SBI RESEARCH

ECOWRAP

RBI RAISES REPO RATE TO 6.5%:EXIT FROM CHAKRAVYUH OF FED NEEDS TO BE COUNTRY SPECIFIC OTHERWISE IT COULD BE A SELF FULFILLING PROPHECY OF RATE HIKES CHASING RATE HIKES

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The increase in repo rate by RBI was widely expected by the market. The RBI has raised growth estimates to 6.4% and inflation is expected at 5.3% for FY24. **There is a sharp upward revision in Q1GDP estimates for FY24 to 7.8%, reflecting the benefits of a significantly benign inflation rate during Q1, with WPI turning negative in May and June 2023 and CPI declining to less than 4.5% in April 2023.** The continuous increase in Federal Funds Rate has made the monetary policy making for emerging economy central banks now a difficult proposition. With the US job market continuing to be significantly resilient even with the latest data, it now looks likely that Fed rate hike could continue even beyond March. Against this background, there is an active debate on the timing and sequencing of monetary stance around the world. The exit from the current policy increases should, however, be different across countries depending on the balance of risk to growth and price stability.

The April monetary policy statement of RBI thus assumes special importance of whether we can signal an exit from coordinated monetary policy increases as otherwise it could become a self fulfilling prophecy of central banks of emerging markets doing a continuous catch up with the Fed.

Between April 2022 till February 2023, with coordinated monetary policy actions, spread between Fed Funds Rate and Repo Rate of cumulative increases has now declined to 192 basis points. Interestingly, the spread is now constant at 192 basis points since December 2022. With Fed likely to go for further rate hikes in March and beyond the spread would compress, provided there are no further rate hike of RBI. **We find evidence that synchronized rate actions have resulted in increased market volatility from pre-pandemic levels with the rate increases from April 2022, though such volatility is lower than that was observed during pandemic levels.**

Else, the policy has unleashed a bouquet of measures to attend the micro structure of markets.

Firstly, RBI green signal to permit lending and borrowing in G-Secs should be having far reaching consequences for major domestic players as also overseas investors, subject to norms. At present Govt Securities are borrowed/lent through CROMS platform. Further, G-Sec held by insurance companies and duration mutual fund are not available for short sellers to cover shorts (since lending stock in repo means borrowing by them which is not permitted). **The proposed development will allow G-sec holders to deploy idle G-sec to generate higher returns.**

Secondly, it is now proposed to expand the scope of TReDs by (i) providing insurance facility for invoice financing; (ii) permitting all entities/institutions undertaking factoring business to participate as financiers in TReDS; and (iii) permitting re-discounting of invoices (that is, developing a secondary market in TReDS). These measures are expected to improve the cash flows of the MSMEs and broaden the base (currently there are only ~45000 MSME sellers registered on TReDS).

Thirdly, the multiplicity of practices across banks and absence of a set matrix to decide their reasonableness, RBI has decided to issue extant regulatory guidelines on levy of penal interest to regulate these practices. Such a move will be more customer friendly and will not be differentiating factor in marketing while setting minimum standards, increasing transparency, achieving higher operating standards and above all promoting a cordial banker-customer relationship.

Fourthly, setting up a broad framework on recognizing and addressing suitable risk related parameters for financial entities will be sacrosanct to ensure markets evolve gradually.

Fifthly, after extending the UPI facility to NRIs who have international mobile numbers linked to their NRE / NRO accounts, RBI has now decided to provide the UPI access to inbound travellers for merchant payments - initially to travellers from G20 countries at select airports. The data suggests that G20 member nations account for the highest foreign tourist arrival numbers in India. In 2021, 3 of the top five places for foreign tourist arrivals in India were G20 members.

RBI RAISES POLICY REPO RATE BY 25 BPS TO 6.50%

- RBI today raised the rate by 25 basis points to 6.50%, as the MPC decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth. This is the sixth time interest rate has been hiked by RBI since May'22, taking the total quantum of hike to 250 bps. However, the decision was not unanimous. Two of the members voted against the repo rate hike and also voted against the withdrawal of accommodation.
- RBI downgraded its CPI inflation projection by 20 bps to 6.50% in FY24 due to the better prospects of the rabi crop especially for wheat and oilseeds. However, the global commodity price outlook, including crude oil, is subject to uncertainties. Commodity prices might face upward pressures with the easing of COVID-related mobility restrictions. The ongoing pass-through of input costs to output prices, especially in services, could continue to exert pressures on core inflation. Against this backdrop, CPI inflation is projected at 5.3% for FY24, with Q1 at 5.0%, Q2 & Q3 at 5.4%, and Q4 at 5.6%.
- Real GDP growth for FY24 is projected at 6.4% against 6.8% growth in FY23 with Q1 at 7.8%, Q2 at 6.2%, Q3 at 6.0% and Q4 at 5.8%,. The reasons for better than expected growth in FY24 is attributed to various factors including stronger prospects for agricultural and allied activities (and hence robust rural demand), rebound in contact-intensive sectors and discretionary spending (and hence robust urban demand), strong credit growth, resilient financial markets, and the government's continued thrust on capital spending and infrastructure.

IMPACT OF RATE HIKE ON BORROWERS

- In 2022-23, ASCB's credit growth continues to be strong. As per the fortnightly bank credit data, incremental bank credit till 13 Jan'23 was at Rs 13.90 lakh crore (11.7% YTD), while deposits grew by Rs 12.0 lakh crore (7.3%), which led to increase in borrowings and tightening of system liquidity.
- With the rise in repo rate, banks have transmitted it to both deposit and credit rates. With this, around 150 basis points (bps) has been transmitted to deposit rates and is likely to provide a fillip to deposit growth rates. While on fresh loans, the transmission is only 125 bps, as around 52% of the loans are in MCLR/Base Rate.

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	Q3 FY23	Q4 FY23	FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24	FY24
Feb'23	6.1*	5.7	6.5	5.0	5.4	5.4	5.6	5.3
Dec'22	6.6	5.9	6.7	5.0	5.4	-	-	-
Sep'22	6.5	5.8	6.7	5.0	-	-	-	-
Real GDP Growth (%)	**Q3 FY23**	**Q4 FY23**	**FY23**	**Q1 FY24**	**Q2 FY24**	**Q3 FY24**	**Q4 FY24**	**FY24**
Feb'23	4.6	4.5	-	7.8	6.2	6.0	5.8	6.4
Dec'22	4.4	4.2	6.8	7.1	5.9	-	-	-
Sep'22	4.6	4.6	7.0	7.2	-	-	-	-

Source:RBI, SBI Research,*Actual

- As 47.6% of the loans are benchmarked to external benchmarks (EBR), so the increase in repo rate of 250 bps (including today's 25 bps hike) will eventually increase interest cost.
- Our analysis indicates that due to repo rate of 250 bps hike during this cycle, interest cost on incremental loans of Retail & MSME consumers will be at around Rs 18,000 crore, as all the new loans benchmarked to Repo Rate (mostly). This will likely impact demand, going forward.

Transmission of Policy Rate

	Mar-22	Latest	Change (in bps)
Repo Rate	4.00	6.50	250
Wt Avg. Lending Rate (WALR) on O/S Rupee Loans	8.74	9.52	78
WALR on Fresh Rupee Loans	7.63	8.88	125
Wt Avg. Domestic Term Deposits (WADTDR) on O/S Deposits	5.03	5.78	75
ASCB-MCLR (1 Year)	7.25	8.35	110
SBI Term Deposits 1-Yr	5.10	6.75	165
SBI EBLR	6.65	8.90	225
SBI MCLR –6 Months	6.95	8.30	135
SBI MCLR –1 Year	7.00	8.40	140

Source: RBI, SBI Research

POLICY SYNCHRONIZATION ACROSS CENTRAL BANKS INCREASING FINANCIAL MARKET VOLATILITY

- The continuous increase in Federal Funds Rate has made the monetary policy making for emerging economy central banks a difficult proposition. With the US job market continuing to be significantly resilient even with the latest data, it now looks likely that Fed rate hike could continue even beyond March.
- There is an active debate on the timing and sequencing of monetary stance around the world. The exit from the current policy increases should, however, be different across countries depending on the balance of risk to growth and price stability.
- **The April monetary policy statement of RBI thus assumes special importance of whether we can signal an exit from coordinated monetary policy increases as otherwise it could become a self fulfilling prophecy of emerging markets doing a catch up with the Fed.**
- Between April 2022 till February 2023, with coordinated monetary policy actions, spread between Fed Funds Rate and Repo Rate of cumulative increases has now declined to 192 basis points. Interestingly, the spread is now constant at 192 basis points since December 2022. With Fed likely to go for further rate hikes in March and beyond the spread would compress, provided there are no further rate hikes of RBI. We find evidence that synchronized rate actions have resulted in increased market volatility from pre pandemic levels with the rate increases from April 2022.

GLOBAL ECONOMIC OUTLOOK

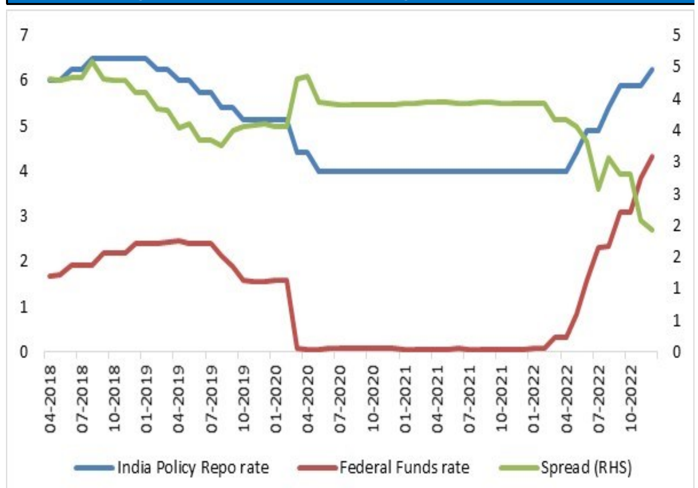
- The outlook on global growth has improved in recent months, despite the persistence of geopolitical hostilities and the impact of monetary policy tightening by central banks across the world.
- Nonetheless, global growth is expected to decelerate during 2023. Despite softening of inflation central banks are reiterating their commitment to bring down inflation close to their targets. Bond yields remain volatile. Thus rising interest rates are still a phenomenon to deal with in 2023.
- Weak external demand in major advanced economies (AEs), the rising incidence of protectionist policies, volatile capital flows and debt distress could, however, weigh adversely on prospects for emerging market economies (EMEs). The FIIs outflows in India have persisted throughout the FY23. Some moderation in outflow is expected given the stable growth outlook.

Rate Hike Cycles Synchronization

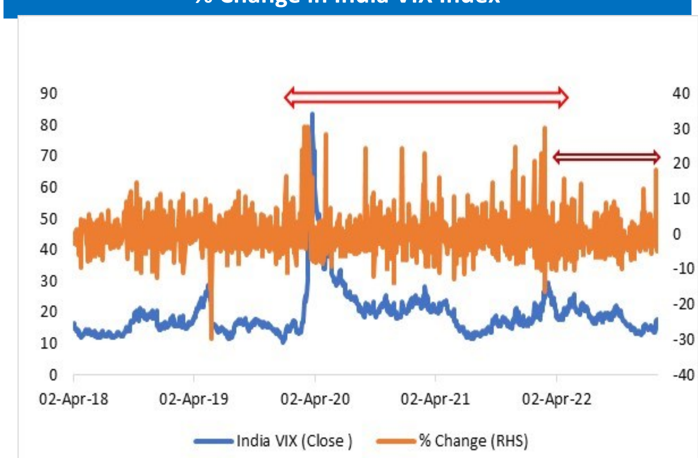
Time	India Repo rate		Federal Funds rate		Spread
	%	Change (in bps)	%	Change (in bps)	%
04-2022	4.00	0.00	0.33	0.00	3.67
05-2022	4.40	0.40	0.83	0.50	3.57
06-2022	4.90	0.50	1.58	0.75	3.32
07-2022	4.90	0.00	2.32	0.74	2.58
08-2022	5.40	0.50	2.33	0.01	3.07
09-2022	5.90	0.50	3.08	0.75	2.82
10-2022	5.90	0.00	3.08	0.00	2.82
11-2022	5.90	0.00	3.83	0.75	2.07
12-2022	6.25	0.35	4.33	0.50	1.92
01-2023	6.25	0.00	4.33	0.00	1.92
02-2023	6.50	0.25	4.58	0.25	1.92
Cumulative Change (%)	**2.50**	**-**	**4.25**	**-**	**-1.75**

Source: CEIC, SBI Rsearch

Spread Between India Repo rate and FFR



% Change in India VIX Index



Source: RBI, SBI Research

LIQUIDITY REMAINS ALMOST NEUTRAL

- RBI has actively managed liquidity in the system through various measures including SDF, change in CRR, VRRR, VRR, LTRO, TLTRO among others. All these measures have enabled the liquidity surplus, as given by LAF operations, to decline significantly from Rs 6.3 lakh crore at the beginning of this fiscal to a modest 0.29 lakh crore as on 7 Feb'23.
- Meanwhile, Government surplus cash balances stand at Rs 2.4 lakh crore. Average core liquidity is Rs 2.5 lakh crore, which is almost neutral given that RBI considers liquidity amounting to 1.5% of NDTL (currently at Rs 2.8 lakh crore) as non-inflationary. Looking ahead, higher forex inflows and Government spending are likely to be counterbalanced by redemption of LTRO and TLTRO (~Rs 80,000 crore during Feb-Apr'23). RBI has committed to continue to remain proactive and maintain liquidity.

DEVELOPMENTAL AND REGULATORY MEASURES

- **Introduction of Securities Lending and Borrowing in Government Securities:** RBI's green signal to permit lending and borrowing in G-Secs should be having far reaching consequences for major domestic players as also overseas investors, subject to norms. At present Govt Securities are borrowed/lent through CROMS platform. Further, G-Sec held by insurance companies and duration mutual fund are not available for short sellers to cover shorts (since lending stock in repo means borrowing by them which is not permitted). The proposed development will allow G-sec holder to deploy idle G-sec to generate higher returns. MFs and Insurance companies shall be able to participate.
- This will ease short covering of G-Sec resulting in better price discovery and enhancing depth in G-Sec market. Also, the volumes should be much better than what we have seen in the equities market through SLB mechanism (Securities Lending & Borrowing Mechanism), fulfilling intended objectives of the regulator.
- **Expanding the scope of Trade Receivables Discounting System (TReDS):** For the benefit of MSMEs, RBI had introduced a framework in 2014 to facilitate financing of their trade receivables through Trade Receivables Discounting System (TReDS). It is now proposed to expand the scope of TReDs by (i) providing insurance facility for invoice financing; (ii) permitting all entities/institutions undertaking factoring business to participate as financiers in TReDS; and (iii) permitting re-discounting of invoices (that is, developing a secondary market in TReDS). These measures are expected to improve the cash flows of the MSMEs and broaden the base (currently there are only ~45000 MSME sellers registered on TReDS).
- These steps, under overarching move to shift towards cash-flow based financing, streamlining receivables receipt and easing operational cycle of MSMEs by aligning cash flows to near real-time basis, should align TReDs with robust solutions to bolster MSME financing, ensuring better price discovery and digitalisation of complete process, going a long way in stabilising this important pivot of entrepreneurial India, providing impetus to growth, employment and exports competitiveness.

Entity-wise Trade Receivables Discounting System (TReDS)

Sr. No.	Entity	Number of MSME sellers registered as at the end of the month (in actuals)			Number of buyers (corporates/other buyers including Govt. Depts./PSUs) registered as at the end of month (in actuals)		
		Mar-22	Dec-22	% Change	Mar-22	Dec-22	% Change
1	A.TREDS Ltd	13342	17275	29.5	1023	1220	19.3
2	Mynd Solutions Private Ltd	10581	14667	38.6	894	1168	30.6
3	Receivables Exchange of India Ltd	10672	13699	28.4	764	1014	32.7

Source: RBI; SBI Research

- **Recovery of Penal Charges on Loans**: Compelled by the multiplicity of practices across banks and absence of a set matrix to decide their reasonableness, RBI has decided to issue extant regulatory guidelines on levy of penal interest to regulate these practices. Such a move will be more customer friendly and will not be differentiating factor in marketing while setting minimum standards, increasing transparency, achieving higher operating standards and above all, promoting a cordial banker-customer relationship which goes a long distance in fostering confidence of the common man in the banking system.
- **Regulatory Initiatives on Climate Risk and Sustainable Finance**: India would, on conservative estimates, need somewhere close to USD 10 trillion in related investments to achieve its commitments to attain net-zero by 2070 (CoP 26/27). India's climate actions are largely financed from domestic sources. India needs ~$20 billion worth of investments each year to achieve its climate targets and fund its green transition. Thus, the role of banks becomes important to meet incremental investments. It opens up ~USD 160 billion opportunities in financing Renewables as of now. Accordingly, setting broad framework on recognizing and addressing suitable risk related parameters for financial entities will be sacrosanct to ensure markets evolve gradually.
- **Extending UPI for Inbound Travellers to India:** After extending the UPI facility to NRIs who have international mobile numbers linked to their NRE / NRO accounts, RBI has now decided to provide the UPI access to inbound travellers for merchant payments — initially to travellers from G20 countries at select airports. The data suggests that G20 member nations account for the highest foreign tourist arrival numbers in India. In 2021, 3 of the top five places for foreign tourist arrivals in India were G20 members. Further, with Visit India Year 2023 initiative kicked off on 31 January this year, more than one lakh foreign delegates are likely to visit India this year. The seamless integration of UPI with various payment mechanisms and its readiness to onboard CBDC (retail) should get a fillip through such endeavours across the latitude of G-20, while taking our digital public goods beyond boundaries, enriching the experience of diaspora.

Indent and Supply of Coins (Pieces in lakh)

Denomination (₹)	FY20		FY21		FY22	
	Indent	Supply	Indent	Supply	Indent	Supply
1	1,000	1,093	1,000	1,000	-	-
2	8,000	7,993	9,500	6,718	2,000	2,000
5	10,000	9,984	11,000	10,995	2,000	2,000
10	12,000	11,565	5,500	5,852	2,000	2,000
20	3,000	458	3,000	5,061	2,000	2,000
Total	**34,000**	**31,093**	**30,000**	**29,626**	**8,000**	**8,000**

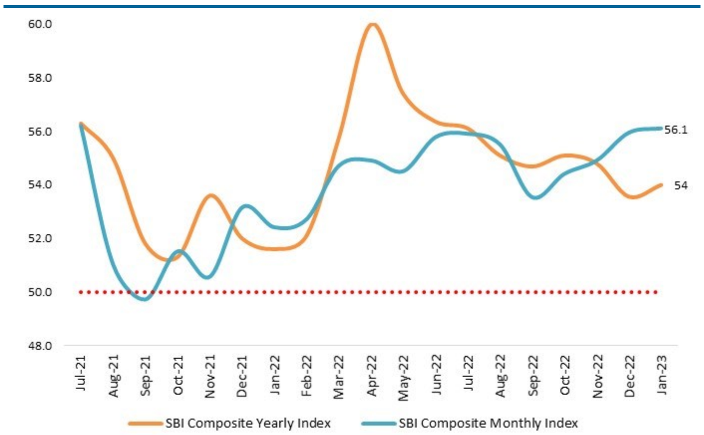
Source: RBI; SBI Research

- **QR Code based Coin Vending Machine:** To improve distribution and usage of coins among public, RBI is preparing a pilot project on QR Code based Coin Vending Machine (QCVM) in collaboration with a few leading banks at 19 locations in 12 cities. These vending machines are intended to be installed at public places such as railway stations, shopping malls, marketplaces to enhance ease and accessibility. During FY22, the indent and supply for coins was lower by around 73.3% and 73.0%, respectively, as compared with last year due to accumulated stock and lower demand in last few years.

SBI COMPOSITE INDEX : JANUARY 2023

- The monthly SBI Composite Index has continued to increase and is at 56.1 (High Growth) in January 2023, compared to 55.9 (High Growth) in December 2022. The yearly index increased to 54.0 (Moderate Growth) in January from 53.6 (Moderate Growth) in December 2022.

SBI Yearly and Monthly Composite Index Trend



Source: SBI Research

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