# RBI Policy: Unlocking all possible measures in a lockdown!

**27 March 2020**


### Key Highlights

- 75 bps of repo rate cut
- Accommodative stance retained
- INR 3.74 lakh crores of liquidity
- 3 months of moratorium

### RBI MPC: actions taken in the 7th bi-monthly policy

- Monetary Policy Committee (MPC) advanced its meeting and declared a 75 bps of rate cut while reverse repo rate lowered by 90 bps; 4 members out of 6 have voted in support of this decision.
- Measures announced under all four categories wherein support was required viz. Liquidity, Monetary transmission, Moratorium for loan repayments and Improvement in functioning of financial markets.
- Liquidity measures of INR 3.74 lakh crores
    - Term Long Term Repo Operations (TLTRO) of 3-year tenor of INR 1 lakh Cr used to buy corporate bonds and commercial papers;
    - Cash Reserve Ratio (CRR) cut of 100 bps to 3%; easing daily CRR requirement to 80% from 90%
    - Marginal Standing Facility or MSF facility increased to 3% of SLR from 2% of SLR (Statutory Liquidity Ratio)
- Regulation and Supervision: Forbearance and transmission
    - Moratorium on term loans of both principal and interest by 3 months
    - Easing working capital financing by reducing margin requirement
    - NSFR requirement postponed by 6 months to 1 October 2020
    - CCB (Capital Conservation Buffer) of 0.625% postponed by 6 months to 30 September, 2020
- Permitting banks to participate in offshore NDF market

### Background of current action

With the objective to mitigate the impact of Covid-19 on the economy, revive growth and preserve financial stability RBI MPC in its policy meeting to be held from 24 March – 27 March 2020, (advanced from 31 March – 3 April 2020) and decided to cut Repo Rate by 75 bps to 4.4%. Accordingly, MSF now stands at 4.65%. Reverse Repo rate is reduced by 90 bps to 4%.

HSBC Global Asset Management

Source – RBI, Bloomberg, Data as at March 2020

RBI continues to maintain the stance as accommodative. In addition to a sizable rate cut, RBI has announced many other progressive measures which involves (i) expanding liquidity in the system sizably by INR 3.74 Lakh Cr to ensure that financial markets and institutions are able to function normally in the face of COVID-related dislocations; (ii) reinforcing monetary transmission so that bank credit flows on easier terms are sustained to those who have been affected by the pandemic; (iii) easing financial stress caused by COVID-19 disruptions by relaxing repayment pressures and improving access to working capital; and (iv) improving the functioning of markets in view of the high volatility experienced with the onset and spread of the epidemic.

Overall, we believe that RBI has done all what it takes in the wake of this crisis and the measures are well appreciated by the market and the financial community. RBI has adopted a combination of conventional and non-conventional measures to protect the financial stability of the economy. In addition, commentary by the governor that the Indian Banking system is safe and sound and the fact that it is fallacious to link (recent) share price to deposit security is a strong comfort on the banking system.

### Recent Market and Economic Developments

Global economic activity has come to a near standstill with an expectation of shallow recovery and financial markets have become extremely volatile. Panic sell-offs have resulted in wealth destruction in equity markets across advanced and emerging economies alike. Flight to safety has rendered fixed income markets illiquid and currencies across the world are experiencing severe depreciation across geographies.

Central banks and governments are in war mode, responding to the situation with several conventional and unconventional measures targeted at easing financial conditions to avoid a demand collapse and to prevent financial markets from freezing up due to illiquidity.

Domestic financial conditions have also tightened alongside across both equity and fixed income segments with FPIs selling. Redemption pressures, drop in trading activity and generalised risk aversion have pushed up yields.

### Inflation

While January/February 2020 inflation was 30 bps above estimates, RBI expects food prices would soften as harvest has been healthy until the onset of usual summer uptick. In addition, the collapse in crude prices should work towards easing both fuel and core inflation pressures, depending on the level of the pass-through to retail prices.

The MPC is of the view that macroeconomic risks, both on the demand and supply sides, brought on by the pandemic could be severe. The need of the hour is to do whatever is necessary to shield the domestic economy from the pandemic.

### Development Policy Measures

1. **Liquidity Management & Transmission: Measures amounting to INR 3.74 lakh crores**

   a) **Targeted Long Term Repo Operations:** Recent risk-off and thinning of trading activity has resulted in surge in liquidity premia on corporate bonds and commercial papers. To mitigate this impact, RBI will conduct TLTROs of cumulative Rs. 1 lakh crores targeted towards 3 year instruments. Banks to deploy the liquidity availed in investment grade corporate bonds and commercial papers. Investments under this category will held to maturity.

   b) **Cash Reserve Ratio:** Reduction in CRR by 100 bps to 3% from 4% which would release Rs. 1.37 Lakh Cr of primary liquidity. This dispensation will be available for 1 year upto 26 March 2021.

   c) **Daily CRR requirement:** Reducing requirement to maintain daily CRR from 90% to 80% effective from 28 March 2020 upto 26 June 2020.

   d) **Marginal Standing Facility:** Banks can borrow overnight from the MSF facility upto 3% of SLR from 2% of SLR upto 30 June 2020. This will release additional Rs. 1.37 Lakh Cr of liquidity. and therefore motivated along with other measures to encourage lending and improve transmission.

   e) **Widening of policy corridor:** Existing policy corridor widened from 50 bps to 65 bps. Reverse repo is 40 bps lower than policy rate and MSF continuing at 25 bps above policy rate. This is in view of persistent excess liquidity

2. **Regulation and Supervision**

Aimed at mitigating the burden of debt servicing, a moratorium of 3 months given for repayment of interest and principal on term loans.

Source – RBI, Bloomberg, Data as at March 2020

a) All commercial banks, co-operative banks, all India financial institutions and NBFCs are permitted to allow a moratorium of three months on payment of instalments in respect of all term loans outstanding as on 1 March 2020

b) In respect of working capital facilities sanctioned in the form of cash credit/overdraft, lending institutions are being permitted to allow a deferment of three months on payment of interest in respect of all such facilities outstanding as on 1 March 2020.

c) In respect of working capital facilities sanctioned in the form of cash credit/overdraft, lending institutions may recalculate drawing power by reducing margins and/or by reassessing the working capital cycle for the borrowers

d) Deferment of Net Stable Funding Ratio by 6 months to 1 October 2020 which will increase availability of funds with banks

e) Deferment of last tranche of Capital Conservation Buffer (CCB) of 0.625% by 6 months to 30 September 2020

The measures forbearance will not result in downgrade of asset classification or impact CIBIL scores.

### 3. Financial Markets

With the intention to improve depth and price discovery in the forex market segments by reducing arbitrage between onshore and offshore markets, RBI is now permitting banks to deal in offshore non-deliverable forward INR market.

**Going Forward**

RBI's comprehensive measures today along with government of India's announced measures so far will give the much needed relief to the financial system particularly at the time when market liquidity for fixed income instruments were getting severely constrained and spreads being elevated beyond the risk adjusted levels. While RBI along with Government of India measures are aimed to provide much need stimulus to stabilise the economy and bring it back to growth, the key risk at this point is intensity, spread and duration of the pandemic. We would however expect RBI (and government) to not lift the pedal off the accelerator until the economy begins to revive and therefore would retain a constructive view on rates.

**We have outlined the impact of the current policy stance on the various fixed income segments here**.

**Overnight rates - the cost of money for the system**

We expect liquidity to remain in the significant surplus zone over the next couple of months supported by RBI actions in the near term. We expect overnight rates to hover closer to reverse repo rates of 4.00%

**Government Securities yields**

We expect G-Sec yields to outperform given the significant reduction in rates and accommodative stance particularly at the shorter end of the segment. While there is potential supply from April 2020, given the significant liquidity we would expect it get absorbed. Also, given the recent sell off we would expect appetite of FPIs to return once global stability returns. In addition, RBI tools such as OMOs and inclusion of India in the global index are options available over the near to medium term.

The key risk however remains on the fiscal side; as weak growth will keep fiscal pressures elevated. It could however get overlooked in the near term.

**Corporate bond yields:**

The recent widening on spreads and risk off sentiment had spiked the liquidity premia across the segments. We would expect significant outperformance in this segment, particularly in the 1 – 3 year segment as TLTRO buying resumes. Also, spread tightening will be in line with G-secs. In addition, easing of supply as we head into beginning of a new financial year should be supportive for rates.

**Impact on HSBC Mutual Fund Schemes**

**HSBC Flexi Debt Fund and HSBC Debt Fund**

With the scope accommodation and easing for the near to medium term and expectation of supply fairly absorbed given surplus liquidity, we would maintain a neutral stance versus Index and take tactical calls depending on how macro-economic environment unfolds.

**HSBC Low Duration Fund and HSBC Short Duration Fund**

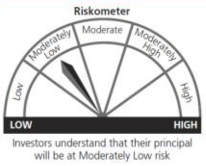
These funds are expected to benefit from attractive carry and outperformance in shorter end of the curve. Moreover, it offers significant value for investors at current yields over policy rate.

Source – RBI, Bloomberg, Data as at March 2020

**HSBC Short Duration Fund**

**This product is suitable for investors who are seeking*:**

- Regular Income over Medium term
- Investment in diversified portfolio of fixed income securities such that the Macaulay^ duration of the portfolio is between 1 year to 3 years



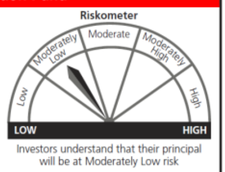

* Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

^ The Macaulay duration is the weighted average term to maturity of the cash flows from a bond. The weight of each cash flow is determined by dividing the present value of the cash flow by the price.

**HSBC Low Duration Fund**

**This product is suitable for investors who are seeking*:**

- Liquidity over short term
- Investment in a mix of debt and money market instruments such that the Macaulay^ duration of the portfolio is between 6 months to 12 months.

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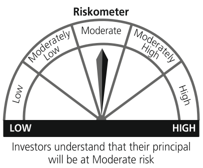
**HSBC Debt Fund**

**This product is suitable for investors who are seeking*:**

- Regular Income over long term
- Investment in diversified portfolio of fixed income securities such that the Macaulay^ duration of the portfolio is between 4 years to 7 years

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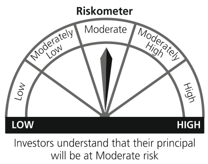
**HSBC Flexi Debt Fund**

**This product is suitable for investors who are seeking*:**

- Regular Income over long term
- Investment in Debt / Money Market Instruments

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Source – RBI, Bloomberg, Data as at March 2020

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