MONETARY POLICY REVIEW

22 May 2020

RBI cuts rates, extends measures to ease financial stress

MPC announced another 40bps reduction in policy rate to 4%. Since the pandemic, RBI has reduced policy rate by 115bps. In addition, RBI has extended moratorium and guidelines on asset classification by another 3 months. Exporters too will get additional benefits. Recent trade and electricity data suggests large contraction due to lockdown and social distancing measures. We expect GDP to contract by 4.7% in FY21 and CPI inflation at 3.5% which makes us believe that RBI has room for another 25bps reduction in policy rate.

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MPC reduces rates: As was the case in Mar'20, RBI called for an out-of policy MPC meeting and reduced repo rate by 40bps to 4% with 5:1 majority in favour. One member pitched in for 25bps. In CYTD20 RBI has reduced policy rates by 115bps. Since last year, rates have been reduced by 250bps.

Easing financial stress: RBI extended the moratorium on term and working capital loans by another 3 months to Aug'20. Interest payment on working capital loans can be converted into funded term loan, to be repaid by Mar'21. Bank exposure to corporates under large exposure framework increased to 30% which will allow banks to lend to corporates. The earlier guidelines on asset classification and higher working capital provision also extended.

GDP to contract in FY21: MPC noted that impact of pandemic is more severe than anticipated because of which GDP growth in FY21 is likely to be negative. However, agriculture sector has shown resilience and remains a bright spot with a spurt in kharif sowing. Our forecast also shows a sharp contraction in GDP growth in FY21 at 4.7% (previous forecast of 0.5%), with a recovery in FY22 to 7.2%. Our downward revision is based on the fact that discretionary demand will be impacted severely because of social distancing norms and dip in consumer confidence. Hence, this round of reduction is largely on the back of contraction in services sector to 5.2%.

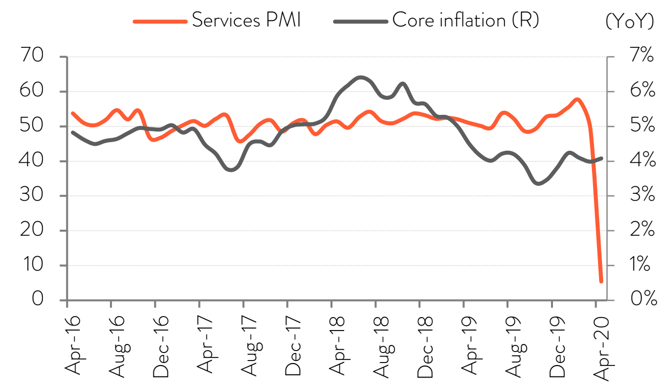
CPI to remain below 4% target: Food inflation did increase in Apr'20 to 10.5% from 8.8% due to supply side restriction because of lockdown. However, both food and core inflation is likely to see a sharp dip due to higher supply and lower demand in the coming months. We expect CPI inflation to average at 3.5% in FY21 which will give RBI headroom for another 25bps reduction in policy rate.

KEY HIGHLIGHTS

- Policy rate reduced by 40bps to 4.0%. Reverse repo rate at 3.35%.
- Moratorium extended and measures to ease stress on exports and imports also announced.
- GDP growth expected to contract in FY21. Inflation expected to remain below 4%.

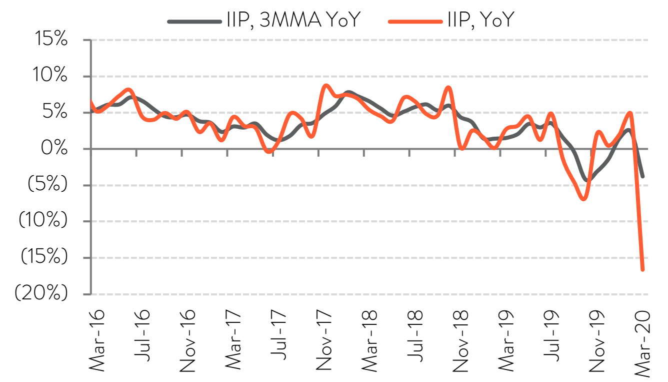
Important disclosures are provided at the end of this report.

FIG 1 – SERVICES PMI COLLAPSES IN APR'20, CORE CPI ALSO DOWN



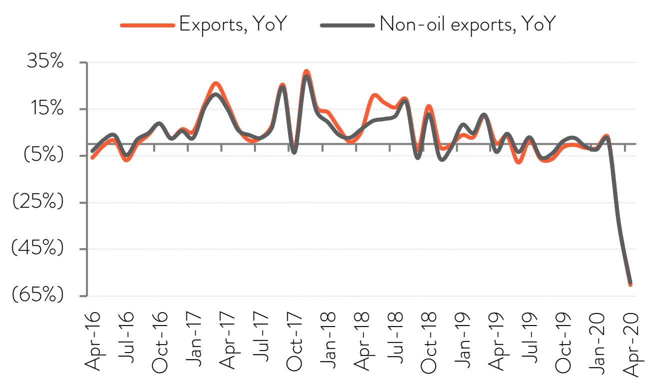
Source: CEIC, Bank of Baroda Research

FIG 2 – IIP GROWTH CONTRACTED SHARPLY IN MAR'20



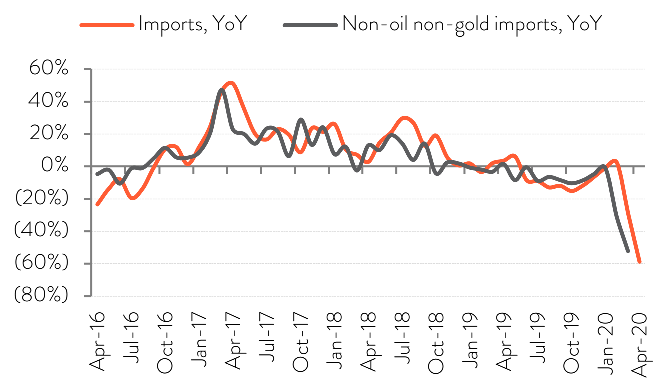
Source: CEIC, Bank of Baroda Research

FIG 3 – EXPORT GROWTH PLUNGED IN MAR-APR'20



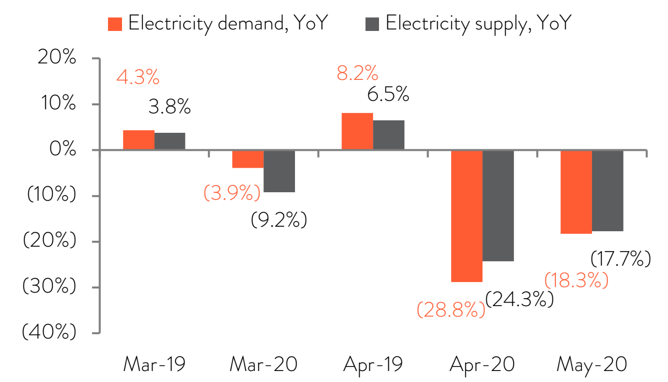
Source: CEIC, Bank of Baroda Research

FIG 4 – SIMILAR TREND IN IMPORTS



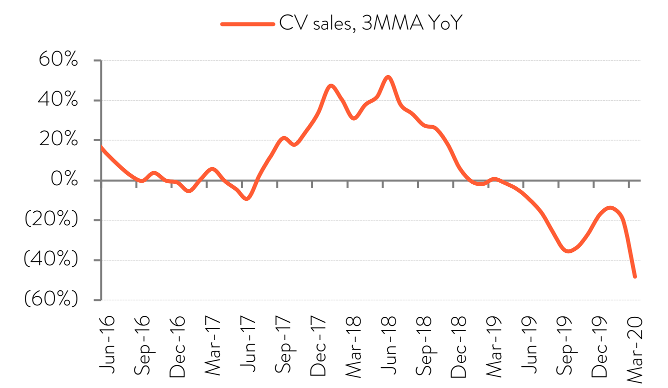
Source: CEIC, Bank of Baroda Research

FIG 5 – ELECTRICITY DEMAND AND SUPPLY HAS ALSO FALLEN SHARPLY



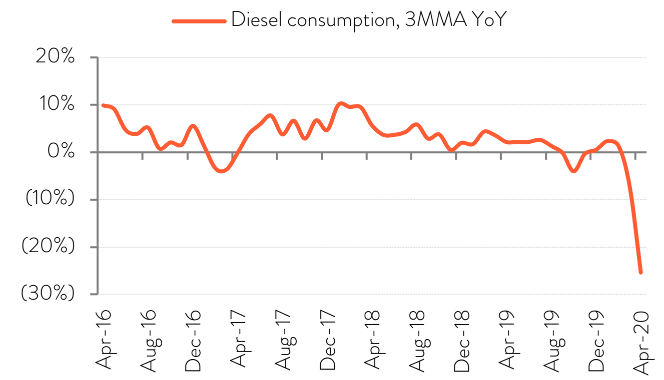
Source: POSOCO, Bank of Baroda Research, Data as of 21 May 2020

FIG 6 – CV SALES DROP FURTHER IN MAR'20



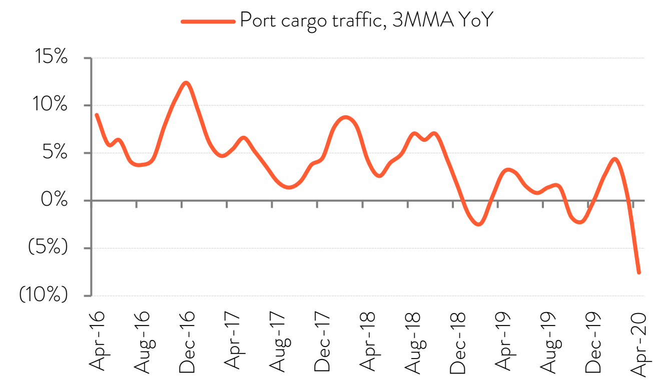
Source: CEIC, Bank of Baroda Research

FIG 7 – DIESEL CONSUMPTION NOSE DIVES IN APR'20



Source: CEIC, Bank of Baroda

FIG 8 – PORT CARGO TRAFFIC ALSO PLUMMETS IN APR'20



Source: CEIC, Bank of Baroda Research

FIG 9 – GDP IS EXPECTED TO CONTRACT SHARPLY TO 4.7% VERSUS EARLIER FORECAST OF 0.5% GROWTH IN FY21-LED BY SERVICES

(% change)	FY17	FY18	FY19	FY20 Est	FY21 Old Est	FY21 New Est
Agriculture, forestry and fishing	6.8	5.9	2.4	3.6	3.3	3.25
Industry	7.7	6.3	4.9	0.8	(4.6)	(6.0)
Mining and quarrying	9.8	4.9	(5.8)	3.3	(0.8)	(0.8)
Manufacturing	7.9	6.6	5.7	(0.4)	(6.5)	(8.3)
Electricity, gas, water supply and other utility services	10.0	11.2	8.2	3.5	(1.3)	(2.5)
Construction	5.9	5.0	6.1	1.7	(2.5)	(3.8)
Services	8.5	6.9	7.7	6.4	2.9	(5.2)
Trade, hotels, transport, communication & services related to broadcasting	7.7	7.6	7.7	5.5	(0.3)	(7.5)
Financial, real estate & professional services	8.6	4.7	6.8	6.6	3.8	(7.5)
Public administration and defence	9.3	9.9	9.4	7.6	6.0	1.8
GVA at basic prices	**8.0**	**6.6**	**6.0**	**4.3**	**0.7**	**(4.4)**
GDP	**8.3**	**7.0**	**6.1**	**4.2**	**0.5**	**(4.7)**

Source: CSO, MOSPI, Bank of Baroda Research | Est-Bank of Baroda Estimate

Regulatory announcements

- RBI had announced a special refinance facility of Rs 150bn SIDBI for on-lending/refinancing. Advances under this facility were provided at the RBI's policy repo rate at the time of availing for a period of 3 months. This facility has been extended for another period of 90 days.

- To stimulate FPI investments under the Voluntary Retention Route (VRR), RBI has given an extension of 3 months to meet the 75% utilisation of investment limits.

- RBI also announced measures to improve exports and imports. These are: 1) maximum permissible period of pre and post shipment export credit sanctioned by banks increased from 12 months to 15 months, 2) Rs 150bn credit line to EXIM bank for a period of 90 days with a rollover of upto 1 year. This will enable it to avail US$ swap facility, and, 3) time period for completion of remittances against normal imports (excluding gold, diamonds/precious stones and jewellery) into India has been increased from 6 months to 12 months.

- To ease the financial stress, RBI had previously allowed regulatory measures such as moratorium on term loan installment, interest deferment on working capital, exemption from 'defaulter' classification, resolution timeline being extended for stressed assets, no changes in asset classification by exclusion of moratorium period. All of these exemptions which were initially granted for 3-months have now been further extended by another 3 months till 31 Aug 2020.

- Additionally, RBI has also permitted lending institutions to convert deferred interest on six months of working capital into a funded 'term loan', to be paid at the end of FY21.

- In order to enable corporate to meet their funding needs, group exposure limits of banks also has been raised from 25% to 30% and will be applicable till 30 Jun 2021.

- RBI has also decided to relax the rules governing withdrawal from the Consolidated Sinking Fund (CSF) to enable States to meet a larger proportion of their redemption of market borrowings falling due in the current financial year. This measure is expected to provide Rs 133bn liquidity to states. Together with the normally permissible withdrawal, this will enable states to meet about 45% of their redemptions due in FY21 through withdrawal from CSF.

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