RBI extends safety net; response proactive, loaded and well timed

The Reserve Bank of India (RBI) in its special address today meant strict business, with a chiselled focus on alleviating financing constraints for economic stakeholders at the grass root level bearing a disproportionate burden of the ravaging second wave of COVID in the country. Wide ranging in scope, these stakeholders included: 1) On the retail side small individual borrowers; 2) On the business side, small business borrowers and MSMEs; 3) Among financial entities – Small Finance Banks (SFBs) and MFIs; and 4) On the sectoral side – Health/healthcare sector. Despite RBI’s stepped-up efforts, support to the widely crippled contact-intensive services sector remains less than desired; hopefully in the offing.

Of the measures announced, the conception of a COVID loan book for banks, earmarking funds lent under a Term Liquidity Facility (of Rs 50000 crore up to 31st March 2022 for healthcare infrastructure and services) with a tenor up to 3 years at the repo rate, is the most laudable. The classification of the loan book as PSL along with parking of surplus liquidity up to the size of this book at reverse repo +40 bps under liquidity adjustment facility (LAF), is definitely an attractive reward to ensure an effective take-off.

To further support lending capacity of small finance banks (SFBs), the RBI will conduct a special three-year Long-Term Repo Operations (SLTRO) of Rs 10,000 crore at the repo rate. It can be deployed for fresh lending of up to Rs 10 lakh per borrower, which along with fresh lending to smaller MFIs is permitted to be classified as PSL. For individual, small borrowers and MSMEs, the RBI has allowed the extant Resolution framework 1.0 to be reassessed for working capital limits and for increasing the period of moratorium and/or extending the residual tenor up to a total of 2 years.

Taking a step forward, a fresh lease of life via Resolution Framework 2.0 for entities having aggregate exposure of less than Rs 25 lakh and who had not availed any of the restructuring frameworks earlier was also announced. In effect, and rightly so, the RBI has categorically refrained from fresh moratoriums and relied on one-time restructuring.

In an adverse economic environment and its amplified impact on businesses across sectors, to buffer banks' balance sheets and enable capital conservation, RBI permitted 100 per cent of floating provisions / countercyclical provisioning buffer (as on December 31, 2020) for making specific provisions for NPAs with prior approval of their Boards.

Amidst a second wave of infections that is yet to peak, India is staring at an unprecedented economic state. Our Daily Activity and Recovery Tracker (DART) Index, capturing early signals and turning points, posted an eighth consecutive weekly decline for the week ending May 2. The slowdown has been pronounced in the preceding three readings led by consumption-based indicators, pegging a sequential loss in economic activity to the tune of 15-20 per cent in April 2021. While we expect a likely peaking of COVID wave in May-21 but localised lockdowns are expected to remain in place through the month, with gradual unlocking only beginning from Jun-21 onwards. This would mean a sequential setback to growth in Q1 FY22, dominated by demand deferment as opposed to Q1 FY21 which saw massive supply disruptions. Basis the current scenario and our assumptions outlined above; we recently revised downwards (by 150 bps) our FY22 GDP growth estimate to 10 per cent.

Indeed, RBI’s response function was proactive, loaded and well timed. It truly exemplifies the popular adage of “A stitch in time saves nine”. Akin to last year (at the time of outbreak of the pandemic), the RBI has displayed its agility to rise to the needs of the economy. The evident downside risks to growth will mean that the central bank maintains an accommodative policy stance while remaining nimble footed on regulatory relaxations in FY22.

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Reserve Bank of India