SBI RESEARCH
ECOWRAP

A GUNG HO POLICY

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As expected, the policy did not surprise anyone and RBI kept the policy rates unchanged. RBI retained the inflation forecast at 5.40% for FY24, which leaves the fear of any rate hike in the current year. The upward revision in GDP forecast to 7% (SBI at 7%) for FY24 looks optimistic, reasonable and is likely to be overshot. Headwinds from the geopolitical turmoil, volatility in international financial markets and geoeconomic fragmentation pose risks to the outlook. Specifically, the emergence of a consistent theme in the **US non-farm payroll (NFP) released this year – wherein the headline figures have been revised lower for 8 of the nine months does not bode well for the US economy,** where better than expected GDP growth numbers have of late raised hopes of the economy avoiding a hard landing, in particular as latest unemployment numbers take US a little closer to triggering the Sahm Rule (SR), a foretelling Recession Indicator .

In our pre-policy report dated 24 Sep'23, we have discussed the peculiar case of banks keeping money under SDF and at the same time borrowing through MSF on days of deficit liquidity mainly on account of 24*7 NEFT and RTGS depicting the pre-cautionary motive. Furthermore, the issue aggravates on weekends and holidays, with funds flows on select Saturdays in particular inching towards the normal trading days as corporates resort to deft funds management, in sync with their own cashflows. This indicates banks, unsure of momentum and funds flows on such periods, tend to be risk agnostic, piling on buffer of extra liquidity that remains unusable in essence. In light with our report to address the issue RBI has now decided to allow reversal of liquidity facilities under both SDF and MSF even during weekends and holidays with effect from 30 December, 2023. This is a welcome step. It is expected that this measure will facilitate better fund management by the banks.

From the regulatory and development prospective, RBI has taken a slew of measures on digital measures like cloud facility for financial sector and enhancement in UPI transactions limit. The proposal to enhance the UPI transaction limit for payment to hospitals and educational institutions from ₹1 lakh to ₹5 lakh per transaction will help the consumers to make UPI payments of higher amounts for education and healthcare purposes. Banks and financial entities are maintaining an ever-increasing volume of data. Many of them are utilising the cloud facilities for this purpose. The Reserve Bank is working on establishing a cloud facility for the financial sector in India for this purpose. Such facility would enhance data security, integrity and privacy. It would also facilitate better scalability and business continuity. The cloud facility is intended to be rolled out in a calibrated fashion over the medium term. With RBI firmly on pushing inflation towards 4% on a consistent basis, we now believe that the first rate cut is now pushed back to second half of calendar 2024, August 2024 could be the earliest one.

REPO RATE KEPT AT 6.5%

- As widely expected, MPC decided to keep repo rate at 6.50%. It also decided to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns to the target, while supporting growth, though not unanimously. One of the members expressed reservations on withdrawal of accommodation.
- RBI retained its inflation projection for FY24 at 5.40% with Q3 at 5.6% and Q4 at 5.2% (both same as last policy). The outlook for inflation will hinges on following factors: Kharif harvest arrivals and progress in rabi sowing, adequate buffer stocks for cereals and a sharp moderation in international food prices, volatility in crude oil prices. For the next fiscal (FY25) assuming a normal monsoon next year, CPI inflation for Q1 FY25 is projected at 5.2%; Q2 at 4.0%; and Q3 at 4.7%.

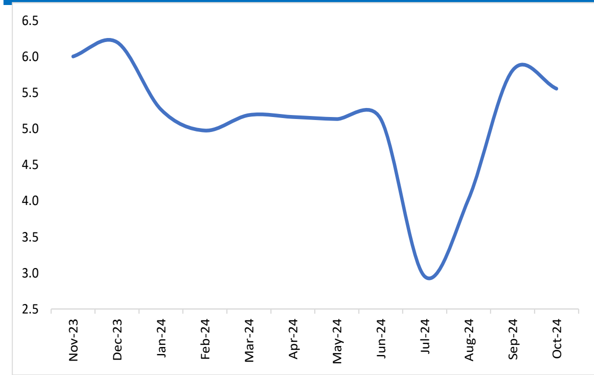
RBI Growth & Inflation Outlook for India						
CPI Inflation (%)	Q3 FY24	Q4 FY24	FY24	Q1 FY25	Q2 FY25	Q3 FY25
Dec'23	5.6	5.2	5.4	5.2	4.0	4.7
Oct'23	5.6	5.2	5.4	5.2	-	-
Aug'23	5.7	5.2	5.4	5.2	-	-
Real GDP Growth (%)	Q3 FY24	Q4 FY24	FY24	Q1 FY25	Q2 FY25	Q3 FY25
Dec'23	6.5	6.0	7.0	6.7	6.5	6.4
Oct'23	6.0	5.7	6.5	6.6	-	-
Aug'23	6.0	5.7	6.5	6.6	-	-
Source: RBI, SBI Research						

- As expected, RBI has revised its real GDP projection from 6.50% to 7.0% for FY24 with Q3 at 6.5% (earlier: 6.0%) and Q4 at 6.0% (earlier: 5.7%). Continued strengthening of manufacturing activity, buoyancy in construction, and gradual recovery in the rural sector are expected to brighten the prospects of household consumption. Healthy balance sheets of banks and corporates, supply chain normalisation, improving business optimism, and rise in public and private capex should bolster investment going forward. With improvement in exports, the drag from external demand is expected to moderate. Headwinds from the geopolitical turmoil, volatility in international financial markets and geoeconomic fragmentation pose risks to the outlook.

LIQUIDITY ISSUE ADDRESSED BY RBI

- We highlighted in our pre-policy report dated 24 Sep'23 the peculiar case of banks keeping money under SDF and at the same time borrowing through MSF on days of deficit liquidity mainly on account of 24*7 NEFT and RTGS depicting the precautionary motive. Furthermore, the issue aggravates on weekends and holidays, with funds flows on select Saturdays in particular inching towards the normal trading days as corporates resort to deft funds management, in sync with their own cashflows. Banks, unsure of momentum and funds flows on such periods, tend to be risk agnostic, piling on buffer of extra liquidity that remains unusable in essence. We even demanded enhancing the timing of CCIL clearing till 5:00 pm (from the present 2:30 pm).
- The Central Bank has now decided to allow reversal of liquidity facilities under both SDF and MSF even during weekends and holidays with effect from December 30, 2023. It is expected that this measure will facilitate better fund management by the banks. This measure will be reviewed after six months or earlier, if needed. (Post advent of online banking 24*7, banks have been doubly cautious to keep more than sufficient funds as cushion to enable probable large outflows post business hours/on Saturdays in particular or on the eve of scheduled holidays as RTGS/NEFT funds movement in large value affects their funds management capability. Also there had been two sets of banks of banks in the market, one resorting to parking funds in SDF and another borrowing from MSF, ideally there should have been interplay amidst these segments first. This asymmetry should also be lessened now as an elongated/eventual effect of RBI's measure today).

CPI Inflation Trajectory (%)



Source: SBI Research; SBI Projections

Liquidity Position (Rs lakh crore)			
	Average in FYTD24	6-Oct-23	7-Dec-23
Repo Outstanding	0.15	0.09	0.09
Reverse Repo Total	0.38	0.07	0.22
SDF	0.90	0.61	0.44
MSF	0.47	0.49	0.67
Net LAF (-absorption)	-0.54	-0.03	0.16
Excess Reserve	0.03	0.03	0.06
System Liquidity (-absorption)	-0.59	-0.06	0.10
Government Cash Balance	1.91	2.79	2.39
Core Liquidity (-Surplus)	-2.50	-2.85	-2.29
Source: RBI, SBI Research			

DEVELOPMENT AND REGULATORY MEASURES

Regulatory Framework for Hedging of Foreign Exchange Risks

- Regulatory framework for forex derivative transactions has been refined and consolidated under a single master direction which should further deepen the forex derivatives market, enhancing operational efficiency.
- This should also position GIFT city as a market maker for derivatives offering at par with major global competitors, in particular the waning importance of Hong Kong offers a good opportunity to position GIFT City IFSC as a robust derivatives center while also offering better visibility to both risk takers as also institutions offering such products given the complexity taking centre stage in global credit markets, inter connected at uneven joints, requiring better hedging by risk takers.

Framework for Connected Lending

- RBI has decided to come out with a unified regulatory framework on connected lending for all regulated entities (REs) of the Reserve Bank, aiming at further strengthening the pricing and management of credit by REs.
- Given the complex and convoluted shape of domestic credit markets on the anvil where NBFCs and Digital First/Only players are jostling for more space and stake in the financial intermediation, Without being sufficiently under the regulatory perimeter and microscope, this move will give regulator more teeth to regulate the flow, underwriting, exposure and extent of credit to various entities, retail and MSMEs FIRST, we believe.

Regulatory Framework for Web-Aggregation of Loan Products

- Web-aggregation of loan products is gaining momentum as these platforms host multiple Legacy/PhyGital/digital only players, enabling customers to have one view. But, of late, there are multiple concerns coming out towards the accountability and responsibility of these aggregator platforms and customer suffering on account of misleading products being marketed irresponsibly.
- The recent CAFRAL report highlighted that out of ~14,000 start-ups formed in the period 2016-21, more than half are in FinTech industry, connected with digital lending business in some way, offering digital platforms to promote unsecured lending chiefly). Aggregators are fast becoming popular for customers to check and compare the multiple offerings from various lending entities.
- These namesake *Bazaars* needed to be brought under the regulatory lens to protect gullible consumer's interests through enhancing accountability, responsibility and transparency, as also to thwart any cartel formation going forward by vested interests.

e-Mandates for recurring online transactions

- RBI has proposed to enhance the additional factor of authentication (AFA) limit to ₹1 lakh per transaction (15,000 at present) for recurring payments of mutual fund subscriptions, insurance premium subscriptions and credit card repayments, to further accelerate the usage of e-mandates.
- The move helps in popularising the e-mandates for payments of recurring nature further and indicates at the maturity of the system. Also, a lot of data can be inferred from the behavioural pattern analysis of the customers, in sync with credit bureau reports as alternate data should be key in better credit underwriting standards evolution.

Setting up of Fintech Repository

- For better understanding of developments in the Fintech ecosystem and to support this sector, RBI has proposed to set-up a Fintech Repository wherein FinTechs would share relevant information voluntarily to the repository going forward.
- With Fin-techs' exponential collaboration with legacy players, their unfettered access to consumer/customer data and their desire to emerge as stand-out digital financial players eventually, it was the need of the hour to nudge the Fin-techs towards becoming part of a system wherein they voluntarily (FIRST) share the data that could also input fresh insights to the ecosystem.

Enhancing UPI Transaction Limit for Specified Categories

- RBI has proposed to enhance the UPI transaction limit for payment to hospitals and educational institutions from ₹1 lakh to ₹5 lakh per transaction.
- The maturity and scale of UPI, as also the GoI desire to position it as a globally public good and a seamless transaction platform for collaborating economies necessitates scaling up its capability and thus the regulator has enhanced the limit under institutional category first) where the dispute settlement/recall may be easier should anything go wrong). We understand, post maturity of scale, the UPI limit would be enhanced in other categories too, wiping out its image of a small-ticket transaction enabling mechanism at present. As UPI integrates more with global payment/remittance system, the scaling up is a natural desire.

Establishment of Cloud Facility for the Financial Sector in India

- Banks and financial entities are maintaining an ever-increasing volume of data. Many of them are utilising the cloud facilities for this purpose. To streamline the ecosystem and to evolve a roadmap, RBI has initiated working on establishing a cloud facility for the financial sector in India, factoring in such facility would enhance data security, integrity and privacy, as also it would also facilitate better scalability and business continuity. The cloud facility is intended to be rolled out in a calibrated fashion over the medium term.
- With cloud system becoming ubiquitous, there is also a greater degree of reliance on off-site centers for storing/managing humongous amount of data by various entities. The intent of RBI appears to be better compliance of India's Data Protection laws / data localization initiative and better measures against cyber threats from hostile elements). As the move has no time limit, it's an early indication of intent and gradual move to the direction by getting all stakeholders on board first.

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