Reserve Bank of India's "whatever it takes"

It was still a disappointment for markets as the widely-expected unconventional easing, through debt purchases and monetisation of the fiscal deficit, were missing in the new measures just announced

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Whatever it takes...

The Reserve Bank of India's Governor Shaktikanta Das announced an additional set of liquidity-boosting measures in an unscheduled press conference held today, topping up about $50 billion worth of measures unveiled less than a month ago on 27 March. Today's announcement includes:

Policy rates: A 25 basis point cut in the reverse repo rate to 3.75%. No change to the repo rate of 4.40%. The move discourages banks from depositing funds with the central bank instead of lending them out.

TLTRO 2.0: A targeted long-term repo operation INR 500 billion to start with, and in tranches thereafter, to support liquidity for small and medium-sized non-bank finance companies (NBFC). Banks are mandated to deploy the same amount of funds within one month and 50% of these are assigned for mid-sized NBFCs and microfinance institutions (MFIs).

Liquidity Coverage Ratio: Freeing up more cash for scheduled commercial banks, with a cut to 80% from 100% in the proportion of liquid assets they are required to be set aside to cover short-term obligations. The cut will be rolled back in two phases in October 2020 and April 2021.

All-India Financial Institutions: A special financial facility of INR 500 billion at the repo rate to NABARD, SIDBI, and NHB, the national lenders to the agriculture sector, small-scale industries, and housing sector, respectively.

Easing lending guidelines: Extension of the loan-repayment moratorium for three months though with additional provisioning of 10% to be fully reversed back in two quarters once the situation is normalised. Easier restructuring of loans to the real estate sector.

More funding for states: Increase in the ways and means advance (WMA) limit for states by 60% until 30 September, 2020.

… but no quantitative easing

The announcement was, however, a disappointment for the markets, which expected aggressive easing via unconventional routes such as debt purchases, as well as monetisation of the fiscal deficit. As the government is embarking on a record domestic borrowing spree to finance the budget gap and this supply-overhang is driving yields higher, the markets were hoping that the central bank would absorb this debt in the secondary market and keep yields from going higher.

Alas, that's not going to happen. Our reasoning for this is that, unlike developed economies where exceptionally low inflation and interest rates have forced central banks on the quantitative easing path, the RBI still has room to ease by cutting policy interest rates. Admittedly, the policy transmission has been weak and the RBI's Operation Twist since December (buying of long-dated government bonds and simultaneously selling short-dated ones) has worked well in keeping yields low.

Governor Das did point out that the potentially low inflation rate allows for further rate cuts. At 5.9% year-on-year in March, inflation is just back within the RBI's 2-6% policy target range. We expect it to fall below 5% within this quarter.

What's ahead?

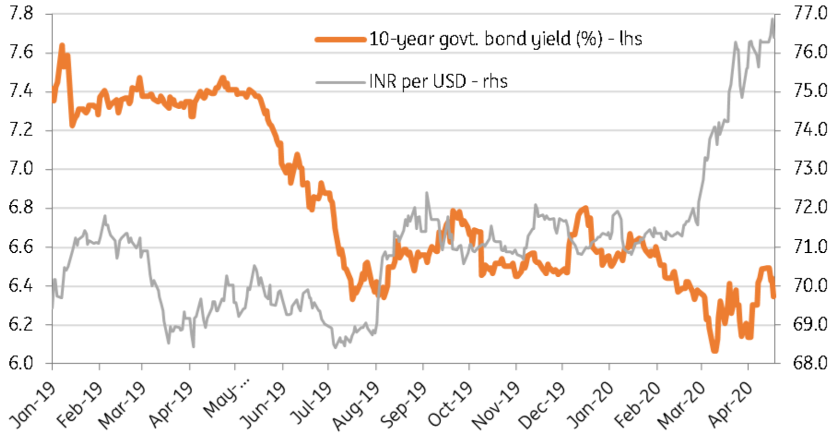
Today's liquidity-boosting measures of INR 1 trillion combined with those worth INR 3.74 trillion announced on 27 March amount to about 2.4% of GDP monetary stimulus so far. Add to this 1.3% of GDP fiscal thrust, including the imminent second package said to be worth INR 1 trillion, and this still doesn't put India among the ranks of the more aggressive, 10-20% of GDP, aggregate policy thrusts seen elsewhere in Asia.

We don't consider economic stimulus as strong enough to position the economy for a speedy recovery once the pandemic ends. Stretched public finances have constrained fiscal stimulus and this has forced the RBI to do all the heavy lifting. However, liquidity-boosting efforts may not be much help to corporate and household cash flows, at least not until confidence returns, which is too difficult to time given the unprecedented nature of the current crisis.

Meanwhile, the markets will continue to ponder the depth of the economic downturn ahead of us and the length of the recovery after that. The extended lockdown until early May adds further downside risk to our view of a 5% YoY GDP fall in the current quarter, the worst ever. No doubt

Indian government bonds and the rupee will remain under pressure in the near-term. Our end-2Q20 USD/INR forecast is 79.0 (spot 76.4).

Under weakening pressure



Source: Bloomberg, ING

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