Governor's Statement - Seventh Bi-monthly Monetary Policy Statement, 2019-20, March 27, 2020

In view of the COVID-19 pandemic, the Monetary Policy Committee (MPC) decided to advance its meeting scheduled for 31st March, 1st and 3rd April 2020. It met on 24th, 26th and 27th March and undertook a careful evaluation of the current and evolving macroeconomic and financial conditions, and the outlook. I wish to take this opportunity to express my deep gratitude to the MPC members for their swift response to the unprecedented situation and for their valuable contribution to the monetary policy decision taken today. I also wish to thank our teams in the RBI for their continued high-quality support to the MPC's work through their hard work, research and logistics.

2. After extensive discussions, the MPC voted unanimously for a sizeable reduction in the policy repo rate and for maintaining the accommodative stance of monetary policy as long as necessary to revive growth, mitigate the impact of COVID-19, while ensuring that inflation remains within the target. While there were some differences in the quantum of reduction, the MPC voted with a 4-2 majority to reduce the policy rate by 75 basis points to 4.4 per cent.
3. Simultaneously, the fixed rate reverse repo rate, which sets the floor of the liquidity adjustment facility (LAF) corridor, was reduced by 90 basis points to 4.0 per cent, thus creating an asymmetrical corridor. The purpose of this measure relating to reverse repo rate is to make it relatively unattractive for banks to passively deposit funds with the Reserve Bank and instead, to use these funds for on-lending to productive sectors of the economy. It may be recalled that during the month of March so far, banks have been parking close to ₹ 3

lakh crore on a daily average basis under the reverse repo, even as the growth of bank credit has been steadily slowing down.

4. This decision and its advancement has been warranted by the destructive force of the corona virus. It is intended to (a) mitigate the negative effects of the virus; (b) revive growth; and above all, (c) preserve financial stability.
5. We are living through an extraordinary and unprecedented situation. Everything hinges on the depth of the COVID-19 outbreak, its spread and its duration. Clearly, a war effort has to be mounted and is being mounted to combat the virus, involving both conventional and unconventional measures in continuous battle-ready mode. Life in the time of COVID-19 has been one of unprecedented loss and isolation. Yet, it is worthwhile to remember that tough times never last; only tough people and tough institutions do.
6. In the recent period, the Reserve Bank has been in action on a daily basis with efforts to alleviate financial stress, build confidence and keep the financial system sound and functioning. Measures taken by the Reserve Bank are given below.
    - a cumulative reduction in the policy repo rate of 135 basis points;
    - accommodative stance of monetary policy as long as necessary to revive growth, while keeping inflation within the target.
    - two USD buy/sell swap auction of USD 5 billion each conducted on March 26 and April 23, 2019, injecting liquidity into the banking system amounting to ₹34,561 crore and ₹34,874 crore, respectively.
    - seven open market purchases, injecting ₹92,500 crore into the system.
    - four simultaneous purchase and sale of government securities under Open Market Operations (special OMOs or what is known

as operation twist) during December and January (December 23 and 30, 2019 and January 6 and 23, 2020) to ensure better monetary policy transmission.

- five long term repo operations (LTROs) between February 17 and March 18, 2020 for one-year and three-year tenors amounting to ₹1,25,000 crore of durable liquidity at reasonable cost (fixed repo rate).
- exemption on incremental credit disbursed by banks between January 31-July 31, 2020 on retail loans for automobiles, residential housing and loans to micro, small and medium enterprises (MSMEs) from the maintenance of cash reserve ratio (CRR).
- two 6-month US Dollar sell/buy swap auction providing dollar liquidity amounting to USD 2.71 billion.
- fine-tuning variable rate repo auctions of ₹50,000 crore and ₹25,000 crore of 8 days and 3 days maturity on March 26 and March 31, respectively, with standalone primary dealers (SPDs) allowed to participate.
- fine-tuning variable rate Repo auction of 16-day maturity amounting to ₹81,585 crore on March 23-24, 2020.
- The amount under the Standing Liquidity Facility (SLF) available for standalone primary dealers was enhanced from ₹2,800 crore to ₹10,000 crore on March 24, 2020 and this will be available till April 17, 2020.

7. Let me assure all that the Reserve Bank is at work and in mission mode, monitoring the evolving financial market and macro-economic conditions; and calibrating its operations to meet any need for additional liquidity support as well as other measures, as

may be warranted. It is our effort to ensure normal functioning of markets, nurture the impulses of growth and preserve financial stability. Incidentally, we have quarantined 150 members of our staff and service providers together with the IT facilitators as a part of our Business Continuity Plan (BCP). The plan was prepared and executed in a matter of days.

8. The MPC noted that global economic activity has come to a near standstill as COVID-19 related lockdowns and social distancing are imposed across a widening swathe of affected countries. Expectations of a shallow recovery in 2020 from 2019's decade low in global growth have been dashed. The outlook is now heavily contingent upon the intensity, spread and duration of the pandemic. There is a rising probability that large parts of the global economy will slip into recession.
9. Turning to growth in India, the implied real GDP growth of 4.7 per cent for Q4:2019-20 in the second advance estimates of the National Statistics Office, released in February 2020, within the annual estimate of 5 per cent for the year as a whole is now at risk from the pandemic's impact on the economy. As regards the outlook for 2020-21, apart from the continuing resilience of agriculture and allied activities, most other sectors of the economy will be adversely impacted by the pandemic, depending upon, I repeat, its intensity, spread and duration. If COVID-19 is prolonged and supply chain disruptions get accentuated, the global slowdown could deepen, with adverse implications for India. The slump in international crude prices could, however, provide some relief in the form of terms of trade gains. Downside risks to growth arise from the spread of COVID-19 and prolonged lockdowns. Upside growth impulses are

expected to emanate from monetary, fiscal and other policy measures and the early containment of COVID-19.

10. As regards inflation, the prints for January and February 2020 indicate that actual outcomes for the quarter are running 30 bps above projections, reflecting the onion price shock. Looking ahead, food prices may soften even further under the beneficial effects of the record foodgrains and horticulture production, at least till the onset of the usual summer uptick. Furthermore, the collapse in crude prices should work towards easing both fuel and core inflation pressures, depending on the level of the pass-through to retail prices. As a consequence of COVID-19, aggregate demand may weaken and ease core inflation further. Heightened volatility in financial markets could also have a bearing on inflation. Given this heightened volatility, unprecedented uncertainty and extremely fluid state of affairs, projections of growth and inflation would be heavily contingent on the intensity, spread and duration of COVID-19. Precisely for these reasons, the MPC refrained from giving out specific growth and inflation numbers.

11. The MPC noted that macroeconomic risks, both on the demand and supply sides, brought on by the pandemic could be severe. The need of the hour is to do whatever is necessary to shield the domestic economy from the pandemic. Central banks across the world have responded with monetary and regulatory measures – both conventional and unconventional. Governments across the world have unleashed massive fiscal measures, including targeted health services support, to protect economic activity from the impact of the virus. The Government of India has yesterday announced a number of measures. The MPC further noted that the Reserve Bank has taken several measures to inject substantial liquidity in the

system. Nonetheless, the priority is to undertake strong and purposeful action in order to minimise the adverse macroeconomic impact of the pandemic. It also underscored the need for all stakeholders to fight against the pandemic. Banks and other financial institutions should do all they can to keep credit flowing to economic agents facing financial stress on account of the isolation that the virus has imposed. Market participants should work with regulators like the Reserve Bank and the SEBI to ensure the orderly functioning of markets in their role of price discovery and financial intermediation. Strong fiscal measures are of course critical to deal with the situation.

12. To summarise, COVID-19 stalks the global economy and the outlook is highly uncertain and negative. Several nations are battling its exponential contagion; countries are shutting down to prevent being sucked into that black hole. Authorities all over the world are mobilising on a massive scale to fight an invisible assassin. India has locked down. Economic activity and financial markets are under severe stress. Finance is the lifeline of the economy. Keeping it flowing is the paramount objective. The time has come for the Reserve Bank to unleash an array of instruments from its arsenal to staunch and mitigate the impact of COVID-19, revive growth and, above all, preserve financial stability. The aggressive action and stance of the MPC provides a befitting launching pad. In turn, the configuration of initiatives unveiled in the Statement on Developmental and Regulatory Policies - which I am now going to announce - amplify the MPC's decision and leverages on it as well. Accordingly, it is appropriate that the MPC's decision and the Reserve Bank's actions be regarded as a comprehensive package with force multipliers.

13. The developmental and regulatory policies can be broadly delineated under four categories:

(1) measures to expand liquidity in the system sizeably to ensure that financial markets and institutions are able to function normally in the face of COVID-19 related dislocations;

(2) steps to reinforce monetary transmission so that bank credit flows on easier terms are sustained to all those who have been affected by the pandemic;

(3) efforts to ease financial stress caused by COVID-19 disruptions by relaxing repayment pressures and improving access to working capital; and

(4) endeavor to improve the functioning of markets in view of the high volatility experienced with the onset and spread of the pandemic.

I. Liquidity Measures

14. A multi-pronged approach, comprising both targeted and system-wide liquidity provision, has been adopted to ensure that COVID-19 related liquidity constraints are eased.

Targeted Long Term Repo Operations (TLTRO)

15. Large sell-offs in the domestic equity, bond and forex markets have intensified redemption pressures. Liquidity premia on instruments such as corporate bonds, commercial paper and debentures have surged. Financial conditions for these instruments, which are used, *inter alia*, to access working capital in the face of the slowdown in bank credit, have also tightened. To mitigate the adverse effects on economic activity leading to pressures on cash

flows across sectors, the Reserve Bank will conduct auctions of targeted term repos of up to three years tenor of appropriate sizes for a total amount of up to ₹1,00,000 crore at a floating rate, linked to the policy repo rate. Liquidity availed under the scheme by banks has to be deployed in investment grade corporate bonds, commercial paper and non-convertible debentures over and above the outstanding level of their investments in these bonds as on March 25, 2020. Eligible instruments comprise both primary market issuances and secondary market purchases, including from mutual funds and non-banking finance companies. Investments made by banks under this facility will be classified as held to maturity (HTM) even in excess of 25 per cent of total investment permitted to be included in the HTM portfolio. Exposures under this facility will also not be reckoned under the large exposure framework. The first auction of ₹25,000 crore will be conducted today. The relevant notification is being issued separately.

Cash Reserve Ratio

16. It is observed that, despite ample liquidity in the system, its distribution is highly asymmetrical across the financial system, and starkly so within the banking system. To help banks tide over the disruption caused by COVID-19, it has been decided to reduce the cash reserve ratio (CRR) of all banks by 100 basis points to 3.0 per cent of net demand and time liabilities (NDTL) with effect from the reporting fortnight beginning March 28, 2020 for a period of one year. This reduction in the CRR would release primary liquidity of about ₹1,37,000 crore uniformly across the banking system in proportion to liabilities of constituents rather than in relation to holdings of excess SLR.

17. Furthermore, taking cognisance of hardships faced by banks in terms of social distancing of staff and consequent strains on reporting requirements, it has been decided to reduce the requirement of minimum daily CRR balance maintenance from 90 per cent to 80 per cent, effective from the first day of the reporting fortnight beginning March 28, 2020. This is a one-time dispensation available up to June 26, 2020.

Marginal Standing Facility

18. In view of the exceptionally high volatility in domestic financial markets which brings in phases of liquidity stress and to provide comfort to the banking system, it has been decided to increase the accommodation under the marginal standing facility (MSF) from 2 per cent of the statutory liquidity ratio (SLR) to 3 per cent with immediate effect. This measure will be applicable up to June 30, 2020. This measure should provide comfort to the banking system by allowing it to avail an additional ₹ 1,37,000 crore of liquidity under the LAF window in times of stress at the reduced MSF rate announced in the MPC's resolution.

19. These three measures relating to TLTRO, CRR and MSF will inject a total liquidity of ₹3.74 lakh crore to the system.

Widening of the Monetary Policy Rate Corridor

20. In view of persistent excess liquidity, it has been decided to widen the existing policy rate corridor from 50 bps to 65 bps. Under the new corridor, the reverse repo rate under the liquidity adjustment facility (LAF) would be 40 bps lower than the policy repo rate, as against existing 25 bps. The marginal standing facility (MSF) rate would continue to be 25 bps above the policy repo rate.

II. Regulation and Supervision

21. Alongside liquidity measures, it is important that steps are taken to mitigate the burden of debt servicing brought about by disruptions on account of COVID-19 pandemic. Such steps, in turn, will go a long way to prevent the transmission of financial stress to the real economy, and ensure the continuity of viable businesses and provide relief to borrowers in these extraordinarily troubled times. These measures include moratorium on term loans; deferring interest payments on working capital; easing of working capital financing; deferment of implementation of the net stable funding ratio; and the last tranche of the capital conservation buffer.

Moratorium on Term Loans

22. All commercial banks (including regional rural banks, small finance banks and local area banks), co-operative banks, all-India Financial Institutions, and NBFCs (including housing finance companies and micro-finance institutions) ("lending institutions") are being permitted to allow a moratorium of three months on payment of instalments in respect of all term loans outstanding as on March 1, 2020.

Deferment of Interest on Working Capital Facilities

23. In respect of working capital facilities sanctioned in the form of cash credit/overdraft, lending institutions are being permitted to allow a deferment of three months on payment of interest in respect of all such facilities outstanding as on March 1, 2020. The accumulated interest for the period will be paid after the expiry of the deferment period.

The moratorium on term loans and the deferring of interest payments on working capital will not result in asset classification downgrade.

Easing of Working Capital Financing

24. In respect of working capital facilities sanctioned in the form of cash credit/overdraft, lending institutions are allowed to recalculate drawing power by reducing margins and/or by reassessing the working capital cycle for the borrowers. Such changes will not result in asset classification downgrade.

25. The moratorium on term loans, the deferring of interest payments on working capital and the easing of working capital financing will not qualify as a default for the purposes of supervisory reporting and reporting to credit information companies (CICs) by the lending institutions. Hence, there will be no adverse impact on the credit history of the beneficiaries.

Deferment of Implementation of Net Stable Funding Ratio (NSFR)

26. The Net Stable Funding Ratio (NSFR), which reduces funding risk by requiring banks to fund their activities with sufficiently stable sources of funding over a time horizon of a year in order to mitigate the risk of future funding stress, was required to be introduced by banks in India from April 1, 2020. It has now been decided to defer the implementation of NSFR by six months to October 1, 2020.

Deferment of Last Tranche of Capital Conservation Buffer

27. The capital conservation buffer (CCB) is designed to ensure that banks build up capital buffers during normal times (*i.e.*, outside periods of stress) which can be drawn down as losses are incurred during a stressed period. Considering the potential stress on

account of COVID-19, it has been decided to further defer the implementation of the last tranche of 0.625 per cent of the CCB from March 31, 2020 to September 30, 2020.

III. Financial Markets

28. The measure for financial markets assumes importance in the context of the increased volatility of the rupee caused by the impact of Covid-19 on currency markets.

Permitting Banks to Deal in Offshore Non-deliverable Rupee derivative Markets (Offshore Rupee NDF Markets)

29. The offshore Indian Rupee (INR) derivative market - the Non-Deliverable Forward (NDF) market - has been growing rapidly in recent times. At present, Indian banks are not permitted to participate in this market, although the benefits of their participation in the NDF market have been widely recognised. The time is apposite to improve efficiency of price discovery. Accordingly, banks in India which operate International Financial Services Centre (IFSC) Banking Units (IBUs) are being allowed to participate in the NDF market with effect from June 1, 2020.

30. Since the last MPC meeting of February 2020, the Reserve Bank has injected liquidity of ₹2.8 lakh crore through various instruments, equivalent to 1.4 per cent of our GDP. Together with the measures announced today, RBI's liquidity injection works out to about 3.2 per cent of GDP.

31. The RBI will continue to remain vigilant and take whatever steps are necessary to mitigate the economic impact of COVID-19 and preserve financial stability. As I had stated earlier, all instruments – conventional and unconventional – are on the table.

32. Before I conclude, let me reiterate that the Indian banking system is safe and sound. In the recent past, COVID-19 related volatility in the stock market has impacted share prices of banks as well, resulting in some panic withdrawal of deposits from a few private sector banks. It would be fallacious to link share prices to safety of deposits. As I have mentioned in my earlier interaction with the media, depositors of commercial banks including private sector banks need not worry on the safety of their funds. I would, therefore, urge members of public as well as the public authorities, who have deposits in private sector banks, not to resort to any panic withdrawal of their funds.

33. In conclusion, let me say that, in spite of the very challenging environment, I remain optimistic. It is worthwhile bearing in mind that the macroeconomic fundamentals of the Indian economy are sound and, in fact, stronger than what they were in the aftermath of the global financial crisis – the fiscal deficit and the current account deficit are now much lower; inflation conditions are relatively benign; and financial volatility measured by change in stock prices from recent peaks and average daily change in the exchange rate of the rupee is distinctly lower. COVID-19 is upon us; but this too shall pass. We need to remain careful and take all precautionary measures. I leave you with this comforting thought. Stay clean. Stay safe. Go digital.

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