SBI RESEARCH

ECOWRAP

IS THE MONETARY POLICY STATEMENT REALLY HAWKISH?...THE NEED FOR 35 BPS BY MPC IS BASED ON WHAT WAS.... AND NOT IS....MARKETS SHOULD WATCH THE GRASS GROW...

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As widely expected, RBI today raised the rate by 35 basis points to 6.25%, as the MPC decided (5-1) to remain focused on withdrawal of accommodation to ensure inflation remains within the target going forward, while supporting growth. However, the decision was not unanimous. One of the members voted against the repo rate hike, while two members voted against the withdrawal of accommodation. The SDF now stands adjusted to 6.0% while MSF has inched up to 6.50% .

With ~47% of the loans benchmarked to external benchmarks (EBR), the increase in repo rate of 225 bps (including today's 35 bps hike) will eventually increase interest cost further. Our analysis indicates that due to this rate hike cycle, interest cost on Retail & MSME consumers will increase at around Rs 68,625 crore (1 bps increase in repo will have combined impact of ~ Rs 305 crore on Consumers – Retail MCLR Loans: Rs 65 crore and MSME MCLR: Rs 240 crore). This may impact demand, going forward.

RBI retained the CPI inflation projection at 6.7 % in FY23 despite core inflation remaining sticky and elevated, and uncertainty surrounding near term outlook of geo-political hostilities, as well as US dollar and imported inflation. On the positive side, food inflation is likely to moderate with the usual winter softening with high likelihood of a bountiful rabi harvest, and downward correction in global commodity prices, including crude oil, thus evenly balancing the risk.

RBI, however downgraded the real GDP growth projections for FY23 to 6.8 % from 7.0 % due to adverse spill overs from the global slowdown and its negative impact on our net exports and overall economic activity. RBI's GDP growth projections for Q3 is 4.4%; and Q4 is 4.2%; Q1 FY24 at 7.1% and Q2 at 5.9%.

We believe that there is some confusion (on WAS/IS) in the market initially regarding the language of Governor's Statement. Today's decision was clearly based on the view that calibrated monetary policy action *was* warranted to keep inflation expectations anchored. This statement should not be read as the action point for future, leading to a "Lost in Translation" scenario by select market participants as the MPC would be scenario/data dependent in its future course.

Liquidity has remained in the surplus mode with decline in average surplus till Oct'22 as given by Net LAF. Going ahead liquidity conditions are likely to improve on the back of moderation in currency in circulation in the post-festival period, pick up in government expenditure in the last few months of the financial year and higher forex inflows.

On developmental and regulatory landscape, today's announcements assume significance as extended period for dispensation of **enhanced HTM limit of 23% till end-March'24** should give the banks great foresight in managing the investment book prudently for extended tenor and a viable roadmap to shift the holdings in a gradual, step-down manner well absorbing the external shocks and containing volatility in benchmark yields which otherwise can thwart the recent buoyancy displayed among banking industry. Major announcements in **UPI** (Single-Block-Multiple-Debits) should further amplify its usage and acceptance while expanding the scope of **BBPS** to include all categories of payments and collections, both recurring and non-recurring in nature is a master stroke to broad base and universalize its acceptance. Allowing entities to hedge gold price by approaching Indian banks in GIFT city thereby reducing the hassle to approach overseas markets should pitch GIFT City to rival the leaders in other jurisdictions in this important commodity segment.

Taking a cue from para 30 of today's statement, we find similarities to what then Fed chair Jenner Yellen proclaimed in 2017 comparing the regulatory steady policy normalization and balance sheet reduction to "watching paint dry"—low on drama and surprise but yielding desired results in a given time frame as also recent address by Fed chair Powell that monetary policy affects the economy and inflation with uncertain lags, and the full effects of Fed's rapid tightening so far are yet to be felt BUT necessitating moderation of pace of rate hikes. We believe landscape should be much greener if one 'watches the grass grow' with some fortitude, and virtue of patience, reposing faith in fine acts of balancing by RBI.

We maintain that the RBI communication is nuanced and has wisely kept the options open on the table regarding future rate changes. We maintain a low probability of a February terminal 25 bps rate hike. However, that will also be accompanied with a change in stance to neutral, if it was to happen so. The next policy statement is due on Feb 6-8 and just comes after the budget announcement on Feb 1 and after the FOMC policy statement on Jan 31-1, first in 2023. From that point, RBI will be in a vantage position of taking a considerate view in February policy.

RBI RAISES RATE BY 35 BPS

- As widely expected, RBI today raised the rate by 35 basis points to 6.25%, as the MPC decided to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth. However, the decision was not unanimous. One of the members voted against the repo rate hike and while two member voted against the withdrawal of accommodation. The SDF now stands adjusted to 6.0%.
- Around 47% of the loans are benchmarked to external benchmarks (EBR), so the increase in repo rate of 225 bps (including today's 35 bps hike) will eventually increase interest cost. Our analysis indicates that due to this rate hike cycle interest cost on Retail & MSME consumers will increase at around Rs 68,625 crore (1 bps increase in repo will have combined impact of ~ Rs 305 crore on Retail – MCLR Loans: Rs 65 crore and MSME MCLR: Rs 240 crore). This will likely to impact demand, going forward.
- RBI retained the CPI inflation projection at 6.7 % in FY23 despite core inflation remaining sticky and elevated, and uncertainty surrounding near term outlook of geo-political hostilities, as well as US dollar and imported inflation. On the positive side, food inflation is likely to moderate with the usual winter softening with high likelihood of a bountiful rabi harvest, and downward correction in global commodity prices, including crude oil. The risks are evenly balanced. CPI inflation projections for Q3 is 6.6%; Q4 is 5.9% and Q1 FY24 is projected at 5.0% and Q2 at 5.4%.
- RBI downgraded the real GDP growth projections for FY23 to 6.8 % from 7.0 % due to adverse spillovers from the global slowdown and its negative impact on our net exports and overall economic activity. The biggest risks to the outlook continue to be the headwinds emanating from protracted geopolitical tensions, global slowdown and tightening of global financial conditions. On the positive side, there is recovering rural demand, increasing consumer confidence, optimistic manufacturing, services and infrastructure sector firms, resilient agriculture sector, highest manufacturing and services PMI among the world. RBI's GDP growth projections for Q3 is 4.4%; and Q4 is 4.2%; Q1 FY24 at 7.1% and Q2 at 5.9%.

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	Q3 FY23	Q4 FY23	FY23	Q1 FY24	Q2 FY24
Dec'22	6.6	5.9	6.7	**5.0**	**5.4**
Sep'22	6.5	5.8	6.7	**5.0**	-
Aug'22	6.4	5.8	6.7	**5.0**	-
Real GDP Growth (%)	**Q3 FY23**	**Q4 FY23**	**FY23**	**Q1 FY24**	**Q2 FY24**
Dec'22	4.4	4.2	6.8	7.1	5.9
Sep'22	4.6	4.6	7.0	7.2	-
Aug'22	4.1	4.0	7.2	6.7	-

Source: RBI, SBI Research

RBI COMMUNICATION

- We believe that there is some confusion (on WAS/IS) in the market regarding the language of Governor Statement. Today's decision **was** based on the view that calibrated monetary policy action is warranted to keep inflation expectations anchored. This statement should not be read as the action point for future.
- Further, the Governor stated that the future course of action will depend on new data considerations, evolving economic outlook and **effect of past policy actions.** This again indicates that today's policy might be taken as the terminal decision as transmission always take time.

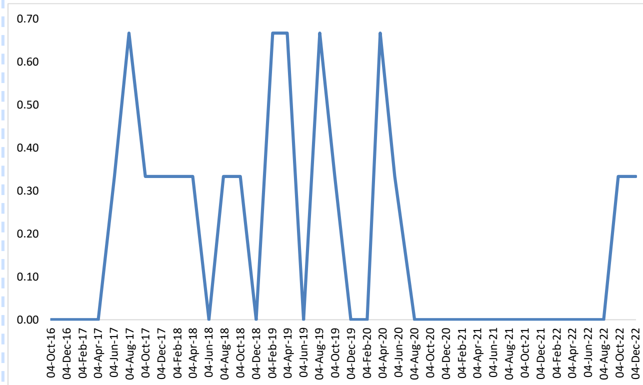
LIQUIDITY REMAINS IN SURPLUS MODE

- Liquidity has remained in the surplus mode with decline in average surplus till Oct'22 as given by Net LAF. The average daily net absorption increased to Rs 460 billion in Nov'22 form Rs 67 billion in Oct'22. This further increased to Rs 1.6 trillion in December so far.
- Meanwhile, the Government surplus cash balances have declined to Rs 894 billion in Dec'22 so far from Rs 3 trillion in Oct'22 and Rs 2.1 trillion in Nov'22.
- Going ahead liquidity conditions are likely to improve on the back of moderation in currency in circulation in the post-festival period and higher forex inflows. Nonetheless, RBI remains committed to managing liquidity by conducting LAF operations.

VOTING PATTERN OF RBI INDICATES GREATER CLARITY AND UNANIMITY

- Voting records of individual members on the policy rate exhibited diversity. Twenty-three of the 39 decisions of the MPC on the repo rate have been unanimous with respect to the direction of policy rate change while there was disagreement on 16 decisions. The disagreement with the 'majority view' was not limited to external MPC members; even internal members had differences on the size as well as direction of policy rate changes. This is in contrast with the view in the literature that only external members help avoid "groupthink" (Sibert, 2006).
- In order to formally analyse the MPC's voting pattern, a Diversity Index (DI) was constructed (using RBI's methodology) on the basis of the voting by individual members. DI was calculated by the formula [1 - {(Number of MPC members supporting the decision minus number of MPC members opposing the decision) divided by the total size of the MPC (6 in this case)}]. The range of DI is from 0 to 1: 0 implying full agreement (6:0) and 1 implying equal division in voting (i.e., 3:3). DI confirms large disagreement on policy rate actions till the onset of Covid-19. After that the DI remained flat and seen traction recently.

Diversity Index

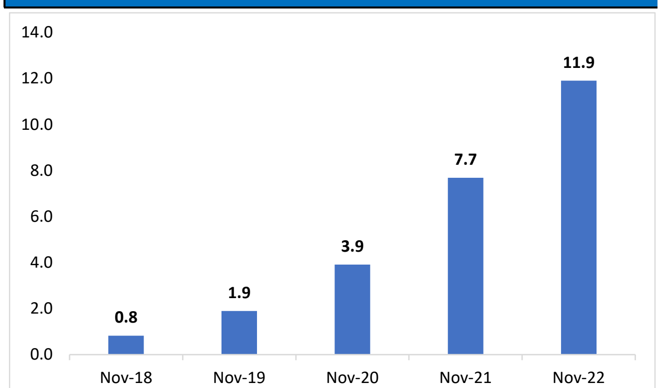


Source: RBI, SBI Research

DEVELOPMENTAL AND REGULATORY MEASURES

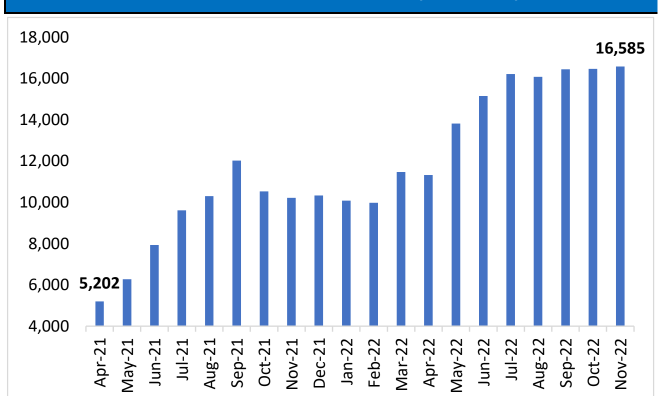
- **Single-Block-and-Multiple-Debits in UPI:** UPI has features which enable processing of mandates for recurring transactions and single-block-and-single-debit functionality. Currently, over 70 lakh autopay mandates are handled every month. The present proposal is to allow a single mandate to make multiple debits from the user account using the UPI. The functionality will reduce time of payment and will have positive impact on e-commerce and financial investments such as mutual fund SIPs.
- **Bharat Bill Payment System (BBPS) to include all Payments and Collections**: BBPS currently allows various types of transactions such as categories of billers who raise recurring bills, facilitating in-bound cross-border bill payments. However, BBPS currently does not enable non-recurring payments or collection requirements of individuals even if they are recurring in nature. Consequently, some categories of payments / collections remain outside the ambit of the BBPS viz., professional service fee payments, education fees, tax payments, rent collections, etc. The present proposal expands the scope of BBPS to include all categories of payments and collections, both recurring and non-recurring in nature. This will make the platform accessible to a wider set of individuals and businesses.

UPI: Transaction Value (Rs lakh crore)



Source: RBI, SBI Research

BBPS: Transaction Value (Rs crore)



Source: RBI, SBI Research

- **SLR Holdings in Held to Maturity (HTM) category:** RBI's decision today to extend the timeline towards dispensation of enhanced HTM limit of 23% till end-March'24 should give the banks great foresight in managing the investment book prudently for extended tenor and a viable roadmap to shift the holdings in a gradual, step-down manner well absorbing the external shocks and containing volatility in benchmark yields which otherwise can thwart the recent buoyancy displayed among banking industry. Banks will now be allowed to include securities acquired between September 1, 2020 and March 31, 2024 in the enhanced HTM limit while the HTM limits would be restored from 23 per cent to 19.5 per cent in a phased manner starting from the quarter ending June 30, 2024.
- **Hedging of Gold Price Risk in the International Financial Services Centre (IFSC)**: Resident entities in India are currently not permitted to hedge their exposure to gold price risk in overseas markets. Further the hedges available are based on onshore price of gold which is higher than offshore price. The present proposal allows the entity to hedge gold price by approaching Indian bank in GIFT city thus reducing the hassle to approach overseas markets in London or the US.

THE GLOBAL ECONOMY

- The global economic outlook is titled towards the downside. Global growth is set to lose momentum as interest rates rise and consumer confidence weakens with the rising cost of livelihood. Global demand is expected to weaken further in 2023. Most of the rating agencies have revised the growth outlook downwards for 2023.
- Inflation remains elevated and persistent across countries with food and energy price shocks and shortages. Despite some signs of moderation in price pressures, which have raised expectations of an easing in the pace of monetary tightening, the current rate cycle is not approaching its peak. Unabating geopolitical tensions continue to impart uncertainty to the food and energy prices outlook.
- With multiple poly-crisis capital flows to emerging market economies (EMEs) will remain volatile and global spill overs pose risks to growth prospects.

WHOLESALE DIGITAL RUPEE FOR G-SEC TRANSACTIONS

- RBI's pilot project launched towards settlement of in secondary markets transactions in G-sec saw trades worth ~Rs.7100 crore during Nov'22. Being a pilot project, most of the 9 banks chosen are still using the testing phase carefully, studying the system closely as transactions are mostly confined to liquid securities. Given the positive impact on transaction costs envisaged, the system should really take off in coming days, spurring growth of various market segments as also incubating further innovation.

THE COURSE OF OUR FUTURE POLICY WILL DULY CONSIDER NEW DATA RELEASES AND THE EVOLVING OUTLOOK OF THE ECONOMY AS WELL AS THE EFFECT OF OUR PAST ACTIONS (FROM TODAY'S POLICY STATEMENT…)

- We take a special recourse to the summing up observations from the governor's statement today (point 30) wherein the central bank has made it ample clear that its glide path going ahead would be a dynamic act of combining the agility, balance and co-ordination that scientifically interprets the unfolding data available and its trajectory, the shape of global economic events juxtaposed against the external shocks and their pass through effects on domestic economy and the impact of the co-ordinated policy actions initiated during the year, in particular on the rate front. **While it may dissuade certain sections of market Pundits baying for immediate desired results, we borrow a line from Janet Yellen in 2017, then Fed Chair, who once compared the regulatory steady policy normalization and balance sheet reduction to "watching paint dry"—low on drama and surprise but yielding desired results in a given time frame. Even Fed chair Powell's recent address at Brookings institute unequivocally proclaiming monetary policy affects the economy and inflation with uncertain lags, and the full effects of Fed's rapid tightening so far are yet to be felt thus necessitating moderation of pace of rate hikes, that upends this line of thought. As the concerted efforts of RBI would bear fruits with a time lag, we believe the landscape should be much greener if one 'watches the grass grow' with some fortitude, and virtue of patience.**

INVESTMENT/CAPEX GAINING MOMENTUM IN CORPORATE SECTOR

- With investment activity getting support from government, a pick-up in the share of fixed assets in total assets of manufacturing companies was visible in H1. Fixed assets improved by more than Rs 1.5 trillion in the listed space ex BFSI (see table for top sectors).
- Moreover, around Rs 6 lakh crore is being added in Gross block by 2400 listed entities in last two years. Further, capital work in progress is around Rs 4.5 lakh crore as of March'2022, which suggests around Rs 10 lakh crore increase in fixed assets (Capex) by these listed entities alone.
- In FY23 (April-Nov), investment announcements as per the provisional numbers crossed Rs 17 trillion. With Private sector already contributed Rs 11.52 lakh crore (April-Nov), we estimate in FY23 the investment announcement will exceed last year's number of Rs 20 trillion driven by private sector.

Increase in Fixed Assets (top 10 sector) Rs in crore

Sector	No of cos	Sept'21	Sept'22	Increase
Power Generation & Distribution	34	570655	608393	37738
Telecom	13	156697	177779	21082
Crude Oil & Natural Gas	6	170861	182700	11839
Chemicals	172	67659	77217	9558
Cement	34	102234	110592	8358
Steel	120	360648	368571	7923
Gas Distribution	8	72468	79329	6860
Pharmaceuticals	159	79206	83971	4765
Miscellaneous	199	22664	26642	3978
Retail	14	14632	18122	3490

Source: Cline; SBI Research

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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