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Measures by the Reserve Bank of India: Containing the Fallout of COVID-19

Vinod Rai

Summary

The Reserve Bank of India, working in tandem with the government, has announced a package of measures designed to introduce liquidity in the market, ensure the transmission of the benefit of lower interest rates and provide forbearance to borrowers who may not be able to meet their repayment obligations. The move is seen as a major succour to borrowers in these rather stressful times.

The Indian nation and its economy are undergoing probably one of their biggest crises. The breakout of the COVID-19 pandemic has created a major emergency and the government has moved in with very stringent and harsh measures to combat the emerging situation. The numbers of COVID-19 cases detected in India, as on 30 March 2020, is 1,024 with 27 deaths. This number is not large for a country with a 1.3 billion people. However, the country, which is at Stage-II of the pandemic spread, is battling the likelihood of a community spread which may have catastrophic consequences. This fear has prompted the authorities to enforce a total lockdown in the country. There is no public transport, passenger rail movement or domestic and international flights, and people have been asked to stay indoors to ensure the containment of the virus. After the announcement of welfare measures by the government and pending an industry stimulus, the Reserve Bank of India (RBI) has announced a slew of measures to facilitate economic activity and maintain liquidity in the market. These measures provide an element of confidence to the citizens that the government and the RBI are working in tandem to contain the fallout of the pandemic.

The RBI's principal concern has been to increase the liquidity in the system and ensure that the lower policy rate fixed by it is transmitted to the clients. It has announced a cut in the repo rate by 75 basis points to 4.4 per cent. The repo rate is the rate at which the banks borrow from the RBI. A low repo rate has the overall effect of reducing interest rates for the system. Lower rates make it easier for entrepreneurs to take loans for working capital, households for house-building, for businesses, vehicles and so on.

In the recent past, empirical evidence has shown that the banks preferred to keep money with the RBI and not lend, as the reverse repo rate (the rate at which the banks lend to the RBI) was attractive. To ensure a transmission of the lower rate, the RBI has now reduced the reverse repo rate (the rate at which the RBI lends to the banks) by 90 basis points to four per cent. This makes the cut sharper than the one on the repo rate so as to encourage the banks to borrow from the RBI rather than lend to it – it has made the corridor between the two rates viz 40 basis points attractive for such borrowing. An average daily amount of ₹3 trillion (S$57.2 billion) was being kept with the RBI. A reduction of the reverse repo to four per cent makes it unattractive for the banks to park it with the RBI and, hence, they will be encouraged to lend. Such increased lending will provide the much-needed resource to businesses for their working capital and longer-term loans.

In another major announcement, the RBI has reduced the cash reserve ratio (CRR) by a full percentage point down to three per cent for a year. The CRR is the percentage of demand and time deposits that the banks have to keep with the RBI. The CRR has been chosen rather than statutory liquidity ratio (SLR) [18.25 per cent] because this increases 'primary liquidity' with the banks a bit better.

The RBI has also targeted long-term repo operations to an additional amount of ₹1 trillion (about $19.1 billion) that can be invested in bonds and other forms of lending instruments, with these investments being classified as 'hold-to- maturity' so that the trading of these bonds is not debilitated by the current stressful conditions. The mark to market would have suffered from that weakness. Additionally, ₹1.37 trillion ($26.1 billion) will be made available under the emergency lending window called the Marginal Standing Facility. The banks will now be able to borrow up to three per cent of their deposits under this window. This is higher than the current two per cent.

Another important facility provided is that of regulatory forbearance which had been a demand of practically all types of borrowers from the banks, non-bank financial companies and housing finance companies. A moratorium of three months has been granted for loan repayment. This will come as a big relief to retail borrowers who will find it difficult to continue with their equated monthly instalment repayment as a consequence of the lack of regular income due to the lock down. They will thus not face the risk of their accounts being classified as non-performing assets or have their credit rating downgraded. Finally, to reduce the volatility of the price of the rupee in international markets, the RBI has allowed the banks to deal in off-shore non-deliverable derivative markets. This will serve as a long-awaited reform measure.

Liquidity in the market was a cause of concern, especially in sectors such as construction and real estate. With the lower policy rates indicated by the RBI and the nudge that it has given to the banks by providing an attractive margin between the repo and reverse repo rates, the banks will be encouraged to lend aggressively. These measures, in conjunction with those already announced by government and also the much expected industry impetus that seems to be in the pipeline, are expected to play a positive role to reinvigorate the sluggish economy in troubled times.

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Mr Vinod Rai is a Distinguished Visiting Research Fellow at the Institute of South Asian Studies (ISAS), an autonomous research institute at the National University of Singapore (NUS). He is a former Comptroller and Auditor General of India. He can be contacted at isasvr@nus.edu.sg. The author bears full responsibility for the facts cited and opinions expressed in this paper.