RBI cut its growth forecast for H1FY21 by -35 bps since its Dec-19 policy but raised its inflation forecast for the same period by +130 bps while keeping its key policy rates unchanged for the second time in a row by an unanimous decision. Thus, Repo rate stays at 5.15% while Reverse repo and MSF rates remain pegged at 4.90% and 5.40%, respectively. However, RBI explicitly provided a guidance that there is policy space available for future rate action. It also recognised that the future path of both growth and inflation remains uncertain. Hence it maintained the status quo while would “persevere with the accommodative stance as long as necessary to revive growth, while ensuring that inflation remains within the target”. RBI also took many other material policy changes both related to operating procedure of monetary policy as well as measures concerning regulatory forbearance to specific sectors particularly, housing, real estate, auto and MSMEs.

i) Revised liquidity framework: With the weighted average call rate (WACR) being the single operating target, the need for specifying a one-sided target for liquidity provision of one percent of net demand and time liabilities (NDTL) does not arise. Accordingly, the daily fixed rate repo and four 14-day term repos every fortnight being conducted, at present, are being withdrawn. However, the Reserve Bank will ensure adequate provision/absorption of liquidity as warranted by underlying and evolving market conditions - unrestricted by quantitative ceilings - at or around the policy rate. Instruments of liquidity management will include fixed and variable rate repo/reverse repo auctions, outright open market operations (OMOs), forex swaps and other instruments as may be deployed from time to time to ensure that the system has adequate liquidity at all times. Instruments of liquidity management will include fixed and variable rate repo/reverse repo auctions, outright open market operations (OMOs), forex swaps and other instruments as may be deployed from time to time to ensure that the system has adequate liquidity at all times.

ii) LTRO: A new instrument Long Term Repo Operations (LTROs) has been introduced by which RBI would conduct term repos of one-year and three-year tenors in appropriate sizes for up to a total amount of ₹ 1,00,000 crore from the fortnight beginning on February 15, 2020 at the policy rate.

iii) External Benchmarking: Drawing upon the experience of linking all new floating rate personal or retail loans and floating rate loans to micro and small enterprises (MSEs) to external benchmarks, the pricing of loans by scheduled commercial banks for medium enterprises is also being linked to an external benchmark effective April 1, 2020.

iv) Credit to specific sectors: Banks would be allowed to deduct the equivalent of incremental credit disbursed by them as retail loans for automobiles, residential housing and loans to micro, small and medium enterprises (MSMEs), over and above the outstanding level of credit to these segments as at the end of the fortnight ending on January 31, 2020 from their net demand and time liabilities (NDTL) for maintenance of cash reserve ratio (CRR). This exemption will be available for incremental credit extended up to the fortnight ending on July 31, 2020.

v) Commercial real estate: Complementing the initiatives taken by the Government of India in the real estate sector, the Reserve Bank has decided to permit extension of the date of commencement of commercial operations (DCCO) of project loans for commercial real estate, delayed for reasons beyond the control of promoters, by another one year without downgrading the asset classification in line with the treatment accorded to other project loans for the non-infrastructure sector.

vi) Extension of OTS for MSMEs: Considering the importance of MSMEs in the Indian economy and for creating an enabling environment for the sector in its efforts towards formalisation, a one-time restructuring of loans to MSMEs that were in default but ‘standard’ as on January 1, 2019, was permitted without an asset classification downgrade. The restructuring of the borrower account was to be implemented by March 31, 2020. The scheme has provided relief to a large number of MSMEs. As the process of formalisation of the MSME sector has a positive impact on financial stability and this process is still underway, it has been decided to extend the benefit of one-time restructuring without an asset classification downgrade to standard accounts of GST registered MSMEs that were in default as on January 1, 2020. The restructuring under the scheme has to be implemented latest by December 31, 2020.
Monetary Policy Review – Once more inflation up, growth down and RBI pauses: However, many feelers for rates to soften more

RBI leaves policy rates unchanged second time on an assessment of growth-inflation dynamics

Exhibit 1: RBI kept policy rates unchanged since Oct 2019, i.e., third time in succession

Exhibit 2: Growth forecasts cut again while inflation estimates revised up materially

Exhibit 3: Real rates corrected, but likely to revert

Exhibit 4: Huge liquidity support continues

Real rates turned negative temporarily but would revert once food inflation cools off; liquidity infusion at record level

Transmission happened even when RBI was in pause mode during Dec-19 and Jan-20

Source: RBI, ASKWA Research

Source: CMIE, RBI, ASKWA Research

Source: CMIE, RBI, ASKWA Research

Source: CMIE, RBI, ASKWA Research

* Last data point pertains to Dec-19 unlike others where it pertains to Jan-20.
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Implication and outlook:

RBI has paused again but interest rates haven’t! During Q3FY20, the WALRs of banks on fresh loans has declined by 18 bps for housing loans, 87 bps for vehicle loans and 23 bps for loans to MSEs. Between Dec-19 and Jan-20 when RBI was in pause mode, fiscal uncertainties ruled before Union Budget and inflation was galloping – interest rates across financial markets and tenure continued to soften (Exhibit 5). Thus it is clear that RBI has finally managed to declog the transmission channel substantially across most stubborn segments of credit market too. The policy date (today) also witnessed the announcement effect of softening interest rates across markets and tenures ranging between 5-19 bps. Clearly RBI has delivered a bigger punch than expected – all while keeping key policy rates unchanged!

There are many elements in the policy to indicated continued softening of interest rates including the following:

i) It has been clearly mentioned in the policy document itself as well as reiterated by RBI Governor in media interaction that policy space for further action exists and the stance remain accommodative. Besides RBI has also invoked the “as long as necessary” clause that expresses final resolve of RBI to lift growth through accommodative monetary policy. We expect RBI to resume rate cuts once again during Apr-20 policy once the peak inflation figure of Jan-Feb 2020 is behind us.

ii) Very significant change in the LAF procedure with the removal of the daily fixed Repo would make the money market in sync with the prevailing durable liquidity condition. However, this may increase the potency of monetary policy more during a tightening cycle.

iii) Provision of LTRO has left a clear arbitrage opportunity for banks to borrow long from RBI and deploy in G-sec market of equivalent opportunity. This is likely to ease the pressure on deposit mobilization resulting in sizable drop in deposit rates. Incidentally similar measure was resorted by ECB post the sovereign debt crisis helping mitigate the impact on the financial markets and banks. As the programme would start from mid-Feb-20 this would help tide over the year-end liquidity pressure by a large extent.

iv) Regulatory forbearance to the job creating sectors including MSMEs, auto, housing and real estate is the most significant confidence building measure done till date. However, all these measures would free up bank capital and would help boost the bottom-line of the banking sector which is turning back into profitability even otherwise.

Overall we have now both a fiscal a monetary policy that is simultaneously accommodative while escaping the “wrath of the market”. Indeed such policy choice is being looked upon by the market as the appropriate response for the growth slowdown that we are facing now. There is also a far greater consensus on this across various spectrum of policy makers and market participants. Indeed we can proclaim once again that “Washington consensus is dead”!

The fixed income opportunity received a further fillip from the policy measure announced today. The Union Budget related measures including restricted market borrowing and foreign flows have been complementary too. We would continue to recommend AAA/Sovereign bonds with 3-7 year average maturities to benefit from the duration play that is still left with significant value.

In the equity space banking sector is the primary beneficiary of today’s measure. RBI also noted that the flow of resources to the commercial sector has improved by its latest count. A moderate recovery in the economy on the backdrop of rural revival on improved Rabi and monsoon-2020 prospects and sector specific measures by government/RBI are expected to buttress equity oriented investment themes.
Monetary Policy Review – Once more inflation up, growth down and RBI pauses: However, many feelers for rates to soften more

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