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RBI Event Note @ Dalal & Broacha

RBI POLICY UPDATE:

- RBI's Monetary Policy Committee (MPC) on Friday decided to cut its benchmark repo rate by 75 bps to 4.40%, amid rising concerns over the impact of coronavirus outbreak on the domestic as well as the global economy. Its steepest rate cut since the global financial crisis.
- The reverse repo rate was slashed even bigger by 90 bps to make it relatively unattractive for banks to passively deposit funds with the RBI and instead, to use these funds for on-lending to productive sectors of the economy.
- MPC also decided to continue with the accommodative stance as long as it is necessary to revive growth and mitigate the impact of coronavirus (COVID-19) on the economy, while ensuring that inflation remains within the target.
- Committee held its policy meeting on March 24, 25 and 27 ahead of the scheduled date in view of the current economic outlook.

Key Policy rates:

Policy Tools	Post policy	Pre policy	Status
Repo	4.40%	5.15%	Changed by 75 bps
Reverse Repo	4.00%	4.90%	Changed by 90 bps
Marginal Standing Facility (MSF)	4.65%	5.40%	Changed by 75 bps
Bank Rate	4.65%	5.40%	Changed by 75 bps
CRR	3.00%	4.00%	Changed by 25 bps

<u>Going Beyond Rate Cuts; Three-way liquidity injection</u>

- CRR Ratio of all banks reduced by 100 bps to 3%, which expected to release liquidity of Rs 1.37 lakh crore. Besides, the requirement of minimum daily CRR balance maintenance from 90% to 80%, effective from the first day of the reporting fortnight beginning March 28, 2020.
- RBI to conduct auctions of long-term repo operation (LTRO) of three-year tenure up to Rs 1 lakh crore at a floating rate linked to the policy rate.
  - Liquidity availed under the scheme by banks has to be deployed in investment-grade corporate bonds, commercial paper and NCDs over & above the outstanding level of their investments in these bonds as on Mar 25, 2020.
  - Eligible instruments comprise both primary market issuances and secondary market purchases, including from mutual funds and non-banking finance companies.
  - Investments made by banks under this facility will be classified as HTM even in excess of 25% of total investment permitted to be included in the HTM portfolio.
- Given 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 has decided to increase the limit of the marginal standing facility (MSF) from 2% of the Statutory Liquidity Ratio (SLR) to 3% with immediate effect.

<u>Other than the above-mentioned measures RBI also announced a host of other measures to ensure that banks do not fall short in their fight against Covid-19 pandemic.</u>

Moratorium on Term Loans:

- All lending institutions are being permitted to allow a moratorium of three months on repayment of instalments for term loans outstanding as on March 1, 2020. The moratorium/deferment is being provided specifically to enable the borrowers to tide over the economic fallout from COVID-19.
- The lending institutions to frame board approved policies for providing relief to all eligible borrowers. Bank boards to frame objective criteria for considering these reliefs.
- Wherever the exposure of a lending institution to a borrower is Rs 5 Cr or above as on March 1, 2020, the bank shall develop an MIS on the reliefs provided to its borrowers which shall inter alia include borrower-wise & credit-facility wise information regarding the nature & amount of relief granted.

Deferment of Last Tranche of CCB & NSFR

- The central bank has extended the deadline for meeting the last tranche of capital conservation buffer (CCB) by another six months. The move would leave about Rs 35,000 Cr capital in the hands of banks for lending to on-lending to productive sectors of the economy.
- Considering the potential stress on account of COVID-19, it has been decided to further defer the implementation of the last tranche of 0.625% of the CCB from March 31 to September 30, 2020. Currently, the CCB of banks stands at 1.875% of the core capital.
- MPC also decided to defer the implementation of Net Stable Funding Ratio (NSFR), which was required to be introduced by banks from April 1, 2020. It has now been decided to defer the implementation of NSFR by six months to October 1, 2020.
- NSFR reduces funding risk by requiring banks to fund their activities with sufficiently stable sources of funding over a time horizon of a year in order to mitigate the risk of future funding stress.

Outlook

In the current scenario, considering the negative sentiments in the economy, the central bank has announced several liquidity boosting measures including cuts in repo rate, reverse repo rate & CRR. MSF increase of 1%, along with LTRO of Rs 1-trillion and CRR cut of 1%, would infuse another Rs 3.74 trillion into the system – that is a big jump in liquidity. Combine this with the OMO and LTRO of the past, and the monetary stimulus provided is 3.2% of GDP, which is quite significant for RBI, which has supplemented the efforts of the government in alleviating the pain caused by Covid-19. We believe these steps should help in tiding through the end of the year issues which many finical institutions were fearing & will go a long way in cushioning the dislocations in various markets. These measures to support working capital requirements, reduce liquidity costs & provide moratorium on term loans will ease stress across many sectors. We expect another 25-50 bps rate cut in forthcoming policy reviews along with any further easing and extension of steps depending on the nature of the spread of COVID-19.

"Covid-19 is upon us but this too shall pass.... Stay clean, Stay Home, stay safe"

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