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India Fights Against COVID-19: RBI's Economic Reforms

A day after Hon'ble Finance Minister of India, Mrs. Nirmala Sitharaman announced a series of measures to deal with the economic distress, the Reserve Bank of India joined the big fight with dynamic economic measures by easing financial stress from COVID -19.

"Make no mistake, it is a fight never seen before", warned the Hon'ble Governor of RBI, Mr. Shaktikanta Das while reassuring words on financial stability. The Monetary Policy Committee met from 25th – 27th March 2020 discussed.

This update sets out various developmental and regulatory policies that directly address the stress in financial conditions caused by COVID-19. They consist of:

(i) expanding liquidity in the system sizeably 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 pandemic. The policy initiatives in this section should be read in conjunction with the MPC's decision on monetary policy actions and stance in its resolution.

Key takeaways from Governor's Announcement:

A. Reduction in Monetary Rate

The MPC in 4:2 majorities voted for a change in monetary rates, reduction in Repo rate was seen by 75 basis points from 5.15% to 4.4%. However, a greater change was seen in the Reserve Repo rate by reduction of 90 basis points from 4.9% to 4%, by encouraging the Banks to lend more to productive sectors of economy rather than depositing with the RBI.

B. Liquidity Management

i. Targeted Long Term Repo Operations (TLTROs)

In order to mitigate the adverse effects on economic activity leading to pressures on cash flows, it has been decided that the RBI will conduct auctions of targeted term repos of up to three years tenor of appropriate sizes for a total amount of up to INR 100,000 crore at a floating rate linked to the policy repo rate. Banks shall be required to acquire up to 50% of their incremental holdings of eligible instruments from primary market issuances and the remaining 50% from the secondary market, including from mutual funds and non-banking finance companies.

ii. Reduction in Cash Reserve Ratio

The Cash Reserve Ratio of all banks to be cut by 100 basis points to 3% of Net Demand and Time Liabilities w.e.f. 28th March, 2020. This reduction in the CRR would release primary liquidity of about INR 137,000 crore. Furthermore, hardships faced by banks in terms of social distancing of staff and consequent strains on reporting requirements, it has been decided to reduce the requirement of minimum daily CRR balance maintenance from 90% to 80%. w.e.f. 28th March, 2020. This is a one – time dispensation will available up to 26th June, 2020.

iii. Marginal Standing Facility

Due to high volatility in domestic markets which is leading to liquidity stress, the limit of 2% of dipping into the SLR has been changed to 3% with immediate effect. This will be applicable only till 30th June, 2020. This will help the banks by allowing it to avail an additional INR 137,000 crore of liquidity.

The three measures relating to TLTROs, CRR and MSF will inject a total liquidity of INR 374,000 crore.

C. Debt Management

i. Moratorium on Term Loans

The Governor announced a relief for all commercial banks (including regional rural banks, small finance bank and local area banks), co-operative banks, all-India Financial Institutions and NBFCs (including housing finance companies and micro-finance institutions) to allow 3-month moratorium on payment of installments in respect of all term loan EMIs outstanding on 1st March , 2020.

The 3-month moratorium will apply to corporate loans, home loans, personal loans and car loans.

ii. Deferment of Interest on Working Capital Facilities

The Governor also announced a relaxation in working capital facilities sanctioned in the form of cash credit/overdraft, by which 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 1st March, 2020. The accumulated interest for the period will be paid after the expiry of the deferment period.

iii. Easing of Working Capital Financing

The lending institution may recalculate drawing power by reducing margins and/or by reassessing the working capital cycle for the borrowers.

The above three points won't be treated as a change in terms and conditions of loan agreements due to financial difficulty of the borrowers and, consequently, will not result in asset classification downgrade as an NPA. It won't affect the credit ratings of the beneficiaries as well.

iv. Deferment of Implementation of Net Stable Funding Ratio

The Basel Committee on Banking Supervision (BCBS) had introduced the NSFR which 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. As per the prescribed timeline, banks in India were required to maintain NSFR of 100 per cent from 1st April, 2020. It has now been decided to defer the implementation of NSFR by six months from 1st April, 2020 to 1st October, 2020.

v. Deferment of Last Tranche of Capital Conservation Buffer

The Capital Conservation Buffer (CCB) is designed to ensure that banks build up capital buffers during normal times (i.e., outside periods of stress) which can be drawn down as losses are incurred during a stressed period. As per Basel standards, the CCB was to be implemented in tranches of 0.625 per cent and the transition to full CCB of 2.5 per cent was set to be completed by 31st March, 2020. Considering the potential stress on account of COVID-19, the RBI has decided to further defer the implementation of the last tranche of 0.625 per cent of the CCB from 31st March 2020 to 30th September, 2020.

D. Financial Markets

Due to the high volatility of Indian Rupee caused by the impact of COVID -19 on currency markets, the RBI has decided to allow Banks to deal in Off-shore Non-Deliverable Rupee Derivative Market w.e.f. 1st June, 2020.

Glossary

RBI – Reserve Bank of India

LTRO – Long Term Repos Operations

MPC – Monetary Policy Committee

MSF – Marginal Standing Facility

NBFC – Non Banking Financial Corporation

CCB – Capital Conversion Buffer

EMI – Equated Monthly Installment

NSFR – Net Stable Funding Ratio

CRR – Cash Reserve Ratio

SLR – Statutory Liquidity Ratio