RBI GOVERNOR'S ADDRESS-APRIL 17, 2020-TIMELY MEASURES

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I. PERSPECTIVE

These are trying times for the global economy in general and the emerging market economies, including India in particular. The World Economic Outlook of the International Monetary Fund (IMF) reveals that the global economy is going through its worst phase since the Great Depression because of massive dislocations in global production, supply chains, trade and tourism. Global financial markets are experiencing extreme volatility; global commodity prices, especially of crude oil, have declined sharply.

Despite a deeply disturbing global landscape because of real and worrisome fault-lines and a distinct deterioration in macroeconomic landscape since March 27, 2020, India is one of the few countries, where GDP growth is projected to be 1.9 percent. The data on monsoon, sowing, fertilizers augur well for agriculture and rural outlook but the situation is grim in the industrial sectors. India is, however, expected to stage a smart recovery to grow at pre-Coronavirus pace of 7 percent in FY 21.

KBK Infographics

Corona Impact IMF World Economic Outlook

GDP Growth Projections

The COVID-19 pandemic will severely impact growth across all regions

(Real GDP, annual percentage change)	2019	Projections 2020	Projections 2021
World	**2.9**	**-3.0**	**5.8**
Advanced Economies	**1.7**	**-6.1**	**4.5**
United States	2.3	-5.9	4.7
Euro Area	1.2	-7.5	4.7
Japan	0.7	-5.2	3.0
Emerging Market and Developing Economies (EMDEs)	**3.7**	**-1.0**	**6.6**
China	6.1	1.2	9.2
India	**4.2**	**1.9**	**7.4**
Russia	1.3	-5.5	3.5
Brazil	1.1	-5.3	2.9
Saudi Arabia	0.3	-2.3	2.9
Pakistan	3.3	-1.5	2.0
Bangladesh	7.9	2.0	9.5
South Africa	0.2	-5.8	4.0

India's growth on fiscal basis (2020 denotes 2020-21)

Source: IMF, World Economic Outlook, April 2020

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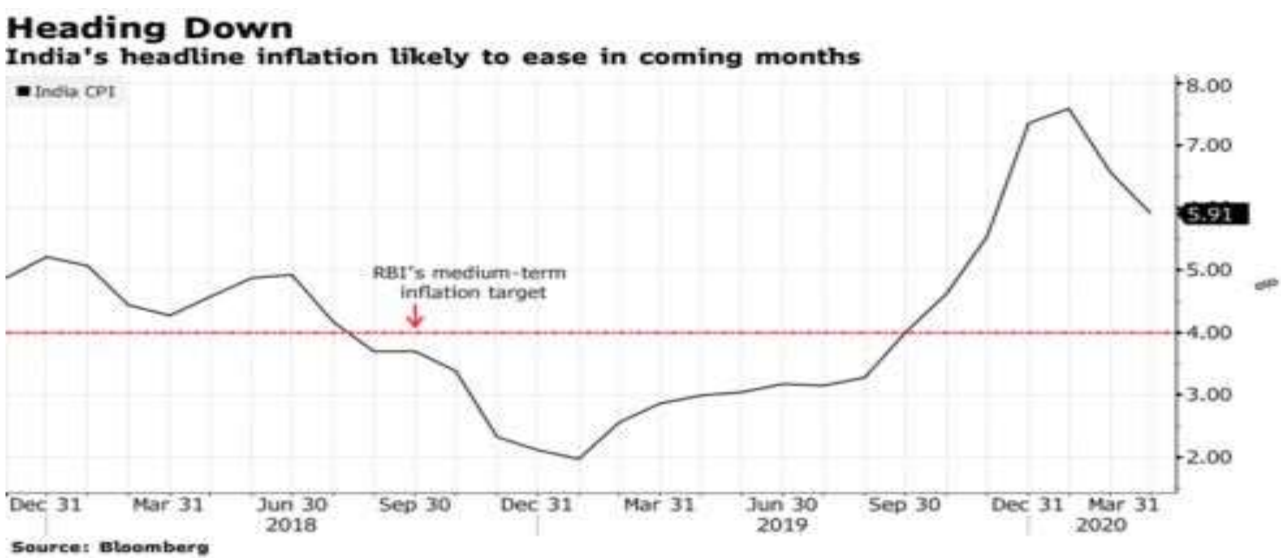
II. EMERGING FAULT-LINES

COVID-19 has impacted economic activity in India directly due to lockdowns, and indirectly through second round effects operating through global trade and growth. Going ahead, heightened risk aversion, pronounced macro-economic slowdown, wholesome impact on the balance of payments because of the free fall in oil reaching hitherto inconceivable levels and greater uncertainty because of marked domestic slowdown and negative global cues would be increasingly important in the growth narrative.

India announced an economic stimulus package worth 1.7 trillion rupees ($22.5 billion) on March 26, 2020, designed to help millions of low-income households withstand a 21-day lockdown due to the coronavirus outbreak.

III. GROWTH INFLATION TRADE-OFF

The present situation is characterized by an increase in Kharif output was up by 37 percent, forex reserves of $476.5 billion estimated to meet almost 12 months of imports, surge in surplus liquidity in the banking system post March 27, 2020 and decline in inflation by 170 bps to from the January 2020 peak. The Governor pointed out "*inflation could recede even further, barring supply disruption shocks and may even settle well below the target of 4% by the second half of 2020-21*". "*Such an outlook would make policy space available to address the intensification of risks to growth and financial stability brought on by Covid-19*."



This is why the dialectics, dilemmas and challenges of the process and pattern of development make it important in these difficult Coronavirus times not to lose hope and to exhibit a sense of flexibility and resilience, which India displayed even in the long-drawn, protracted struggle for India's independence. This trial of adversity-this 'agni pareeksha' (trial by fire)- is ours. Meeting the onslaughts of this trial of adversity in a synchronised and resolute manner would enable us to be successful in the trial of prosperity in the future. The RBI Governor did well to quote Mahatma Gandhi, who justifiably maintained "*in the midst of death life persists, in the midst of untruth, truth persists, in the midst of darkness, life persists*". This is how things should be -even in the most difficult days, we should never lose a sense of balance and proportion, an ability to look at the look at the larger picture without in any way being oblivious of the ground level realities. In its pursuit of addressing unsettled issues, emerging challenges, cognisable dilemmas and unfolding scenarios, the RBI took several important decisions on 17 April 2020 in its aggressive attempt for a 'whatever it takes' programme.

IV. THE NEW NORMAL-NOT MORE OF THE SAME!

This was the second time that the Governor addressed the media since the nationwide lockdown was clamped on March 25, 2020. This was, however, his first address since the extension of the lockdown by the Prime Minister till May 3, 2020. Essentially the decisions announced on April 17, 2020 are aimed at maintaining liquidity in the system, facilitating and incentivising bank credit flows, easing financial stress and enabling formal working of markets. These decisions are based on a clear understanding of the structure, spread and repercussions of the underlying macro-economic issues. What makes these decisions welcome is the fact that they were taken in quick succession of the unscheduled pre-term MPC (monetary policy committee) meeting, wherein the Cash Reserve Ratio (CRR) was slashed by 100 basis points (bps) (together with the reduction in the requirement of minimum daily CRR balance from 90 percent to 80 percent till June 30, 2020), the Repo rate was reduced, in its steepest cut since October 2004, to a 15-year low of 4.40 percent . There were also measures like three-month moratorium on payment of installments of Term Loan outstanding and deferment of interest on working capital (WC) facilities by three months. This deferment will not be considered for computation of NPAs and revised drawing power (DP) calculations will be done by reassessing the credit history of the borrower.

V. POLICY MEASURES

The RBI governor stressed "*the mission is to minimize the epidemiological damage in the country due to coronavirus. I want to convey the RBI's resolve and the way forward*". He also clarified that this is not the last of the announcements on financial support during the crisis and "*the central bank will monitor the evolving situation continuously and use all its instruments to address challenges posed by the pandemic*".

Some of the policy measures announced are as under:

1. **TLTRO of Rs. 50,000 crore.** RBI will conduct auctions of targeted term repo operation (TLTRO 2.0) of up to three years tenor for a total of up to Rs. 50,000 crore ($6.54 billion) at the policy repo rate. The funds availed must be deployed in investment grade bonds, commercial paper (CPs) and non-convertible debentures (NCDs) of Non-Banking Financial Companies (NBFCs) both small and large as also micro-finance institution with 50 percent of it going to small and mid-sized NBFCs and Micro Finance Institutions (MFIs). These investments will be classified as held-to-maturity even in excess of the 25 percent of total investments that is permitted to be categorised under HTM and these exposures won't be reckoned under the large exposure framework. The funds availed need to be deployed within 30 working days from the date of the auction. This measure would provide the much-needed relief to finance companies, who are confronted with a severe resource crunch.
   But of late, it has been observed that liquidity with the banking sector has never been an issue as could be seen that banks parked their surplus liquidity with the RBI. While this earmarking would certainly be helpful, perhaps an innovative mechanism of directly financing these finance companies instead of going through banks could have been considered to reduce their costs in these stretched times. True, this has never been done in the past but then extraordinary times call for extraordinary and bold measures and a departure from the past. There is also the issue of ALM mismatches of NBFCs-

lending by banks to all NBFCs even if their rating is BBB plus if they have good quality assets.

2. **Refinancing Measures of Rs. 50,000 crore to All India Financial Institutions (AIFIs).** The RBI also announced refinancing measures of Rs. 50,000 crore for All India Financial Institutions (AIFIs) such as NABARD, SIDBI and National Housing Bank (NHB). This measure, which comprises of (i) Rs. 25,000 crore to NABARD for refinancing regional rural banks (RRBs), cooperative banks and micro finance institutions (MFIs). (ii) Rs.15,000 crore to SIDBI for on-lending/refinancing. (iii) Rs.10,000 crore to NHB for supporting housing finance companies (HFCs) will benefit farm lenders, small businesses and housing finance companies. Advances under this facility to all India financial institutions (AIFIs) will be charged at the RBI's policy repo rate at the time of availment.

3. **Reduced reverse repo rate.** Drawing comfort from the surplus liquidity in the system because of government spending and various liquidity enhancing measures of the RBI, the Governor slashed the reverse repo rate by 25 basis points to 3.75 percent from 4.0 percent with immediate effect. Given that a humongous sum of Rs. 4.9 lakh crore has been parked by the banks with the RBI, this reduced reverse repo rate would induce banks to increasingly deploy these surplus funds for lending to mid-sized and smaller companies and thus give a boost to the flagging economy. The policy repo rate remains unchanged at 4.40 per cent, and the marginal standing facility (MSF) rate and the Bank Rate remain unchanged at 4.65 per cent.

4. **Ways and Means Advances for States**: On April 1, 2020 the RBI had announced an increase in the ways and means advances (WMA) limit of states by 30 per cent. The WMA limit of states has now been increased by 60 per cent over and above the level as on 31 March, 2020 to provide greater comfort to the states for undertaking COVID-19 containment and mitigation efforts, and to better plan their market borrowing programmes. Since the increased limit will be available till September 30, 2020, this measure would ensure that the state governments do not incur high interest costs by concentrating their borrowings at the start of the year.

5. **Moratorium Period.** The 90-day NPA norm shall exclude the moratorium period. In respect of all accounts for which lending institutions decide to grant moratorium or deferment, and which were standard as on March 1, 2020, the 90-day NPA norm shall exclude the moratorium period, i.e., there would an asset classification standstill for all such accounts from March 1, 2020 to May 31, 2020. Thus, banks will not have to classify some (non-NPA) stressed borrowers as defaulters, who may be finding it difficult to adhere to the prescribed repayment schedule prior to the moratorium period. The requirement on the part of the banks to maintain higher provision of 10 percent on moratorium loans over two quarters will ensure that banks distinguish the borrowers facing temporary cash flow problems from those with basic long-term issues.

   NBFCs, which are required to comply with Indian Accounting Standards (IndAS), would be guided by the guidelines duly approved by their boards and as per advisories of the Institute of Chartered Accountants of India 10 (ICAI) in recognition of impairments. In other words, NBFCs have flexibility under the prescribed accounting standards to consider such relief to their borrowers.

6. **Extension of Resolution Timeline.** Under RBI's prudential framework of resolution of stressed assets dated June 7, 2019, in the case of large accounts under default, Scheduled Commercial Banks, AIFIs, NBFC-ND-SIs and NBFCD are currently required to hold an additional provision of 20 per cent if a resolution plan has not been implemented within 210 days from the date of such default. Recognizing the challenges to resolution of stressed assets in the current volatile environment, the period for resolution plan has been extended by 90 days to provide relief to banks on finalizing resolution plans.

7. **Distribution of Dividend.** In an effort to strengthen the financial system of the country's financial institutions, the RBI decided to freeze dividend payments by scheduled commercial banks (SCBs) and cooperative banks for the financial year 2019-20. This prudent restriction, which shall be reviewed on the basis of the financial position of banks for the quarter ending 30 September, 2020, will help banks conserve capital and absorb credit losses.

8. **Liquidity Coverage Ratio (LCR).** To ease the liquidity position at the level of individual institutions, the LCR requirement for Scheduled Commercial Banks has been reduced from 100 per cent to 80 per cent with immediate effect. The requirement, which shall be gradually restored back in two phases – 90 per cent by October 1, 2020 and 100 per cent by April 1, 2021, will provide an impetus to lending.

9. **NBFC Loans to Commercial Real Estate Projects**: At present, if the Date for Commencement for Commercial operations (DCCO) in respect of loans to commercial real estate projects gets delayed for reasons beyond the control of promoters, it can be extended by an additional one year, over and above the one-year extension permitted in normal course, without treating the same as restructuring. Extension of a similar treatment to loans given by NBFCs to commercial real estate will provide relief to both the NBFCs and the real estate sector in the sense that developers will get more time and the NBFCs classification will get delayed.

VI. CONCLUDING OBSERVATIONS

RBI Governor's Address of April 17, 2020 coming as it does quickly on the heels of the March 27, 2020 Policy is contextually significant. The Governor identifies and isolates critical success factors and dissects an innovative policy option transcending the conventional framework of allocation of risks in these extraordinary times.

The liquidity infusion measures include a cut in the reverse repo rate, Rs 50,000-crore targeted long- term repo operations (TLTRO) and refinancing facilities for NABARD, SIDBI and NHB; targeted liquidity provision to liquidity poor sectors with hindrances to market access; and supply of fresh currency of Rs 1.2 lakh crore from March 1 till April 14, 2020 to nation-wide currency chests. Simply put, the increased liquidity together with a cut in the reverse repo rate will incentivise banks to actively lend to those institutions most in need of funds and make it affordable for businesses to borrow. Thus, on the whole, it is a good Policy and would go some way in nudging banks to move banks away from 'narrow banking'- what Dr. Rakesh Mohan characterized as 'lazy banking'. But some distressed segments and market players clearly expected much more from the RBI to revive growth. As a Hindi film punch line has it "*yeh dil maange more*" (this heart years for more, much more). But it has to be realized that this is not a one-off Policy- this is part of a continuum starting from the Finance Minister's economic stimulus package of March 26, 2020, the RBI's unscheduled Monetary Policy of March 27, 2020 and now the measures in the Monetary and Credit Policy announced on package of April 17, 2020.

The measures spelt out by the RBI provide an explicit recognition of the tightening financial conditions of small and mid-sized corporates, NBFCs and MFIs (micro finance institutions) and will certainly improve the situation. Further, both the Government of India and the RBI have repeatedly stressed that they are alive to the situation, particularly for mid-size and small companies, constantly monitoring the ground realities and would proactively deal with the situation within their overall constraints. This too shall pass!

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