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RBI ASSURES CONTINUED LIQUIDITY SUPPORT: YIELD CURVE IS A PUBLIC GOOD & MARKETS SHOULD APPRECIATE

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As widely expected, RBI's Monetary Policy Committee has unanimously decided to keep policy repo rate unchanged at 4% and has decided to continue with the accommodative stance as long as necessary. The stance follows after the landmark Union Budget 2021-22 which has given a strong thrust to physical infrastructure. The current statement has not altered the GDP forecast of –7.5%. For FY22, RBI has projected growth rate at 10.5% (in the range of 26.2% to 8.3% in H1 and 6.0% in Q3).

However, markets behaved differently following the RBI policy with the yields hardening several notches. In the Indian markets it is common to find debt market players behaving differently with one set of players acting pro-cyclically with the RBI monetary policy stance, the other set of players acts counter-cyclically and sometimes both the players act combatively. Such combativeness in behavior might be inconsistent with signalling stance of the RBI and that is precisely what happened today. This is precisely why RBI Governor again espoused yield curve as a public good today!

Meanwhile, RBI has revised Q4 inflation at 5.2% for Q4 FY21 (earlier: 5.8%). For H1 FY22 RBI provided a range of 5.0-5.2%(earlier: 4.6-5.2%) while Q3 FY22 growth was projected at 4.3% with balanced risks. Cost push pressure from services is clear upside to the inflation trajectory.

As expected, the regulatory and development policy took the center stage. RBI has now extended the On Tap TLTROs under which banks deploy the availed liquidity in corporate bonds, commercial paper, and nonconvertible debentures issued by entities in eligible 26 stressed sectors to NBFCs. The normalization of CRR to 4% has commenced and this will drain approximately Rs 1,50,000 crore of liquidity from the system and will open room for RBI to do more OMOs to support Government borrowing. Furthermore, RBI has extended the facility to avail of funds under the marginal standing facility (MSF) by dipping into the Statutory Liquidity Ratio (SLR) up to an additional 1% of NDTL till 30 Sep'21.

For banks, RBI has extended the Enhanced HTM limit of 22% (from 19.5%) of NDTL till March 31, 2023 to include securities acquired between April 1, 2021 and March 31, 2022. Banks have been allowed to deduct credit disbursed to 'New MSME borrowers' from their NDTL for calculation of the CRR only for exposures up to Rs 25 lakh per borrower. We expect banks will be able to potentially lend around Rs 23 lakh crore fresh loans to MSMEs till end Sep'21. RBI had also deferred the implementation of last tranche of the Capital Conservation Buffer (CCB) of 0.625% along with Net Stable Funding Ratio (NSFR) guidelines. This can have a capital ease of around Rs 65,000 crore.

For the financial markets, RBI has permitted FPIs to invest in defaulted corporate bonds. This will widen the market, give a market based assessment of recovery rate (LDG), and will provide a faster exit route for the bond-holders. In line with US treasury's 'Treasury Direct', the RBI has allowed retail investors to buy and sell government securities (G-secs) in both primary and secondary markets directly through an online portal called 'Retail Direct'. In the payment sphere, RBI has taken a number of steps to build consumer confidence such as the setting-up of a centralized industry-wide 24x7 helpline, making Ombudsman mechanism simpler by integrating all the existing Ombudsman schemes and introducing centralised processing of grievances following a 'One Nation One Ombudsman' approach. Overall the monetary policy while maintaining status quo is in wait and watch mode and will be guided by the trajectory of inflation and delivery on infrastructure spending.

RBI HOLDS THE RATES

- As widely expected, RBI's Monetary Policy Committee unanimously decided to keep policy Repo rate unchanged at 4% and decided to continue with the accommodative stance as long as necessary (to revive growth on a durable basis with check on inflation). Reverse repo rate remains unchanged at 3.35% and MSF and the Bank Rate remain at 4.25%.
- In the last monetary policy, RBI projected FY21 real GDP contraction at 7.5% (NSO: -7.7%), which RBI has not altered. For FY22, RBI projected growth rate at 10.5% (in the range of 26.2% to 8.3% in H1 and 6.0% in Q3). We also believe that FY21 real GDP decline will be in the range of 7.0%-7.5% with a marginal growth in Q3. Q4 GDP growth will definitely be in positive zone in the range of 2-3%.
- Coming to CPI inflation projections, RBI has revised Q4 inflation at 5.2% for Q4 FY21 (earlier: 5.8%). For H1 FY22 RBI has provided a range of 5.0-5.2% (earlier: 4.6-5.2%) while Q3 FY22 projected at 4.3% with balanced risks. Broad-based escalation in cost-push pressures in services and manufacturing prices due to increase in industrial raw material prices could impart upward pressure on CPI, going forward.

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	Q3 FY21	Q4 FY21	FY21	Q1 FY22	Q2 FY22	Q3 FY22
Feb'21	6.4*	5.2	6.3	5.2	5	4.3
Dec'20	6.8	5.8	6.5	5.2	4.6	-
Oct'20	5.4	4.5	5.8	4.3	-	-
Real GDP Growth (%)	**Q3 FY21**	**Q4 FY21**	**FY21**	**Q1 FY22**	**Q2 FY22**	**Q3 FY22**
Feb'21	0.1	0.7	-7.7	26.2	8.3	6.0
Dec'20	0.1	0.7	-7.5	21.9	6.5	-
Oct'20	-5.6	0.5	-9.5	20.6	-	-

Source: RBI, SBI Research, *Actual

IMPACT OF DEVELOPMENTAL & REGULATORY MEASURES

- **TLTRO on Tap Scheme – Inclusion of NBFCs:** RBI has extended the On Tap TLTROs under which banks deployed the availed liquidity in corporate bonds, commercial paper, and nonconvertible debentures issued by entities in eligible 26 stressed sectors as identified by Kamath Committee, to NBFCs which can then use these funds to lend to these sectors. This will help in expanding credit to these sectors given the outreach of NBFCs.
- **Restoration of CRR in two phases beginning March 2021:** CRR which was reduced by RBI to 3% of NDTL from fortnight beginning March 28, 2020 will now be restored to 4% of NDLT in two phases: 3.5% from 27th Mar 2021, and 4% from 22nd May 2021. With the 1% rise in CRR, it will absorb around Rs 1.50 lakh crore of liquidity from the system and will open room for RBI to do more OMOs to support Government borrowing.
- **Marginal Standing Facility (MSF) - Extension of Relaxation:** RBI has extended the facility to avail of funds under the MSF by dipping into the Statutory Liquidity Ratio (SLR) up to an additional 1% of NDTL till 30 Sep'21. This is an excellent step as economy is still recovering and banking system is in need of funds to support that revival. Taking the current excess SLR holdings of ASCB, this move will result in increased access to funds to the extent of Rs 1.65 lakh crore and this also qualifies as high-quality liquid assets (HQLA) for the LCR.
- **SLR Holdings in Held to Maturity (HTM) category:** RBI has extended the Enhanced HTM limit of 22% (from 19.5%) of NDTL extended till March 31, 2023 to include securities acquired between April 1, 2021 and March 31, 2022. Further, HTM limits would be restored from 22% to 19.5% in a phased manner starting from the quarter ending June 30, 2023. We believe this will not have much impact on buying by banks.
- **Credit to MSME Entrepreneurs:** Banks have been allowed to deduct credit disbursed to 'New MSME borrowers' from their NDTL for calculation of the CRR. This exemption will be available only for exposures up to Rs 25 lakh per borrower for credit extended up to the fortnight ending October 1, 2021 for a period of one year from the date of origination of the loan or the tenure of the loan, whichever is earlier. By going by the ECLGS numbers, we estimate that banks will be able to lend around Rs 23 lakh crore fresh loans to MSME till end Sep'21. So, for the period of 1-year, it is estimated that banks will save CRR of Rs 8000 crore from the fresh loans to the MSME units.
- **FPIs Investment in Defaulted Bonds:** The option to directly invest in defaulted corporate bonds provides flexibility to FPIs who could earlier only get exemptions through investment through the security receipts and debt instruments issued by Asset Reconstruction Companies and debt instruments issued by an entity under the Corporate Insolvency Resolution Process. These exemptions are the short-term limit and minimum residual maturity requirement under the Medium Term Framework for investment by FPIs in corporate bonds. This will widen the market, give a market based assessment of recovery rate(LDG), and will provide a faster exit route for the bond-holders
- **Allowing Retail Investors to Open Gilt Accounts with RBI:** As a major structural reform, RBI allow retail investors to buy and sell government securities (G-secs) in both primary and secondary markets directly through an online portal called '**Retail Direct**'.
- Currently, the G-sec market is dominated by institutional investors like mutual funds, banks, insurance companies. However, small investors are also allowed to bid for G-secs via their demat accounts in 2016 through their respective DP bank. However, such access was allowed only to the secondary market in G-sec. Today's announcement will allow the retail investors to directly buy/sell the G-secs in the primary market as well.
- Though retail investors do not make a significant contribution to trading activity in the market but as long-term investors, they impart stability to the market. Thus, many countries have drawn retail investors to broaden the market. For instance, the Japanese Government launched special Japanese Government Bond (JGB) issues in 2003 and 2006 exclusively for retail investors (floating and fixed rate) with tenor, rate and other features suiting their requirements. This instrument is available with banks and post offices. Brazil also began issuing securities to small investors over the Internet in January 2002.
- The RBI's online portal has US counterpart named '**TreasuryDirect**'. It was launched in 2004, offering Americans a one-stop shop for purchasing and redeeming savings bonds and other Treasury securities online. Currently, trading through TreasuryDirect is $23.6 billion, which is only a tiny part (0.08%) of the overall US government debt (27.8 trillion), perhaps reflecting lower rate of returns. However, the biggest drawback of US TreasuryDirect is that investors can't sell the securities bought through TreasuryDirect to other people. They just receive payments from the government as they mature within their TreasuryDirect account, or else transfer those treasuries to a brokerage account elsewhere to sell them, which will incur fees. We believe that RBI's Retail Direct might avoid this drawback.
- This measure will have positive impact on financial savings also, which has expected to reach 21.4% of GDP in FY21, up from 7.9% in Q1 and 10.0% in Q4 of FY20.
- **Payment and Settlement Systems:** In the payment sphere, RBI has taken a number of steps to buildup consumer confidence in the digital transactions. Some of the major are:
- Setting-up of a ***centralized industry-wide 24x7 helpli***ne for addressing customer queries in respect of various digital payment products and give information on available grievance redress mechanisms. However, we believe the helpline should have basic facilities related to all banks at one go, like blocking ATM cards of any bank, freeze of any bank account immediately to stop frauds etc, then only it will serve the purpose. Otherwise, customer may be dialing helpline numbers through IVRS. Further, this helpline number should be a special number like 100 for police.
- It is now proposed to bring all the 18,000 non-clearing bank branches under CTS clearing by Sep'21. This is an welcome move and all the bank branches in the country would be covered under the CTS, which will enhance customer convenience and bring in operational efficiency in the system.

- If we look the latest CTS data for Nov'20, it indicates 5.8 crore transactions, with average ticket size of RS 83,000. So, we believe RBI should popularise the available payment channels (say IMPS, UPI, NEFT and RTGS), so that the cheque transaction will be reduced further.
- To make Ombudsman mechanism simpler, efficient and more responsive, RBI to integrate all the Ombudsman schemes and introduce centralised processing of grievances following a 'One Nation One Ombudsman' approach. We believe this will make the process of redressal of grievances easier by enabling the customers to register their complaints under the integrated scheme, with one centralised reference point. As per the latest available data, around 35% of the complaints are related to ATM/Debit Cards, Mobile/Electronic transaction, so there should be a quick resolution process, which will increase consumer confidence in the payment system.
- **Capital Conservation Buffer and Net Stable Funding Ratio:** Earlier, in view of the continued uncertainty on account of COVID-19, RBI had deferred the implementation of last tranche of the Capital Conservation Buffer (CCB) of 0.625% along with Net Stable Funding Ratio (NSFR) guidelines. With a view towards supporting and nurturing the recovery after the pandemic, RBI further deferred the implementation of last tranche CCB and the implementation of NSFR by another six months from 1 Apr to 1 Oct'21. At present, as per the regulatory requirement Indian Banks needs to have a regulatory capital of 9% of risk Weighted Assets (RWA) along with additional Capital Conservation Buffer of 1.875% which is now slated to increase to 2.5% from 1 Oct'21. This can have a capital ease of around Rs 65,000 crore, which will be very crucial for Banks and can be converted to credit of more than Rs 8.5 lakh crore, assuming Risk Weighted Assets (RWA) of 70% and CAR at 10.875%. Though overall capital of SCBs, as on Mar'20 is above regulatory requirement, at 14.70%, this cushion will help relatively less stronger banks to stay afloat in the immediate aftermath of the pandemic.

YIELD CURVE AS A PUBLIC GOOD

- RBI Governor in the policy statement indicated that, "*...the maintenance of financial stability and the orderly evolution of the yield curve were explicitly regarded as public goods as the benefits accrue to all stakeholders in the economy*". Bank of Japan was perhaps the first central bank to proclaim that yield curve is a public good and it is heartening to see the RBI echoing the same.
- In the Indian markets, it is common to find debt market players behaving differently. For example, if one set of players acts pro-cyclically with the RBI monetary policy stance, the other set of players acts counter-cyclically and sometimes both the players act combatively. An analysis of month-wise G-sec trading since Jan'14 indicates that out of 85 months only 18 times the activity (buy/sell of G-sec bonds) of one set of banks and another set of banks have been on same side of the market. In the remaining 67 times both have dealt in G-sec market in opposite direction.

Number of Complaints at BOs

Categories	2019-20	% Share in Total Complaints
ATM/ Debit Cards	67,800	**22%**
Mobile / Electronic Banking	41,310	**13%**
Non-observance of Fair Practice Code	36,215	12%
Credit Cards	28,713	9%
Failure to Meet Commitments	25,036	8%
Levy of Charges without Prior Notice	18,558	6%
Others	90,998	29%
Total	3,08,630	100%

Source: T&P, 2019-20, RBI, SBI Research

Risk Weighted Assets and Capital Conservation Buffer (CCB) of SCBs

Description	Amount (Rs Crore)	CRAR
Risk Weighted Assets	10469078	
Capital Fund	**1543304**	**14.70%**
Tier I	1319431	12.60%
Tier II	223873	2.10%
Regulatory Requiement Capital		9.00%
CCB (with last tranch of 0.625% w.e.f. 01st Oct'2021)		2.50%
Capital relief till Sept'21 for 0.625% deferement of CCB		65432
or Say Rs crore		65000

Source: RBI; SBI Research; March'2020

Activity in G-sec Trading in India

Number of Months (Total: 85 months)		One set of Banks: Buy	One set of Banks: Sell
Another set of Banks	Buy	8	38
Another set of Banks	Sell	29	10

Source: SBI Research

- It may be always argued for a better price discovery, there should be players on both side of the market., but being combative does not help either the market or the regulator and we get to a sub optimal solution.
- Further, the borrowing pattern of last 10 years indicates that instead of being competitive the market participants are mostly combative in their dealings. They are acting in a way which might be even inconsistent with the RBI's signal.

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