May 22, 2020

Focus on growth revival; extension of moratorium

Repo rate .... Lowered by 40 bps at 4%

CRR...Unchanged at 3%

- The Reserve Bank of India (RBI) reduced the policy repo rate by 40 basis points (bps) to 4.0% with immediate effect. Reverse repo rate was cut by 40 bps to 3.35% while MSF was reduced from 4.65% to 4.25%. The RBI kept the policy stance unchanged at 'accommodative', in order to focus on revival of growth and mitigate the impact of Covid-19 on the economy
- Deficient demand, post lifting of lockdown, is expected to put pressures on core inflation (excluding food and fuel) imparting uncertainty to the near term outlook on inflation. However, softer global prices of metals, anticipated low level of crude, normal monsoon and favourable base effect are seen pulling down headline below target in Q3FY21 and Q4FY21
- Restrictions, including social distancing and temporary shortage of labour, are seen keeping economic activity in Q2FY21 subdued. A recovery is expected to gain momentum from Q3FY21 onwards. RBI has avoided putting a number to the growth estimates though it has highlighted that heightened uncertainty about duration of the pandemic and adherence to social distancing measures poses significant downside risks to full year growth
- Amid extension of the lockdown, earlier announced moratorium has been extended by another three months up to August 31, 2020, providing relief to borrowers, especially MSME. Deferral of interest payment on working capital (WC) facilities up to August 31, 2020 and conversion of accumulated interest on working capital loan into term loan is seen providing liquidity support to major borrowers
- In the wake of the extended lockdown and the severity of the challenges faced, RBI has extended liquidity measures announced earlier at the beginning of the turmoil. However, the aforesaid announced extension does provides respite to lenders on delinquencies and asset quality, impact of moratorium on credit culture. Hence, repayment trend needs to be watched. In addition, concerns related to NBFCs and HFCs including long term liquidity assistance or one-time restructuring were not announced thereby putting pressure on shadow lenders
- The debt market reacted positively to the rate cut announcement. While some monetary easing was expected what led to the rally of around 10bps on the 10 year G-Sec was the forward guidance of potential for further rate cut. 10 year G-Sec yield fell below 6.0% mark and was trading around 5.90%
- The RBI assessment is that CPI will fall over the second half the year and will fall below the 4% target over Q3 and Q4 of the financial year. Importantly, the forward guidance is strong noting space for further easing will open up if CPI behaves as expected. The summary assessment hence is that risks to growth are acute while those to inflation may be temporary. Although the RBI has not provided an explicit growth forecast, it has now acknowledged a negative print for FY 21. The silver lining noted is that in agriculture where Kharif sowing is robust. Hence, effectively the focus is on reviving growth through rate cuts and other liquidity measures as inflation is not a concern. The market however continue to await any concrete plan on OMOs to counter higher G-Sec (both central and state) supply

Research Analyst

Kajal Gandhi
kajal.gandhi@icicisecurities.com

Vishal Narnolia
vishal.narnoliai@icicisecurities.com

Yash Batra
yash.batra@icicisecurities.com

Exhibit 1: Measures taken by RBI with the impact

Measures taken by RBI	Impact
Repo rate reduced by 40 bps to 4.0%	Reduce borrowing costs structurally for borrowers over time
Reverse repo reduced by 40 bps to 3.35%	Move undertaken to encourage banks to induce lending rather than parking additional funds with RBI
Measures to ease financial stress	
Permitting lending instituitions to extend moratorium on term loans by another three months up to August 31, 2020	Such extension of moratorium amid Covid-19 will provide much needed respite for borrowers, especially MSME. However, risk of deterioration of credit culture impacting repayments cannot be ruled out
Deferral of interest payment on working capital (WC) facilities up to August 31, 2020	Address challenge faced by borrowers amid lockdown. Provides buffer to repay interest on working capital facilities availed till August 31, 2020. Respite for lenders in near term, however, remains an overhang on asset quality
In respect to the above measure, lending instituitions are permitted to convert the accumulated WC interest upto 31st Aug 2020 into a funded term loan which should be repaid by 31st March 2021.	
Increase in group exposure of banks from 25% to 30% of their capital limits up to June 30, 2021	
Measures to improve functioning of markets	
Rollover of ₹15000 crore of refinance facility provided to SIDBI by 90 days	This would provide SIDBI longer duration to avail refinance facility at the repo rate to provide loans to MSMEs
Providing additional three months for FPIs in voluntary retention scheme	Amid Covid-19, FPIs would get some relief to invest 75% of their alloted limits by six months vs. three months earlier
Measures to support exports and imports	
Increase in period of pre-shipment & post-shipment export credit from one year to 15 months	Provides respite to exporters on availing credit for higher duration
Credit line for Exim bank worth ₹15000 crore to be provided for 90 days	Credit line provided to Exim Bank for 90 days with a rollover up to one year would provide support to the bank to meet its forex requirements
Extension of time payments for imports from six months to one year for imports made up to July 31, 2020	This move would provide importers with more liquidity buffer and would also help them manage their operating cycles

Source: Company, ICICI Direct Research

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Pankaj Pandey **Head – Research** **pankaj.pandey@icicisecurities.com**

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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