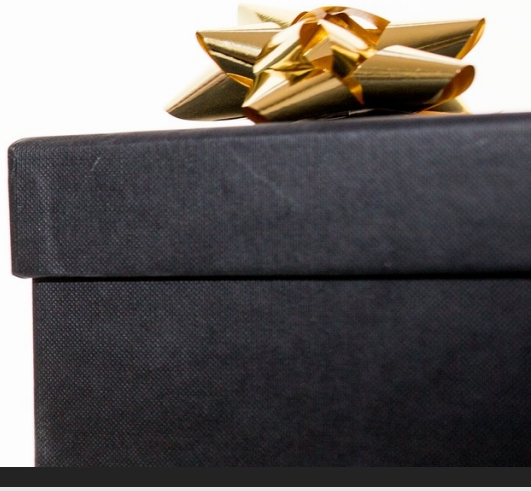
RBI's March 2020 Monetary Policy: A Much Needed Boost in Times of Financial Carnage



iFAST Research
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Policy Announced:
March 27, 2020

Introduction

The preponed Monetary Policy Committee (MPC) meet was held on March 27, 2020, wherein Shaktikanta Das, the governor of the Reserve Bank of India (RBI), announced some much-needed booster shots for India's financial system at this critical juncture. Preponement of the meeting, which was originally scheduled to be held in April 2020, became necessary given the uncertainties plaguing the markets.

Besides reducing the repo rate by 75 bps, the RBI maintained its 'accommodative' stance and expressed caution in light of the Coronavirus-led headwinds. Liquidity improvement, transmission of lowered rates and credit flows, and relief on debt servicing were the other areas addressed.

Our note covers the highlights for each area.

Parameter	Revised rate (%)	Earlier rate (%)	Change
Repo	4.4	5.15	-75 bps
Reverse Repo	4	4.9	-90 bps
Cash Reserve Ratio (CRR)	3	4	-100 bps
Statutory Liquidity Ratio (SLR)	18.25	18.5	-25 bps
Marginal Standing Facility Rate (MSFR)	4.65	5.4	-75 bps
Bank Rate	4.65	5.4	-75 bps

Source: RBI

Key Highlights

"RBI maintains its accommodative stance; cuts rates sharply"

"Liquidity infusion and loan moratoriums have been prioritised"

"Coronavirus spread and prolonged lockdowns are the major downside risks"

Liquidity Improvement

Targeted Long-Term Repo Operations (LTRO)

- RBI will conduct auctions of targeted long-term repos (in tranches) of up to a 3-year tenor for a total amount of up to Rs 1,00,000 crore, at a floating rate linked to the repo.
- These funds will then be made available to the banks by the RBI, and will have to be invested by the banks within 15 days in investment grade corporate bonds, commercial paper and non-convertible debentures. This will be in addition to their outstanding investments in these instruments.
- 50% of such investments will have to be acquired by banks from primary market issuances, and the balance 50% can be bought from the secondary market (such as mutual funds and non-banking financial companies). These acquisitions shall classify as held-to-maturity investments and not marked-to-market, thereby reducing volatility in their financials.

Cash reserve ratio (CRR)

- The RBI reduced the CRR, which represents the ratio of net demand and time liabilities that banks are required to deposit with the RBI, by a 100 bps.
- Reduction will release Rs 1.37 lakh crore into the system, and hopefully address the asymmetrical distribution of liquidity vis-a-vis requirements.

Statutory Liquidity Ratio (SLR)

- SLR represents the extent of net demand and time liabilities that banks have to invest in liquid instruments specified by the RBI.
- The reduction of this rate by 25 bps will ensure that banks have more capital to lend to the economy.

Marginal Standing Facility Rate (MSFR)

- MSFR is the rate of interest at which scheduled banks borrow overnight from the RBI (against government securities) to meet cash shortages or liquidity-related challenges.
- In times like these, higher volatility in the markets and an economic downturn results in a liquidity crunch. To tackle this, the RBI has permitted banks to tap into their SLR reserves.
- MSFR, as a percentage of SLR, has been increased from 2% to 3%. This reduces the need for banks to borrow overnight funds from the RBI.
- However, even after doing this, if banks need to borrow additional overnight funds from the RBI, they can do so at a reduced rate of 4.65%, as against the earlier rate of 5.4%. This lower rate of interest can then be passed on to the borrowers.
- By way of these norms, nearly Rs 1.37 lakh crore of liquidity will be infused into the system.

Liquidity Improvement

Loan Relief

The RBI has allowed banks and non banking financial companies (NBFCs) to offer a moratorium on various credit products. However, no asset classification downgrade (i.e., accounting for non-performing assets) will have to be done by banks and NBFCs, thereby reducing their provisioning and keeping their capital base intact. The moratorium will also not affect the credit history of the borrowers.

Retail Term Loans

- All banks and non-banking financial companies are permitted (not mandated) to allow a 3-month moratorium on payment of instalments of all retail term loans outstanding (principal as well as interest) as on March 1, 2020.
- The due dates of equated monthly instalments (EMIs) will stand deferred to June 2020, consequently causing the repayment schedule, subsequent payment dates and tenor to shift by 3 months.
- Credit card dues, despite being a revolving credit facility, can also be deferred in the same fashion as term loans.

Working Capital

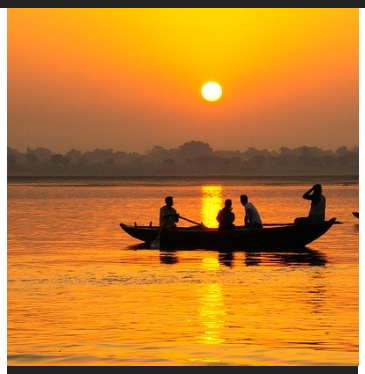
- Banks and NBFCs are allowed (not mandated) to allow deferment of interest payments by 3 months in respect of cash credit and overdraft facilities outstanding as on March 1, 2020. Accumulated interest of these 3 months (March-May 2020) will be payable at the end of the period.
- Drawing limits of borrowers can be recalculated through reduction of margins and/or reassessment of the duration.

Macroeconomic Outlook Offered

Global

- The global outlook appears gloomy as pain points are seen everywhere.
- Expectations of a shallow recovery in 2020 vis-a-vis 2019 have been dashed.
- Signs of recession are visible, and intensity, duration and spread of Covid19 will determine what lies ahead.
- Central banks and governments working towards financial stability and demand push.

Macroeconomic Outlook Offered



Domestic

- Covid19 updates are being monitored closely.
- Outlook for agriculture and allied activities is positive, with foodgrains output, at 292 million tonnes, coming in higher by 2.4 percent year-on-year.
- Service indicators look weak, and several sectors are hit because of the pandemic.
- GDP targets (4% in Q4 FY20, 5% for FY20) are at risk.

Inflation

- CPI in February 2020 was 6.6%, versus 7.6% in January.
- May stay benign in the coming months due to depressed demand, sufficient food grain and horticulture production.
- The MPC targets to keep it in the range of 4% (+/- 2%) in the medium term.
- Low crude prices should act in India's favour.

Sectors

- The agrarian sector should do well since the government hasn't imposed any restrictions on essential goods and services.
- Industrial and service sectors will succumb to the ongoing pandemic and bear the brunt of weaknesses in supply chains.

Financial Markets

- Steps will be taken to improve depth and price discovery in foreign exchange dealings by reducing arbitrage between onshore and offshore markets.
- This assumes importance on account of increased volatility in the USD-INR rate in recent weeks.

iFAST Research Views

Prima facie, RBI's stimulus package exceeds expectations on almost all counts. The decisions are in line with those taken by global central banks to rejuvenate demand, besides easing pressures pertaining to cash flows and debt repayment.

The quantum of liquidity infusion into the system, which stood at approximately 1.4% of GDP in the February MPC meet, will now be around 3.2% of GDP by virtue of the aforementioned announcements. The governor explicitly mentioned that Indian banking is safe, and so are private banks.

That said, we believe there were some misses as well:

#1 - Commercial papers (CPs)

Steps taken by the RBI to revive the CP market may have some gaps. Banks have been directed by the RBI to invest in commercial papers of specific investment grade corporates/institutions for a duration of up to 3 years. Generally, investment grade corporates don't face difficulties in raising capital through CPs, and banks often invest in them without much nudging.

That said, in today's times, given the large-scale impediments that most businesses are facing and the resultant impact on their financials, CPs of such corporates may not necessarily be in the investment grade. In which case, the intended corporates may not receive the intended help.

Moreover, some of these entities may be in need of long term investible capital of durations longer than 3 years. Unless requisite capital is made available to such struggling businesses, overall economic overhaul could be a tall ask.

#2 - Working Capital

Currently, several entities have shuttered their operations completely, and wouldn't require WC support right away. Subject to economic stabilisation, demand for WC will increase 2-3 months later, causing the demand for loans to get bunched up. It remains to be seen whether RBI will be able to pitch in with a similar support mechanism at that stage as well. There was no mention of assuring emergency credit lines, a pretty pivotal facility at the moment, to the borrowers.

#3 - Sundry

Business loans, that are taken for capital expenditure, were left out. No ballpark guidance was given on fronts such as inflation and growth.

In conclusion:

In the past, despite reduction in lending rates, banks haven't passed on benefits to the borrowers to the extent envisaged by the MPC. Resolution of this roadblock will hold the key to transmission effectiveness, that is, the ease with which policy rate cuts reflect in the cost of capital for borrowers.

Furthermore, credit growth has been extremely subdued, in stark contrast to the stimulus. This can be attributed to the following:

- Due to unfavourable economic conditions, borrowers have struggled to generate requisite cash flows to pay back debt. This has led banks to fear the higher accrual of non-performing assets (NPA) and play defensive.
- In the services sector, income levels have not augmented well enough in recent years to meaningfully enhance credit rating of individuals. Consequently, they too face difficulty in availing financing facilities.
- Disruptions due to Covid19 have caused activities across all industries to either reduce substantially or stop completely. This, coupled with a weak demand scenario, has reduced the need for borrowed funds.

Lower interest rates will be futile unless accompanied by an uptick in demand for credit. The latter would be a function of finding solutions to these three pain points.

While attempts to bring the borrowing costs down and infuse liquidity in such dramatic measure (as was announced today) augur well, other fiscal and policy initiatives by the government should complement it too. This will help curtail downside risks associated with the virus and continued lockdowns.

It is heartening to see things moving in the right direction, and that the RBI, on its part, is open to resorting to conventional and unconventional actions depending on how situations evolve.