MONETARY POLICY REVIEW

06 August 2020

RBI allows restructuring while holding rates

MPC unanimously voted to keep policy rate unchanged and maintained accommodative stance. RBI would like to wait for inflation to fall before reducing rates any further. More importantly, RBI allowed one-time restructuring for corporates and households impacted by pandemic. This will provide much needed time to recover. A broad-based recovery will have to wait for a vaccine. More than RBI, revival will require higher government spending as seen in Q1 to revive demand. We expect GDP to fall by 5% in FY21.

Sameer Narang
Dipanwita Mazumdar | Jahnavi
chief.economist@bankofbaroda.com

MPC holds rates: MPC members unanimously voted to keep key policy rates unchanged while maintaining accommodative stance. With inflation at 6.1% in Jun'20 and 6.5% in Q1FY21, RBI would like to wait for inflation to come down to 4% before reducing rates. However, RBI moved on to other fronts. First, a restructuring window has been provided to corporates and households. Second, additional liquidity of Rs 100bn has been provided for NABARD and NHB. Third, LTV ratio of gold loans increased to 90% from 75% earlier. *(Details in the Regulatory Announcements section).*

CPI to moderate in H2: With a large negative surprise in Q1FY21, CPI inflation in H1 is likely to remain above RBI's target of 4%. Food as well as domestic retail fuel prices are elevated. However, abundant sowing and gradual unlocking of economy will bring food inflation lower. Public policy by way of open market sales and PDS will also play a role. We expect CPI to average at 3.8% in H2FY21. However, there are upside risks by way of local lockdowns disrupting supply chains.

GDP to contract in FY21: MPC noted that real GDP would contract in H1FY21 as well as throughout FY21. It noted that deviations from normal monsoon as well as protracted spread of COVID-19 pose downside risk to growth in FY21. Agriculture sector remains a bright spot with progress in Kharif sowing. We expect GDP to contract by 5% in FY21.

More stimulus in H2: Unless a vaccine is available, economic activity is likely to settle below pre-COVID levels. RBI's consumer confidence survey is at the lowest level. This calls for an economic stimulus to revive spending. Centre has increased its spending by 13.1% in Q1 and is likely to maintain this momentum. RBI's role will be important to absorb a part of this debt and look for room for any further rate reduction depending upon inflation.

KEY HIGHLIGHTS

- Policy rate kept unchanged at 4%.
- Restructuring window provided to corporates and households.
- Policy space remains in H2, when inflation softens.

Regulatory announcements

- RBI has decided to provide a window under the Prudential Framework to enable the lenders to implement a resolution plan in respect of eligible corporate exposures without change in ownership, and personal loans, while classifying such exposures as Standard subject to specified conditions.
- Key highlights of the resolution plan include: only those borrowers will be eligible which were classified as 'standard' and were not in default for more than 30 days as on 1 Mar 2020; the resolution can be invoked anytime till 31 Dec 2020 but has to be completed within 180 days of invocation; lenders will have to keep 10% as provisions on the post resolution debt; post invocation asset classification will be retained as 'standard'.
- RBI constituted expert committee under the chairmanship of K.V.Kamath which will put forth recommendations for resolution plans regarding: financial parameters, sector specific benchmark ranges and threshold above which the committee will undertake the validation process.
- A separate framework has been announced for restructuring of personal loans, with resolution deadline of 31 Dec 2020 and resolution period of 90 days since the date of invocation. The details of the plan can be decided based on the Board approved policies of the lenders, subject to extension of the residual tenor of the loan, with or without payment moratorium, by a period not more than two years.
- RBI has announced additional refinance facility of Rs 100bn for NABARD and NHB. The additional Rs 50bn for NABARD will be over and above Rs 250bn refinance facility announced earlier. Similarly for NHB, the additional Rs 50bn will be over and above Rs 100bn announced earlier.
- To allow banks more flexibility to manage their day end cash reserve ratio (CRR) balances, online facility in e-Kuber system has been launched wherein banks will be able to set the amount (specific or range) that they want to keep with RBI at the end of the day and depending upon this pre-set amount, MSF/reverse repo bids, will be auto generated at the end of the day.
- With regard to debt restructuring of MSMEs, RBI had previously announced policy for those MSMEs which under the 'standard category' as on 1 Jan 2020 and restructuring was to be completed by 31 Dec 2020. This policy has been now been extended to those MSMEs also which were 'standard' as on 1 Mar 2020 and their restructuring implementation deadline is allowed uptil 31 Mar 2021.

- The permissible loan to value ratio (LTV) for loans against pledge of gold ornaments and jewellery for non-agricultural purposes has been increased from 75% to 90%. This relaxation shall be available till March 31, 2021.
- In order to address the concerns of current and CC/OD account holders, RBI will provide appropriate safeguards which will even enable speedier resolution for the implementation of the resolution framework for COVID-19 related stress.
- With the objective to provide substantial capital saving to banks and in order to boost the bond market, the general market risk charge of 9% will continue but the calculation of total market risk will incorporate both debt and equity instruments.
- RBI has reviewed the priority sector guidelines (PSL) in order to address the regional disparities in flow of priority sector credit and also to provide an incentive framework for banks. Scope of the PSL has also been widened to include start-ups, raising the targets for small & marginal farmers as well as weaker sections. Limits have also been increased for renewable energy including solar and compressed bio-gas plants.
- RBI has decided to set up an online dispute mechanism (ODR) for digital payments. Additionally an Innovation hub will also be created to promote innovation across financial sector through technology.
- RBI has introduced a positive pay mechanism for cheques with value Rs 50,000 and above. Within this, cheques will be processed for payment by drawing bank on informations shared at the time of issuance. Thereby, lowering the possibility of fraud and fewer instance of cheque tampering.
- Additionally, RBI has also proposed to start a pilot scheme in off-line mode for small payments, to help those who face issues such as lack of connectivity or poor internet connection.

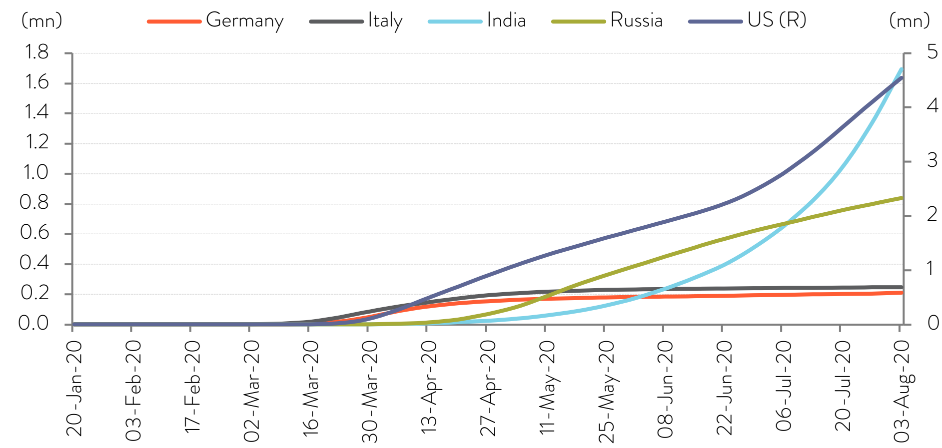
Global Scenario

Since the last policy,

1) COVID-19 cases globally rose by 13.5mn. In the US, it increased by 3.2mn. For India, it rose by 1.8mn.

2) Global macros showed early signs of recovery as visible in the manufacturing PMIs, consumer sentiment index and auto sales data.

FIG 1 – COVID CASES CONTINUE TO RISE IN US AND INDIA



Source: Bloomberg, Bank of Baroda Research

FIG 2 – GLOBAL INDICATORS

Indicators	Last Policy (May'20)	Current (Jul'20)
Manufacturing PMI		
US	43.1	54.2
Eurozone	39.4	51.8
China	50.6	51.1
Consumer Confidence		
US	72.3	72.5
Eurozone	(18.8)	(15)
China	115.8	112.6*
Auto Sales (YoY%)		
US	(29)	(13)
Eurozone	(52)	(23)*
China	7	2*

Source: Bloomberg, Note: *Jun'20

Disclaimer

Visit us at **www.bankofbaroda.in**

For further details about this publication, please contact:

Economics Research Department

Bank of Baroda

chief.economist@bankofbaroda.com