

RBI reinforce liquidity measures while keeping the interest rate constant

By Junko Oguri

Original post [here](#).

At its most recent monetary policy meeting, the Reserve Bank of India reinforced a number of measures to fight against shocks caused by COVID-19. The measures to ease liquidity issues include (i) establishment of On Tap Targeted Long-Term Repo Operations (TLTRO), (ii) extension of Statutory Liquidity Ratio (SLR) Holdings in the Held To Maturity (HTM) category, and (iii) adjustments in Open Market Operations (OMOs) to purchase State Development Loans and increase the overall purchase amount.

*See the blog posts below for our past analysis on India during the COVID19 crisis:

- [India Extends Special Liquidity Facility to Mutual Funds](#) (May 14, 2020)
- [RBI to provide liquidity to non-bank financial firms](#) (July 9, 2020)
- [RBI expands its regulatory reach: Reforms to watch](#) (September 10, 2020)
- [RBI announces further liquidity measures in response to COVID-19](#) (September 10, 2020)

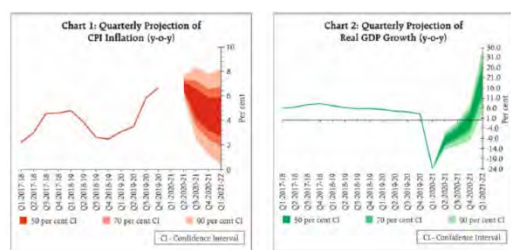
The Background

The [Monetary Policy Committee \(MPC\)](#) of the Reserve Bank of India (RBI) met from October 7 to 9. The meeting, which had been originally scheduled from September 28 to October 1, was postponed once, and it was finally held after three external members were [replaced](#) on October 5.

The MPC held the policy interest rates constant, retaining the repo rate (key lending rate) at 4.0 percent and the reverse repo rate (key borrowing rate) at 3.5 percent. The result aligned with market expectations after RBI had reduced the repo rate by 115 basis points (bps) since late March.

However, the Monetary Policy Statement also noted the worsening projection of the economy due to the shock and uncertainty brought by the COVID-19 crisis. The real GDP (gross domestic product) for the full year is expected to decline by 9.5 percent, “with risks tilted to the downside” (Figure 1).

Figure 1: Quarterly Projection of CPI Inflation and Real GDP Growth



Sources: [RBI](#)

Therefore, RBI also announced a series of accommodative measures to “provide impetus towards reviving the economy.” Nine measures across the following four areas were [announced](#) on October 9: (i) enhance liquidity support for financial markets; (ii) offer regulatory support to improve the flow of credit to specific sectors within the ambit of the norms for credit discipline; (iii) provide a boost to exports; and (iv) deepen financial inclusion and facilitate ease of doing business by upgrading payment system services.

This post will focus on (i) the enhanced liquidity support for financial markets.

Liquidity Measures Announced on October 9

Three measures announced are:

1. The establishment of On Tap Targeted Long-Term Repo Operations (TLTRO);
2. Extension of statutory liquidity ratio (SLR) Holdings in the Held to Maturity (HTM) category; and
3. Changes in Open Market Operations (OMOs) to purchase State Developments Loans (SDLs) and increase the overall purchase amount

These three measures were either a modification or reintroduction of the measures that had been implemented earlier during the COVID-19 crisis (Figure 2).

Figure 2: Development of selected liquidity measures announced by RBI during the COVID-19 crisis

	2020	1. TLTRO	2. SLR Holding Related	3. OMOs (announced date and amount based on the announcements)
Mar		27 : Announced TLTROs to purchase investment grade corporate bonds, CPs, and non-convertible debentures [NCDs] up to three years for a total amount of ₹1 trillion in primary market and secondary market, including from mutual funds and NBFCs.		18 : Announced to conduct OMOs of ₹100 billion to purchase Government securities (GS) 20 : ₹150 billion GS 23 : ₹150 billion GS

Apr	<p>17: Announced TLTROs 2.0 to purchase investment grade bonds, CPs, and Non-Convertible Debentures(NCDs) of Non-Banking Financial Company (NBFCs), with at least 50 percent of the total amount availed going to small and mid-sized NBFCs and Microfinance institutions (MFIs) up to three years for a total amount of ₹500 billion</p>	<p>23: Simultaneous purchase and sale of ₹100 billion GS each</p>
June		<p>29: simultaneous purchase and sale of ₹100 billion GS each</p>
Aug	<p>31: Announced to increase the statutory liquidity ratio (SLR) holdings in Held-To-Maturity (HTM) category from 19.5 percent to 22 percent, valid until March 2021 (see our blog post here)</p>	<p>25: Simultaneous purchase and sale of GS for an aggregate amount of ₹200 billion in two tranches of ₹100 billion each</p> <p>31: Simultaneous purchase and sale of ₹100 billion GS each (see our blog post here)</p>
Sep		<p>07: Simultaneous purchase and sale of ₹100 billion GS each</p> <p>14: Simultaneous purchase and sale of ₹100 billion GS each</p> <p>17: ₹100 billion GS</p> <p>24: Simultaneous purchase and sale of ₹100 billion GS each</p>
Oct	<p>09: Announced to conduct On tap TLTRO with tenors of up to three years for a total amount of up to ₹1 trillion.</p>	<p>09: Announced to keep the SLR holdings in HTM category at 22 percent till March</p> <p>09: ₹200 billion GS (the Governor’s Statement confirmed to double the</p>

<p>The scheme will be available up to March 31, 2021.</p>	<p>2022, an extension from the August announcement</p>	<p>size, responding to the market participants' expectation) 09: Announced to conduct OMOs in State Development Loans (SDLs) as a special case during the 2020 financial year. The OMOs would be conducted for a basket of SDLs comprising securities issued by states.</p>
---	--	--

Sources: RBI press releases and reports

1. On Tap TLTRO

RBI announced an “On tap TLTRO” scheme, aiming to ensure abundant liquidity in the financial system.

The long-term repo operation (LTRO) is an RBI scheme which enables banks to borrow funds from RBI at the repo rate (currently 4 percent) by providing government securities as collateral. It is aimed to ensure adequate liquidity at the longer end of the yield curve (see [here](#) for the LTROs’ operational guidance, which also applies to TLTROs). LTRO is a scheme similar to the “long-term refinancing operations” used by the European Central Bank (ECB) during the sovereign debt crisis (see [here](#) for our recently published Journal of Financial Crisis case study for “The European Central Bank's Three-Year Long-Term Refinancing Operations”.)

Targeted long-term repo operations, TLTRO, are a kind of LTRO with certain restrictions for the use of funds borrowed from RBI. Under the TLTRO, banks are required to use the borrowed funds to invest in specific securities, aimed to ease the liquidity stress in the targeted market. RBI has released the ₹1 trillion (approximately \$1,360 million) “TLTROs” in March and ₹500 billion “TLTROs 2.0” in April (Figure 3).

Banks participating in the TLTROs schemes are expected to purchase specific kinds of securities designated by RBI. For instance, under the TLTROs announced on March 27, banks were required to purchase investment grade corporate bonds, commercial paper, and non-convertible debentures. The TLTROs 2.0 released on April 14 required banks to purchase bonds from Non-Banking Financial Companies (NBFCs) to support the liquidity in small and middle-sized firms. While the TLTROs scheme enables banks to borrow at low rates, it also incorporates a penalty mechanism. If banks fail to purchase the targeted securities under specified window period (30 days for TLTROs, 45 days for TLTROs 2.0), banks would be charged interest at the repo rate plus 2 percent for the number of days the funds were not deployed. Furthermore, the

incremental interest liability will have to be paid along with regular interest at the time of maturity.

The exposures under the TLTROs will be exempted from several regulations. For instance, the investments made by banks will be classified as Held-To-Maturity (HTM) even in excess of the 25 percent of total investments permitted to be included in the HTM portfolio. Furthermore, all exposures under the TLTROs will be exempted from the large exposure framework.

According to a [media](#) report, after the launch of TLTROs and TLTROs 2.0, banks’ investment in CPs, bonds, debentures and shares of public and private corporations (so-called “non-SLR investments”) have increased, boosting the liquidity to the private sectors in need.

The overall design of the newly released “On tap TLTRO” is largely consistent with its predecessors, requiring banks to purchase corporate bonds, commercial paper, and non-convertible debentures issued by specific sectors. Meanwhile, banks can also use the liquidity available under the “On Tap TLTRO” scheme to extend bank loans to these designated sectors. This reflects the changes in the purpose of the TLTROs. Whereas the former TLTROs schemes were established to ease the liquidity constraints in financial markets, the “On Tap TLTRO” is expected to achieve the “revival of activity in specific sectors that have both backward and forward linkages, and multiplier effects on growth” in India, and to “enable banks to conduct their lending operations smoothly and seamlessly without being hindered by illiquidity frictions, ensuring that liquidity in the system remains comfortable”.

While further details are yet to be announced, RBI announced that it would conduct the On tap TLTROs with tenors of up to three years for a total amount of up to ₹ 1 trillion at a floating rate linked to the policy repo rate. The newly established scheme will be available up to March 31, 2021. RBI also noted that the total amount and the duration of the scheme are subject to change upon “a review of the response to the scheme”. Banks that had accessed the earlier targeted long-term repo operations (TLTROs and TLTROs 2.0) may be given the option to reverse these transactions before maturity and instead participate in the On Tap TLTRO. The [FAQ](#) for TLTROs is expected to be revised accordingly. Figure 3 below summarizes the developments of TLTRO set forth by the RBI in response to the COVID-19 crisis.

Figure 3: Development of TLTROs framework by RBI

	TLTROs	TLTROs 2.0	On Tap TLTRO
Date Announced	March 27, 2020	April 1, 2020	October 9, 2020
Background	<ul style="list-style-type: none"> Large sell-offs in financial markets due to COVID-19, 	<ul style="list-style-type: none"> Specific sectors and entities experiencing 	<ul style="list-style-type: none"> The Indian economy entering into a decisive

	<p>redemption pressures, the surge of liquidity premia on instruments such as corporate bonds, the thinning of trading activities</p>	<p>liquidity constraints and/or hindrances to market access</p>	<p>phase in the fight against the pandemic, shifting RBI's focus from containment to revival</p>
Aim	<ul style="list-style-type: none"> To mitigate the adverse effects on economic activity leading to pressures on cash flows 	<ul style="list-style-type: none"> To channel liquidity to small and mid-sized corporates, including NBFCs and MFIs, that have been impacted by COVID-19 disruptions 	<ul style="list-style-type: none"> To revive economic activities in specific sectors that have both backward and forward linkages, and multiplier effects on growth To enable banks to conduct their lending operations smoothly and seamlessly without being hindered by illiquidity frictions, ensuring that liquidity in the system remains comfortable
Requirement ("target")	<ul style="list-style-type: none"> Required to acquire investment grade (BBB or higher) corporate bonds, commercial paper, and non-convertible debentures over and above the outstanding level of their investments in 	<ul style="list-style-type: none"> Required to acquire investment grade bonds, commercial paper, and non-convertible debentures of NBFCs. Required to acquire at least 50 per cent of the total amount 	<ul style="list-style-type: none"> Required to acquire corporate bonds, commercial paper, and non-convertible debentures issued by entities in specific sectors over and above the outstanding level of their investments in such instruments as on September 30, 2020.

Treatment of
acquired
securities

- these bonds as on March 27, 2020.
- Required to acquire up to 50 per cent from primary market issuances and the remaining 50 per cent from the secondary market, including from mutual funds and NBFCs.
 - Investments made by banks will be classified as HTM even in excess of the 25 per cent of total investments normally permitted to be included in the HTM portfolio.
 - Exposures under this facility will also be exempt under the large exposure framework.
 - On [April 15](#), RBI noted that the maximum amount for a particular bank to invest in securities should not exceed 10 per cent of the allotment.
- availed from small and mid-sized NBFCs and MFIs.
- Investments made by banks will be classified as HTM even in excess of the 25 per cent of total investments normally permitted to be included in the HTM portfolio.
 - Exposures under this facility will also be exempt under the large exposure framework.
 - No maximum 10 per cent allocation for individual company rule.
- The liquidity available under the On Tap TLTRO scheme can also be used to extend bank loans to these sectors.
 - Investments made by banks will be classified as HTM even in excess of the 25 per cent of total investments normally permitted to be included in the HTM portfolio.
 - Exposures under this facility will also be exempt under the large exposure framework.

Announced			
Size of the Schemes	₹ 1 trillion	₹ 500 billion	₹ 1 trillion
	March 27, 2020		
	April 3, 2020		
Operations	April 9, 2020	April 23, 2020	To be Announced
	April 15, 2020		
	April 17, 2020		
Tenor	3-year	3-year	NA

2. SLR Holdings in Held to Maturity (HTM) category

As we have reported in our former [blog post](#), on August 31, RBI decided to allow banks to hold fresh acquisitions of statutory liquidity ratio (SLR) securities acquired after September 1, 2020, under the HTM category - up to an overall limit of 22 percent of net demand and time liabilities (NDTL) - until March 31, 2021. The limit was originally set at 19.5 percent. If banks were to exceed this limit, banks would need to sell off their liquid assets so that the exposure would be contained under the SLR. The aim of raising the limit in August was to “engender orderly market conditions and ensure congenial financing costs”, aiming to help to limit losses in the currently volatile market.

On October 9, in order to “give more certainty to the markets about the status of these investments in SLR securities after March 31, 2021”, RBI announced an extension of the SLR holdings in HTM to March 2022. Moreover, HTM limits would be restored from 22 percent to 19.5 percent in a phased manner starting from the quarter ending June 30, 2022. RBI underscored that banks shall plan their investments in SLR securities in an “optimal manner with a clear glide path for restoration of HTM limits.”

3. Open Market operations (OMOs) in State Developments Loans (SDLs)

The MPC also made two announcements related to the OMOs. First, RBI decided to conduct open market operations (OMOs) in State Developments Loans (SDLs) as a special case during the current financial year (April 1, 2020 to March 31, 2021). RBI explains that the objective of the SDLs OMOs is to improve liquidity and facilitate efficient pricing, and the OMOs would be conducted for a basket of SDLs comprising securities issued by states. Notably, the SDLs have been treated as eligible collateral for the [Liquidity Adjustment Facility](#) (LAF) along with T-bills, dated government securities and oil bonds. LAF is a liquidity scheme in which banks can borrow from and lend to RBI through repo and reverse repo arrangements. On [October 16](#), RBI

announced it would purchase SDLs under OMOs for an aggregate amount of ₹ 100 billion on October 22, 2020, through a multi-security auction using the multiple price method.

Additionally, “Financial Market Guidance” in the [Governor’s statement](#), doubles the size of OMOs auctions from ₹ 100 billion to ₹ 200 billion, consistent with market participants’ expectations.

Ways Forward: Challenges for India

The three measures above are not the only liquidity measures so far implemented by RBI. For instance, RBI has established a ₹ 500 billion (\$6.6 billion) [special liquidity facility for mutual funds \(SLF-MF\)](#) on April 24 and a ₹ 300 billion (\$4 billion) [special liquidity scheme \(SLS\)](#) on July 1.

These measures, along with other policy interventions, are expected to ease the liquidity problems in Indian financial markets while balancing the interest rate. However, a number of challenges remain in India. The piled up non-performing assets have been casting a dark shadow in the Indian financial system for a long time. As Viral V. Acharya argues in his recent book [“Quest for Restoring Financial Stability in India”](#), India had been in the state of fiscal dominance (a [situation](#) in which government debts have become so large that monetary policy is subordinated, with rates having to stay low to stop the government’s finances collapsing) prior to the outbreak of COVID-19, piling up twin deficits (current account deficits and fiscal deficits). As a consequence, COVID-19 has not only been challenging the country’s public health but also the economy and the financial system.

However, some remain positive. On October 9, Governor Shaktikanta Das confirmed in his [speech](#) that the country has entered the recovery stage in his view. He said that “the deep contractions of Q1:2020-21 are behind us; silver linings are visible in the flattening of the active caseload curve across the country.” Governor Das also underscored that the optimism by citing the falling trend in household expectation inflation and other positive outlook indicators. “If [...] the current momentum of upturn gains ground, a faster and stronger rebound is eminently feasible,” he emphasized. Following RBI’s actions, the Government [announced](#) a ₹ 730 billion (approximately \$10 billion) stimulus package on October 12. According to the announcement, the package is meant to stimulate consumer spending during India’s festival season, which climaxes in October and November.

“The upturn momentum” dubbed by Governor Das will be difficult to maintain if the country fails to contain the spread of COVID-19. As of October 15, according to the [John Hopkins Coronavirus Resource Center](#), India faces over 7 million confirmed cases and more than 110,000 deaths. The cumulative confirmed case number is the highest among the world after the US, while [some](#) suggest that the contracted number may be higher than the officially reported numbers. Controlling this pandemic will be critical for the lives of over 1.3 billion people and for the economy.