



March, 2020

RBI delivers big, displaying both intent and ability

In a surprise press conference earlier today, the Reserve Bank of India (RBI) brought forward its Monetary Policy Committee (MPC) meeting (which was to be held in early-April) and unveiled a detailed stimulus plan, delivering on all three counts - Rates, Liquidity, and Regulatory Easing.

Summary of measures announced

1. Policy repo rate cut by 75 bps; effective easing even higher

The RBI MPC cut the policy repo rate by 75 bps to 4.40%, with four members of the MPC voting for 75 bps and two for 50 bps easing.

At 4.65%, the Marginal Standing Facility (MSF) rate remains 25 bps above repo rate. But the reverse repo rate was lowered by 90 bps to 4.00%. The reverse repo rate will now be 40 bps below the repo rate (instead of the previous norm of being 25 bps lower).

Impact: This step was taken to incentivize banks to lend out to the market, rather than park excess liquidity with the RBI. Given abundant banking sector liquidity, the reverse repo rate could become the more effective one, and as such, the **de-facto easing was closer to 90 bps.**

2. Liquidity infused, both targeted and system-wide

- Targeted Long Term Repo Operations (TLTRO) of up to INR1 trillion, for a 3-year tenor, at a floating rate linked to the policy repo rate, was announced. Banks will have to deploy this in investment grade corporate bonds, commercial paper and non-convertible debentures. These can be from the primary market upto 50% and the remaining 50% from the secondary markets, including from the mutual funds and non-banking finance companies. Investments made by banks under this facility will be classified as Held to Maturity (HTM).
- Cash Reserve Ratio (CRR) cut by 100 bps to 3.0%, for a period of one year. This will infuse primary liquidity of INR1.37 lakh crore across the banking system.
- Marginal Standing Facility was increased from 2% of the Statutory Liquidity Ratio (SLR) to 3%, for up to June 30, 2020. This amounts to INR 1.37 lakh crore of additional liquidity.

Impact: The three measures relating to TLTRO, CRR and MSF will inject total liquidity of INR3.7 lakh crore into the system, with the TLTRO likely to force banks to participate in a significant way in the money and bond markets. This should get much needed liquidity into our bond and CP markets, where yields had been marked higher amidst MF redemptions and lack of buyers.



3. Regulatory forbearance likely to help banks and borrowers alike

- A 3-month re-payment moratorium for all term loans outstanding, as on March 1, 2020, was announced.
- Deferment of interest to be paid on working capital loans (cash-credit/overdraft) outstanding as on March 1, 2020 for three months, was also announced.
- Working capital financing norms were eased. Lending institutions will be allowed to recalculate drawing power by reducing margins and/or by reassessing the working capital cycle for the borrowers.
- Implementation of Net Stable Funding Ratio (NSFR) norm has been deferred by six months to October 1, 2020
- Last Tranche of Capital Conservation Buffer has also been deferred by 6 months to September 30, 2020

Impact: The RBI clarified that the regulatory forbearance steps on loan and interest payment will neither result in an asset class downgrade, nor have an adverse impact on the credit history of the beneficiaries. Pushing forward the last tranche of the capital conservation buffer will free-up capital for the banking system.

4. Steps to curb select financial market volatility

- Domestic banks will be permitted to deal in offshore rupee NDF markets with effect from June 1, 2020.

Impact: This will provide liquidity to the NDF market, and help curb volatility

Our takeaway and outlook going forward

Markets had been eagerly waiting for the RBI to step in with its 'bazooka' over the past few weeks, with hopes slowly dwindling over time, leading to a sharp selloff in the corporate bond market. Although arguably slightly delayed, however, the RBI has delivered much more than expected - cutting the repo rate by 75bps, widening the corridor, infusing liquidity and easing regulatory norms.

Markets heaved a huge sigh of relief, rallying significantly across various segments, but most of all in the shorter end of the money market and corporate bond curve, which had been equally brutally sold off over the past few weeks. While 3 month CD/CPs rallied by almost 250 bps, the 1-2 year segment rallied by about 175 bps, the 3 year AAA bonds by 125 bps and the 10-year AAA bond by 40-50 bps. The reaction on the Government security side was somewhat less, with the 3-4 year G-Sec down by 35 bps and the 10-year G-Sec by about 8-10 bps to 6.14%.

The RBI seems to have deliberately stayed away from any announcements about the size of its OMO program as well as any hints about whether it will directly monetize the government's deficit. Markets will be watching for further updates about the fiscal stimulus package, and the likely government borrowing calendar for the next year which is to be announced on Monday, following which some clarity on RBI's stand on these issues may emerge.



Overall, we believe the actions of RBI will help alleviate the nervousness in our bond markets, which had led to a vicious cycle of poor liquidity, yields moving higher, investors getting nervous, increased investor redemptions thereby leading to further selling pressure. The various measures along with the normalisation of the market yields, we believe, will set into motion a sense of stability and gradual decline in yields across various segments making it a relatively attractive environment for fixed income investors.
