

RBI announced a few measures to help tide through the Covid second wave crisis comprising of liquidity enhancing measures, a fresh resolution plan and a few regulatory relaxations. In his statement, RBI Governor also made an assessment of the global and domestic economic scenario.

## Significant observations by RBI:

- **Assurance:** RBI Governor has assured to “continue to monitor the emerging situation and deploy all resources and instruments at its command in the service of the nation, especially for our citizens, business entities and institutions beleaguered by the second wave”.
- **Second wave impact:** As per his assessment, “With restrictions and containment measures being localised and targeted, businesses and households are learning to adapt. Consequently, the dent to aggregate demand is expected to be moderate in comparison to a year ago. ... Overall, the high frequency indicators are emitting mixed signals”.
- **Inflation:** Going forward, a normal south-west monsoon, as forecast by the IMD should help to contain food price pressures, especially in cereals and pulses. The build-up in input price pressures across sectors, driven in part by elevated global commodity prices, remains a concern. The inflation trajectory over the rest of the year will be shaped by the COVID-19 infections and the impact of localised containment measures on supply chains and logistics.
- **GSAP impact:** G-SAP has engendered a softening bias in Gsec yields which has continued since then.
- **Directed liquidity:** With system liquidity assured, the RBI is now focusing on increasingly channelising its liquidity operations to support growth impulses, especially at the grassroots level.

## Liquidity measures

- **GSAP:** The second tranche of purchase of government securities for an aggregate amount of ₹35,000 crore under G-SAP 1.0 will be conducted on May 20, 2021.
- **Liquidity for health sector:** On-tap liquidity window of Rs.500 billion with tenure of up to 3 years at repo rate will be opened till 31 March 2022. Banks can support entities including vaccine manufacturers, medical facilities, hospitals and also patients under this scheme. These loans (granted till Mar-22) will continue to be classified under priority sector till repayment or maturity, whichever is earlier. Banks are expected to create a COVID loan book under the scheme. By way of an additional incentive, such banks will be eligible to park their surplus liquidity up to the size of the COVID loan book with the RBI under the reverse repo window at a rate which is 25 bps lower than the repo rate or, termed in a different way, 40 bps higher than the reverse repo rate.
- **Long-term financing for SFBs:** Special long-term repo operation (SLTRO) of up to Rs.100 billion will be conducted (October 31, 2021) for small finance banks for fresh lending of up to Rs.1 million per borrower.
- **SFBs to MFIs:** Small finance banks are now permitted to recognise lending to smaller microfinance institutions of asset size up to Rs.5 billion for on-lending to borrowers as priority sector lending. The facility will be available up to 31 March 2022.

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- **MSMEs:** Exemption of credit disbursed to new MSME borrowers from NDTL for the purpose of CRR calculation available for exposures up to ₹25 lakh and for credit disbursed up to the fortnight ending October 1, 2021 is being extended till December 31, 2021.
- **States overdrafts:** States have been permitted to remain in overdraft for a maximum of 50 days compared to 36 days earlier. The number of consecutive overdraft days have been increased from 14 days to 21 days.

## Resolution Framework 2.0

- **Applicability:** Borrowers i.e. individuals and small businesses and MSMEs having aggregate exposure of upto ₹25 crore and who have not availed restructuring under any of the earlier restructuring frameworks including under the Resolution Framework 1.0 dated August 6, 2020), and who were classified as 'Standard' as on March 31, 2021 shall be eligible to be considered under Resolution Framework 2.0. One-time loan restructuring for individuals and MSMEs will be available till 30 September 2021, with moratorium up to 2 years. Restructuring under the proposed framework may be invoked up to September 30, 2021 and shall have to be implemented within 90 days after invocation.
- **Extension:** restructuring of their loans under Resolution Framework 1.0, lending institutions are being permitted to use this window to modify such plans to the extent of increasing the period of moratorium and/or extending the residual tenor up to a total of 2 years.
- **Working capital:** For small businesses and MSMEs restructured earlier, lending institutions are also being permitted as a one-time measure, to review the working capital sanctioned limits, based on a reassessment of the working capital cycle, margins, etc.

## Other measures

- **KYC relaxation:** Banks have been permitted to i) extend the scope of video KYC known as V-CIP use limited KYC for new categories of customers such as proprietorship firms, authorised signatories and beneficial owners of Legal Entities and for periodic updation of KYC. ii) conversion of limited KYC accounts opened on the basis of Aadhaar e-KYC authentication in non-face-to-face mode to fully KYC-compliant accounts, iii) enabling the use of KYC Identifier of Centralised KYC Registry (CKYCR) for V-CIP and submission of electronic documents (including identity documents issued through DigiLocker) as identify proof, iv) introduction of more customer-friendly options, including the use of digital channels for the purpose of periodic updation of KYC details of customers, v) no punitive restriction on operations of customer account(s) shall be imposed till December 31, 2021 where periodic KYC updating is due/pending.
- **Provisioning flexibility:** Banks are being allowed to utilize 100 per cent of floating provisions/countercyclical provisioning buffer held by them as on December 31, 2020 for making specific provisions for nonperforming assets with prior approval of their Boards.

## Takeaways:

RBI relied on non-monetary measures to deal with the second wave of Covid. While noting the expected softening of growth outlook from the earlier estimates, it is clearly worried about impending hardening of inflation and limited maneuverability in view of the fact that monetary stance is already accommodative and policy rates are at a cyclical low. The key take-away though, is RBI's reiteration of "**whatever it takes, howsoever long it takes**" stance to support the economy and look through temporary blips in inflation and capital flows. Hence, the liquidity related measure emerged as the primary tool for intervention. Notable here beyond maintaining a comfortable systemic liquidity; off late RBI has focused on what can be termed as directed (targeted) liquidity to maximize the impact of its measures. Thus, clearly easy loan to the health sector is the need of the hour and RBI taken care to include most of the entities related to health sector under its policy ambit. The stressed sectors including SFBs, MFIs, MSMEs, and of course affected individuals are its second target area of intervention. This is likely to succeed in underwriting risks for many struggling units on ground if the agencies succeed in their outreach. The success of Resolution Framework 1.0 during first wave has paved the way for announcing the second version of it along with extension of the first one. Regulatory relaxation in KYC would ensure business continuity during online work period while provisioning flexibility would help banks avoid sudden break in their bottom lines. Overall, the measures are once again well thought out and were the need the hour. While RBI has done its bit and is likely to take further follow up measures, the fiscal and administrative measures by the Government would need to play the role of first line of defence in the context of unprecedented health challenge that we are currently facing.

## Investment Strategy

We recently went Underweight on Fixed Income. But that was largely a derivative decision, given our strong view on the expected strength of equity markets and in the general Hybrids (like REITs). Needless to add this is only a call on relative weights of the two asset classes in a portfolio. Fixed income strategy stays anchored with our long held view of a gradual bear-flattening of the yield curve. Longer end will rise only very sedately, while offering substantial carry in the medium term (5-6 years).

Hence the fixed income product strategy should be anchored toward the following opportunities as before.

- ✓ 5-6 year remain the sweetest part of the yield curve. Offers the best carry, is likely to suffer the least dislocation in yields (and hence MTM impact).
- ✓ Floating Rate Funds, especially those with a large active component in OIS participation, to take advantage of rising short term yields.
- ✓ Tactical sub-AAA credits, as always, with tactical being the key-word.

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