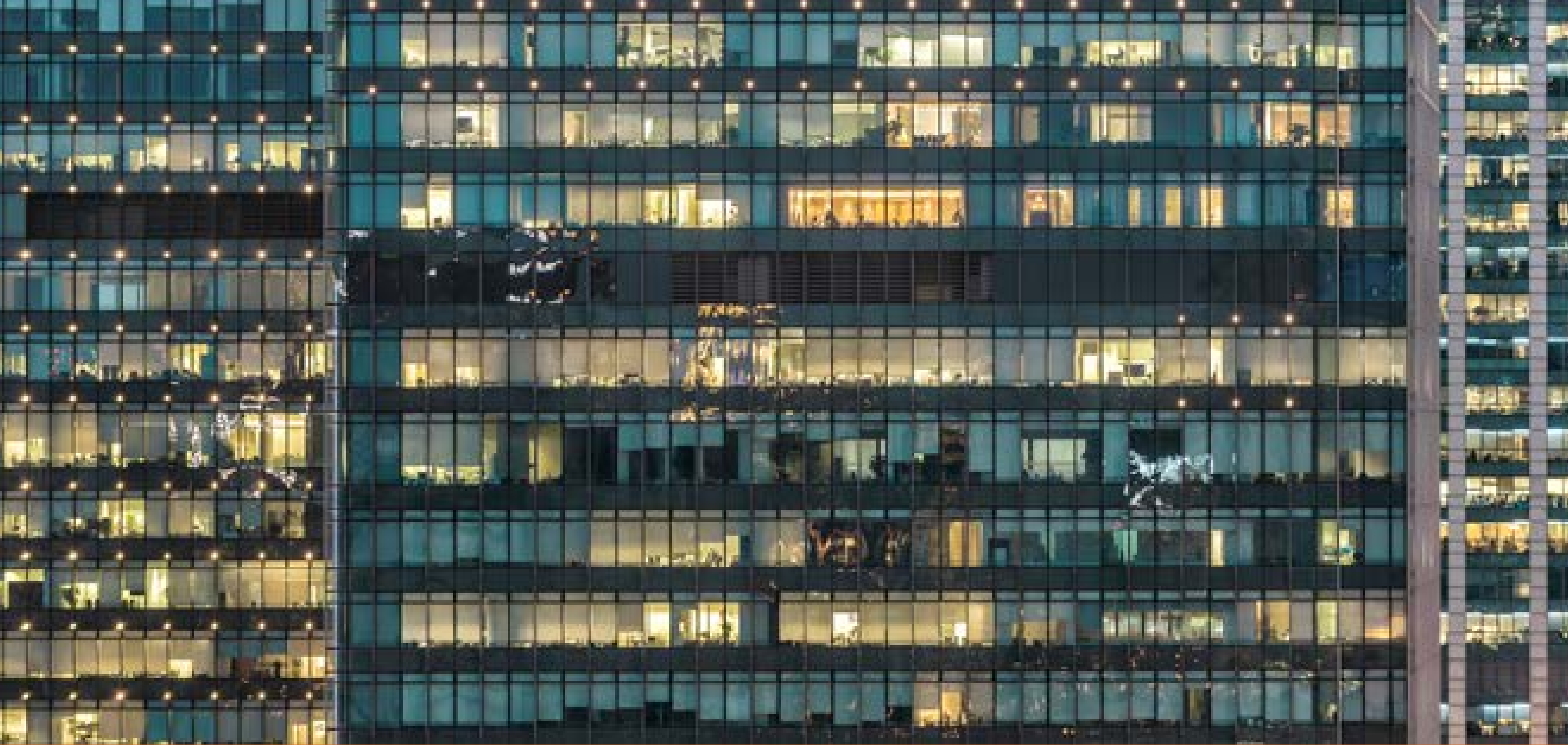

Financial RegTech Newsletter

April 2020

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RBI's Monetary Policy Report

The global economic growth trajectory remains uncertain as the COVID-19 situation is evolving. The crisis is impacting both demand and supply elements of the Indian economy. Global lockdowns and reduction in global trade have affected the Indian economy and the global output is expected to contract in 2020.[1] Economies are experiencing uncertainties in their financial markets, equity markets have witnessed sell-offs, sovereign bond yields have reduced and financial conditions have tightened. The prices of global commodities, especially crude oil, have reduced sharply owing to reduced demand and failed negotiations between the Organization of Petroleum Exporting Countries (OPEC) and Russia.[2]

COVID-19 and its subsequent impact were the main themes of the half-yearly Monetary Policy Report published by the Reserve Bank of India (RBI) in April 2020.[3] The report focuses on the macroeconomic outlook around factors such as inflation, growth, balance of risk, price and liquidity for the country.

1. https://m.rbi.org.in/Scripts/PublicationsView.aspx?id=19439
2. Ibid.
3. Ibid.

RBI's Monetary Policy Report

Macroeconomic outlook

Crude oil prices (Indian basket) have fluctuated widely from USD 70 per barrel in early January 2020 to USD 23 per barrel on March 30, 2020, and further decreased to USD 19.9 per barrel in April 2020.[4] The decrease in crude oil prices can be attributed to Saudi Arabia's decision to reduce prices and increase production, as an arrangement with Russia on production cuts could not be finalised. As per the RBI, the baseline scenarios assume crude oil prices (Indian basket) to average around USD 35 per barrel during financial year 2020–21.[5]

The nominal exchange rate (USD–INR) was volatile between October 2019 and December 2019. The value of INR has weakened considerably from January 2020, reflecting a generalised weakening of currency in emerging markets. As per the RBI, the baseline assumes the exchange rate of 1 US dollar to be at INR 75.[6]

Even before the COVID-19 crisis, the RBI acknowledged that the Indian economy was undergoing a slowdown. The RBI's Monetary Policy Committee (MPC) met four times between October 2019 and March 2020 to intensify efforts to restore growth amidst the slowdown. As the domestic demand reduced between December 2019 and February 2020, inflation rose sharply and breached the mandated inflation band. In its off-cycle meeting held in March 2020, the MPC noted that the pandemic had severely impacted both demand and supply and they were required to take measures to safeguard the economy. The MPC reduced the policy repo rate by 75 basis points (bps) to 4.4 %.[7] MPC further reduced repo rate by 40 bps to 4% in May 2020.[8] The RBI has also taken several measures to improve liquidity, monetary transmission and credit flows to the economy. Changes in the macroeconomic developments between December 2019 and March 2020 warranted for changes in baseline assumptions.

4. https://www.ppac.gov.in/content/149_1_PricesPetroleum.aspx
5. https://m.rbi.org.in/Scripts/PublicationsView.aspx?id=19439
6. Ibid.
7. Ibid.
8. https://m.rbi.org.in/scripts/BS_CircularIndexDisplay.aspx?Id=11894

Outlook for inflation

The trajectory for inflation in the near term is dependent on the reversal in vegetable prices, inflationary pressure on food prices and evolution of the COVID-19 outbreak. The RBI's Industrial Outlook Survey expected an increase in selling prices due to an increase in cost of raw materials, though the pricing power of firms is expected to remain weak. All forward-looking indicators are indicating towards a softer inflation trajectory. The RBI expects consumer price index (CPI) inflation to ease from 4.8% in Q1 to 4.4% in Q2 to 2.7% in Q3 and 2.4% in Q4 of FY20–21.[9]

Outlook for growth

Forecasting the growth outlook for 2020 is highly challenging as agriculture and allied activities are expected to be less adversely affected by the COVID-19 crisis compared to other sectors of the economy.

Balance of risk[10]

- Exchange rate: As per the RBI, if INR depreciates by 5% from the baseline, inflation would rise by 20 bps while GDP growth would increase by 15 bps through increased net exports. However, an appreciation of 5% would moderate inflation by 20 bps and GDP growth by around 15 bps.
- International crude oil prices: If the Indian basket of crude oil prices increases by 10% above the baseline, inflation would be higher by 20 bps and growth would weaken by 15 bps. If the prices fall by 10% below the baseline, inflation could ease by 20 bps and growth would be higher by 15 bps, depending on the pass through to domestic product prices.
- Food prices: Adequate buffer stocks in cereals and a good rabi harvest (2019) would soften the inflation by 50 bps. However, a deficient or partly skewed monsoon and unexpected increase in non-vegetable food prices would push inflation up by about 50 bps in 2020–21.

9. https://m.rbi.org.in/Scripts/PublicationsView.aspx?id=19439
10. Ibid.

RBI's Monetary Policy Report

Prices and costs[11]

Headline inflation measured by the CPI remained below the target rate for 13 consecutive months till Q2 2019–20 and breached its upper threshold of 6% to reach 7.6% before easing to 6.6% in February 2020. This was due to an increase in vegetable prices. Fuel inflation also increased after December 2019. Core inflation (excluding fuel and food) increased to 4.3% from 3.4% in the same period. Projection errors were observed in CPI inflation (excluding food and fuel inflation) during March 2020 due to cost-push scenarios like higher motor vehicle prices owing to introduction of BS-VI vehicles, a sharp increase in gold prices and higher mobile tariffs. However, easing of fuel prices in this period helped in offsetting the increase and balancing the upside.

Year-on-year (YoY) comparison of CPI inflation indicated a rise in Q3 2019–20 inflation figures. Normally, food prices used to decline in the third quarter of the year, but this time it showed its highest ever increase during the third quarter of any year in the history of the index. Consequently, food price inflation rose up to double digits by the end of Q3 2019–20.

CPI of fuel came out of deflation by signalling a sharp increase to 6.4% in February 2020 from (-)0.3% in July 2019. The increase can be attributed to the supply chain disruptions caused due to geopolitical tensions.

The pattern of core inflation has remained identical with other categories. It registered an increase to 4.3% in January 2020 from 3.4% in October 2019. This was due to volatile movements in crude oil prices. However, this started easing shortly after geopolitical tensions between the US and Iran and the US and China eased, and the price war between OPEC and Russia de-escalated. There was an increase in inflation in sectoral CPIs like CPI-IW (industrial worker), CPI-AL (agricultural labourer), CPI-RL (rural labourer) during the August–December 2019 period mainly due to rise in food prices. Wholesale Price Index (WPI) inflation fell during August–October 2019 as opposed to other CPIs because of decline in prices of non-manufactured food products.

Costs were mostly in sync with the WPI inflation. Inflation in farm inputs and industrial raw material prices (extracted from WPI) eased after April 2019 and continued in negative territory during September–November 2019, before gaining a momentum between December 2019–February 2020. This increase is attributed to recovery in prices of global crude oil and petrochemicals. Additionally, the cost of minerals and non-food articles were also impacted due to the price dynamics of non-farm input costs.

11. https://m.rbi.org.in/Scripts/PublicationsView.aspx?id=19439

RBI's Monetary Policy Report

Demand and output[12]

The Indian economy in 2019–20 had witnessed the weakening of demand due to decrease in investment and restraint in Government expenditure. On the supply side, there was a mixed sentiment with agriculture and allied activities gaining momentum due to a late surge in monsoon and deacceleration of industrial growth due to reduced manufacturing activity. GDP growth lost momentum, averaging from 5.5% in H1 2019–20 to 4.7% in Q3 2019–20. Gross fixed capital formation (GFCF) growth turned negative in Q2 and Q3 of 2019–20 and its share in the GDP dropped to 30.2% in 2019–20 from 31.9% in the previous year. The gross domestic savings rate (GDS) rate also reduced to 30.1% of GDP in 2018–19 from 32.4% of GDP in 2017–18.

Government expenditure saw moderation in H2 2019–20 due to sharp slowdown in Q4 2019–20. Based on the latest data available, the Centre's market borrowing was INR 2,68,000 crore during H2 2019–20 which is 5.3% lower than its level a year ago. Total gross borrowing of the country stands at INR 13,44,521 crore. As per the RBI report, the current account deficit (CAD) narrowed to 0.2% of GDP in Q3 2019–20 from 0.9% in Q2 2019–20. This reduction is due to a lower trade deficit and a rise in services receipts. The contraction in imports also helped in narrowing the CAD. Remittances from abroad remained strong and the net outgo of payments remained unchanged as compared to the previous year. However, the fiscal condition of the Central government has deteriorated due to a reduction in tax rates. Direct taxes contracted by 3.3% and indirect taxes grew by 1.6% during the eleven months of FY19–20, well below the budgeted estimates.

In terms of aggregate supply, gross value added (GVA) growth deaccelerated to 4.7% in H2 2019–20. This decrease is attributed to a slowdown in industrial and services activities. As the economy hit a multi-quarter low in Q3 2019–20 and with the outlook being bleak, aggregate demand is adversely impacted by a likely recession. Private consumption is at a risk due to the pandemic. Domestic production will be impacted due to the nationwide lockdown affecting supply.

12. https://m.rbi.org.in/Scripts/PublicationsView.aspx?id=19439

RBI's Monetary Policy Report

Financial markets and liquidity conditions[13]

Equity markets experienced extreme uncertainty in February and came to a standstill in March. This led to a sharp decline in trading activities. The sentiment of finding a safe haven asset and flight to safety led to a decreased confidence in the Indian equity markets and Indian currency. In a move to strengthen the credit market through providing liquidity, long-term repo operation (LTRO) was introduced to reduce the cost of funds for banks.

The money market remained robust owing to the proactive liquidity management steps taken by the RBI. The steps also led to an increase in the share of collateralised money-market debt in the overnight money market. However, the risk premium in the money market increased to 97 bps in H2 2019–20 from 87 bps in H1 2019–20, owing to fears of illiquidity in the market.

With regards to Government securities, the yields of both the new benchmark (6.45% GS 2029) and the old benchmark (7.26% GS 2029) increased in December 2019 post the announcement of the Monetary Policy. This happened due to:

- policy rates remaining unchanged
- foreign portfolio investments (FPIs) selling their stake due to negative growth outlook.

The situation improved soon after the RBI decided to opt for open market operations (OMOs). The new benchmark yield of Government securities increased by 9 bps while the old benchmark yield of Government securities increased by 15 bps. After Union Budget 2019–20, the Government decided against additional borrowing from the market, due to which new and old benchmarks fell by 10 bps and 14 bps, respectively. Corporate bond yields fell in the second half of 2019 due to surplus liquidity conditions. The AAA-rated corporate bond yield fell by 42 bps to 7.02 in March 2020 from 7.44 in September 2019. Overall, AAA 5-year yield came down by 108 bps during 2019–20. Resource mobilisation due to issuance of corporate bonds in the primary market stood at INR 3.1 lakh crore, which was higher by 3% as compared to the previous year.

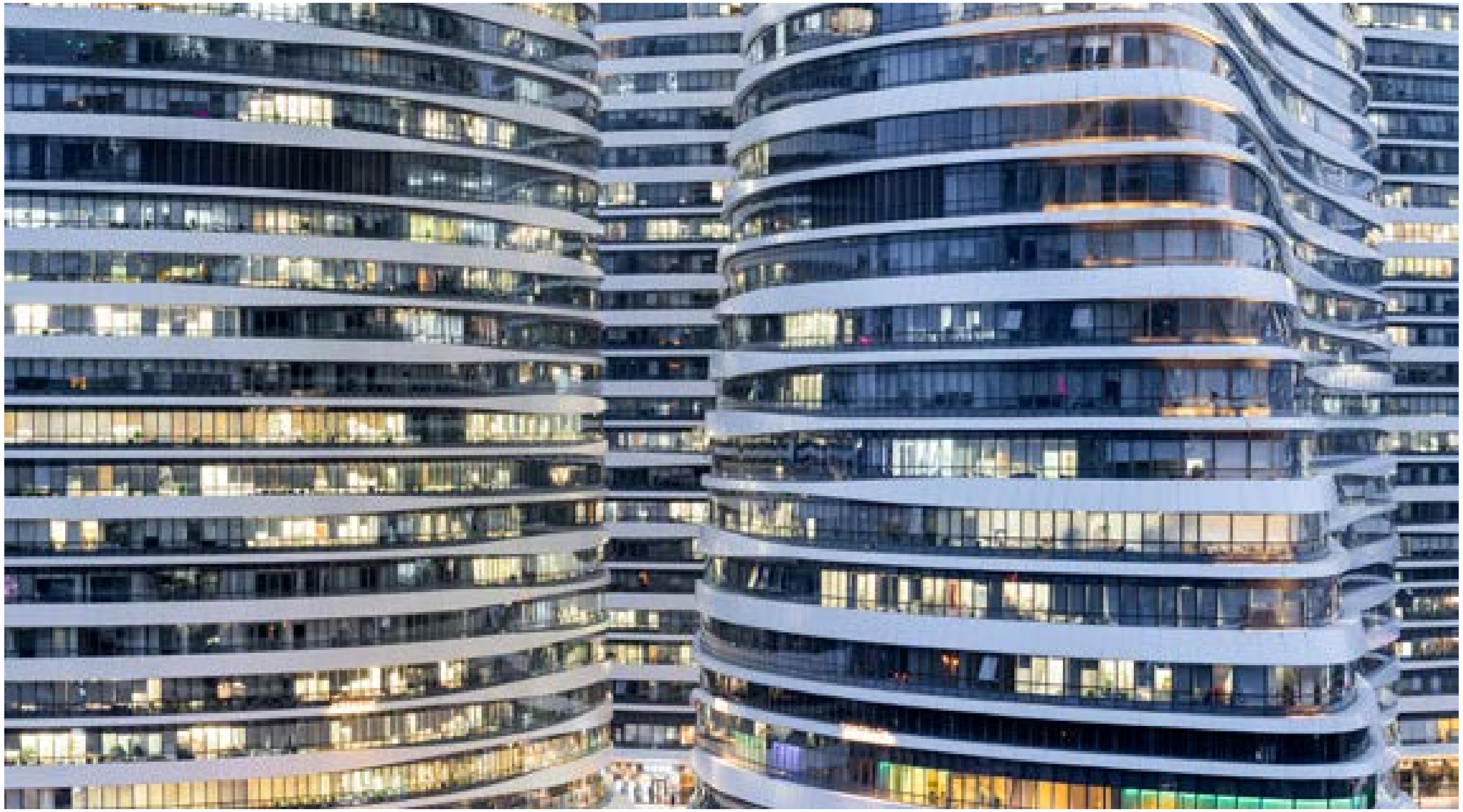
Equity markets in India experienced gains till mid-January 2020, in the backdrop of easing of global crude oil prices, higher GST collections and increase in manufacturing purchasing manager's index (PMI). However, the BSE Sensex declined by overall 23% in March 2020, mainly due to the COVID-19 crisis and panic selling. Mutual funds became net buyers at INR 38,939 crore and FPIs became net sellers at INR 5,599 crore in the Indian equity markets.

13. https://m.rbi.org.in/Scripts/PublicationsView.aspx?id=19439

RBI's Monetary Policy Report

In the foreign exchange market, INR remained highly volatile. As a result, the Indian rupee depreciated to INR 76.15 against 1 USD on 24 March 2020. However, this decline was relatively modest when compared to other emerging market economies. INR depreciated by about 2.9% in terms of the 36-currency nominal effective exchange rate (NEER) and 1.3% in terms of the 36-currency real effective exchange rate (REER).

Credit growth witnessed a slowdown across all banking institutions, especially private sector banks. Credit growth for agriculture and industry has remained low in the previous five months. Personal loans had a moderate growth on YoY basis to 17% from 16.7%. Also, though there was an overall decrease in the non-performing asset (NPA) ratio across the industry, the overall NPA ratio of scheduled commercial banks (SCBs) remained unchanged.



RBI's Monetary Policy Report

External environment[14]

Economic activity has reduced across major advanced economies as well as emerging market economies. As per the International Monetary Fund (IMF), the global GDP growth rate in 2019 was 2.9%, the lowest since the global financial crisis of 2008–09. On 23 March 2020, the IMF announced that the global economy has entered a recession in 2020. Basis the early incoming data, the GDP of Singapore shrank by 10.6% in Q1 2020 and unemployment claims surged to a peak in the US. Crude oil prices plummeted and prices of global commodities also shrank due to reduced demand. Equity markets across the globe have been affected adversely. Gold and other fixed income assets such as sovereign debt have experienced uncertainty. Central banks across advanced economies as well as emerging markets have resorted to rate cuts. They have also initiated various liquidity-bolstering measures in the wake of difficult financial conditions. Stimulus packages in the range of 0.8–16% of the GDP have been announced by various central banks worldwide.

Most advanced economies and emerging market economies have resorted to conventional and unconventional methods to deal with the economic impact of the COVID-19 crisis.

- The US Federal Reserve has resorted to emergency rate cuts – 50 bps on 3 March and a subsequent rate cut of 100 bps on 15 March. It also reduced the primary credit rate to 0.25%.
- The European Central Bank (ECB) has announced favourable terms for targeted long-term refinancing operations (TLTROs) for one year from June 2020. The ECB has announced a new EUR 750 billion pandemic emergency purchase programme, under which private and public sector securities can be purchased until the end of 2020.
- The Bank of England (BOE) has reduced its bank rate to an all-time low of 0.1% owing to two subsequent rate cuts of 50 bps and 15 bps respectively. It has announced additional asset purchases worth GBP 200 billion in 2020.
- The Bank of Japan has announced the purchase of commercial papers and corporate bonds worth JPY 2 trillion. They have announced to provide loans against corporate debt as collateral at 0% interest, with a maturity period of up to one year.

14. https://m.rbi.org.in/Scripts/PublicationsView.aspx?id=19439

Regulatory news

RBI announces fresh set of measures to deal with the COVID-19 pandemic

The RBI has announced another set of measures for dealing with the ongoing pandemic. The announcements are related to export proceeds, review of limits and implementation of countercyclical capital buffer (CCyB). The RBI has extended the period for realisation of export proceeds from nine months to fifteen months from the date of export. This will be applicable for realisation and repatriation of export proceeds for exports made up to or on 31 July 2020. This will provide flexibility to exporters to realise the receipts, especially from pandemic-affected countries. The RBI has also increased the Ways and Means Advances (WMA) limit by 30% from the current limit for states and union territories (UTs). This will be in effect from 1 April 2020 till 30 September 2020. It was advised that CCyB would be activated basis the situation and the same will be preannounced. After reviewing the CCyB indicators, the RBI has decided that it is not necessary to activate CCyB for a period of one year or earlier, as may be necessary.

The detailed notification can be accessed here.

RBI extends Fixed Rate Reverse Repo and MSF window

The RBI has extended the window timings for Fixed Rate Reverse Repo Operations and MSF operations for better liquidity management. Earlier, it was extended till 30 April. The RBI has now decided to continue with new timings till further notice.

The detailed notification can be accessed here.

Final Directions on Hedging of Foreign Exchange Risks

The RBI has released the final directions on hedging of foreign exchange risks. These directions will help in easing access to the domestic foreign exchange derivatives markets via:

a) merging of facilities for residents and non-residents into a single facility for all users

b) allowing user having valid hedging exposures to hedge the same by any available instrument

c) introducing facility to hedge anticipated exposures, and

d) simplifying procedures for authorised dealers offering foreign exchange services.

The detailed notification can be accessed here.

RBI Announces Special Liquidity Facility for Mutual Funds

The RBI has announced a special liquidity facility worth INR 50,000 crore for mutual funds facing liquidity pressure due to the COVID-19 pandemic. This will help in improving financial stability and minimise the economic impact due to the pandemic. The RBI will conduct 90-day repo operations at a fixed repo rate. Funds availed under this shall be used only for liquidity requirements of mutual funds by a) extending loans and b) undertaking outright purchase of repos against collateral of investment-grade corporate bonds, commercial papers, debentures and certificate of deposits held by mutual funds. Exposures under this facility would not be considered under the Large Exposure Framework.

The detailed notification can be accessed here.

Other regulatory news

Measures to further facilitate fund raising from capital markets in the backdrop of COVID-19 pandemic

The Securities and Exchange Board of India (SEBI) has issued a press release granting certain temporary relaxations from the regulatory provisions related to rights/public issuance by listed entities. The eligibility requirements of average market capitalisation of public shareholding have been reduced to INR 100 crore from INR 250 crore. The criteria for minimum subscription has also been relaxed. The threshold for minimum subscription requirements for rights issue has been reduced to 75% from 90%. The requirement related to not filing the draft letter of offer has been relaxed. Listed entities raising funds up to INR 25 crore will not have to file an offer draft document. The existing limit is only up to INR 10 crore. Above relaxations will be applicable to the rights issue that open on or before 31 March 2021.

The detailed notification, can be accessed here.

Relaxation in timelines for compliance with regulatory requirements by depository and depository participants

SEBI has extended the timelines for various regulatory requirements to be met by depository and its participants. The new timelines and sections have been published in detail mentioning the related circular numbers.

The detailed notification can be accessed here.

Choice of CRA Selection by NPS Subscribers

All National Pension Scheme (NPS) subscribers can exercise the choice of changing of Central Record Keeping Agency (CRA) twice a year. Further, one can exercise the choice of changing of CRA again if they become a member of the NPS through their employer.

The detailed notification can be accessed here.

Paperless KYC process through Aadhaar Authentication Services of UIDAI

The Insurance Regulatory Development Authority of India (IRDAI) has recommended insurance companies to follow paperless know your customer (KYC) processes in order to fulfil KYC norms for availing insurance services. This notification contains the list of prominent insurance companies operating in India.

The detailed notification can be accessed here.

Global regulatory news

EBA publishes phase 1 of its technical package on reporting framework 2.10

The European Banking Authority (EBA) has released the reporting framework 2.10. This includes the list of validation rules, data point model (DPM) dictionary and XBRL taxonomies with a set of XML files. This covers updated guidelines on funding plans and integrates the reporting of remuneration benchmarking exercise and fraudulent payments into the DPM and XBRL taxonomies.

The detailed notification, can be accessed here.

EU banks sail through the COVID-19 crisis with sound capital ratios

The EBA has published a quarterly report for Q4 2019 covering risks and vulnerabilities in the EU banking sector. Capital quality and asset ratios have improved. However, return on equity (RoE) degraded further. The common equity tier 1 ratio has improved and reached 14.8% from 14.4% in the previous quarter. The ratio of non-performing loans declined from 2.9% to 2.7% in Q4 2019. IFRS 9-related figures showed improvement in asset quality. The bank's RoE declined by 80 bps and reached to 5.8%, well below the average cost of equity in that region. The cost-to-income ratio for banks also increased from 63.3% to 64%. The net interest income also remained at a very low level.

The detailed notification can be accessed here.

ESAs consult on Environmental, Social and Governance disclosure rules

Three major European Supervisory Authorities (ESAs) have released a consultation paper for getting inputs on environmental, social and governance (ESG) disclosure standards for market participants, products and advisers.

The standards in the consultation paper aim to provide more protection to end investors, improve the disclosures to investors regarding financial products and improve the disclosures from a broad range of financial market participants and financial advisers.

The standards have been developed under the EU Regulation on sustainability-related disclosures in the financial services sector (SFDR). SFDR has asked ESAs to develop Regulatory Technical Standards on content, methodology and presentation of ESG disclosures at both product and entity levels.

The detailed notification can be accessed here.

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