Massive Monetary Easing by RBI: Forbearance measures and rate cuts a great step to deal with current ambiguity

Brickwork Ratings, Mumbai, 28 March 2020: The Reserve Bank of India (RBI) convened its Monetary Policy Committee (MPC) meeting well before its scheduled date of 3 April 2020, considering the urgency of intervention in the wake of severe uncertainty caused by the COVID-19 outbreak. The RBI deserves to be complemented for its comprehensive intervention in advancing an accommodative monetary policy, ensuring adequate liquidity and creating greater clarity through regulatory forbearance. The major announcements by RBI MPC include a 75 basis points (bps) cut in the repo rate to 4.4%, cut in reverse repo by 90 bps to 4%, and the widening of the LAF corridor from 50 bps to 65 bps, in addition to continuing the accommodative monetary policy stance. The stance taken by the RBI are as per expectations, includes enabling an adequate and cheaper working capital, supporting corporates suffering from business losses and introducing forbearance measures and additional liquidity infusing tools. However, the RBI has been bold and gone well beyond the market and BWR expectations in cutting the repo rate by 75 bps.

As the current situation has created considerable uncertainty, the MPC has understandably refrained from providing a growth outlook for the next fiscal. The outlook is now heavily contingent upon the intensity, spread and duration of the pandemic. Most sectors of the economy have adversely been impacted due to lockdowns related to the COVID-19 outbreak and the imposition of social distancing. All sectors, except the continuing resilience of agriculture and allied activities, are likely to show sharp deceleration. However, on the inflation front, the MPC expects some ease, taking cues from falling crude oil prices, and food and core inflation. Overall, the tone of the MPC lays greater emphasis on downward risk to growth, led by weakening demand and supply.

In addition to massive rate cuts, the RBI governor announced substantive measures to address stress in financial conditions caused by COVID-19, in its accompanying “Statement on Developmental and Regulatory Policies”. Expanding liquidity in the system substantially to ensure financial markets and institutions to function normally in the face of COVID-related dislocations, reinforcing monetary transmission so that bank credit flows on easier terms are
sustained to those affected by the pandemic, easing financial stress caused by COVID-19 disruptions by relaxing repayment pressures and improving access to working capital, and improving the functioning of markets in view of the high volatility experienced with the onset and spread of the pandemic, are the major ones.

- To ensure adequate liquidity is available to all constituents, the RBI introduced an instrument called Targeted Long-Term Repos Operations (TLTROs), of up to three years tenor, of appropriate sizes for a total amount of up to Rs 1,00,000 crore at a floating rate linked to the policy repo rate. Liquidity availed under the scheme by banks has to be deployed in investment-grade corporate bonds, commercial paper, and non-convertible debentures over and above the outstanding level of their investments in these bonds as on 27 March 2020.

- As a one-time measure, to help banks, the RBI reduced the Cash Reserve Ratio (CRR) of all banks by 100 bps to 3.0% of Net Demand and Time Liabilities (NDTL) with effect from the reporting fortnight beginning 28 March 2020. This will release primary liquidity of nearly Rs 1,37,000 crore uniformly across the banking system in proportion to the liabilities of constituents, rather than in relation to the holdings of excess SLR. A one-time dispensation of reducing the requirement of minimum daily CRR balance maintenance from 90% to 80%, effective from the first day of the reporting fortnight beginning 28 March 2020 up to 26 June 2020, is also aimed at easing banks’ daily liquidity operations.

- In view of the exceptionally high volatility in domestic financial markets, which bring in phases of liquidity stress, and to provide comfort to the banking system, the RBI increased the limit to borrow overnight under the Marginal Standing Facility (MSF), from the current 2% to 3% of the SLR with immediate effect.

Alongside the above liquidity measures, the RBI also announced regulation and supervision measures to mitigate the burden of debt servicing.

- All commercial banks, co-operative banks, all-India Financial Institutions, and NBFCs and all lending institutions are being permitted to allow a moratorium of three months on the payment of instalments with respect to all term loans outstanding as on 1 March 2020.

- To enable borrowers to tide over the economic fallout, with respect to working capital facilities sanctioned in the form of cash credit/overdraft, lending institutions are being permitted to allow a deferment of three months on interest payment for all such facilities
outstanding as on 1 March 2020. The accumulated interest for the period will be paid after the deferment period expires. The same will not be treated as a change in the terms and conditions of loan agreements due to financial difficulty faced by borrowers and, consequently, will not result in an asset classification downgrade.

- With respect to working capital facilities sanctioned in the form of cash credit/overdraft, lending institutions may recalculate the drawing power by reducing margins and/or reassessing the working capital cycle for the borrowers. The rescheduling of payments will not qualify as default for the purposes of supervisory reporting and reporting to credit information companies (CICs) by the lending institutions.

- The RBI deferred the implementation of the Net Stable Funding Ratio (NSFR) by six months from 1 April 2020 to 1 October 2020 and the last tranche of 0.625% of the capital conservation buffer (CCB) from 31 March 2019 to 31 March 2020.

- To improve the efficiency of price discovery, the RBI permitted banks in India that operate International Financial Services Centre (IFSC) Banking Units (IBUs) to participate in the NDF market with effect from 1 June 2020.

In keeping with the statement made by the RBI governor that he will do whatever it takes, RBI’s measures to ensure sufficient liquidity, lowering the cost of credit and advancing regulatory forbearance in the current crisis caused by the COVID-19 pandemic are timely, comprehensive and appropriate. The regulatory relaxation of the 3-month moratorium for EMI payments on all outstanding loans provides great relief, and the Governor’s assurance that the banking system is safe and sound provides a measure of comfort. All these measures help prevent deterioration in the borrowers’ credit profile and ensure adequate medium-term liquidity in the market, reduce the cost of funds and help reduce banks’ lending rates substantially.

Although these are important supply side measures, their effectiveness will largely depend on demand, which is currently almost muted. The announcements and measures are timely and provide the necessary condition for reversal, but one needs to be very careful about how the situation unfolds in the coming days. Regulatory forbearance has to be temporary and must be closely monitored to prevent an increase in NPAs. A large increase in liquidity, substantially through monetisation, can pose a potential threat to economic stability in the medium-term unless the capacity utilisation expands fast when normalcy returns. Even so, it was necessary to take the risk to prevent the economy from sliding fast, and the RBI must be complimented for these comprehensive and timely interventions.
Experts View

"The bold steps taken by the RBI bring in a much-required breather to the financial sector. The Repo, CRR and MSF rate cuts are strong enablers for strengthening liquidity in the banking system to extend credit to the domestic economy at cheaper interest rates. Furthermore, the moratorium of 3 months for term loan installments and interest on working capital facilities is a welcome relief to ensure stability in the financial sector. Lenders, including banks and non-banks, have been severely handicapped in operating under the 21-day nationwide lockdown, and the moratorium will provide some cushion to the lending community to realign its operations and collection machinery to ensure there is no sudden spurt in delinquency levels, especially in the low-income borrower segments. However, the ability of the lenders to ensure credit discipline among borrowers as the 3-month moratorium comes to an end and collect the accumulated interest and principal dues in a timely manner after this period will remain a key monitorable," says Vydianathan Ramaswamy, Director and Head- Financial Institutions, Brickwork Ratings.

"The announced liquidity boosting measures and permit to defer the payments by 3-month will help prevent the deterioration of the borrowers’ credit profile. It is also expected that the CRR cut shall help bring down the banks' lending rates by at least 50 bps (repo-linked, as well as MCLR). Also, we may see softening of the bond yields, thus enabling the government to borrow funds at cheaper rates during FY 20-21. Furthermore, these steps will control NPA growth in the last quarter of this fiscal year (FY20) and the first quarter of the next fiscal year (FY21), bringing improvement in banks' performance during these quarters, as well as provide adequate liquidity for lending. However, the interest rates offered on term deposits by banks, including savings banks, are expected to be reduced by about 25 bps. Going forward, based on the inflation conditions, the RBI is expected to review the CRR as it will have a multiplier effect on money supply. Also, we expected that SEBI may allow some changes in the treatment of default on NCDs on rescheduling," says BalKrishna Piparaiya, Senior Director, Brickwork Ratings.

“The additional 3-year long-term repo worth Rs 1 trillion is announced with a condition that such funds availed are to be necessarily deployed in the corporate bonds and Commercial Papers (CP) carrying an investment grade. This step could push corporates to take advantage of this announcement and raise money via CPs, thus boosting the dried-up CP market. Also, the rate cut, along with liquidity-boosting measures announced by the RBI, may lead to a reduction in yields in
the short term. We may see the yields on overnight funds offered by the Mutual Funds (MFs) fall as low as 4% as such overnight funds of MFs offer yield 25% to 40% lower than the repo rate. Hence, the investment in the CPs of corporates could fetch better yields for commercial banks availing the long-term repos,” says AP Kamath, Senior Director, Brickwork Ratings.

"The RBI’s announcements today on rate cut, moratorium and liquidity measures will provide the much-needed support to the market and economy, which are critical to tide through the current challenges. India’s banking system has been given access to Rs. 3.74 trillion of potential liquidity at a 75 bps lower cost than before. The LTRO, CRR cut of 100 bps, increase in Marginal Standing Facility (MSF) to 3% of the Statutory Liquidity Ratio (SLR) and repo rate cut of 75 bps should result in a large liquidity infusion into the financial system. The 3-month EMI moratorium and working capital interest forbearance, which will not result in an asset classification downgrade and will have no adverse impact on the credit history of beneficiaries, is a positive step, which will provide relief to various categories of borrowers. However, this being an optional move, its implementation has been left to the lending institutions. The RBI’s decisions to counter the COVID-19 impact on the economy are timely and progressive,” says Rajee Ramamurthi, Senior Director, Brickwork Ratings.

“The RBI has taken comprehensive measures, including the targeted liquidity injections, regulatory forbearance and incentivising banks in every possible way to lend more. This is certainly positive for the yield curve and the March quarter results of financial entities. But we also need to remember that currently, demand for credit is too weak because of the economy-wide shut-down. Hence, the RBI will be required to act aggressively later also when demand would start reviving. Also, a refinance window for Mutual Funds is also a need of the hour. But there is no announcement to that effect. The RBI and SEBI need to come out with a coordinated action on that front too in order to protect the confidence of common savers," says Rupa Rege Nitsure, Group chief Economist, L&T Finance Holdings.

"The policy and regulatory measures delivered today are more than what most market participants expected and would surely help ease the current financial sector dislocations. The liquidity measures and targeted LTROs are a huge positive for the credit market in particular, that
had almost frozen amid very high credit risk premia. We think this will further lower corporate rates, relatively more to the 3-5 years tenors, and reduce the credit spreads in the market. The moratorium on all term loans (all financial institutions), deferment of interest payment on working capital facilities, and easing working capital financing through cash credit/overdraft, etc., would provide relief to stakeholders at a time when they are struggling with payments of their financial obligations. On the policy interest rate front, apart from the higher-than-expected rate cut, the widening of the rate corridor was needed to discourage banks to park back excess liquidity with the RBI. We think more rate cuts could be on the anvil, depending on the scope and depth of the Covid-19 impact on domestic and global economy and financial markets. Separately, the RBI allowing IFSC banks to participate in the NDF market is also a welcome move and would lead to more liquidity in the NDF market and reduce arbitrage and volatility in the NDF, vis a vis onshore market, "Says Madhvi Arora, Economist, Edelweiss Securities.

Contacts:

Dr M Govinda Rao
Chief Economic Adviser
+9180 40409940
govindrao.m@brickworkratings.com

Anita Shetty
Research Editor
+91 22 67456663
anitashetty@brickworkratings.com

Investors and Media Contact
+9184339 94686
liena.t@brickworkratings.com
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