is supporting financial stability through additional injection of Rs 3.74tn of liquidity into the system through LTROs, CRR and MSF facilities. Moratorium on loans will allow firms and households to adjust for cash flow mismatch. We believe RBI's focus will be on injecting more liquidity rather than reducing policy rates now. On the fiscal side too, we expect measures to support MSMEs and other impacted sectors.

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MPC goes all out: With a 4-2 vote, MPC members reduced repo rate by 75bps to 4.4%. LAF corridor has been widened with reverse repo rate reduced by 90bps to 4% thus incentivising banks to lend rather than keep funds with RBI. Policy stance remains accommodative.

Liquidity measures to tide over crisis: RBI has decided to infuse Rs 3.74tn liquidity into the system through various measures. 1) Conducting Targeted Long Term repos (TLROs) at floating rate linked to policy rate amounting to Rs 1tn. 2) Reducing CRR requirement by 100bps to 3% from 4% earlier. This is expected to infuse liquidity of Rs 1.74tn. Minimum daily CRR balance also reduced from 90% to 80% up to 26 Jun 2020. 3) SCBs can dip into MSF facility by another 1% of SLR upto 30 Jun 2020. This is expected to add another Rs 1.74tn liquidity. (*Details in Regulatory announcements section*).

Moratorium and deferment on loans: Given the cash flow mismatch which will arise from lockdown, RBI announced moratorium on all term loans outstanding on 1 March 2020 for three months. For working capital loans, deferment of interest announced for three months. This measure will ensure financial stability when real economy will have a cash flow mismatch.

Monetary and fiscal push: With more than 70% of the economy in lockdown, the reduction in policy rates, moratorium on loans and additional liquidity measures will ensure financial stability. We expect more liquidity enhancing measures in the coming days. On the fiscal side too, we expect more measures after initial Rs 1.7tn stimulus to support MSMEs and impacted sectors such as hotels, restaurants, airlines and transport. While RBI has refrained from issuing growth and inflation outlook, we believe FY21 GDP growth is estimated to be 1.5% lower from our earlier estimate of 5.5% with risks tilted to the downside.

KEY HIGHLIGHTS

- Policy rate reduced by 75bps to 4.4%.
- Policy corridor widened.
- Rs 3.74tn liquidity infusion announced.
- Growth and inflation forecast uncertain.

Regulatory announcements

- RBI has announced Targeted Long Term Repo Operations (TLROs) through term repos of 3 year maturity totalling Rs 1tn at a floating rate linked to policy rate. Liquidity availed under TLROs has to be deployed in investment grade corporate bonds, commercial paper and non-convertible debentures. Investments made by banks under TLROs will be classified as HTM even if it is in excess of 25 per cent of total permitted investment. Exposures under TLROs will also not be reckoned under the large exposure framework (LEF). These instrument will bring down rising credit risk spreads.
- RBI has reduced CRR by 100bps to 3% of NDTL from 28 Mar 2020. This will inject liquidity of Rs 1.37tn and will be applicable for a period of one year. In addition, minimum daily CRR requirement has also been reduced to 80% from 90%. This will be available up to 26 Jun 2020. Further, accommodation under MSF has also been increased from 2% to 3% of SLR upto 30 Jun 2020. This measure too will provide additional liquidity support of Rs 1.37tn.
- To provide relief to the real economy due to cash flow mismatch arising from lockdown, a 3-month moratorium on payment of all term loan will be allowed by all banks and NBFCs (including HFCs) as on 1 Mar 2020. This will ease the burden of debt servicing amidst the supply disruptions owing to lockdown. Additionally, this will not result in asset classification downgrade.
- RBI has also allowed financial institutions to reduce margins and asses the working capital need of the borrowers and even permitted a deferment of 3-months on payment of interest on working capital loans to ease the burden.
- RBI has also deferred the implementation of Net Stable Funding Ratio (NSFR) by 6 months to 1 Oct 2020.
- Apart from this, RBI has also postponed the implementation of the last tranche of Capital Conservation Buffer (CCB) of 0.625% to 30 Sep 2020.
- Taking into account the recent volatility in rupee due to the Covid-19 outbreak (USD/INR has depreciated by 5% in CYTD20), RBI has permitted banks to participate in the rupee Non-Deliverable Forward (NDF) markets from 1 Jun 2020.

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