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20 BPS HIKE IN REVERSE REPO RATE OUTSIDE MPC

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The large size of the FY23 market borrowings at Rs 14.3 lakh crores and with no progress on the inclusion of Indian debt market in the global bond indices yet begs the question whether the RBI might have to delay the liquidity normalisation in an effort to support the large borrowings programme. While the budget needs to be complemented for fiscal transparency as it is on course to align all off balance PSU borrowings (7.7% of GDP) and fiscal deficit (6.4%) possibly by FY24, this would clearly result in a trade-off between liquidity normalisation or rate adjustments. The larger question is the blurring of debt management and liquidity management operations of RBI. This again raises the question of whether debt management functions of the RBI needs to be separated from monetary management.

Based on the ownership pattern of Government of India dated securities as on Sep'21 and given the total net borrowings of Centre at Rs 11.2 lakh crore, we believe demand of securities from banks has to be around Rs 4.2 lakh crore (considering NDTL increase of 10% and 27% of SLR). The insurance sector could subscribe to Rs 2.7 lakh crore. This implies RBI would have to still ensure demand of at least Rs 2.0 lakh crore through OMO purchases. This leaves the question of liquidity normalisation complicated. It is an irony that outstanding Dated Government Securities (as on January'22-end), aggregating Rs 80.8 trillion and due for redemption till 2061, have a handful of formidable players like Banks and Insurance companies who together account for ~62% ownership among themselves / Rs 50 trillion though overall share of Banks has dwindled by ~10% in the last decade (from 47.25% in March'2010).

Given that Banks and Insurance companies largely carry the burden of managing the market of G-secs, the next question is of redemption patterns. In the current fiscal (YTD), out of total G-Sec issuance of Rs 8.27 Tn, bonds due for repayment in 0-5 and 5-10 years bucket constituted 28.4% and 24% of total value respectively, implying ~48% of amount raised were through papers having maturities in excess of 10 years. Banks prefer papers of 10 years and below and insurance companies of larger than 15 years. RBI may have to change the composition of outstanding as well as fresh/to-be-issued papers in FY23 with medium duration offerings / 10 years and below elbowing longer tenor papers to balance redemption pressures going forward. It is to be noted that satiating market's craving for liquidity annihilation of late through siding with longer period 28 -days VRRR are only measures of exigencies and not permanent tools of liquidity adjustment.

The questions is whether India could take a quick decision of getting included in bond index that many puritans believe would help in bringing annual inflows somewhere close to Rs 1.5 lakh crores / US$15-20bn in our Rs 80 trillion debt paper market. As India pursues an ambitious roadmap to clock unprecedented growth on exports front in the realigning supply chain ecosystem that has forced relocation of the 'factories to the world' from certain jurisdictions, the RBI may find its arsenal equipped with insufficient gunpowder should the inflows spike. Also, the Damocles' sword of RBI in managing such rupee swings through interventions dubbed as 'precision strikes' is serrated more towards appreciation check, thereby requiring frequent interferences. This could open up a Pandora's box!

Elsewhere, the real problem might have started when the credit growth started picking up in H2, but the deposits growth lagging behind. The incremental credit deposit ratio currently stands at 140 indicating sooner than later there is a need to increase the deposits rate to garner more durable liquidity in terms of bank deposits. Any delay in raising deposit rates may result in a only large incremental increase in later point of time as banks will have to do a catch up. Also, small saving rates continue to be attractive in terms of rates. Recently, some private banks have raised their term deposits rates in the tenures like 2-3 Y, 3-5 Y and above 5 Years buckets. With the increase in deposits rates, the lending rates also need to increase to preserve the margins. However, this will be a catch-22 situation as the high lending rates will be danger to incipient recovery. This conundrum gets more complex in FY23. In FY22, Small savings collections exceeded the budgeted amount by a large Rs 2 lakh crores, and that had resulted in net borrowing falling short by Rs 1.7 lakh crores. The challenge lies in FY23 with net borrowings increasing by Rs 4.1 lakh crores and small savings supposed to be lower by Rs 1.7 lakh crores than the revised FY22 amount. If this numbers in FY23 fructify, there will be large pressures on bank deposit rates to go up given that small saving rates are already much higher than bank deposit rates.

Given all this, we believe the time is now appropriate to go for a 20 bps hike on reverse repo rate, but outside the MPC meeting as enshrined in the RBI act that clearly lays down that reverse repo is more of a liquidity management. A hike in reverse repo is also required as a larger corridor has resulted in rate volatility.

JUMP IN MARKET BORROWINGS TO DILUTE LIQUIDITY NORMALIZATION?

- In FY23, Gross market borrowing through dated securities has been budgeted at Rs 14.3 lakh crore and taking repayments of Rs 3.1 lakh crore (adjusted for Rs 64,000 crore switch announced recently) net market borrowing stands at Rs 11.2 lakh crore (67.4% of fiscal deficit). The short-term borrowing for FY23 has been pegged at Rs 50,000 crore, that we expect might be scaled up if need arises.
- The good thing is that the Government has reduced the EBR mobilised through NSSF and fully serviced bonds to nil in FY23 and the amount for FY22 has also been revised down to Rs 752 crore from Rs 30,000 crore in FY21 BE. Furthermore, there has been a progressive decline in extra budgetary resources (EBR) for PSUs to Rs 2.14 lakh crore in FY23 from the revised Rs 2.53 lakh crore in FY22, a 15% decline. Thus the total borrowing requirement after taking into account the Centre, State and EBR comes to Rs 19.9 lakh crore or 7.7% of the GDP. The Government plans to completely align the fiscal deficit and overall borrowings by FY24.
- Given a huge borrowing requirement and no progress on the inclusion of Indian debt market in the global bond indices yet, RBI might have to support Government borrowings in FY23 and this could delay the process of liquidity normalisation.

BANKS AND INSURANCE COMPANIES HAVE HIT A WALL

- Based on the ownership pattern of Government of India dated securities as on Sep'21 and given the total net borrowings of Centre at Rs 11.2 lakh crore, we believe demand of securities from banks has to be around Rs 4.2 lakh crore (considering NDTL increase of 10% and 27% of SLR). The insurance sector could subscribe to Rs 2.7 lakh crore. This implies RBI would have to ensure demand of atleast Rs 2.0 lakh crore. The rest amount will be purchased by PDs, Mutual Funds, FPI and others.
- Outstanding Dated Government Securities (as on January'22-end), aggregating 80.76 trillion and due for redemption till 2061, have a handful of formidable players like Banks and Insurance companies who together account for ~62% ownership among themselves though overall share of Banks has dwindled by ~10% in the last decade (from 47.25% in March'2010). Interestingly, Banks lean more towards shorter tenor, preferably for 10 year or below offerings, leaving the higher tenors for insurance companies and others with analogous appetite.

Market Borrowings through Dated Securities (Rs lakh crore)

Centre	FY 21	FY 22(BE)	FY 22 (RE)	FY 23 (BE)
Gross Borrowing	12.8	12.1	10.5	14.3
Repayments	2.3	2.8	2.7	3.1
Net Borrowing	10.5	9.2	7.8	11.2
State				
Gross Borrowing	8.7	11.0	7.8	9.0
Repayments	1.5	2.1	2.1	2.4
Net Borrowing	7.2	8.9	5.8	6.6
Total				
Gross Borrowing	21.5	23.0	18.3	23.3
Net Borrowing	17.8	18.1	13.5	17.8

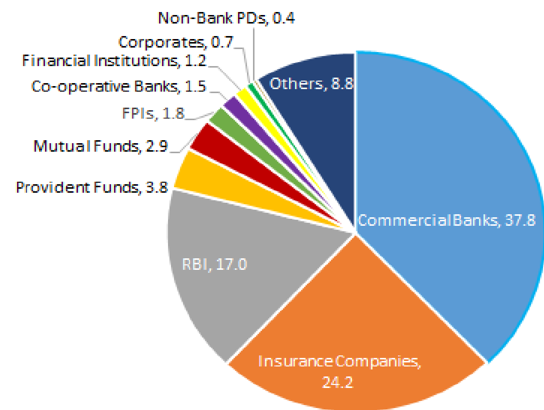
Source: SBI Research

Total Borrowing Requirements including EBR (Rs lakh crore)

	FY 21	FY22 (BE)	FY22 (RE)	FY23 (BE)
Net market borrowing of Centre	10.5	9.2	7.8	11.2
Net market borrowing of State	7.2	8.9	5.8	6.6
Extra Budgetary Resources of Center (through fully serviced bonds & NSSF)	1.2	0.3	0.0	0.0
Extra Budgetary Resources for PSUs	3.9	3.5	2.5	2.1
Total Borrowing	**22.9**	**21.9**	**16.0**	**19.9**
Total Borrowing (% of GDP)	**11.6**	**9.8**	**6.9**	**7.7**
Fiscal Deficit of Center (% of GDP)	**9.2**	**6.8**	**6.9**	**6.4**

Source: Union Budget Documents & SBI Research

Ownership Pattern of Government of India Dated Securities (% Share, Sep'21)



Source: SBI Research

- In the current fiscal (YTD), out of total G-Sec issuance of Rs 8.27 Tn, bonds due for repayment in 0-5 and 5-10 years bucket constituted 28.4% and 24% of total value respectively, implying ~48% of amount raised were through papers having maturities in excess of 10 years, by all means not a favourable fiefdom of the otherwise bankable banks. In FY21, the ratio for corresponding issuances in 0-5 and 5-10 years buckets was 20.5% and 21%, while 58.5% of the securities issued were maturing beyond 10 years even as the total amount issued stood much higher at Rs 16.85 Tn. As RBI itself has been one of the significant absorbers of G-Sec issuances (~17% share), the composition of outstanding as well as fresh/to-be-issued papers may have to undergo patent change with medium duration offerings elbowing longer tenor papers to balance re-demption pressures going forward. It is to be noted that satiating market's craving for liquidity annihilation of late through siding with longer period 28-days VRRR are measures of exigencies and permanent tools of liquidity adjustment.
- In our calculations, as per market demand, we expect tenor with distribution as alongside.

THE LARGELY UNDERUTILIZED DEBT STORY OF FPIS

- While FPIs have been allowed to invest in debt securi-ties since 1997, their enthusiasm for debt side has been quite damp as compared to the exuberance shown for equities where FPIs investment successfully rivals that of domestic MF industry. In the last two CYs 2020 & 21, positive inflows of Rs 58,000 crore have been seen only in Debt-VRR (attracting long term and stable investments with tenor commitment) leading to exhaustion of limits available while general debt portfolio has seen successive outflows in these years, with outflow in the first year of the pandemic being in excess of 1 lakh crore, showing the fragile, somewhat opaque and flight-prone underlying dotting the global monetary ecosystems as overall investment limits have largely remained underutilized in debt as well as corporate bonds dismally (@6% of available stock).

WILL INDIAN BONDS FIND HOME IN GLOBAL BONDS INDEX SOMETIME SOON

- The dilly-dallying on part of the policy makers, taking calculated, even if apparently staggered steps towards inclusion of Indian bonds in global indexes, that many puritans believe would help in bringing annual inflows somewhere close to Rs 1.5 lakh crores / US$15-20bn in our Rs 80 trillion debt paper market, is not without a reason.

Maturity Profile of Outstanding Government Securities (Rs Bn)

FY	Short Term Securities (0-5 Yrs)	Mid Term Securities (5-10 Yrs)	Long Term Securities (>10 Yrs)	Total
FY22	341		2302	2643
FY23	843	284	2000	3127
FY24	1053	1888	1633	4574
FY25		896	3181	4078
FY26		2370	3132	5502
FY27	1495	962	3861	6318
FY28			4412	4412
FY29		248	3723	3971
FY30			3509	3509

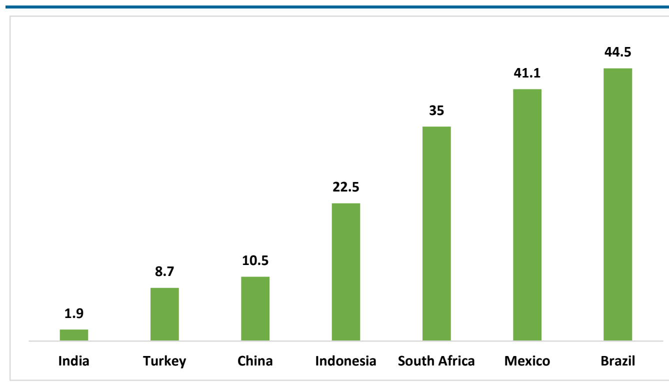
Source: RBI, SBI Research

Expected Distribution

Tenor	Share
1-5yr	20%
5-9yr	15%
10yr	24%
11-15yr	21%
Long term	20%

Source: SBI Research

Government Bond Ownership by Foreign Investors (%)



Source: SBI Research

- To extrapolate the inflows in such bulk volume, in particular at the upper end of the band, one would need to look beyond the likely effects on softening yield, at the probable appreciation in rupee. As India pursues an ambitious roadmap to clock unprecedented growth on exports front in the realigning supply chain ecosystem that has forced relocation of the 'factories to the world' from certain jurisdictions, the RBI may find its arsenal equipped with insufficient gunpowder should the inflows spike, in particular during spans of quick rebalancing in indexes as political conflicts and trade wars are of-late doing tango in unison. Also, the Damocles' sword of RBI in managing the rupee swing, through interventions dubbed as 'precision strikes' is serrated more towards appreciation check, thereby requiring frequent interferences, not taken kindly by global investors who demand greater scrutiny post inclusion in index.

INCREMENTAL CREDIT GROWTH SIGNIFICANTLY SURPASS DEPOSITS GROWTH: SIGNS OF RATE UPTURN COMING?

- During 2021-22, signs of credit recovery became visible in H2, supported by the cumulative reduction in the policy repo rate by 115 bps since March 2020, as well as various liquidity enhancing measures undertaken by the RBI, and supported by several sector specific measures announced by the government during the year.
- As per the latest available data for the week ended 14 Jan'2022, ASCB's incremental credit grew by Rs 5.46 lakh crore, compared to last year growth of Rs 2.72 lakh crore. While, the incremental deposits growth is Rs 8.6 lakh crore during Apr-Jan FY22, compared to last year growth of Rs 10.5 lakh crore. However, If we break the total incremental growth to H1 & H2 FY22, it is clearly evident that there was meagre credit growth in H1, despite huge deposits growth. During that time (H1FY22) bank were investing in G-secs and are not under stress due to rising yield.
- The real problem might have started when the credit growth started picking up in H2, but the deposits growth is lagging behind. The incremental credit deposit ratio currently stands at 140 indicating sooner than later there is a need to increase the deposits rate to garner more durable liquidity in terms of bank deposits. A delay in raising deposit rates may result in a large incremental increase in later point of time . Also, small saving rates continue to be attractive in terms of rates.

Incremental Deposit and Advances and small savings (Rs Thousand Crore)

Year	Deposits	Advances	CD Ratio	National Small Saving
FY 19	1147	1146	100	212
FY20	990	599	61	280
FY 21	1540	580	38	305
FY 22 H1	485	7	2	137
FY 22 H2*	384	539	140	61

Source: CGA,RBI; *Credit and Deposit incremental is till 14 th jan'22 and small savings till Dec'21, #Accretion to liabilities during the year

- Recently, some private banks like HDFC & ICICI Banks have raised their term deposits rates in the tenures like 2-3 Y, 3-5 Y and above 5 Years buckets.
- With the increase in deposits rates, the lending rates also need to increase to preserve the margins. However, this will be a catch-22 situation as the high lending rates will be danger to incipient recovery.

TD Rates of Selected Banks

Banks	2Y - 3 Y	3Y-5Y	5Y-10Y
Axis	5.40	5.40	5.75
HDFC	5.20 (-5.15)	5.40 (5.35)	5.60 (5.50)
ICICI	5.20	5.45 (5.40)	5.60
IDBI	5.20	5.40	--
Union Bank	5.30	5.40	5.50
SBI	**5.10**	**5.30**	**5.40**

Source: SBI Research; *Previous rates are shown in brackets

SMALL SAVINGS (SS) RATES ARE HIGHER THAN BANK DEPOSITS RATES

- To protect the interest of the small depositors during the pandemic, Government has not revised small savings schemes rates since Q1FY21. However, RBI has reduced key policy repo rate by 115 bps to 4.0% and Reverse Repo Rates by 155 bps to 3.35%. With this, banks have also reduced their interest rates (both deposits & lending) significantly.
- If we look at SCBs, the lending rates (weighted average lending rates on fresh loans) has declined by 99 bps (PSBs:132 bps, Pvt Banks: 67 bps) and weighted average domestic term deposit rates reduced by 132 bps (PSBs: 123 bps, Pvt banks: 136 bps) during Mar'20 to Dec'21.
- In FY22, small savings collections exceeded the budgeted amount by a large Rs 2 lakh crores, and that had resulted in net borrowing falling short by Rs 1.7 lakh crores. The challenge lies in FY23 with net borrowings increasing by Rs 4.1 lakh crores and small savings supposed to be lower by Rs 1.7 lakh crores than the revised FY22 amount. If this numbers in FY23 fructify, there will be large pressures on bank deposit rates to go up given that small saving rates are already much higher than bank deposit rates.

20 BPS HIKE IN REVERSE REPO RATE

- Given all this, we believe the time is now appropriate to go for a 20 bps hike on reverse repo rate, but outside the MPC meeting as enshrined in the RBI act that clearly lays down that reverse repo is more of a liquidity management. A hike in reverse repo is also required as a larger corridor has resulted in rate volatility.
- For example, the call money rate showed extreme volatility in the month of Jan'22. The gap between High and Low rates during Jan'22 was as high as 79 bps. Even at three instances the call money rate touched the 4.0% mark also. The reason for this enormous volatility in call money rate is due to wide LAF corridor (currently at 65 bps). Further, the auctioned variable reverse repo rate is stands at 3.99%, just below the repo rate.

Transmission of Policy Rates: Small Savings Rates vs Bank Rates

Instruments	Q1FY21*	Q4FY22	Difference (in bps)
Savings Deposits	4.0	4.0	No Change
PPF	7.1	7.1	
5 year Recurring Deposit	5.8	5.8	
1-Yr Term Deposit	5.5	5.5	
2-Yr Term Deposit	5.5	5.5	
3-Yr Term Deposit	5.5	5.5	
5-Yr Term Deposit	6.7	6.7	
Sr. Citizen Savings Scheme	7.4	7.4	
Post Office Monthly Income Scheme	6.6	6.6	
KVP	6.9	6.9	
NSC	6.8	6.8	
Sukanya Samriddhi A/C	7.6	7.6	
Memo			
RBI's Repo Rate (26 Mar'2020)	5.15	4.00	-1.15
Wtd Avg Dom. Term Deposits Rates (WADTDR)	6.38	5.06	-1.32
Weighted Average Lending Rates on Fresh Loans (WALR)	8.71	7.72	-0.99
10 Yr G-sec Yield (Avg)	6.42^	6.36^	-0.06

Source: SBI Research * rates as on end March 2020 ^ Avg of previous quarter

Monthly Maximum & Minimum Call Rate (%)

Month	Max	Min	Difference
Aug-21	3.27	3.13	0.14
Sep-21	3.37	3.13	0.24
Oct-21	3.33	3.17	0.16
Nov-21	3.44	3.16	0.28
Dec-21	3.66	3.25	0.41
Jan-22	4.00	3.21	0.79

Source: SBI Research

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