ICRA

ICRA COMMENTS ON RBI'S FIRST BI-MONTHLY MONETARY POLICY STATEMENT FOR 2020-21

In line with our expectations, MPC cuts Repo rate by 40 bps, while maintaining policy stance as 'Accommodative'

May 2020

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Anil Gupta
+91 124 4545314
anilg@icraindia.com

Aditi Nayar
+91 124 4545 385
aditin@icraindia.com

HIGHLIGHTS

- In line with our expectations, the Monetary Policy Committee (MPC) voted for a 40 bps cut in the policy Repo rate under the Liquidity Adjustment Facility (LAF) to 4.00% from 4.40% in the second consecutive out-of-cycle policy meeting. While the decision to cut the Repo rate was unanimous, five members voted for a cut of 40 bps, whereas one member voted for a 25 bps cut. Moreover, the monetary stance was unanimously retained at 'accommodative' for as long as necessary to revive growth and alleviate the impact of Covid-19 on the economy, while ensuring that inflation remains within the target, in the First Bi-monthly monetary policy statement for FY2021.

- With a cut in the Repo rate, the Marginal standing facility (MSF) rate, Reverse repo rate and bank rate were also revised lower by 40 bps to 4.25%, 3.75%, and 4.25%, respectively.

- RBI continues to remain pro-active in ensuring financial markets remain liquid, stable and functioning normally. RBI undertook several measures to expand liquidity in the system, such as conducting Targeted Long-Term Repo Operations and open market operations (OMO) in Q4FY2020 and April 2020.

- With high risk aversion leading to slow credit offtake, the surplus liquidity parked by banks under reverse Repo stood much higher at Rs 7.2 trillion as on May 21, 2020. Net of various liquidity infusion measures, the daily average liquidity surplus under the LAF rose to Rs 5.8 trillion during May 2020 (till May 21, 2020) from Rs 4.8 trillion during April 2020 and Rs 3.0 trillion during March 2020. With higher liquidity surplus, the daily weighted average call money rate declined further during May 2020 and stood at 3.81% (upto May 21, 2020) as compared to 4.08% during April 2020. With the today's cut of 40 bps in reverse repo rate, the call money rates and other short-term lending rates are expected to decline further.

- The RBI decided to continue with its earlier policy of easing the burden of debt servicing by extending the moratorium on payments of instalments for term loans and deferring the interest payments of working capital facilities by an additional three months. The moratorium which was earlier set to end on May 31, 2020 now stands extended till August 31, 2020. In addition, RBI has also permitted all lending institutions to convert accumulated interest on working capital facilities over the deferment period into a funded interest term loan, which will be repayable by March 2021.

- Other supportive measures announced by RBI include an interim relief granted to lending institutions, to exclude the entire moratorium period from the calculation of the 210 days resolution period for implementation of a resolution plan under the prudential framework on resolution of stressed assets. Besides this, limits on exposure to a single group has been

Outlook: With a substantial cut having been front-loaded, we now expect the MPC to be in wait and watch mode, to parse incoming data on evolving growth-inflation dynamics. Nevertheless, in the current context, there is a higher likelihood of a negative surprise on the growth expectations relative to the inflation expectations. Moreover, the statement itself suggests that headroom is available for at least one further rate cut. The timing of the same will depend on how quickly inflation appears to be reverting towards 4% and whether the rate of fresh Covid-19 infections forces further extensions in the lockdown.

Given the likely muted demand for most non-essential items, weak pricing power for producers, and favourable base effect related to food items in H2 FY2021, the average YoY CPI inflation is expected to cool to around 4.0% with a downside bias in FY2021 from 4.8% in FY2020, even though social distancing norms may drive up prices in some sectors. With the further extension of the lockdown, and the expectation of substantial delays in getting the full supply chain operational, especially given the likelihood of enduring labour mismatches following the return of migrant workers to their home states, we now expect Indian GDP (at constant 2011-12 prices) to contract by 5.0% in FY2021.

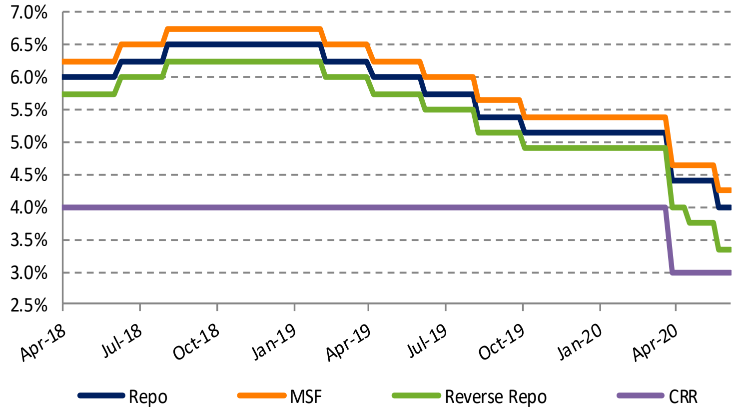
As expected, MPC cuts repo rate by 40 bps, maintains monetary policy stance at 'accommodative'

The six-member MPC voted for a 40 bps cut in the Repo rate to 4.00% from 4.40%, in today's off-cycle policy review. While the decision to cut the Repo rate was unanimous, five members voted for a cut of 40 bps, whereas one member voted for a smaller reduction of 25 bps. Moreover, the monetary stance was unanimously retained at 'accommodative' for as long as necessary to revive growth and alleviate the impact of Covid-19 on the economy, while ensuring that inflation remains within the target.

The CPI inflation had declined to 5.8% in March 2020 from 6.6% in February 2020, receding into the MPC's medium-term inflation target range of 4%+/-2%, after a gap of three months. The sequential dip in the YoY CPI inflation in March 2020 was driven by a continued correction in inflation for food and beverages, and to smaller extent, miscellaneous items. Given the limited transactions in retail items, other than food, the CSO had released the price data for April 2020 on selected sub-groups, namely, food and beverages, excluding meat and fish, and prepared meals, snacks, sweets, etc., and housing. The MPC noted that this truncated data indicated a reversal in the trend of softening of food inflation in April 2020, following the supply related disruptions related to the Covid-19 outbreak. In monthly terms, the inflation food and beverages (excluding meat and fish, and prepared meals, and snacks) hardened by 3.9% in April 2020, led by vegetables (+7.2%), pulses and products (+6.6%), cereals (+2.5%), etc., which the MPC has highlighted as pressure points. The Committee noted that as supply chains get reinstated in coming months with graded relaxations in the lockdown, the food inflation is expected to moderate from the level recorded in April 2020. According to the MPC, the expectation of a normal monsoon supports a further softening of the food inflation trajectory. Following the global demand supply disruptions, the MPC highlighted that the international crude oil prices are likely to remain modest, despite the recent firming up. Lower commodity prices will help to contain the input costs for domestic firms. Based on these factors and the favourable base effect, the MPC expects the headline inflation to ease below its target in Q3 FY2021 and Q4 FY2021.

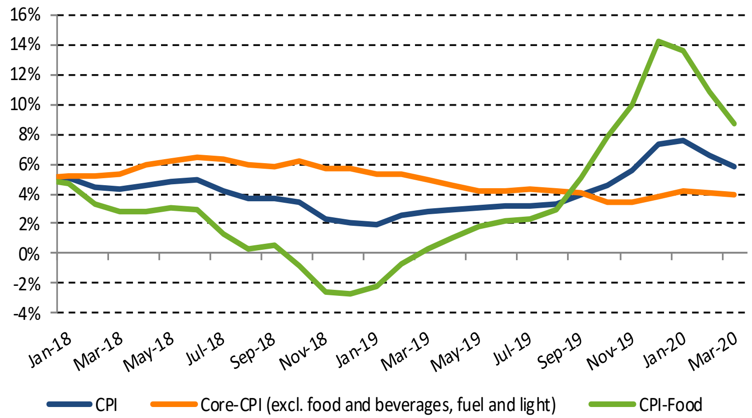
Domestic economic activity has been severely disrupted by the lockdown, as revealed by some high frequency indicators, such as a sharp plunge in the electricity demand, and collapse in the output of capital goods, consumer durables and non-durables. Lead indicators of the services sector have also deteriorated sharply, such as the considerable contraction in the sales of commercial vehicles, domestic airline passenger traffic, foreign tourist arrivals, and non-oil merchandise exports. With the further extension of the lockdown, the MPC expects economic activity aside from agriculture to remain depressed in Q1 FY2021. Subsequently, it anticipates that temporary labour shortages and social distancing measures, will continue to dampen economic activity in Q2 FY2021, even if lockdown gets lifted by end-May with some restrictions, which is in line with our analysis. The MPC expects a recovery in economic activity in Q3 FY2021, which would gather momentum in the subsequent quarter, based on normalcy in the supply chains and revival in the aggregate demand. However, the MPC cautioned that for FY2021 as a whole, there remains a considerable uncertainty about the likely duration of the ongoing pandemic, hence downside risks to the domestic economic growth remain significant.

Chart 1: Movement in Key Rates



Source: RBI; CEIC; ICRA Research

Chart 2: CPI Inflation, CPI-food and core-CPI inflation (YoY)



Source: CSO; CEIC; ICRA Research

RBI remains in proactive liquidity management mode to keep the financial markets liquid, stable and functioning normally, amidst the adversity and the prevailing risk-off sentiment

With high risk aversion leading to slow credit offtake, the surplus liquidity parked by banks under reverse Repo stood much higher at Rs 7.2 trillion as on May 21, 2020. RBI undertook various measures to augment the liquidity conditions in the economy in Q4 FY2020 and April 2020. For instance, the RBI conduct targeted long-term repo operations (TLTRO) specifically for purchase of corporate bonds of Rs. 1.0 trillion, and TLTRO 2.0 for Rs 500 billion in April 2020 specifically for NBFCs (utilized Rs 128.50 billion). This was in addition to LTROs of Rs 1.25 trillion done by RBI during February and March 2020. Net of various liquidity infusion measures, the daily average liquidity surplus under the LAF rose to Rs 5.8 trillion during May 2020 (till May 21, 2020) from Rs 4.8 trillion during April 2020 and Rs 3.0 trillion during March 2020.

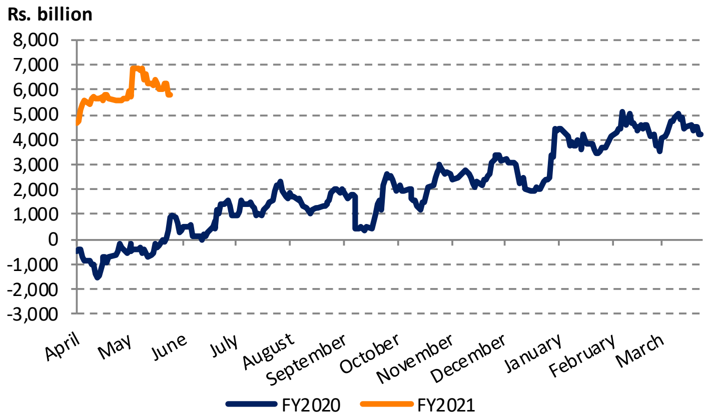
During current financial year, RBI also injected liquidity of Rs 1.20 trillion through open market operation (OMO) purchases of G-sec. RBI also conducted “Twist OMOs” of Rs. 100.0 billion during April 2020 to flatten the yield curve, which was in addition to “Twist OMOs” of Rs. 200.0 billion in March 2020.

In addition, RBI also provided refinance line of Rs 250 billion to National Bank for Agriculture and Rural Development (NABARD), Rs 150 billion to Small Industries Development Bank of India (SIDBI) and Rs 100 billion crore to National Housing Bank (NHB) for refinance of loans extended by Non-banking financial companies, regional rural banks and housing finance companies. In addition to Rs 250 billion of special liquidity facility (SLF) to mutual funds to ease their liquidity pressures amid expectations of higher redemptions in debt funds.

With higher liquidity surplus, the daily weighted average call money rate declined further during May 2020 and stood at 3.81% (upto May 21, 2020) as compared to 4.08% during April 2020 and 4.92% during March 2020. With the today’s cut of 40 bps in reverse repo rate, the call money rates and other short-term lending rates are expected to decline further.

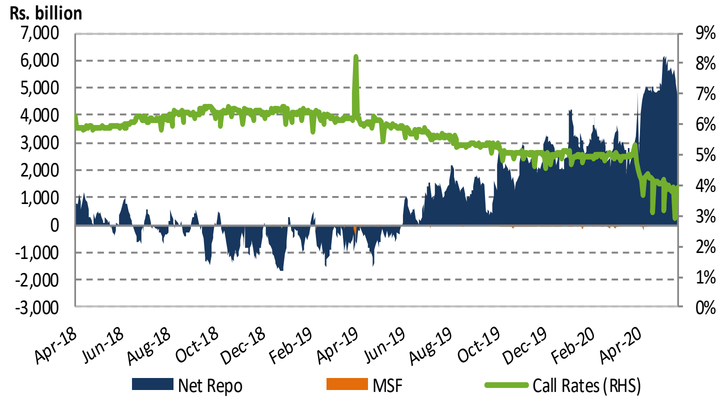
The MPC highlighted its commitment to keep the financial markets liquid, stable and functioning normally, amidst the adversity and the prevailing risk-off sentiment.

Chart 3: Liquidity Infusion (-)/ absorption (+)
(Net overnight & term Repos/Reverse Repos; MSF; SLF; MSS)



Source: RBI; CEIC; ICRA Research

Chart 4: Call money rates



Source: RBI; ICRA Research

Other Key Developments

As the economic impact of Covid-19 broadens, RBI decides to extend the duration of certain measures announced in its earlier policy (March 2020), while introducing additional measures aimed at minimizing systemic asset quality stress as well as ensure availability of liquidity

1) Relief measures with respect to moratorium on term loans and deferment of interest on working capital facilities extended to August 31, 2020

RBI has permitted all commercial banks (including regional rural banks, small finance banks and local area banks), co-operative banks, All-India Financial Institutions, and NBFCs (including housing finance companies and micro-finance institutions) to extend the moratorium relief announced in its policy meet in March 2020. As against moratorium of 3 months till May 31, 2020 under the earlier policy announcement; the moratorium has been extended till August 31, 2020.

1) The terms of the moratorium for the extended duration remains the same as the previous dispensation, under which a moratorium on payment of instalments in respect of all term loans outstanding as on March 1, 2020 was permitted. Accordingly, the repayment schedule and all subsequent due dates, as also the tenor for such loans, has been shifted across the board by an additional three months to August 31, 2020.
2) In respect of working capital facilities sanctioned in the form of cash credit/overdraft, the above intuitions are being permitted to allow a deferment of an additional three months on payment of interest in respect of all such facilities outstanding as on March 1, 2020.

Above moratorium will not result in asset classification downgrade till August 31, 2020.

Covid-19 and the following lock-down impacted cash flows of most borrowers at large. While a phased upliftment of the lock-down is likely to result in a gradual uptick in economic activity, the over-hang is likely to prolong a meaningful recovery of cash flows for borrowers in the near term. As a result, RBI has decided to extend the moratorium by three months, which is likely to aid borrowers manage their cash flows in the interim. However, this measure fell short of market expectations of a one-time restructuring package, instead of an extension of the moratorium. In ICRA's view, overall collection efficiency could see some drop as more borrowers may opt for moratorium with the revised extension. Also, given the importance of NBFC's to the stability of the financial system, willingness of banks to grant moratorium to NBFCs will remain critical. Further, NBFC's face funding challenges, given the limited availability of moratorium on debt capital instruments and moratorium relief granted by lending institutions may provide limited relief.

2) Conversion of Deferred interest on Working Capital facilities into Funded Interest Term Loan

RBI has permitted all lending institutions to convert accumulated interest on working capital facilities over the deferment period (from March 1, 2020 to August 31, 2020), into a Funded Interest Term Loan (FTIL), which will be repayable by March 31, 2021. In our view, this measure remains a positive given the potential challenges borrowers faced in servicing accumulated interest obligations in June 2020. However, repayment of interest by March 31, 2021 on working capital facility is still considerably short-period, and a longer period could have been considered. Similarly, relaxation of drawing power by March 31, 2021 could increase the repayment burden on borrowers unless the economy picks up in H2FY2021.

3) **Extension of timeline under the prudential framework for resolution of stressed assets**

As per RBI's prudential framework on resolution of stressed assets, a resolution plan is required to be implemented within 210 days from default (including the 30-day review period following default), failing which an additional provision of 20% is required to be made by the lender, which steps up to 35% in case the matter remains un-resolved upto 365 days. Considering the on-going challenges to conclude resolutions in a time bound manner due to Covid-19, RBI has permitted lending institutions to exclude the entire moratorium period from March 1, 2020 to August 31, 2020 from the calculation of the 210 days resolution period, subject to the review and resolution period not expiring on March 1, 2020.

In ICRA's view, the extension is un-likely to translate into a meaningful reduction in provisioning requirement for lending institutions for the stressed accounts existing at the date of notification of the circular as those accounts would have required resolution within 210 days of notification, i.e. by January 3, 2020 and were not affected by the moratorium / lockdown.

4) **Increase in limit on group exposures likely to benefit larger banks**

RBI has permitted banks to increase exposures to a single group from 25% of the bank's eligible capital base to 30% on a one-time basis, which shall be applicable till June 30, 2021. In ICRAs view, larger banks operating with a competitive cost of funds are likely to see an increase in exposure to large groups as increased volatility in the bond market is likely to draw large groups to banks for meeting funding requirements. Nevertheless, the intended benefit of this measure remains dependent on the bank's ability and willingness to lend to certain group of borrowers.

5) **Measures to support EXIM trade finance**

As per RBI's statement, India's merchandise trade de-grew sharply in April 2020, with exports shrinking by 60.3% and imports by 58.6% on a Year on Year basis (y-o-y). Considering the impact Covid-19, RBI has now permitted to extend the maximum permissible period for pre-shipment and post-shipment credit sanctioned by banks to 15 months from the existing one year. In order to extend US$ liquidity, RBI has decided to extend a line of credit of Rs.150 billion to EXIM Bank for availing a US$/Rs swap facility, for a period of 90 days from the availment of the facility, with an option to rollover of up to one year. Additionally, in order to facilitate importers in managing their operating cycles, RBI has permitted to extend the period of remittances against normal imports to be completed from six months to 12 months.

ICRA

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

Alliance with Moody's Investors Service

The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

The ICRA Factor

Our services are designed to

- Provide information and guidance to institutional and individual investors/creditors;
- Enhance the ability of borrowers/issuers to access the money market and the capital market for tapping a larger volume of resources from a wider range of the investing public;
- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

ICRA

Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
Tel: +91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: communications@icraindia.com
Tel: +91 124 4545 860

Registered Office:

1105, Kailash Building, 11th Floor,
26, Kasturba Gandhi Marg,
New Delhi - 110 001
Tel: + 91 11 2335 7940-45

Corporate Office:

Building No.8, 2nd Floor,
Tower A, DLF Cyber City Phase II,
Gurgaon- 122 002
Tel: +91 124 4545300

Ahmedabad

1809-1811, Shapath V,
Opposite Karnavati Club
S.G. Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/01

Bengaluru 1

'The Millenia', Tower- B, Unit No. 1004,
10th Floor,1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber,
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre,
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

No. 7-1-58, 301, 3rd Floor, 'CONCOURSE',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Hyderabad 2

4A, 4th Floor, SHOBHAN,
6-3-927, A&B Somajiguda,
Raj Bhavan Road,
Hyderabad – 500082
Tel: +91 40 40676500

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony,
S. No. 210 CTS 3202 Range Hills Road,
Shivajinagar,Pune - 411 020
Tel: +91 20 2556 0194, 020 6606 9999

Email: info@icraindia.com
Helpdesk: 9354738909
Website: www.icra.in/ www.icraresearch.in