NSE

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RBI steps up policy response, over to the Government now

In continuation to the liquidity bonanza announced on March 27th (details here), the RBI announced a slew of additional measures today aimed at injecting adequate targeted liquidity, facilitating and incentivising bank credit flows and easing financial stress. To start with, *TLTRO 2.0* (targeted long-term repo operations)[1] would provide for Rs500bn for investments in bonds issued by NBFCs and micro finance institutions (MFIs); secondly, there is a Rs500bn refinancing facility for NABARD, SIDBI and NHB[2] to facilitate on-lending; and lastly, States have been accorded a 60% hike on their WMA limits (Ways and Means Advances[3], ~Rs320bn at present) to ease liquidity stress and allow them to plan their borrowing schedules better through the year.

While the policy repo rate—which is decided by the MPC—was left unchanged, the reverse repo rate[4] by another 25bps, on top of the 90bps cut on March 27th, to 3.75% in a bid to spur bank lending. Given the current (surplus) nature of systemic liquidity, the reverse repo is the *de facto* policy rate. Several regulatory changes were also announced including exclusion of moratorium period from 90-day NPA norm but with 10% higher provision, extension of resolution timeline for stressed accounts, restriction on dividend pay-outs by banks, reduction in LCR[5] requirement of banks and forbearance on restructuring of NBFC loans to commercial real estate.

The RBI has remained proactive in taking swift policy actions to mitigate the liquidity shock caused by COVID-19. The daily price data of essential food items as well as household fuels are pointing to a declining inflation trajectory ahead, with RBI expecting inflation to fall to sub-3% by H2FY21. This is expected to keep the room open for further monetary easing. With economic activity undergoing an unprecedented downturn, the RBI is expected to cut rates by another 50-75bps, *ceteris paribus*, besides ensuring adequate liquidity in the system. The Govt.'s response, however, has been relatively underwhelming, and needs to be significantly stepped up, particularly to reduce supply-side bottlenecks, ease stress in the MSME sector and address industry-specific issues.

- **TLTRO 2.0 and special refinance facility for All India Financial institutions to ease liquidity stress in the non-banking space:** With Banks favouring investments in primary bond issuances by public sector entities and large corporates, NBFCs, MFIs and small and mid-sized corporates that have got severely impacted from disruptions caused by COVID-19 continue to face liquidity constraints. To address this, the RBI introduced TLTRO 2.0 worth Rs 500bn, earmarked for investments in bonds and commercial papers issued by NBFCs and MFIs. The RBI also announced a special refinance facility for a total amount of Rs 500bn at the prevailing repo rate to NABARD (Rs 250bn for refinancing regional rural banks, cooperative banks and MFIs), SIDBI (Rs 150bn for on-lending/refinancing) and NHB (Rs 100bn for supporting housing financing companies).

TLTRO 2.0 worth Rs500bn announced, earmarked for investments in bonds issued by NBFCs.

Special refinance facility worth Rs 500bn for NABARD, SIDBI and NHB.

- **Reverse repo rate cut by 25bps to spur bank lending:** Amid surplus liquidity conditions, the amount of money parked by banks with the RBI through reverse repo operations has shot up meaningfully, touching Rs 6.9trn on April 15th. With an aim to encourage banks to lend, the RBI cut reverse repo rate by another 25bps, on top of the 90bps cut on March 27th, to 3.75%. This is still 50bps shy of the post-GFC (global financial crisis) low and may see further cuts if lending doesn't improve.

Reverse repo rate slashed by 25bps to 3.75% to encourage banks to lend.

WMA limit for states enhanced by another 30%.

- **WMA limit of states enhanced:** States have been particularly struggling for liquidity and are borrowing from markets at unprecedented high spreads to central

[1] TLTRO is a monetary policy tool introduced by the RBI on March 27th to enhance liquidity in the system. Under this facility, banks borrow collateralised funds for one to three years from the RBI at the repo rate for investments in corporate bonds, commercial papers and non-convertible debentures.
2 NABARD: National Bank for Agriculture and Rural Development; SIDBI: Small Industries Development Bank of India; NHB: National Housing Board
[3] Ways and Means Advances (WMA) is a mechanism used by the RBI under its credit policy to provide funding to states to deal with temporary cash flow mismatches.
4 Reverse Repo rate is the rate at which the central bank (RBI) borrow money from scheduled commercial banks.
5 Liquidity Coverage Ratio (LCR) is the proportion of high liquid assets set aside by banks to meet short-term obligations, calculated as the ratio of a bank's high-quality liquid assets to total net cash outflows over a 30-day stress period.

government securities (Figure 5). To provide comfort to states in terms of managing their market borrowings better, the RBI increased the WMA limit of states by 60% for six months ending September 30th, 2020.

- **Regulatory forbearance to ease financial stress:** The RBI also announced a slew of regulatory measures to ease financial stress including **a) Exclusion of three-month moratorium period until May-end from the NPA classification norms** (90-day NPA) for accounts that were standard as on March 1st, 2020 but with a requirement of 10% additional provision on such accounts. **b)** Extension of relaxed NPA classification norms to NBFCs. **c) Extension of resolution timeline** for large default accounts by 90 days from current norm of 210 days. Failing to reach a resolution plan within 300 days (erstwhile 210 days) of default require lending institutions to maintain an additional 20% provision. **d) Restriction on dividend pay-outs** by scheduled commercial banks and cooperative until September 30, 2020. **e) Reduction in liquidity coverage ratio** (LCR) requirement from 100% to 80%, to be gradually restored back in two phases: 90% by October 1, 2020 and 100% by April 1, 2021. **f) Extension of restructuring forbearance to loans given by NBFCs to commercial real estate**, whereby like banks, NBFCs are also allowed to extend the date of commencement for commercial operations (DCCO) of commercial real estate projects which have got delayed beyond the promoters' control by an additional one year, without treating them as restructured accounts.

A slew of regulatory measures announced to ease financial stress on financial institutions and corporates.

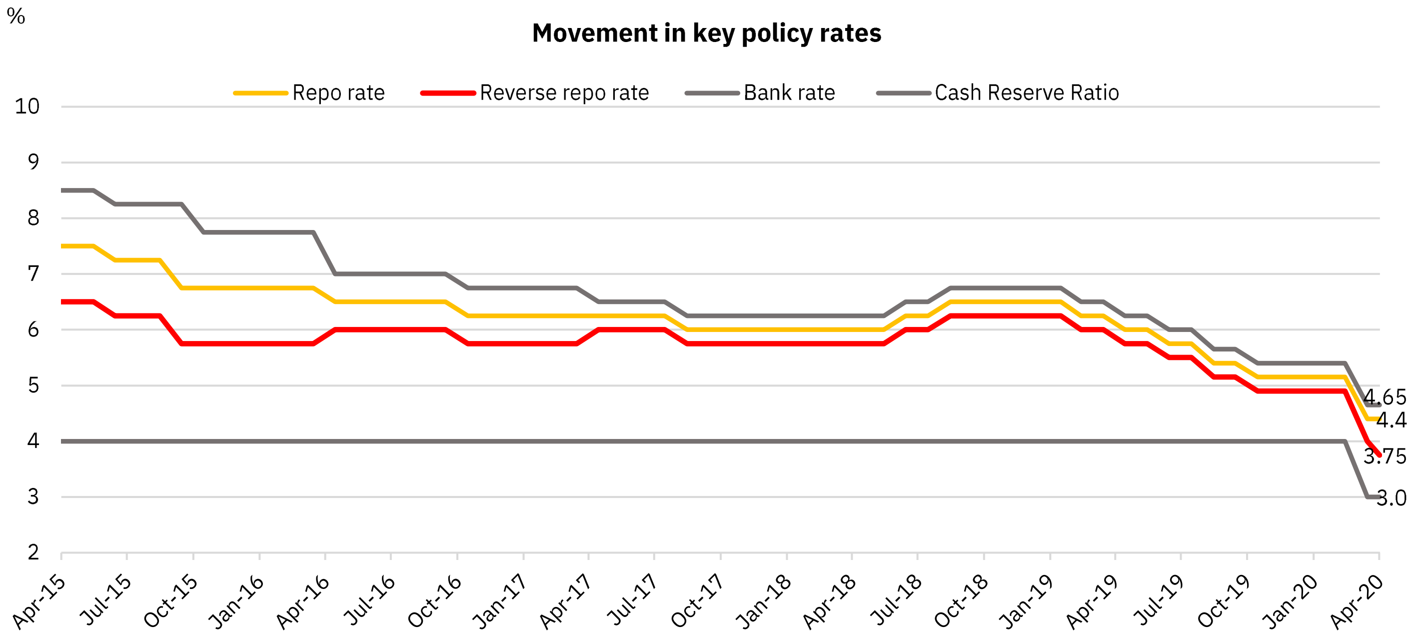
- **RBI committed to do *'whatever it takes'* to ensure financial stability:** The RBI, on several occasion, has highlighted the need to do 'whatever it takes' to contain the social and economic shock caused by COVID-19 pandemic. This is reflected in the proactive policy response by the RBI thus far. The COVID-19 pandemic is expected to be deflationary in nature, the initial signs of which are eminent in the daily price data of essential food items as well as household fuels (LPG, Kerosene). The RBI projections point to a sub-3% reading by H2FY21. This is expected to keep the room open for further monetary easing, even as RBI may wait for an opportune time to act. As such, with economic activity undergoing an unprecedented downturn as witnessed from several high frequency indicators such as auto sales, fuel sales, merchandise trade performance etc., we expect the RBI to cut policy rates by another 50-75bps, *ceteris paribus*, besides taking further measures to ensure adequate liquidity in the system using conventional as well as unconventional tools.

RBI indicates availability of space to cut rates further, citing comfort on inflation.

- **Over to the Government now:** The Government's response thus far through fiscal measures has been relatively underwhelming and restricted to the poor sections of the society. The Rs 1.7trn relief package announced on March 26th, translating into 0.8% of GDP, largely comprises of cash transfers and food security to poor and migrant workers and insurance cover to health workers. While some of these measures are not new (PM Kisan spending) but just frontloaded, some (wage hike under MGNREGA) may not translate into an immediate relief in the wake of a nation-wide lockdown. Relief measures taken by state governments, largely in the form of direct transfers, amount to approximately 0.2% of GDP on an aggregate basis. When compared with other developed and developing economies, fiscal easing in India has been fairly limited (Figure 8). In this backdrop, fiscal policy response needs to be significantly stepped up, particularly to address supply-side bottlenecks, ease stress in the MSME sector, revive exports, and address industry-specific issues.

Figure 1: Reverse repo rate slashed by 25bps to 3.75%; repo rate and bank rate kept unchanged

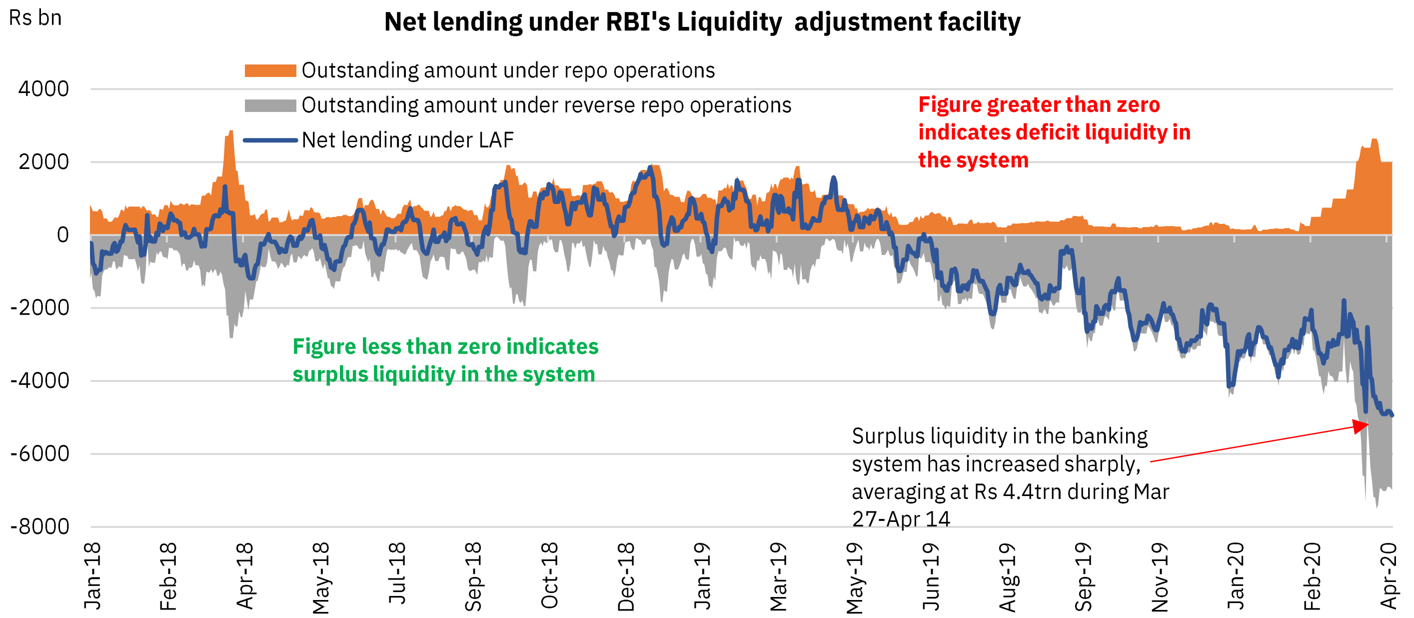
With an aim to encourage banks to deploy the surplus liquidity available with them in investments and loans to productive sectors instead of parking them with the central bank, the RBI reduced the reverse repo rate by another 25bps, on top of the 90bps cut on March 27th, to 3.75%, thereby widening the LAF corridor to 90bps from 65bps earlier.



Source: RBI, CMIE Economic Outlook, NSE.

Figure 2: Net lending under RBI's Liquidity Adjustment Facility

Systemic liquidity has remained in surplus since June and has increased sharply over the last few weeks, thanks to continued liquidity injection by the RBI through various conventional as well as unconventional measures and sustained government spending. Net liquidity absorption under the RBI's Liquidity Adjustment Facility has averaged at Rs4.4trn during the period March 27-April 14th. The amount of outstanding money parked by banks with the RBI surged to as high as Rs 7.5trn on April 6th, averaging at ~Rs 6.75trn during the same period.



Source: CMIE Economic Outlook, NSE

Figure 3: Total Long-term Repo Operations (LTROs) announced thus far

Date	Tenor	Category	Notified amount (Rs bn)	Bids received (Rs bn)	Amount alloted (Rs bn)
17-Feb-20	3-year	LTRO	250.0	1,944.1	250.4
24-Feb-20	1-year	LTRO	250.0	1,231.5	250.2
02-Mar-20	3-year	LTRO	250.0	1,719.7	250.3
09-Mar-20	3-year	LTRO	250.0	488.6	250.2
18-Mar-20	3-year	LTRO	250.0	271.0	250.1
27-Mar-20	3-year	TLTRO	250.0	605.0	250.1
03-Apr-20	3-year	TLTRO	250.0	997.6	250.1
09-Apr-20	3-year	TLTRO	250.0	1.134.5	250.1
17-Apr-20	3-year	TLTRO	250.0	614.2	250.1
23-Apr-20	3-year	TLTRO 2.0	250.0	To be conducted	To be conducted
Total			**2,500.0**	**7,871.7**	**2,251.6**

Source: RBI, NSE

Figure 4: Spreads between G-sec yields and the policy rate have shot up...

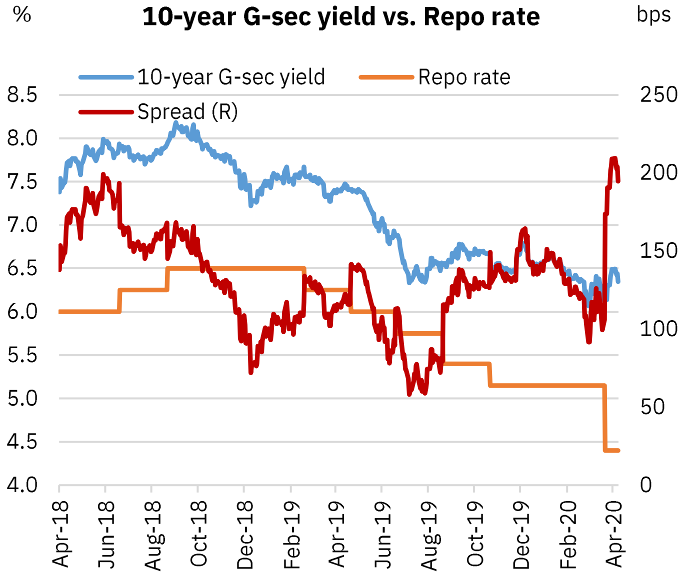
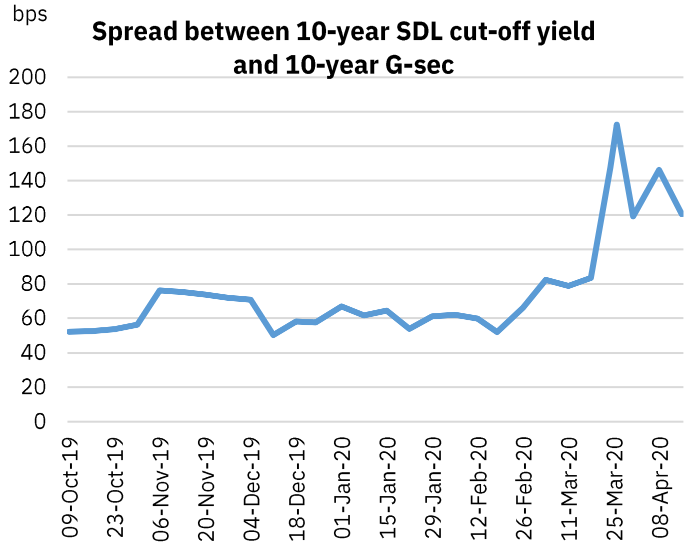


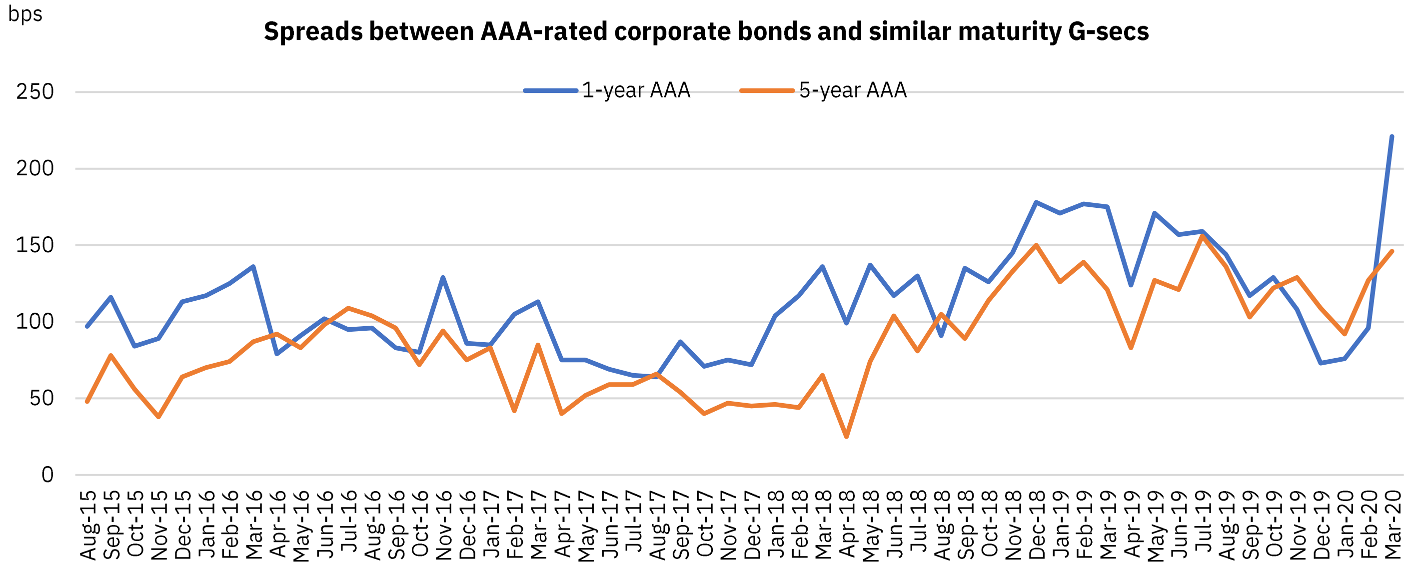
Figure 5: ...and so have the spread between 10-year SDL cut-off yields and same maturity G-sec, reflecting tight financial conditions and supply pressures



Source: RBI, Refinitiv Datastream, NSE.

Figure 6: Credit spreads for AAA-rated corporate bonds

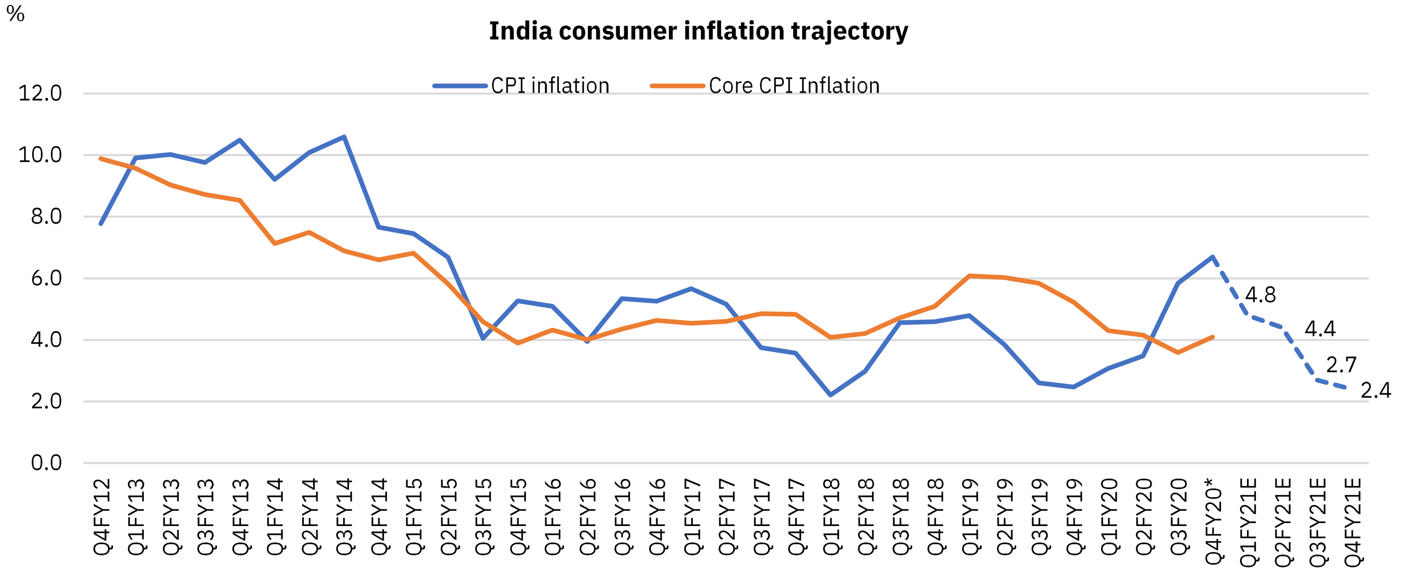
Liquidity premia on corporate bonds has also shot up thanks to sustained FPI selling (net outflows at Rs 609bn in March and Rs 59bn in April thus far), drop in trading activity, redemption pressures and increasing risk aversion.



Source: CMIE Economic Outlook, NSE.

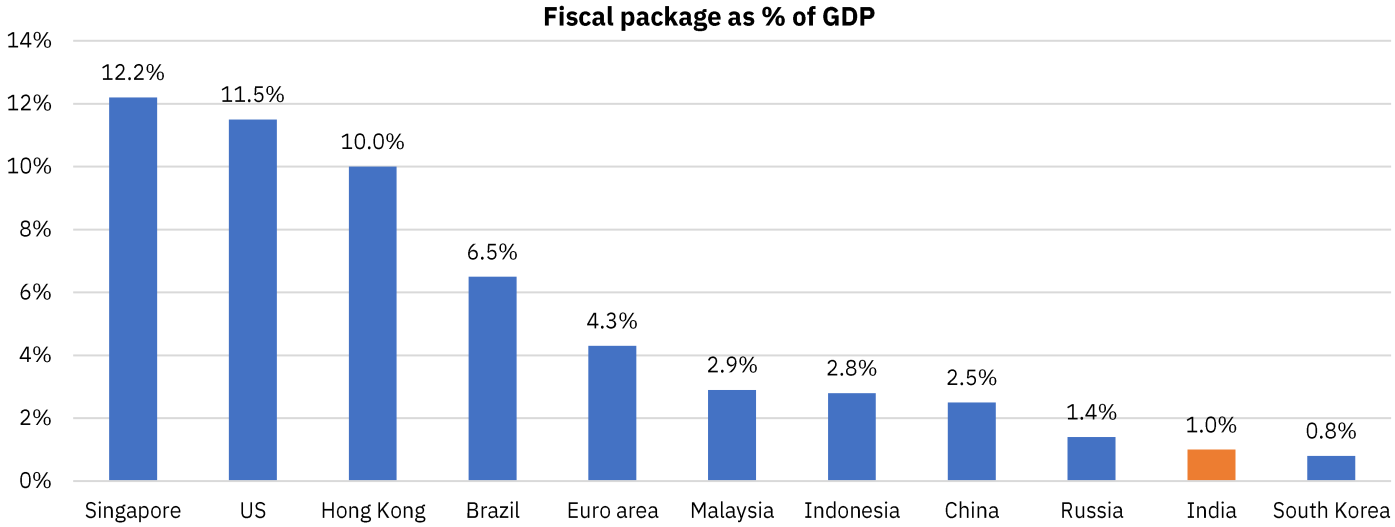
Figure 7: India's quarterly CPI inflation trajectory

While inflation is expected to have peaked out given the ebbing vegetable prices, the future outlook remains highly unclear and is contingent on depth, spread and duration of COVID-19 and the severity of consequent supply and demand shock in the economy. Nevertheless, the impact of COVID-19 is expected to be deflationary, as also evident in the daily price data of essential food items and household fuels (kerosene, LPG). Considering current situation, expects inflation to ease to sub-3% by Q3FY21 (4.8%/4.4%/2.7%/2.4% in Q1/Q2/Q3/Q4FY21). For FY22, the RBI expects inflation to hover in the range of 3.6-3.8% assuming a normal monsoon and no major policy shocks. This is expected to keep the space open for further monetary easing as required.



Source: CMIE Economic Outlook, RBI Monetary Policy Report, NSE.

Figure 8: Fiscal packages announced by countries as % of GDP



Source: Internal Monetary Fund, NSE

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