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Professional Risk Opinion

RBI's Surprise Liquidity Booster and additional relaxations

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There are challenges faced by the Indian economy due to rapid rise in COVID-19 cases and fatalities, emergence of new mutants of infection and localised lockdowns. This comes just when the economy seemed to be recovering. Against this background the RBI Governor, in an unscheduled announcement today, enumerated a number of liquidity-boosting measures and relaxations including restructuring to alleviate the financial related concerns in the economy. These measures chiefly include special liquidity facility to the emergency health services, small finance banks for on-lending, relaxation of OD facility for state governments, resolution framework 2.0 and additional relaxation on the KYC norms. The Governor added that the RBI will continue monitoring the emerging situation and deploy the necessary resources to mitigate the impact of the second wave.

The RBI Governor acknowledged the high frequency indicators released so far in April 2021 have shown a mixed picture and the dent to aggregate demand owing to the second wave of the pandemic is likely to be moderate than the previous year. Also, he pointed out that the projections of economic growth and inflation released in the April 2021 monetary policy committee would not see a broad deviation. CARE Ratings' view is that there will be an impact on aggregate demand for services besides consumer durable goods and we need to be watchful. We have already rolled down our GDP forecast from 11-11.2% to 10.2% with a downward bias.

Announcement of Second Tranche of GSAP 1.0: The RBI is also likely to undertake the second auction under the GSAP 1.0 program of **Rs 35,000 crs on May 20, 2021** after a stupendous response witnessed in the first auction of Rs 25,000 crs undertaken in April 2021. The 10 year GSec auction has eased from 6.12% on April 5, 2021 to 6.01% on May 4, 2021. The 10 year GSec yield has furthered softened and is trading below 6% at 12 noon.

Impact Analysis of RBI's Measures

Measures	Impact
1. Term Liquidity Facility of Rs 50,000 crs for Emergency Health Services • On-tap liquidity window for tenor of 3 years at "repo rate" i.e 4% till March 31, 2022 • Services to which banks can lend include – vaccine manufacturers, importers/suppliers of vaccines, hospitals/dispensaries, pathology labs, manufacturers and suppliers of oxygen and ventilators among others • Banks are supposed to create a **"COVID Loan Book"** under this scheme **Incentives to Banks:** • Classification of this lending under priority sector till repayment and maturity • Banks can park additional surplus liquidity to the size of the COVID loan book under the reverse repo window at an interest rate which is 40 bps more than reverse repo rate. The rate of interest at which they can park the funds is 3.75% (3.35% + 40 bps)	This is a positive move which will incentive banks to undertake fresh lending to the emergency health services especially at this juncture when the healthcare system in India has been stretched. **Cost savings for the banking system:** Let's consider the weighted average deposit rate of 5.38% as of March 2021 as the cost of borrowings for the banks. In case banks utilise the available funding under this facility, the borrowing at a lower rate of 4% i.e the repo rate will lead to a saving of Rs 690 crs on the total borrowing window of Rs 50,000 crs. Additionally, the incentive of parking surplus liquidity under the reverse repo window will garner earnings of around Rs 200 crs for the banking system. Therefore, the banking system is likely to benefits to the tune of around Rs 890 crs from the implementation of this scheme. However, one needs to see whether banks borrow via this channel because in the previous "On Tap TLTRO Scheme" of Rs 1 lakh crs, the borrowing has been only Rs 5,000 crs as of May 4, 2021.
2. Liquidity Measures for Small Finance Banks • A Special 3 year long term repo operations of Rs 10,000 crs at repo rate to be deployed for fresh lending of Rs 10 lakhs per borrower. The facility is open till October 31, 2021	Small finance banks play as important role in lending to the last mile of individuals and small businesses and therefore both these measures will positive impact credit growth.

• Classification of on-lending by Small Finance Banks to Micro-Finance Institutions to be reckoned as priority sector lending	However, the purpose of borrowing by individuals and small businesses needs to be seen as to whether it is for credit for growth purpose or for repaying of loans.
3. Relaxation of Overdraft facility for State governments • The maximum number of days of OD in a quarter has been increased to 50 days (from previous 36 days) • The number of consecutive days of OD has been increased to 21 days (from 14 days) • Both these facilities are available till September 30, 2021	Additional relief to the state governments following the recent revision in WMA limits. Given the lockdowns announced there will be a fall in revenue collections of states which will pressurize their budgets as some payments like salaries and other fixed costs must be paid. Relaxation on overdraft will be beneficial for these states. As of February 2021, there are 3 states namely Andhra Pradesh, Manipur and Telangana, who had resorted to overdraft facility aggregating Rs 2,892 crs. The cost of borrowings for state governments availing OD ranges between 6% (up to 100% of WMA limit) and 9% (more than WMA limit). This is likely to be lower than the funds raised by the state governments from the markets and state governments resorting to overdrafts are likely to benefit.
4. Resolution Framework 2.0 for related stressed assets of individuals, small businesses and MSMEs: • Borrowers who have not availed restructuring under earlier frameworks and are classified as standard as on March 31, 2021 shall be eligible for resolution framework 2.0 • Individuals and small businesses who have restructured under Framework 1.0 – The lending institutions can increase the period of moratorium and extend residual tenor by 2 years • Working capital limits of small businesses and MSMEs (who have restructured under 1.0) are permitted for review.	This is likely to provide relief to the small borrowers who are one of the most vulnerable sections and are facing large-scale implications of the lockdowns on their business.
Additional Relaxations	
5. Credit to MSME Entrepreneurs – The credit facility to new MSMEs (up to exposure of Rs 25 lakhs) which banks were allowed to deduct from the NDTL for calculation of CRR has been extended till December 31, 2021.	
6. Rationalisation of KYC Requirements: • Extending the scope of KYC known as V-CIP (video-based customer identification process) for new categories of customers such as proprietorship firms, authorised signatories and beneficial owners of Legal Entities and for periodic updation of KYC) • 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 • enabling the use of KYC Identifier of Centralised KYC Registry (CKYCR) for V-CIP and submission of electronic documents	

Mixed signals from high frequency indicators

Positive News	Negative News
• Consumption demand is holding up with double digit growth during January- March 2021 (YoY)	• Decline in toll collections in April 2021 indicating that mobility has declined, albeit less impactful that April 2020
• Average daily electricity generation is 40% more in April 2021 than corresponding month last year	• Registration of automobiles in April 2021 has seen a moderation compared with March 2021
• Rail freight growth has been robust with a growth of 76% YoY in April 2021	• Prices pressures in pulses, edibles oils and rising WPI inflation
• PMI Manufacturing continues in expansion mode with a minor dip in April 2021	
• Robust trade growth in April 2021 (based on preliminary data) and high foreign exchange reserves at $588 bn on April 30, 2021	

Concluding Remarks

The additional measures announced by the RBI coupled with the announcement of the second tranche of the GSAP 1.0 program is likely to be beneficial to alleviate the constraints faced by a number of stakeholders in the economy from the financing side. The markets have also viewed these measures positively with the BSE Sensex rising by more than 200 points at around 12 PM while the bond markets have seen additional buying reflected by decline in GSec yields.

These measures along with the compliance measures which were announced by the Central Government in April 2021 are likely to provide some relief and liquidity boost to businesses and individuals amidst challenges faced by them during the lockdowns. However, there are two things which one needs to be cautious about:

- One, is whether the bank lending is likely to be strong following these measures because despite a host of liquidity measures from RBI in FY21, bank credit off-take was only 5.6% in FY21.
- Secondly, with mounting cases and several states releasing restrictions on a frequent basis, it will be interesting to see how significant any deviation (if any) in RBI's economic growth and inflation outlook amidst the second wave of the COVID-19 pandemic will be.

The interesting part here is that as the RBI believes that the impact this time will be less than that of last year, there will probably be no announcement of a moratorium as of now. Depending on the evolving circumstances there can be more measures expected from the RBI in the coming months.

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