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RBI FORWARD GUIDANCE ENCOMPASSES GUARANTEED LIQUIDITY: REMINISCENT OF DEVELOPED MARKET CENTRAL BANKS

'Be the Bank of Choice for a Transforming India'

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As widely expected, RBI's Monetary Policy Committee unanimously decided to keep policy repo rate unchanged at 4% for the 5th straight time and has decided to continue with the accommodative stance as long as necessary. RBI retained the projection of real GDP growth for FY22 at 10.5% overall and 26.2% in Q1, 8.3% in Q2, 5.4% in Q3 and 6.2% in Q4. Coming to CPI projections, RBI has revised Q4 inflation at 5.0% for Q4 FY21 (earlier: 5.2%) and projected 5.2% for Q1 FY22, 4.4% for Q3 and 5.1% for Q4, with risks broadly balanced.

Liquidity remains the key focus area of RBI, which has come up with further measures to maintain system liquidity. The RBI has now unveiled a guaranteed liquidity support through the announcement of G-SAP, a secondary market purchase of G-secs, with Rs 1 lakh crore commitment in Q1. Such guaranteed OMO support over and above the discretionary liquidity support is somewhat explicit forward guidance. Interestingly, such an assured OMO support was resorted to by Bank Indonesia and BSP (Central Bank of Philippines) in 2020, but that was in primary market. However, the assured liquidity support is a clear resemblance to Developed Market central banks. Thus, the RBI has nicely dovetailed a liquidity strategy specific to Indian context.

Separately, RBI has also decided to extend the TLTRO on Tap Scheme by a period of six months, i.e., till September 30, 2021. RBI will provide fresh liquidity support of ₹50,000 crore to institutions including NABARD (₹25,000 crore), NHB (₹10,000 crore) and SIDBI (₹15,000 crore). RBI has also allowed banks another 6-months (till September 30, 2021), to classify lending to registered NBFCs (other than MFIs) as PSL up to 5% of a bank's total PSL, for on-lending to Agriculture/MSME/Housing.

To encourage farm credit to individual farmers against pledge/hypothecation of agricultural produce and leverage the inherent safety of Negotiable Warehouse Receipts (NWRs)/electronic-NWRs (e-NWRs), RBI has enhanced the loan limit from ₹50 lakh to ₹75 lakh per borrower. This is an excellent step and will increase the overall loan amount which was merely ₹437.9 crore in FY20 as against 1.4 lakh eNWR/NWR issued.

Regarding the payment system infrastructure, RBI has proposed to enable payment system operators, regulated by RBI, to take direct membership in CPSs. This facility is expected to minimize settlement risk in the financial system and enhance the reach of digital financial services to all user segments. RBI has also increased the account limit and made interoperability mandatory for full-KYC PPIs and for all payment acceptance infrastructure. This will increase the use of the existing payment infrastructure and will boost digital transactions in the country.

Most importantly, the RBI shift from time-based guidance to state based guidance is a commitment to support growth in an implicit manner in the current uncertain environment. Time- based is more explicit, state-based is implicit. For example, growth on a durable basis is not quantifiable but an implicit guidance on the state of the economy.

One challenge that the RBI might have to face in FY22 is the movement in exchange rate. Increasingly, the current scenario reminds us of the 2008-09 playbook. International commodity prices at that point had increased at a much faster rate than the rate of appreciation in the exchange rate during such phase and as a result the net effect on inflation through import prices still remained positive and strong and rupee movement had reversed from appreciation to depreciation in a very short span. Currently, the weighted component of imported inflation has been rising as crude oil prices have increased. With rupee also showing depreciating tendencies and increasing commodity prices, the inflationary impact might turn positive, as the increase in commodity prices could be much faster than rupee appreciation that was the trend in March. This risk has to be recognized and the risk management policy has to be dynamic to result in effective forex exposure management. Interestingly, RBI has recently turned a net seller of dollars in foreign exchange market as there were many oversold dollar positions in the market as a result of stability in the rupee exchange rate that got reversed with exponential jump in Covid cases. The apex bank has been following a policy of leaning with the wind in the forward market, showing resemblance to the Sparos effect postulated by John Sparos (Speculation, Arbitrage and Sterling, Economic Journal, 1959)

RBI HOLDS RATE

- RBI's Monetary Policy Committee unanimously decided to keep policy Repo rate unchanged at 4% and decided to continue with the accommodative stance as long as necessary (to revive growth on a durable basis with check on inflation). Reverse repo rate remains unchanged at 3.35% and MSF and the Bank Rate remain at 4.25%.
- RBI retained the projection of real GDP growth for FY22 at 10.5% overall and 26.2% in Q1, 8.3% in Q2, 5.4% in Q3 and 6.2% in Q4. The factors that will affect growth are: (a) buoyant rural demand and record agriculture production, (b) strengthening of urban demand on the back of normalisation of economic activity, (c) expanded production-linked incentives scheme and rising capacity utilization, and (d) fiscal stimulus from increased allocation for capital expenditure under the Union Budget 2021-22. On the negative side, consumer confidence has dipped with the recent surge in Covid-19 infections in some states.

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	FY22*
Apr'21	5.0	5.2	5.2	4.4	5.1	5.0
Feb'21	5.2	5.2	5.0	4.3		
Dec'20	5.8	5.2	4.6			
Real GDP Growth (%)	**Q4 FY21**	**Q1 FY22**	**Q2 FY22**	**Q3 FY22**	**Q4 FY22**	**FY22**
Apr'21	-1.0	26.2	8.3	5.4	6.2	10.5
Feb'21	0.7	26.2	8.3	6.0		10.5
Dec'20	0.7	21.9	6.5			

Source: RBI, SBI Research *Average

- Coming to CPI projections, RBI has revised Q4 inflation at 5.0% for Q4 FY21 (earlier: 5.2%) and projected 5.2% for Q1 FY22, 4.4% for Q3 and 5.1% for Q4, with risks broadly balanced. High international commodity prices and increased logistics costs could impart upward pressure on CPI, going forward.

IMPACT OF DEVELOPMENTAL & REGULATORY MEASURES

- **Extension of On Tap TLTRO:** To revive certain sectors, RBI had announced last October, an 'On Tap TLTRO' scheme worth Rs 1 trillion till March 2021 at floating rate linked to repo rate. Banks were required to invest TLTRO money in debt issues by companies in specific sectors over and above the outstanding as on 30th September 2020, or extend loans in these sectors. Furthermore, investments made under this facility can be classified under HTM even in excess of 25% of total investments. As exposure under the scheme is exempt from LEF norms, this will open more investment opportunities for banks. The scheme was also extended to allow banks to lend to NBFCs. RBI has decided to extend the TLTRO on Tap Scheme by a period of six months, i.e., till September 30, 2021 to improve the liquidity in the system.
- **Fresh Liquidity Facility of ₹50,000 crore for All India Financial Institutions:** RBI has already provided special refinance facilities for a total amount of ₹75,000 crore during Apr-Aug 2020 to support the continued flow of credit to the real economy in the aftermath of the Covid-19 pandemic. Now RBI has provided fresh liquidity support of ₹50,000 crore to institutions including NABARD (₹25,000 crore), NHB (₹10,000 crore) and SIDBI (₹15,000 crore).
- **Asset Reconstruction Companies:** It's a welcome move and a potential enabler for the entire financial eco-system, as regulatory guidelines for Asset Reconstruction Companies (ARCs) were issued in 2003 post enactment of SARFAESI Act 2002. Since then, not only the ARCs have grown in number and size, the amount of stressed assets (GNPA) of ASCB also grew by more than 13x i.e. from 0.68 lakh crore in March'2003 to around Rs 9 lakh crore as on in March'2020. As per the latest list there are around 28 ARCs registered with RBI and their potential for resolving stressed assets is yet to be realised fully. It would be important to see the outcome of the committee and how it will help the ARCs to leverage their resources for efficient management of stressed assets. It is pertinent to mention that, till December 2020, realisation by Financial Creditors (FCs) under IBC resolution plans in comparison to their claims is 39.80% i.e. Rs 1.97 lakh crore against claim of Rs 4.96 lakh crore.
- **Permitting banks to on-lend through NBFCs:** With a view to augment the liquidity position of the NBFCs, RBI has allowed banks another 6-months (till September 30, 2021), to classify lending to registered NBFCs (other than MFIs) as PSL up to 5% of a bank's total PSL, for on-lending to Agriculture/MSME/Housing. Around ₹37,000 crore has been lent by banks to NBFCs for on-lending to the specified priority sectors by December 2020. This move will improve the available sources of funding, especially for new-age mid and small-sized NBFCs, at a relatively lower cost, while improving banks' ability to meet their priority sector lending targets.
- **Way and Means Advances (WMA) limits for the State Governments/UTs:** In view of the financial constraints faced by State/ Governments, RBI has continued the enhanced interim WMA limit of ₹51,560 crore granted by RBI due to the pandemic for a further period of six months i.e., up to September 30, 2021. The overall limit of these advances, which are meant to be temporary in character and are to be used to bridge any gaps that might arise for short periods between the expenditure and receipts of State Governments, have also been enhanced to ₹47,010 crore for all states, as against the current limit of ₹32,225 crore (fixed in February 2016), representing an increase of about 46%, given the unprecedented challenges faced by state government due to COVID-19.
- **Financial Inclusion Index:** In line with its global peers RBI will construct and periodically publish a "Financial Inclusion Index" (FI Index) to track the performance of financial inclusion in India. This will be quite informative will represent the actual status of India's financial inclusion drive. BIS in 2017 published one research paper in which using demand and supply-side information authors created a composite index that measures the extent of financial inclusion at country level, for 137 developed and less-developed countries (https://www.bis.org/ifc/publ/ifcb47p.pdf). The research postulated that the degree of financial inclusion is determined by three dimensions: usage, barriers and access to the financial system. Under these dimensions India ranked 88 for usage, 84 for access and 73 for barriers for 2014. However, we believe that if the same research is conducted now, India will perform far better as India initiated various initiatives (like PMJDY) to increase financial inclusion.
- **Enhancement of Loan limit against eNWR/NWR under PSL guidelines:** In order to encourage farm credit to individual farmers against pledge/hypothecation of agricultural produce and leverage the inherent safety of Negotiable Warehouse Receipts (NWRs)/electronic-NWRs(e-NWRs) RBI has decided to enhance the loan limit from ₹50 lakh to ₹75 lakh per borrower. This is an excellent step and will increase the overall loan amount which was merely ₹437.9 crore in FY20 as against 1.4 lakh eNWR/NWR issued.

Registered warehouses with WDRA, NWRs/e-NWRs issued and loan financed

Year	No. of registered warehouses	No. of NWRs/e-NWR issued	Total Quantity of Stocks against NWR/eNWR (in Lakh Ton)	Total loan against NWRs/e-NWR (Rs crores)
2011-12	240	8056	1.4	591.0
2012-13	92	8242	1.4	105.7
2013-14	68	6121	2.6	108.0
2014-15	234	16993	5.1	388.4
2015-16	588	15178	5.7	203.5
2016-17	214	19350	3.6	148.4
2017-18	261 (Online-106)	12313 (e-NWR-114)	3.5 (eNWR – 1.8)	118.5 (against e-NWR-Rs.0.2 Cr)
2018-19	607 (Online – 601)	89114 (e-NWR-77332)	7.2 (eNWR- 5.2)	135.6 (against-e-NWR-28.2)
2019-20	1005	138637 (e-NWR-134939)	9.5 (eNWR - 8.9)	437.9 (e-NWR-379.7)
2020-21	124	44139 (eNWR only)	3.7 (eNWR only)	284.6 (eNWR only)
Total	**3433**	**358143**	**41.9**	**2521.7**

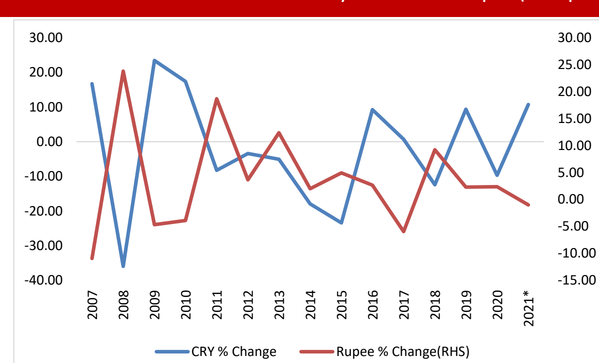
Source: DFPD; SBI Research

- **Centralised Payment Systems (CPS), viz- RTGS and NEFT – Membership for entities other than banks:** To encourage participation of non-banks (PPI issuers, WLA and TReDS etc) across payment systems, RBI has proposed to enable payment system operators, regulated by RBI, to take direct membership in CPSs. This facility is expected to minimise settlement risk in the financial system and enhance the reach of digital financial services to all user segments.
- **Interoperability of Prepaid Payment Instruments (PPIs), and Increase in account limit to ₹ 2 lakh:** In line with increase in limits of Payment Banks and optimal utilization of payment I nstruments (like cards, wallets etc.), RBI has also increased the account limit and made interoperability mandatory for full-KYC PPIs and for all payment acceptance infrastructure. This will increase the use of the existing payment infrastructure and will boost digital transactions in the country.
- **Permitting Cash Withdrawal from Full-KYC PPIs issued by Non-banks:** RBI has allowed cash withdrawals for full-KYC PPIs of non-bank PPI issuers. This measure will boost migration to full-KYC PPIs and would also complement the acceptance infrastructure in Tier III to VI centres. This will help the customers to withdraw their money from ATMs during their needy time. So, these PPIs will act like bank accounts.
- **Relaxation in the period of parking of External Commercial Borrowing (ECB) proceeds in term deposits:** So far the drawn ECBs had to be kept in non-interest bearing account after one year if it remained utilized. The pandemic has led to incomplete utilization of funds, due to the demand slowdown. RBI's announcement today for extension of period to keep unutilized ECB in the form of fixed deposit from 1 year to 2 years will be beneficial for ECB borrowers as it will obviate the need for parking it in non-interest bearing account after 12 months from drawdown date.

LIQUIDITY, EXCHANGE RATE MANAGEMENT AND INFLATION: SIMILARITY WITH THE FY08 PLAYBOOK?

- Till Jan'21, RBI has purchased $75.2 billion worth of US Dollar to keep the Rupee from appreciating excessively and the outstanding net purchase stood at $47.4 billion. This is the highest amount of forex purchase since FY08 when RBI had made purchases to the tune of $ 78.2 billion, before capital outflows pushed RBI to turn to net seller in FY09 to defend the Rupee which saw its value depreciate by around 24% in calendar year 2008.
- Inflation increased significantly in India during November 2007-August 2008, a period when the exchange rate underwent appreciation largely on account of increased inflows of foreign capital, which should have benefitted inflation management through favourable pass-through effects. Since August 2008, inflationary pressures subsided considerably even though the exchange rate depreciated. While this might have enhanced the price competitiveness of Indian exports at a time when external demand was contracting, the pass-through effects on domestic inflationary conditions should have worked towards moderating the rapid decline in prices.
- A prima facie observation of the trends in the behaviour of the nominal exchange rate and inflation may suggest that the exchange rate pass-through effects on prices were working in the opposite direction in relation to the expected normal behaviour. However, in view of the leads and lags in transmission of effects from exchange rate to inflation, as also the unprecedented volatility seen in the primary determinants of inflation during 2008-09, empirical evidence on pass-through has to be seen as a dynamic process. International commodity prices increased at a much faster rate than the rate of appreciation in the exchange rate during the first phase and, as a result, the net effect on inflation through import prices still remained positive and strong. Similarly, since August 2008, the decline in global commodity prices was much sharper than the exchange rate depreciation, causing the net effect on import costs to be negative and significant.
- Now fast forward to the present.
- Currently, the weighted component of imported inflation has been rising as crude oil prices have increased. From a low of $20 per barrel, crude oil Indian basket is at $61 in Feb and the weighted average imported component has gone from 0.55 in Jun'20 to 0.93 in Feb'20. With Rupee also showing depreciating tendencies, and increasing commodity prices, the inflationary impact might turn positive, as the increase in commodity prices could be much faster than rupee appreciation which took place recently. This could play spoilsport in terms of RBI exchange rate management.
- However, the good thing is currently, with regards to the exchange rate management strategy, rupee is not witnessing any speculative threats as of now. RBI was earlier buying heavily in the spot market and simultaneously doing sell buy swaps to keep manage exchange rate and ensure there was not enough liquidity overhang. However, there were many oversold dollar positions in the market as a result of stability in the rupee exchange rate. But with the trigger points of COVID-19 cases rising and the rising focus of RBI on yield, such trend of upturn in Rupee is now witnessing a reversal with dollar buying. This risk has to be recognized and the risk management policy in line with the spot and forward market trends has to be dynamic to result in effective forex exposure management. Interestingly, RBI has recently turned a net seller of dollars in foreign exchange market.

Y-o-Y movement of Core commodity Index and Rupee(end period)



Source: SBI Research, * indicates till 07 april

CORPORATE RESULTS

- Corporate, in the listed space, reported better growth numbers across parameters in Q3FY21 after improved EBIDTA in Q2FY21 post a dragged Q1FY21.
- We expect strong Q4 FY21 numbers in listed space, particularly in sectors such as Automobile, FMCG, Pharma, Cement, Steel, Consumer Durable etc. In Infra space also we see a broad based recovery across parameters in Q4 primarily driven by sharp uptick in execution with labour force and supply chain at pre-covid levels, robust awarding in roads, water infra, urban infra and healthcare, upcycle in real estate with key markets like MMR, Pune, Bangalore etc.
- Further, with positive demand environment, we expect consumer durables to register healthy growth rates and end the year on a high given positive consumer sentiment, more so in rural India, soaring temperatures aiding cooling products portfolio etc.

IMPROVING CREDIT RATIO

- While analysing rating for various sectors, we observed improvement in credit ratios post second quarter FY21. Overall, we saw improvements in rating upgrades during Q3 and Q4 FY21 as compared to Q1 and Q2 FY21. Credit ratio in H1FY21 improved to 0.24, with 1451 upgrades as compared to 6110 downgrades, from 0.10 in H1FY21 with 773 upgrades and 7454 downgrades. Some of the sectors reported improvement in credit ratio includes Capital Goods, Healthcare, Pharma, Steel, Cement etc.

Improving credit ratio

Period	Upgrades	Downgrades	Credit Ratio (U/D)
Q1FY21	235	3792	0.06
Q2FY21	538	3662	0.15
H1	**773**	**7454**	**0.10**
Q3FY21	644	3259	0.20
Q4FY21	807	2851	0.28
H2	**1451**	**6110**	**0.24**

Source: Crisil; SBI Research; numbers for all rating agencies

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