

RBI announces further liquidity measures in response to COVID-19

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Original post [here](#).

The Reserve Bank of India (RBI) announced on August 31 a series of measures intended to “restore macroeconomic and financial stability,” including:

- Special open market operations (OMOs);
- Repurchase (repo) operations; and
- Temporary relaxation of certain liquidity requirements for banks (see [here](#)).

These latest interventions follow a month-long fiscal and regulatory campaign to bolster support for markets and businesses most impacted by the pandemic. For more information on previous actions taken by the RBI in response to COVID-19, please see [here](#) and [here](#).

Background

In a monetary policy statement dated August 6, the RBI acknowledged the need to manage both systemic liquidity and medium-term Consumer Price Index inflation (see [here](#)). This assessment led to, among other targeted operations, the introduction of special financing facilities to support the National Housing Bank and the National Bank for Agricultural and Rural Development (NABARD) and a macroprudential rule change enabling lenders to implement resolution plans (with respect to eligible corporate exposures) without changes in ownership (see [here](#)).

Despite the RBI’s efforts to calm markets, traders were expecting the central bank to announce that it would buy government bonds to alleviate some of its debt burden (see [here](#)). Their anxieties played out on August 14 as primary dealers who had underwritten a government bond issue were forced to “rescue” the sale, exacerbating the central bank’s attempts to maintain the premium that the bonds had previously commanded over the yield curve (see [here](#)). An unexpected ₹46.5 million (USD 632,400) of 10-year bonds remained unsold, despite the fact that banks have been sitting on excess liquidity (see [here](#)). Furthermore, the July spike in retail inflation to 7% complicated policymakers’ promises to hold course against inflationary pressures (see [here](#)).

On August 25, the RBI announced that it would conduct special OMOs that would involve the simultaneous purchase and sale of government securities for an aggregate amount of ₹200 million (USD 2.72 million) in two tranches of ₹100 million (USD 1.36 million) each (see [here](#)). The auctions, held on August 27 and September 3, were again under-sold. Primary dealers were forced to buy bonds worth ₹180 million (USD 2.44 million), more than half the amount issued (see [here](#)). The RBI decided to devolve the auction amidst concerns about the tepid response, leading economists to predict that only the RBI, by buying government bonds through OMOs, would be able to cool down yields and entice banks sitting on excess liquidity to

participate in future sales (see [here](#)). In an additional attempt to control inflation, the RBI announced on August 28 that nine State Governments had offered to sell securities by way of auction (see [here](#)).

Special liquidity measures announced August 31

Also on August 31, the RBI said that it would conduct additional special OMOs for the simultaneous purchase and sale of government securities (see [here](#)). Similar to before, the RBI would hold auctions on September 10 and September 17 in an aggregate amount of ₹200 million (USD 2.72 million), again divided into two equal tranches.

The RBI also stated its intention to conduct repo operations in an aggregate amount of ₹1 billion (USD 13.60 million) at floating rates in mid-September. The purpose would be to “assuage pressures on the market on account of advance tax outflows” (see [here](#)). In an effort to reduce the cost of funding, banks that have drawn down funds under long-term repo operations (LTROs) will be able to reverse these transactions before maturity, reducing their interest liability by returning funds taken at the repo rate of 5.15% and accessing funds at the current repo rate of 4.00%.

Finally, the RBI decided to allow banks to hold fresh acquisitions of statutory liquidity ratio (SLR) securities acquired after September 1, 2020, under the held to maturity (HTM) category - up to an overall limit of 22% of net demand and time liabilities (NDTL) - until March 31, 2021. Normally, banks would have to sell off their securities, as well as government and state development loans, in order to comply with HTM regulatory limits. It is expected that raising the ratio of securities that banks can hold to maturity within their SLR (mandatory holding requirement) will help to limit losses in the currently volatile market (see [here](#)).

In addition to the actions described above, the central bank suggested that it is comfortable with the appreciation of the rupee, which it hopes will drive down import-related inflation (see [here](#)). The deployment of special OMOs also indicates that the RBI is willing to combat rising prices using tools other than interest rate adjustments (see [here](#)). This unconventional use of currency management in place of monetary policy suggests that the RBI is committed to “maintaining congenial financial conditions, [mitigating] the impact of COVID-19 and [restoring] the economy to a path of sustainable growth while preserving macroeconomic and financial stability” (see [here](#)).