SBI RESEARCH

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RBI MAINTAINS STATUS QUO FOR 7TH TIME : WITH INFLATION ALIGNED AT 4% IN FY26, SHALLOW RATE CUT CYCLE COULD TURN PROLONGED... 75 BPS CUT ATLEAST THIS FY MAKING REPO RATE HEAD SOUTH OF 6%... CLIMATE CONCERNS A RUBIK'S CUBE THIS YEAR AS C/D RATIO SHOOTS ABOVE 80..IT'S A DÉJÀ VU OF THE EDGY 70S AS TENSIONS FLARE UP IN THE MERCURIAL MIDDLE EAST...CASCADING EFFECTS WEIGHING ON MINT STREET MIND AS RUPEE STANDS SOLID AGAINST A RESURGENT DOLLAR ...

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Along anticipated lines, RBI MPC Kept policy repo rate unchanged at 6.50% (seventh-time in a row), with one of the six members vouching a different stance to reduce the policy rate by 25 bps. The Central Bank also decided to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns to the target, while supporting growth. Clearly, the Mint street has more on its minds than what most can gauge as it navigates through the 'right path' balancing growth and price prints, with pass-through of exogenous shocks likely to have a toll on the economic well being of nations.

RBI retained its inflation projection for FY25 at 4.5% with Q1 at 4.9%, Q2 at 3.8%, Q3 at 4.6%, and Q4 at 4.5%. However, the outlook for inflation will largely be shaped by food price uncertainties (indications of a normal monsoon on one side while increasing incidence of climate shocks on other side). In a worst case scenario, crude can have a pass-through effect too as select lobbies wage a war on India's decision to source the oil from Russia. **The good thing is however, that with 4% inflation target in FY26, the RBI is possibly guiding the market with a prolonged rate cut cycle. Possibly with more than a couple of rate cuts. We expect a series of rate cuts beginning October 2024, followed by another in December 2024 and possibly in February 2025. The stance change can happen in October itself .**

Real GDP growth projection for FY25 is retained at 7.0% (Q1: 7.1%, Q2: 6.9%, Q3: 7.0%, and Q4: 7.0%) with risks evenly balanced. While agriculture may be supported by expected normal monsoon in a best case scenario, manufacturing is expected to maintain its momentum on the back of sustained profitability. **With a gross investment rate at 33.3% for FY25 as per professional forecasters, a 7% growth rate assumption by RBI implies an ICOR at 4.75, well above the 4.28 for FY24. Alternatively, the 7% growth forecast for FY24 with a 4.28 ICOR could thus be a clear underestimate and growth could well be higher than if not equal to 7.5% in FY25.**

Meanwhile, the global economy exhibits resilience and is likely to maintain steady growth path with risk balanced on either side. Global inflation is treading down, though stubborn services prices are keeping it elevated relative to targets.

Liquidity deficit has declined since the last policy in Feb'24. For efficient market functioning, RBI conducted fourteen fine tuning variable rate reverse repo (VRRR) operations . Government surplus cash balances have decreased to an average of Rs 2.5 lakh crore post Feb'24 policy while durable/core liquidity surplus has come down to Rs 1.76 lakh crore. **The fine tuning of LCR norms will ensure that banks will find to easier to maneuver frictional liquidity mismatches against the backdrop of 24/7 payment systems.**

The transmission to banks' lending and deposit rates continued in H2:2023-24, with banks increasing rates on the back of persistent credit demand. Banks have now passed on the earlier hike of 250 bps to both deposits and lending rates. The share of EBLR-linked loans in total outstanding floating rate loans increased to 56.2% as at end-December 2023. Concomitantly, the share of MCLR linked loans declined to 39.4%. The increasing share of EBLR-linked loans with shorter reset periods and the increase in the MCLRs aided transmission to WALRs on outstanding loans of SCBs in the current tightening cycle. **The C/D ratio of banks has moved past 80 now, as banks continue to meet the robust credit demand from new as also sunrise sectors (climate transition/ start-ups) though pressure on mobilizing liabilities from non-deposits sources remain**

Continuing a slew of reforms pitching India as one of the most forward looking financial markets, the Mint Street announced

- FPIs access to Sovereign Green Bonds (The cumulative expenditure needed for adaptation without any additionality, is estimated to be Rs 56.68 trillion till 2030 for India, assuming FY24 as the base year). The mop up through Sovereign Green Bonds clearly would need an imminent and big push to smoothen the ambitious targets on carbon neutrality front and deep pocket overseas funds, in particular pension and sovereign funds
- Mobile app for common investors to popularize and bring convenience to the revolutionary Retail Direct Scheme,
- Proposed changes in LCR dispensation to meet the increased adoption of online banking to maintain sufficient liquidity
- Enabling cash deposit through UPI in CDMs
- Giving SFBs a level playing field to help hedge interest rate risk in their balance sheet and commercial operations more effectively. SFBs at present have nearly 1% of the systemic (SCBs) deposits but exhibit a higher growth rate, vis-à-vis peers
- Boosting participation of non-bank payment system operators to offer wallets as plateauing CBDC-Retail transactions (estimated to have 40 lakh users and 4 lakh merchants, having touched the milestone of 10 lakh transactions per day in December 2023) require new strategies, also testing the platform's readiness for multi-channel transactions.
- Use of third-party UPI apps for making UPI payments from PPI wallets which should go a long way in strengthening the fabric of the markets.

REPO RATE KEPT AT 6.5%

- As widely expected, MPC decided to keep repo rate at 6.50% (seventh-time in a row), though not unanimously. One of the members voted to reduce the policy repo rate by 25 bps. RBI also decided to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns to the target, while supporting growth. One of the members voted for a change in stance to neutral.
- RBI retained its inflation projection for FY25 at 4.5% with Q1 at 4.9%, Q2 at 3.8%, Q3 at 4.6%, and Q4 at 4.5%. The outlook for inflation will largely be shaped by food price uncertainties (indications of a normal monsoon on one side while increasing incidence of climate shocks on other side). Further prices of certain pulses and vegetable along-with crude oil prices need close monitoring.
- Real GDP growth projection for FY25 is retained at 7.0% (Q1: 7.1%, Q2: 6.9%, Q3: 7.0%, and Q4: 7.0%) with risks evenly balanced. While agriculture may be supported by expected normal monsoon, manufacturing is expected to maintain its momentum on the back of sustained profitability. The prospects of fixed investment remain bright with business optimism, healthy corporate and bank balance sheets, robust government capital expenditure and signs of upturn in the private capex cycle. Headwinds from geopolitical tensions, volatility in international financial markets, geoeconomic fragmentation, rising Red Sea disruptions, and extreme weather events, however, pose risks to the outlook.

LIQUIDITY MANAGEMENT BY RBI

- Liquidity deficit has declined since the last policy in Feb'24. Net LAF has remained in the deficit mode since mid-Sep'23, with average of Rs 0.74 lakh crore post Feb'24 policy
- The liquidity situation improved in March with system liquidity turning intermittently surplus in the first half of the month. In these circumstances, the Reserve Bank conducted fourteen fine tuning variable rate reverse repo (VRRR) operations during February and early March to absorb intermittent surplus liquidity.
- Government surplus cash balances have decreased to an average of Rs 2.5 lakh crore post Feb'24 policy
- On the banking side the review of LCR norm is a smart move as owing to the 24*7 payment systems, banks were keeping more than sufficient funds / unusable liquidity as cushion to enable probable large outflows post business hours/on Saturdays in particular as RTGS/NEFT funds movement in large value affects funds management capability. The possible release of this unusable liquidity could now help to ameliorate frictional liquidity mismatches.

RBI Growth & Inflation Outlook for India

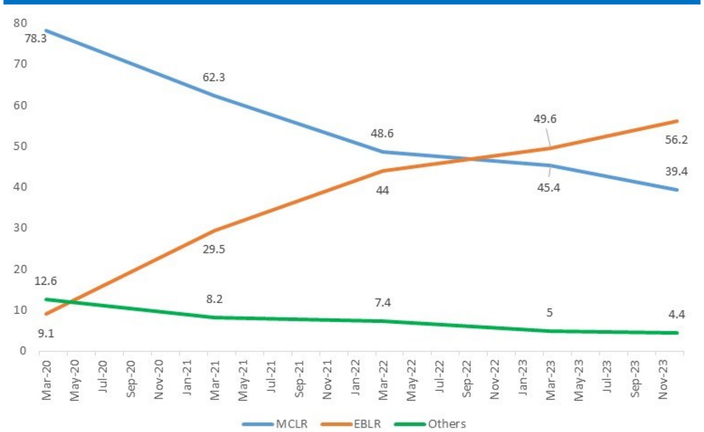
CPI Inflation (%)	Q4 FY24	FY24	Q1 FY25	Q2 FY25	Q3 FY25	Q4 FY25	FY25
Apr'24	5.0*	5.4	4.9	3.8	4.6	4.5	4.5
Feb'24	5.0	5.4	5.0	4.0	4.6	4.7	4.5
Dec'23	5.2	5.4	5.2	4.0	4.7	-	-
Real GDP Growth (%)	**Q4 FY24**	**FY24**	**Q1 FY25**	**Q2 FY25**	**Q3 FY25**	**Q4 FY25**	**FY25**
Apr'24	6.8*	7.6	7.1	6.9	7.0	7.0	7.0
Feb'24	6.8*	7.3	7.2	6.8	7.0	6.9	7.0
Dec'23	6.0	7.0	6.7	6.5	6.4	-	-

Source: RBI, SBI Research,* estimated from RBI Fan chart

MONETARY POLICY TRANSMISSION

- The transmission to banks' lending and deposit rates continued in H2:2023-24, with banks increasing rates on the back of persistent credit demand. RBI has not changed the policy repo rate from February 2023, however banks have passed on the earlier hike of 250 bps to both deposits and lending rates. During, H2FY24 (Oct'23 to Feb'24), RBI has not changed repo rate but banks have increased 1-yr MCLR by 15 bps, WALR on Outstanding loans increased by 1 bps and WADTDR Outstanding Deposits by 17 bps, however, Fresh Retail deposit and WALR of Fresh Rupee Loans declined by 2 bps.
- The share of EBLR-linked loans in total outstanding floating rate loans increased to 56.2% as at end-December 2023 from 49.6% in March 2023. Concomitantly, the share of MCLR linked loans declined to 39.4%. The increasing share of EBLR-linked loans with shorter reset periods and the increase in the MCLRs aided transmission to WALRs on outstanding loans of SCBs in the current tightening cycle.

Outstanding Floating Rate Rupee Loans of SCBs across Interest Rate Benchmarks



Source: RBI, SBI Research

DEVELOPMENT AND REGULATORY MEASURES

- ***Trading of Sovereign Green Bonds in IFSC***: Government of India raised two tranches of sovereign green bonds amounting to Rs 16000 crore across two maturities in 2023. The bonds were domestically issued and were eligible for investment by foreign portfolio investors (FPIs) registered with SEBI. With view to widen the investor base and meet the growing demand for fund to meet transition and adaption need the RBI has decided to permit eligible foreign investors in the International Financial Services Centre (IFSC) to also invest in such bonds. The cumulative expenditure needed for adaptation in a Business as Usual (BAU) scenario, without any additionality, is estimated to be Rs 56.68 trillion till 2030 for India, assuming 2023-24 as the base year of analysis.
- ***RBI Retail Direct Scheme - Introduction of Mobile App :*** RBI announced to introduce a mobile application for its Retail Direct Scheme. The app will help investors in different types of government securities such as bonds and treasury bills. The Retail Direct Scheme was introduced in 2020, which enables investors to buy/sell securities in primary auctions or through the Negotiated Dealing System - Order Matching system (NDS-OM) platform. The scheme gives access to individual investors to maintain Retail Direct Gilt (RDG) account with the RBI and invest in government securities.
- ***Changes in LCR framework:*** As part of post Global Financial Crisis (GFC) reforms, BCBS had introduced Liquidity Coverage Ratio (LCR), which required banks to maintain High Quality Liquid Assets (HQLAs) to meet 30 days net outgo under stressed conditions. Further, as per Banking Regulation Act, 1949, the banks in India are required to hold liquid assets to maintain Statutory Liquidity Ratio (SLR). In view of the fact that liquid assets under SLR and HQLAs under LCR are largely the same, RBI has been allowing banks to use a progressively increasing proportion of the SLR securities for being considered as HQLAs for LCR so that the need to maintain liquid assets for both the requirements is optimised.
- **With the events of last year concerning select banks in USA coming under intense and quick deposit withdrawal that brought to the fore embedded risks for systemic stability (accentuated across geographies with the advent of online/digital banking), RBI has announced today revisiting the framework, with proposed modifications expected to facilitate better management of liquidity risk by**

Issuance of Sovereign Green Bonds		
(Auction cut-offs)	**7.10% GOI SGrB 2028**	**7.29% GOI SGrB 2033**
Feb 9, 2023	7.23%	7.2965%
Jan 25, 2023	7.10%	7.29%

- ***Enabling UPI for Cash Deposit Facility:*** Deposit of cash through Cash Deposit Machines (CDMs) is primarily being done using debit cards. Given the experience gained from card-less cash withdrawal using UPI at the ATMs, RBI has now proposed to also facilitate deposit of cash in CDMs using UPI. The measure would further enhance customer convenience and make the currency handling process at banks more efficient. This will help other bank customers to deposit cash at their convenience.
- ***Dealing in Rupee Interest Rate Derivative products – SFBs:*** RBI has been steadfastly endeavoring to deepen the rupee dominated derivates products, offering Regulated Entities sustainable avenues to hedge their underlying exposure, without being susceptible to vagaries of such products having a forex connotation and ensuing volatility. SFBs at present have nearly 1% of the systemic (SCBs) deposits but have exhibited a higher growth rate, vis-à-vis peers. Giving them a level playing field to help hedge interest rate risk in their balance sheet and commercial operations more effectively, as also with a view to provide them with greater flexibility, RBI has proposed to allow them to deal in permissible rupee interest derivative products in terms of Rupee Interest Rate Derivatives (Reserve Bank) Directions, 2019.
- ***Distribution of CBDCs through Non-bank Payment System Operators:*** To make CBDC-Retail accessible to a broader segment of users RBI has allowed non-bank payment system operators to offer CBDC wallets. CBDC-Retail is estimated to have 40 lakh users and 4 lakh merchants. After touching the milestone of 10 lakh transactions per day in December 2023, volumes are expected to have settled slightly below this level. The present measure not only give necessary fillip to the CBDC-Retail in form of more access and choices but also test the resiliency of the CBDC platform to handle multi-channel transactions.
- ***UPI access for PPIs through third-party applications:*** At present, UPI payments from prepaid payment instruments (PPIs) can be made only by using the web or mobile app provided by the PPI issuer. It is now proposed to permit the use of third-party UPI apps for making UPI payments from PPI wallets. This will increase the use of PPI by customers.

GLOBAL OUTLOOK

- The global economy exhibits resilience and is likely to maintain steady growth path with risk balanced on either side. Global inflation is treading down, though stubborn services prices are keeping it elevated relative to targets. This has prompted marketed expectations of possible rate cut in advance economies in the latter half of 2024. However, the positive growth outlook is marred by geopolitical tensions, volatility in international financial markets, geoeconomic fragmentation, rising Red Sea disruptions, and extreme weather events, however, pose risks to the outlook. The rising gold prices clearly indicate the build up underlying risk to global growth.

FINANCIAL STABILITY AND EXTERNAL ENVIRONMENT

- Despite volatile global markets, there has been orderly movements in domestic markets in H2FY24.
- Overnight money market rates hovering around MSF in initial period of H2FY24 reflecting tight liquidity conditions, moderated Feb 24 onwards with pick up in government spending.
- Fresh Issuance of Certificate of Deposits (CDs) from Rs 3 Lakh crore in H1FY24 to Rs 5.5 Lakh Crore in H2FY24 due to asymmetry in credit and deposit growth.
- G-sec yields hardened initially but softened in later period of H2FY24 due to control in domestic CPI inflation, decline in crude oil prices, decline if US yields, and proposed inclusion of GoI bonds in global emerging market indexes.
- FPI flows remained volatile in H2FY24 despite FIIs being net buyers in domestic equity markets.
- In H2FY24, Indian rupee depreciated by 0.4% against US dollar. Overall, foreign exchange market remained orderly with range bound INR due to strong macroeconomic fundamentals, moderation in CAD, revival of capital flows, and rising foreign exchange reserves.

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Contact Details:
Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India, Corporate Centre
M C Road, Nariman Point, Mumbai - 400021
Email: soumya.ghosh@sbi.co.in, gcea.erd@sbi.co.in
Phone:022-22742440
: @kantisoumya