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RBI'S REGULATORY CHANGES ARE CRUCIAL IN THE CURRENT ECONOMIC SCENARIO

EXPERT VIEW

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"It was well worth the wait," is probably how analysts, market participants and corporates would like to describe the set of measures announced by the Reserve Bank of India (RBI) governor in his press conference on Friday.

The measures had a bit of everything that the real economy and the financial markets were crying out for—reduction in rates, provision of liquidity, aiding transmission of lower rates, freeing up the financial markets and easing financial stress by forbearance.

On rates, while the headline will read as a 75-basis point (bp) rate cut, there was an effective easing of 90 bps, with the additional 15 bps coming by way of an expansion in the corridor, with an indirect admission by the governor that the reverse repo rate will be the effective overnight rate. Effective borrowing costs in the G-sec repo market is now likely to fall substantially with the surplus liquidity, and with non-bank participants likely to drive the rate lower than even 4%. This will help reduce interest rates across the spectrum and make loans cheaper, going forward.

The governor has provided liquidity on multiple fronts—both direct and indirect—for the banking system. The first step of cash reserve ratio (CRR) cut will not only help infuse **₹1.37 trillion** liquidity, but will also increase profitability. The reduction in daily CRR maintenance to 80% increases the operating flexibility for banks, just when liquidity is most needed due to the volatile nature of corporate cash flows. In addition to all of this, was the provision of an additional ₹1 trillion in the form of targeted longer-term refinancing operations (TLTROs) to banks to buy corporate bonds and CPs in both primary and secondary markets, and an additional dispensation to classify them as hold to maturity. This has the effect of aiding transmission by bringing corporate bond spreads lower.

The move to allow Indian banks to participate in non-deliverable forward (NDF) markets is ground-breaking. It will potentially enable the RBI to intervene offshore through the banking system to check undue volatility, as well as help Indian banks to quote to clients for their forex requirements round-the-clock.

Sweeping regulatory changes announced in terms of moratoriums and deferments are crucial in the context of the current economic scenario. We expect Q1 FY21 growth to contract as most businesses, especially small and medium enterprises (SMEs), will see revenue loss while facing a cash crunch.

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ICICI Bank expects Q1 FY21 growth to contract as businesses, especially SMEs, will see revenue loss while facing a cash crunch.

While the central bank has taken a lot of commendable steps, two more measures could have been considered. First, the RBI could consider participating in primary auctions of bonds of the government of India, or to subscribe to a private placement of bonds. This is much needed to ensure that the borrowing programme goes through smoothly. It could consider this and communicate it proactively to ensure that long bond yields do not militate against the transmission of lower rates, especially when the borrowing calendar starts.

Second, creation of a SPV (special purpose vehicle) funded by the RBI could be considered, which could directly purchase corporate bonds in primary and secondary markets. Both these measures are much needed to ensure companies do not find the availability and cost of money an issue.

> RBI's move to allow Indian banks to take part in NDF markets is commendable

Due to the high level of policy intervention that are still expected, the markets are likely to tread cautiously. Sovereign benchmark yield could broadly trade in the range of 5.7-6.2% in the near term, but we expect short-end yields closer to 5%, resulting in a bull steepening of the curve. We still expect some depreciation pressure to persist on the Indian rupee, even as the RBI intervenes actively to prevent a run-away dollar strength. Volatility is here to stay, but the recent actions by the government and the regulators give us the confidence that we will be able to come out of this crisis very soon.

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