Monetary Policy Review – May 2020

Another off cycle rate cut

Monetary Policy Committee (MPC), in it's bi monthly MPC meeting reduced Repo rate & Reverse Repo rate by 40bps to 4% & 3.35%, respectively, and maintained an accommodative stance.

Post Covid 19 outbreak, RBI advanced it's MPC meeting twice and lowered Repo rate by total of 115bps (i.e. on March 27, 2020 by 75bps and May 22, 2020 by 40bps) along with other regulatory measures in order to support the economy. In the latest policy announcement, the RBI has tried to address liquidity issues of MSME, state Governments, exporters and importers, along with extending moratorium on term and working capital loans by another 3 months.

Further, RBI only gave directional guidance on inflation and economic growth and refrained from giving any numerical projections. RBI also noted the deterioration in economic growth prospects and acknowledged negative GDP print for FY21. RBI expects headline inflation will fall below 4% over Q3FY21 and Q4FY21. Hence, overall risks to growth are severe while those to inflation may be temporary. However, on positive side, kharif sowing is robust.

Moratorium extended for 3 months: In order to ease financial stress, the RBI has allowed extension of moratorium on term loans by an additional three months till August 31, 2020. Similarly, RBI has also allowed deferment of interest on working capital facilities for another three months till August 31, 2020 and considering lockdown led strain on cash flow, it allowed accumulated interest to be converted into a term loan and repayable by the end of FY2021

Measures to improve the functioning of markets

- Special Refinancing facility of ₹15,000cr to SIDBI extended by additional 90 days.
- Additional duration (extension of 3 months) to meet investment limit by FPI under Voluntary Retention route (VRR).

Measures to support exports and imports

- Increase in export credit sanctioned by banks from existing one year to 15 months, for disbursements made up to July 31, 2020.
- Liquidity Facility to Exim Bank of India of ₹15,000cr for a period of 90 days.
- Extension of time for payment for normal imports from six to twelve months.

Measures to ease financial stress

- Moratorium extended by 3 months on term loans till August 31, 2020.
- Accumulated interest on working capital facilities will be converted into a funded interest term loan which shall be repaid in current FY21.
- Extension of resolution timeline.
- Group exposure limit increased from 25% to 30%.

Measures to ease State Government financial stress

- Ease financial stress of state governments by relaxing the rules governing withdrawal from Consolidated Sinking Fund (CSF).

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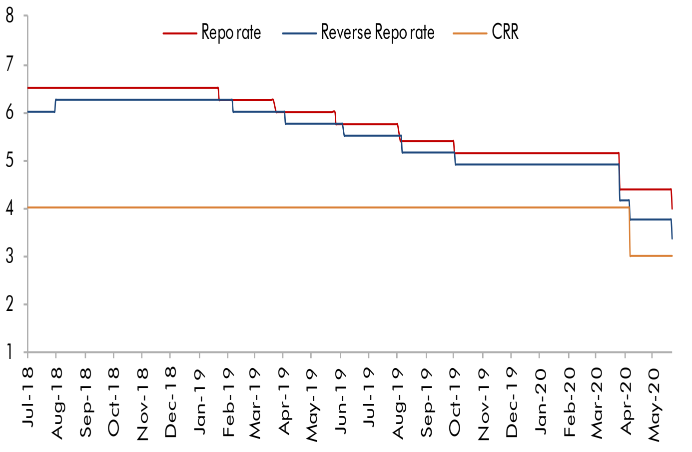
OurTake: We believe RBI has been taking calibrated move and responding to the evolving situation, like announcing extension of moratorium for another 3 months and other supporting measures. However, investors were also expecting an announcement of a comprehensive restructuring of loans. We opine that RBI will come up with one-time restructuring once the lockdown is lifted. Any successful restructuring requires some certainty of cash flow, hence, once the lockdown is lifted, RBI will have better understanding of the cash flow position of every sector and accordingly will announce restructuring plans.

All measures by RBI are intended towards easing the funding pressures and liquidity provided by RBI to banks ideally be addressing the liquidity issues of stressed segments of the economy. However, banks are parking excess liquidity of over ₹7 lakh cr with the RBI, which clearly indicates little demand for credit and heightened risk aversion among the banks. Rate cut would not immediately improve credit off take for banks given the lack of economic activity, negative growth prospects coupled with the reluctance of corporates to add debt in present scenario. Hence, everything depends on when the lockdown will end and economic activity resumes.

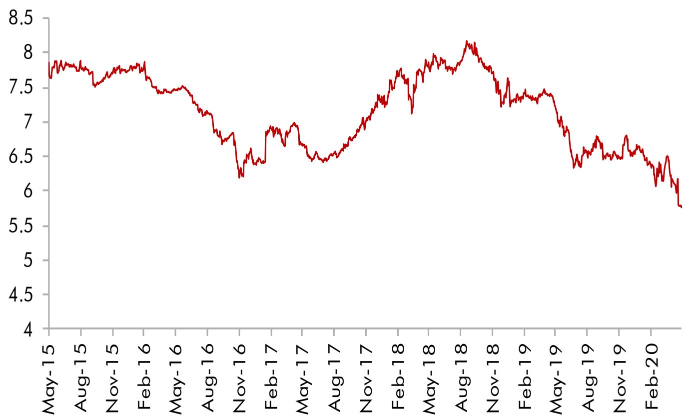
We expect extension of moratorium could have negative impact on financial institutions. It could lead to lower collection, as cash flow of borrowers would not improve immediately once economic activity resumes. Consequently, it will impact asset quality. Additionally, there is a risk of credit culture being affected due to a prolonged moratorium period. Hence, we expect higher slippages and provision costs in FY21.

Exhibit 1: Repo rate lowerd 115bps in last two months



Source: Company, Angel Research

Exhibit 2: 10 year G-sec Movement



Source: Company, Angel Research

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