Ecowrap

'Be the Bank of Choice for a Transforming India'

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HOUSEHOLD FINANCIAL LIABILITIES NOSEDIVED IN FY20: REFLECTING SIGNIFICANT SLOWDOWN IN DISPOSABLE INCOME, LIKELY TO GAIN FASTER PACE IN FY21?

The RBI Annual Report reaffirms our conviction that the current slowdown in growth will be long and protracted. For the record, Net Household Financial Savings of the Household jumped by Rs 3.4 lakh crores in FY20, largely reflecting a significant meltdown in household financial liabilities in FY20 by 22% that had increased by 39% for the 6 year period ended 2019. While the decline in net financial liability is a welcome departure, on hindsight it portrays unwelcome trends in household saving behavior. For one thing in common, households were able to increase their liabilities / leverage significantly over the 6 year period ended FY19 by as much as 1.9 times, with disposable income jumping by 2.3 times. However, in FY20, disposable income has expanded by only 0.8 times, and liabilities have thus grown by only 1.1 times. Furthermore, Households in FY20 have drawn down their exposure to Government by a sharp Rs 2 lakh crore and instead increased their exposure to Insurance and Retirement Corpus, perhaps as a precautionary motive and also as a proof that Households are now increasingly trying to "*Keep up with Joneses*" with income slowdown. We believe Household Leverage may have further slowed down in FY21 with perhaps even a negative growth in disposable income. This may still not result in a decline in Net Household Financial Savings in FY21 as people have accumulated currency, deposits and even shares in large numbers. **But the bottom line is grim: consumer demand will be a non starter even in FY21 and continue to be pandemic proof through increased precautionary savings as pandemic continues to ravage through the economy.**

Elsewhere, some developments suggest that the shrinkage of world trade may be bottoming out in the third quarter of 2020, that India should take advantage of. The problem is, India is still in the midst of a significant pandemic disruption that indicates Q2GDP for India could also be a washout.

Meanwhile, regarding the RBI balance sheet, it clearly changed after 20-March with rupee securities holding witnessing an increase while the growth in foreign currency assets moderating. The pre and post-COVID period does not show any major difference in growth of notes issued.

One more interesting part of information from the RBI AR is the currency composition of RBI. Interestingly, the number of banknotes in circulation has grown by 7% to 116 billion pieces as on Mar'20. 2000 denomination note which was launched after demonetisation, has not been printed with its number going down to 2.7 billion pieces as on Mar'20, from 3.3 billion pieces in Mar'19. The share of 2000 denomination notes has come to 22.6%. This was 50% in 2017, as the major focus was on remonetising the economy. The % composition of bank notes in value terms shows that 500 denomination notes have 60.8% share in the total value of bank notes in circulation, which is 24,210 billion (y-o-y increase: 15%). With printing of 500 denomination notes taking precedence, due to ease of use, the value of 2000 denomination notes has declined by Rs 11 lakh crore in the economy, from Mar'17 to Mar'20. The combined share of 500 and 2,000 banknotes was, thus 83.4% in the total banknotes in circulation.

As an anecdote, according to RBI, the impact due to factor income loss (capital and labour) of 68 days of lockdown on the manufacturing and mining sectors could be as high as Rs 2.7 lakh crore (on constant prices). Interestingly, as per our published estimates (Ecowrap dated 17 Aug'20), the nominal GVA loss for manufacturing and mining sectors (in Q1) is around Rs 3.1 lakh crore (at current prices).

RBI today released its Annual Report (AR) for the year July 1, 2019 to June 30, 2020.

A DECLINE IN HOUSEHOLD FINANCIAL LIABILITIES IN CURRENT TIMES

- Despite a sharper decline in household financial assets in Q4 FY20, the preliminary estimates suggests that household financial saving has improved to 7.6% of GNDI in FY20, after touching a low of 6.4% in FY19. In value terms, the net financial savings increased by Rs 3.4 lakh crore in FY20 compared to FY19 owing to Rs 1.3 lakh crore increase in Insurance, provident and pension funds and a decline of Rs 1.7 lakh crore in financial liabilities (primarily, loans and advances by banks and NBFCs). For the 6 year ended FY19, while disposable had jumped 2.1 times, household leverage has jumped by 1.7 times. However in FY20, financial liabilities increased by only 0.8 times while disposable income increased by 1.1 times indicating consumer deleveraging.
- We foresee an interesting trend for financial savings in India in FY21. We believe Household Leverage may have further slowdown in FY21 with perhaps a negative growth in disposable income. This may still not result in a decline in Net Household Financial Savings in FY21 as people have accumulated currency, deposits and even shares in large numbers. **But the bottom-line is grim: consumer demand will be a non starter even in FY21 and continue to be pandemic proof through increased precautionary savings as pandemic continues to ravage through the economy.**
- We believe that Government should use this opportunity to still incentivize households to save more say by increase Section 80C/ PPF limit. We estimate that an increase in PPF limit by even Rs 50,000 for individual households will lead to additional savings of more than Rs 1 lakh crore compared to the revenue foregone of Rs 10,000 crore. Even we add up the extra interest burden of around Rs 8,500 core (@ 8.5% on Rs 1 lakh crore), the total revenue foregone is only Rs 20,000 crore compared to Rs 1 lakh crore jump in savings (incentive saving multiplier is at least 5 times more!)

Financial Saving of the Household Sector

	2015-16	2016-17	2017-18	2018-19	2019-20
In Rs Lakh Crore					
A. Gross financial saving	15.0	16.1	20.6	20.0	21.7
of which:					
Currency	2.0	-3.3	4.8	2.8	2.9
Deposits	6.4	9.8	5.3	7.8	7.4
Shares and Debentures	0.3	1.7	1.8	0.8	0.8
Claims on Government	0.7	1.2	1.6	2.0	0.0
Insurance Funds	2.6	3.5	3.4	2.6	3.5
Provident and Pension funds	2.9	3.3	3.7	4.0	4.3
B. Financial Liabilities	3.9	4.7	7.4	7.7	6.0
Net Financial Saving (A-B)	**11.1**	**11.5**	**13.2**	**12.3**	**15.7**
% of GNDI					
A. Gross financial saving	10.7	10.4	11.9	10.4	10.5
of which:					
Currency	1.4	-2.1	2.8	1.5	1.4
Deposits	4.6	6.3	3.1	4.1	3.6
Shares and Debentures	0.2	1.1	1.0	0.4	0.4
Claims on Government	0.5	0.7	0.9	1.0	0.0
Insurance Funds	1.9	2.3	2.0	1.3	1.7
Provident and Pension funds	2.1	2.1	2.1	2.1	2.1
B. Financial Liabilities	2.7	3.0	4.3	4.0	2.9
Net Financial Saving (A-B)	**7.9**	**7.3**	**7.6**	**6.4**	**7.6**

Source: RBI; SBI Research; FY20 Amount is SBI estimate

GLOBAL ECONOMY

- RBI Annual report assess that the global economic is well below pre-COVID levels. In Q1:2020, GDP contracted in the range of 1.2-13.6 per cent among AEs; among EMEs, growth varied between 4.5 per cent and (-) 6.8 per cent. In its latest update (June 2020), the IMF has projected global growth at (-) 4.9 per cent for 2020, with a steeply negative impact on economic activity in H1 and more gradual recovery than expected earlier. India's growth is projected at (-) 4.5 per cent for 2020-21.
- However, some developments suggest that the shrinkage of world trade may be bottoming out in the third quarter of 2020. Global commercial flights, which carry a substantial amount of international air cargo, had slumped by (-) 74.0 per cent between January and April, but they rose 58.0 per cent through mid-June. Container port throughput also appears to have staged a partial recovery in June, along with new export orders in PMIs.
- The Annual report clearly flags risk from global economic disruption on domestic economy. The RBI notes that the deceleration in manufacturing activity is aggravated by decline in trade due to trade disruptions with the onset of COVID-19 and declining demand. Accordingly, an import disruption, ceteris paribus, would lead to non-availability of crucial components, resulting in contraction in manufacturing GVA by as much as 2.5 per cent.
- RBI has suggested that foreign trade policy should increasingly focus on leveraging exports via free/preferential trade arrangements. In this context, completion of the India-EU free trade agreement and a post-Brexit free trade agreement/ preferential arrangement with the UK may confer early mover advantages. India also needs to tie up special trade arrangements with countries supplying rare materials that are essential to new export products which are gaining ascendency in the competitiveness ladder.

DOMESTIC OUTLOOK

- The Annual Report notes that consumption demand slumped during 2019-20. Gross fixed capital formation could not sustain its past momentum and contracted. The corporate tax regime reform of September 2019 has not yet gained traction in boosting capital expenditure.
- On the supply side, agriculture and allied activities accelerated with record food grains and horticulture production supported by allied activities, which remained robust. Industrial sector activity plummeted during 2019-20, driven down mostly by the manufacturing subsector.
- With services sector growth also decelerating, the outlook for the economy is clouded by uncertainty and testing challenges, mainly the intensity, spread and duration of COVID-19.
- On inflation the Report nots that headline inflation picked up strongly during the closing months of 2019-20 and the short-term outlook for food inflation has turned uncertain. Global crude oil prices have started firming modestly in more recent weeks. Disruptions in food and manufactured items' supply chains could amplify sectoral price pressures, thus posing an upside risk to headline inflation. Heightened volatility in financial markets could also have a bearing on inflation.

IMPACT OF COVID-19 ON RBI BALANCE SHEET

- COVID-19 impacted the domestic economy in March 2020. Since RBI follows July-June period for finalisation of accounts unlike the other entities its balance sheet was exposed for full 3-month before finalisation of accounts. Based on the Weekly balance sheet (B/S) data the evolution of RBI B/S is divided into two buckets 5-July to 20-March and 27-March to 26-June.
- Clearly the dynamics of the B/S changed after 20-Marc with rupee securities holding witnessing a increase while the growth in foreign currency assets moderating. The pre and post-COVID period does not show any major difference in growth of notes issued.
- Overall the RBI B/S expanded by 30% as on June 30, 2020 (13.4% for the year ended June 30, 2019). The increase on the asset side was due to increase in domestic and foreign investments by 18.40 per cent and 27.28 per cent, respectively, increase in loans and advances by 245.76 per cent and increase in gold by 52.9%
- Because of steep rise in gold prices and advances, the RBIs allocation to contingency increased to meet the required ratio of available realised equity at 5.5%.

Impact of COVID-19 on RBI Balance Sheet

Period	Changes in Assets		Changes in Liability	
5-July to 20-Mar	1 Foreign Currency Assets	19.5%	1 Notes Issued	9.7%
	2 Gold Coin and Bullion	24.9%	2 Deposits	31.1%
	3 Rupee Securities (including Treasury Bills)	0.8%	3 Other Liabilities	16.4%
	4 Loans and Advances	63.0%		
27-Mar to 26-June	1 Foreign Currency Assets	7.8%	1 Notes Issued	9.2%
	2 Gold Coin and Bullion	9.7%	2 Deposits	0.7%
	3 Rupee Securities (including Treasury Bills)	12.3%	3 Other Liabilities	11.6%
	4 Loans and Advances	-5.8%		

Source: RBI, SBI Research

FRAUDS IN VALUE HAVE INCREASED BY 159% IN FY20 BUT DECLINING IN FY21

- The number of cases on frauds reported by banks were generally hovering at around 4500 in the last 10 years till FY17. However, after that the number has increased substantially to 5916 in 2017-18, 6799 in 2018-19 and 8707 in 2019-20.
- Similarly, the amount involved in frauds was increasing gradually, followed by a significant increase in 2017-18 to Rs 410 billion, around doubled in 2018-19 to Rs 715 bn and increased by 159% to Rs 1856 billion in 2019-20.
- In 2019-20, the number of frauds increased by 28%, while the amount involved rising by 159%, though mostly related to occurrences in earlier years. The average lag between the date of occurrence and its detection by banks was 22 months. The average lag between the date of occurrence of frauds and their detection by banks/FIs was 24 months during 2019-20. In large frauds, i.e., Rs 100 crore and above, however, the average lag was 63 months (53 months in FY19).
- In terms of area of operations, frauds related to advances constituted the preponderant share in number and total amount involved in frauds over the years. There was a concentration of large value frauds, with the top fifty credit-related frauds constituting 76% of the total amount reported as frauds during 2019-20.
- The fraud numbers are showing a declining trend, which may be due the better practices followed by banks/FIs. However, we believe this is also due to lockdown and slow in detection process.
- To improve the fraud risk management framework for banks, a need for (i) better directions on frauds in the light of experience gained and big data analytics; (ii) comprehensive reviews to sensitise on fraud prevention, prompt/accurate reporting and follow up action; (iii) need for user-friendly fraud registry.

Fraud Cases - Bank Group-wise												
Bank Group	No. of Frauds				Amount Involved (Rs crore)				Ticket Size (Rs crore)			
	FY19	FY20	Q1FY20	Q1FY21	FY19	FY20	Q1FY20	Q1FY21	FY19	FY20	Q1FY20	Q1FY21
PSBs	3,568	4,413	1,133	745	63,283	1,48,400	31,894	19,958	17.7	33.6	28.2	26.8
% Share	52.5	50.7	56	47.8	88.5	79.9	75.5	69.2	-	-	-	-
Pvt Banks	2,286	3,066	601	664	6,742	34,211	8,593	8,009	2.9	11.2	14.3	12.1
% Share	33.6	35.2	29.7	42.6	9.4	18.4	20.3	27.8	-	-	-	-
FBs	762	1026	250	127	955	972	429	328	1.3	0.9	1.7	2.6
% Share	11.2	11.8	12.4	8.2	1.3	0.5	1.0	1.1	-	-	-	-
Others	183	202	40	22	563	2,061	1,312	548	3	10	33	25
% Share	2.7	2.3	1.9	1.4	0.8	1.2	3.2	1.9	-	-	-	-
Total	**6,799**	**8,707**	**2,024**	**1,558**	**71,543**	**1,85,644**	**42,228**	**28,843**	**10.5**	**21.3**	**20.9**	**18.5**

Source: RBI, SBI Research

CURRENCY COMPOSITION AND MANAGEMENT

- Interestingly, the number of banknotes in circulation has grown by 7% to 116 billion pieces as on Mar'20. 2000 denomination note which was launched after demonetisation, has not been printed with its number going down to 2.7 billion pieces as on Mar'20, from 3.3 billion pieces in Mar'19. The biggest increase is in the printing of 500 denomination notes, which rose to 29.4 billion pieces as on Mar'20, from 21.5 billion pieces in Mar'19. The number of small denomination notes (upto 100) has declined from 80 billion pieces as on Mar'19 to 78.4 billion pieces as on Mar'20. 200 denomination notes have seen a yearly increase of 1.4 billion pieces to 5.4 billion pieces in Mar'20.
- The % composition of bank notes in value terms shows that 500 denomination notes have 60.8% share in the total value of bank notes in circulation, which is 24,210 billion (y-o-y increase: 15%). The share of 2000 denomination notes has come to 22.6%. This was 50% in 2017, as the major focus was on remonetising the economy. With printing of 500 denomination notes taking precedence, due to ease of use, the value of 2000 denomination notes has declined by Rs 1091 billion in the economy, from Mar'17 to Mar'20. The combined share of 500 and 2,000 banknotes was, thus 83.4% in the total banknotes in circulation.
- Thus, the share of small denomination notes has come down to 16.6% as on Mar'20 from 17.8% as on Mar'19. However, it is still higher than the pre-demonetization level of 13.6%.

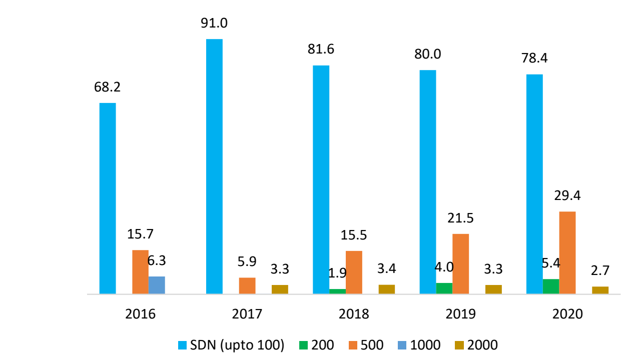
COUNTERFEIT NOTES

- According to RBI, the number of counterfeit notes has declined by 6.5% in FY20 to 2.97 lakh pieces. However the interesting part is that the Rs 10 denomination counterfeit notes have increased by whopping 144.6%.

CAPITAL FLOWS

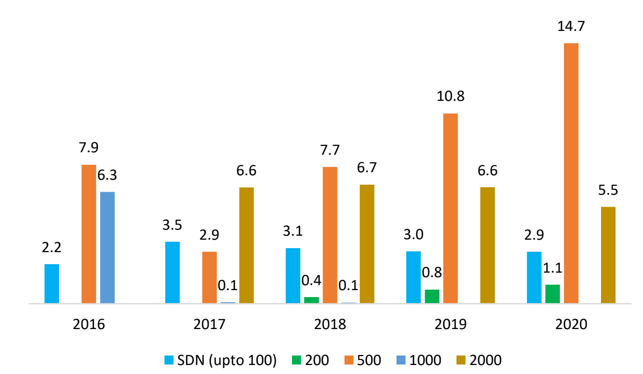
- In FY20 India's current account deficit was 0.9% of GDP vis-a-vis 2.1% in FY19 as the merchandise trade deficit contracted, reflecting the terms of trade gains accrued from lower commodity prices for crude oil, coal and fertilisers, and a contraction in import volumes.
- India received significant amount of capital flows in FY20 (amounting to $83.18 billion), more than enough to cover for current account deficit (CAD of $24.65 billion). India continued to remain attractive destination for foreign capital receiving net FDI of $44.41 billion (48% yoy increase).
- After witnessing portfolio outflows in FY19, net portfolio investment also turned positive ($1.4 billion). Another major component was net External Commercial Borrowings which increased to $22.9 billion from $10.4 billion in FY19. This in turn led to significant accretion of forex reserves ($59.49 billion).

Banknote Composition(billion pieces)



Source: SBI Research

Banknote Composition(Rs trillion)



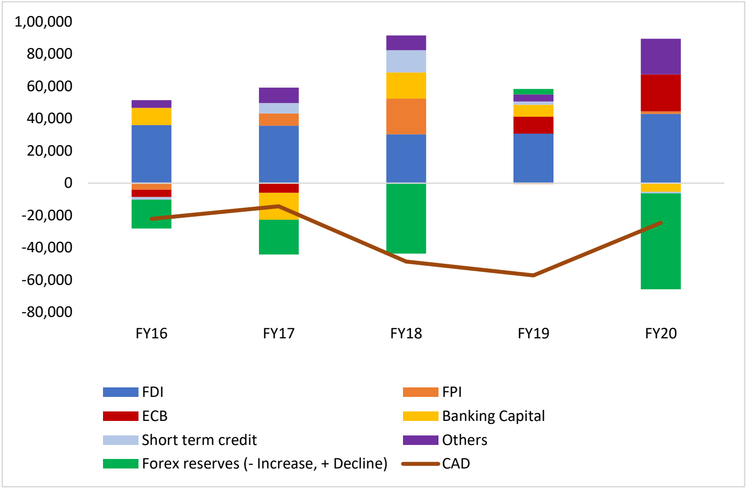
Source: SBI Research

Denomination-wise Counterfeit Notes					
Denomination	No. of pieces			% YoY	
	2017-18	2018-19	2019-20	2018-19	2019-20
2 and 5	1	-	22	-	-
10	287	345	844	20.2	144.6
20	437	818	510	87.2	-37.7
50	23,447	36,875	47,454	57.3	28.7
100	2,39,182	2,21,218	1,68,739	-7.5	-23.7
200	79	12,728	31,969	16011.4	151.2
500 (MG Series)	1,27,918	971	11	-99.2	-98.9
500 [MG (New) Series]	9,892	21,865	30,054	121.0	37.5
1,000	1,03,611	717	72	-99.3	-90.0
2,000	17,929	21,847	17,020	21.9	-22.1
Total	5,22,783	3,17,384	2,96,695	-39.3	-6.5

Source: RBI; SBI Research

- Though large amount of foreign capital is beneficial for an economy, however, if there is not absorbed in the economy due to insufficient demand, then there is a possibility of upward pressure on the exchange rate, overheating of the economy and asset price bubbles.
- Also, another important point to be highlighted is the quality of imports that are financed by higher CAD. Gold imports which constitute a major proportion of our imports represent non-productive imports. absorption of foreign capital is crucial for economic growth. It is the quality of CAD which matters in enhancing the absorptive capacity of the economy through growth-inducing imports.
- As far as external debt position is concerned, it increased by US$ 15.4 billion (20.6% of GDP) from its level at end-March 2019 (19.8% of GDP), primarily on account of commercial borrowings. However, major external vulnerability indicators including share of short-term debt, foreign exchange reserve cover of imports improved during FY20. This should provide support against the current uncertain environment.

Capital Flow composition($ million)



Source: SBI Research

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