SBI RESEARCH

ECOWRAP

METHODOLOGICAL ISSUES PLAGUE CPI ESTIMATES: AFFORDABLE HOUSING SHOWING SIGNS OF RATE INDUCED SLOWDOWN: INDIAN MARKET'S CONVENTIONAL BIAS TOWARDS RATE HIKE IN APRIL NEEDS TO BE JINXED WITH RESTRAINT & RATIONALE

Issue No. 63, FY23
Date: 14 Mar 2023

CPI inflation, moderated mildly but still remained above the 6% mark. CPI stood at 6.44% in Feb'23 as compared to 6.52% in Jan'23. In Indian context, we believe much of the data collated for inflation calculation has innate structural issues, distorting the figures by over reliance on select non-essential parts or not factoring the changing contours of manufacturing/ services (viz. increasing share of locally made smart phones or incremental online shopping at greatly reduced prices).

The 250 basis point rate hike has been correctly frontloaded even though the time may have now come for RBI to pause and rethink the impact of past rate hikes.

First, the good thing. **MSMEs so far, have shown remarkable resilience in financial health even after the policy rate has increased by 250 bps since April 2022**. Around more than 2200 small entities, in listed space, managed to maintain interest coverage ratio, in aggregate, of near 3 in recent quarters (Q3FY2023) as well. However, around 381 companies have reported interest coverage ratio of less than one within the same universe.

Second, a cause for rethink. With the rise of 250 bps in repo rate from May 2022, the incremental housing loans of ASCBs have increased by over Rs 1.8 lakh crore in Apr'22-Jan'23 compared to Rs 1.4 lakh crore during the same period last year**.** However, it is important to look at the segment wise home loans. **We estimated the fresh disbursal of loans by the ASCB. The results show that on an average the proportion of home loans up to Rs 30 lakhs in total loans disbursed has declined to 45% during Jan-Feb'23 from around 60% of the total disbursals in Jun'22 quarter. Moreover, if we look at above Rs 50 lakh loans, their share has increased from 15% to ~25% of the fresh housing loans during this fiscal. This indicates that the demand for housing loans by people at the lower end of the strata, who take loans for affordable housing sector, has been noticeably hit.**

Meanwhile, the rapid increase in EBLR has resulted in banks either increasing the loan tenure or increasing EMI or both depending on the age of the borrower, original tenure of the loan as also the residual tenure of the loan. **Our analysis indicates that of around 55 lakh home loan accounts linked to EBLR, approx. 47 lakh customers with loans amounting to approx. Rs 8 lakh crore witnessed increase in tenure, EMI or both in their existing home loans.**

So what's next for Fed & RBI?

The contagion has hit the underbelly of the Fed, with latest CME-Fed Watch (a gauge for market participants to meter the markets expectation of potential changes to the fed funds target rate) showing 41% of the respondents not expecting any rate hike in Fed's next meet on 21-22 March while 59% of respondents expect hike of not more than 25 bps.

The collapse of Silicon Valley Bank (SVB) has taken the financial markets by surprise. A major bank in start-up lending space, SVB saw surge in deposits after the COVID-19 lockdown which resulted in bank parking its excess liquidity in long maturity bonds. However, with sharp rise in inflation in advance economies since the Russia-Ukraine War, aggressive rise in interest rates accentuated the asset liability mismatch. Large MTM losses on the long bonds created a liquidity crisis which resulted in bank being put under FDIC receivership. The SVB case is one of many such cases in local area banks in the US. The SVB subsidiary in the UK was also put under bankruptcy by Bank of England and taken over by HSBC.

While the fall of SVB has been compared to that of Lehman Brothers, there are some notable differences in 2023. The current crisis has originated in deposit taking banks unlike the investment banks in 2008 which depend on wholesale funding. Further the global presence of SVB is no match by that of marquee Wall Street Banks.

The approach to resolve the crisis is different with US government not inclined for bail out and wants all deposit liability to be paid with minimal haircut and open liquidity support to other similar banks. However, the next few days could be crucial.

For the Indian context, we believe the bias of the markets siding with pre-fabricated rate rise numbers need to be jinxed, by taking much smaller hikes of say, 10/15 bps, if at all, that should augur well for the markets, the customers/consumers paying higher for longer instalments and the regulator too to gauge the impact of its previous actions in controlling the spiral for the last 10 months. **A good example in this context should be of Japan that has restrained itself from falling into the loop despite cheerleaders calling from the sides.**

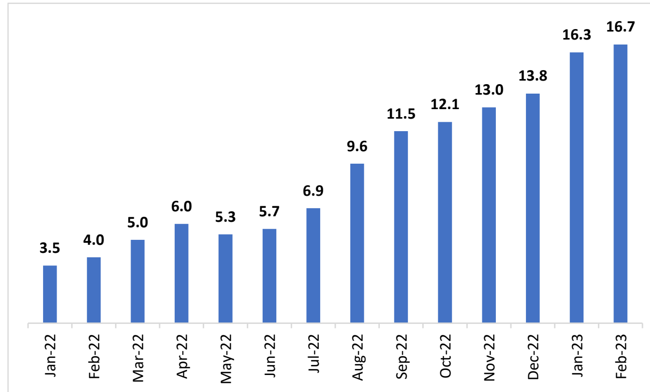
CPI STILL MORE THAN 6%

- CPI inflation, though moderated mildly but still above the 6% mark. CPI stood at 6.44% in Feb'23 as compared to 6.52% in Jan'23. The cereals CPI is the main culprit and grew by 16.73% in Feb'23. Core CPI stood at 6.12%.
- **The increase in cereals CPI is a statistical error**. While cereals inflation is on increasing trend for the past 2 years, the recent increase in perplexing. Further the difference between the weighted contribution of cereals CPI and calculated cereals CPI (sum of item-wise) is so large (18 bps in Jan and Feb). The average difference between Jan'15 to Dec'22 is merely 3 bps. This is an unexplained behaviour exhibited in cereals inflation.
- Another item that is also perplexing us is the Milk inflation. Milk inflation increased to 8-year high to 9.65% in Feb'23. **The NSO methodology is faulty** in calculating inflation regarding milk and milk products. A large quantity of milk and milk products is used by the commercial establishments for making sweets, tea, coffee, etc., which is included in the CSO estimates of private consumption of milk but is excluded from the NSS estimates.

DEEP DIVE INTO 250 BPS RATE HIKE FOR THE MSME SECTOR

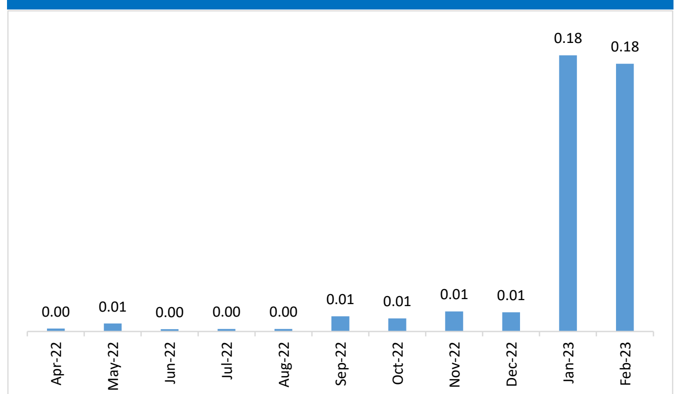
- MSME, so far, have shown resilience in financial health even after the policy rate has increased by 250 bps since April 2022. Around more than 2200 small entities, in listed space, managed to maintain interest coverage ratio, in aggregate, of near 3 in recent quarters (Q3FY2023) as well. However, around 381 companies have reported interest coverage ratio of less than one within the same universe.
- Moreover, EBIDTA and PAT margin too improved from 14.27% and 4.03% in Q3FY22 to 16.52% and 5.28% in Q3FY23 respectively.
- Further, good part is the overall GNPA ratio (PSBs and PVBs) in the MSME sector fell from 9.3% in March 2022 to 7.7% in September 2022. Asset quality of advances below Rs 25 crore, which are usually vulnerable to asset quality concerns, improved in September 2022 vis-à-vis March 2022. It is important to mention, Regulatory for-bearance and restructuring schemes introduced since 2018 has now came to an end.
- As on September 30, 2022, the share of restructured loans in the MSME portfolio of SCBs stood at 5.21% compared to 5.31% as on March 31, 2022.

Cereals and products Inflation (% YoY)



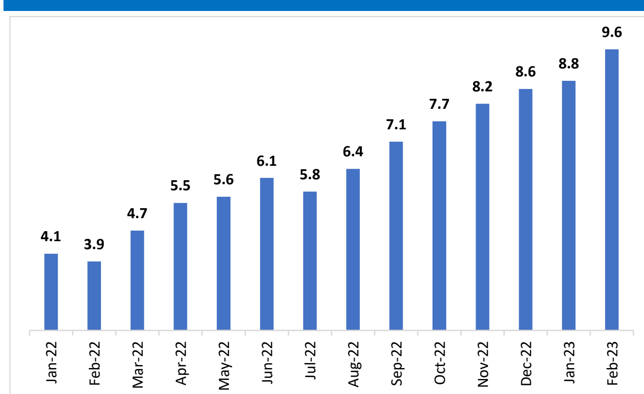
Source: SBI Research

Difference between the weighted contribution of cereals CPI and calculated cereals CPI (sum of item-wise) in %



Source: SBI Research

Milk & Milk Products Inflation (% YoY)



Source: SBI Research

Interest coverage of Small Companies in the listed space					
Description	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Aggregate Interest Covergae (I/C) Ratio	2.9	2.5	2.9	2.8	2.9
No of Cos I/C less than 1	363	401	361	385	381

Source: Cline; SBI Research; ~ 2200 listed entities with quaterly revenue upto Rs 100 crore; IC = PBIDT/Interest

- Under ECLGS, which was pivotal in providing support and additional liquidity for business entities during COVID-19, an amount of Rs 2.82 lakh crore has been disbursed till September 30, 2022, of which SCBs have disbursed Rs 2.46 lakh crore.
- However, in RBI report, September 2022 position of the ECLGS lending indicates that distress continues in the MSME sector, with one-sixth of accounts that availed funds under the ECLGS turning NPA, and if the trend (rate hike) continues, it may be difficult for small entities, specially with higher reliance on finance, to absorb the additional burden and the path may not be smooth going forward.

DEEP DIVE INTO 250 BPS RATE HIKE FOR THE HOME LOAN BORROWERS : ARE AFFORDABLE HOUSING TAKING A HIT OWING TO HIGHER INTEREST RATE?

- With the rise of 250 bps in repo rate from May 2022, banks have transmitted it to both deposit and credit rates. **The incremental housing loans of ASCB have increased by over Rs 1.8 lakh crore in Apr'22-Jan'23 compared to Rs 1.4 lakh crore during the same period last year.** However, it is important to look at the segment wise home loans.
- **We estimated the fresh disbursal of loans by the ASCB. The results show that on an average the proportion of home loans upto Rs 30 lakhs in total loans disbursed has declined to 45% during Jan-Feb'23 from around 60% of the total disbursals in Jun'22 quarter. Moreover, if we look at above Rs 50 lakh loans, their share has increased from 15% to 25% of the fresh housing loans during this fiscal. This indicates that there is an emerging asymmetry in home loan market.**
- **This also shows that the demand for housing loans by people at the lower end of the strata who take loans for affordable housing sector has been hit.** The linking of home loans with an external benchmark or repo rate has led to removal of the differential interest rate for borrowers who are taking home loans of Rs 30 lakhs and below. In principle, to ensure immediate transmission as per RBI norms, home loans of lower amount are offered interest rates linked to EBLR. This in turn could possibly explain the decline in home loans at the lower bracket as rates have significantly increased within a short span of time with the RBI frontloading the rates.
- Home loans have been linked with repo rate since Oct'19. Repo rate was reduced by RBI during Oct'19 to May'20 while it was increased from May'22 to Feb'23.
- **Meanwhile, the rapid increase in EBLR has resulted in banks to either increase the loan tenure or increase in EMI or both depending on the age of the borrower, tenure of the loan and the residual tenure of the loan. Our analysis indicates that of around 55 lakh home loan accounts linked to EBLR, approx. 47 lakh customers with loans amounting to approx. Rs 8 lakh crore witnessed increase in tenure or EMI or EMI & tenure in their existing home loan.**
- **Our preliminary analysis shows that the 250 bps rise in repo rate, and pass-through in EBLR, could increase the interest component alone by at least 16% for a retail borrower** (home loan) in a year resulting in a situation where outstanding loan amount increases incrementally, even though it is being serviced. In extreme cases, the interest servicing could outstrip the principal component itself. On the downside, if the borrower wants to keep the EMI unchanged, the loan tenure could extend beyond 5 years, the maximum permissible RBI extension limit.
- **It is estimated that the interest cost on home loan borrowers might have increased more than Rs 20,000 crore.**

Estimate of Impact of Rate Hike on Home Loan Buyers

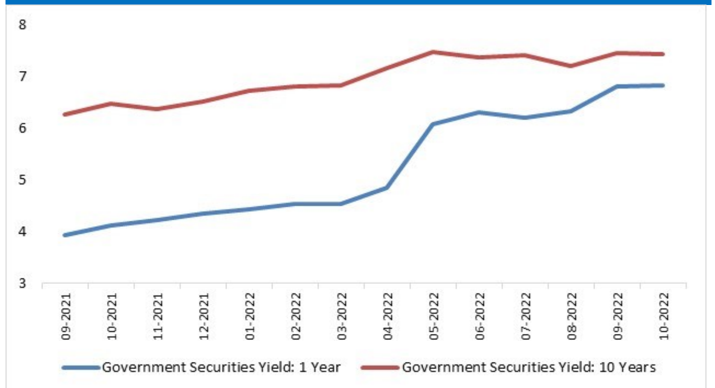
	# of Accounts (in lakh)	Amount oustanding (Rs lakh crore)
Total Home Loan Customers	115	18.9
EBLR share	48%	
Total Home Loan a/c linked with EBLR	55.2	9.1
Out of which:		
Borrowers who have either increase in loan tenure or increase in EMI or increase in both EMI & tenure	47.0	8.2
Borrowers who have capability to prepay	8.2	0.9

Source: SBI Research, RBI

RATE HIKE IMPACT ON WIDER ECONOMY: SPREAD CPMPRESSION, DECLINE IN PROFITABILITY

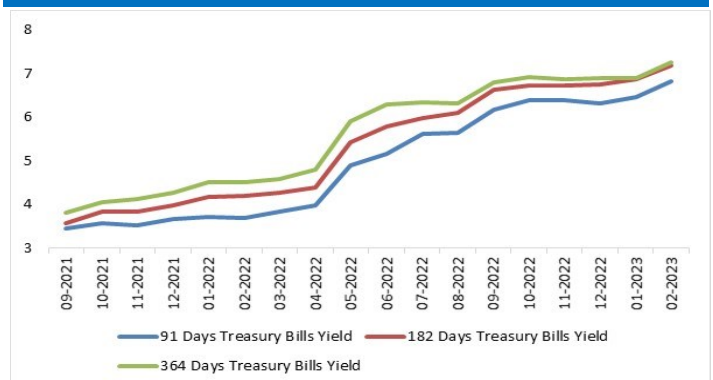
- 1 year government securities yield has risen from 3.9% in Sep 21 to 6.8% in Oct 22. In the same period, 10 year government security yields has risen only from 6.2% to 7.4%.
- Spread compression between 1 year and 10 year G-sec yield has started only from the month of April 22, when global monetary tightening started. Treasury Bills yield started expanding with rate hike cycle in April 2022, with 91 days T BIll yield increasing in faster pace than the 364 days T Bill yield.
- 364 days T Bill yield is actually compressing into 182 days T Bill yield. Both the G-Sec and T Bill markets reflecting a similar behaviour of shorter dated yield increasing in faster pace than longer dated securities, signifying shady longer term prospects of the economy, if the rate hike continues in the same pace.
- Corporate Performance was recovering after the pandemic with Rs 1364 billion in Mar 21 to Rs 1725 billion in Mar 22. However, with the onset of hike, the same is on decreasing trend with Rs 1509 billion in Dec 2022.
- EBIT to Sales of Private Corporates decreased temporarily in Dec 21 and remained stable at 15.2% till Mar 22. However, with the onset of rate hike cycle, it is in decreasing trend and is currently at 13.5% in Dec 22.
- Bank Food Credit is of Seasonal Nature with seasonal peaks and troughs of similar magnitude. However, after April 22, the peaks and troughs of seasonal cycle of bank food credit has actually declined.

Government Securities Yield



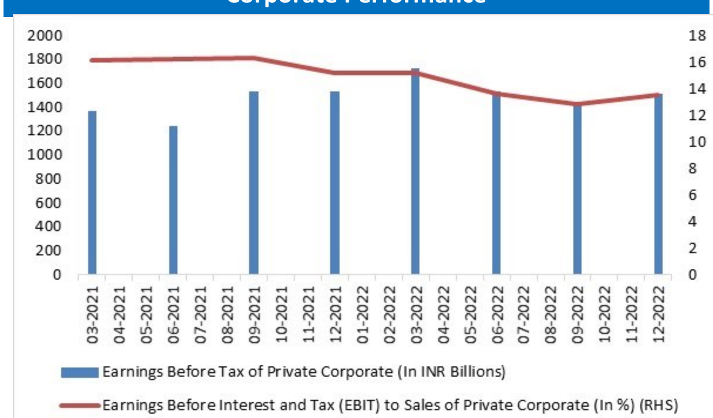
Source: CEIC, SBI Research

Treasury Bills Yield



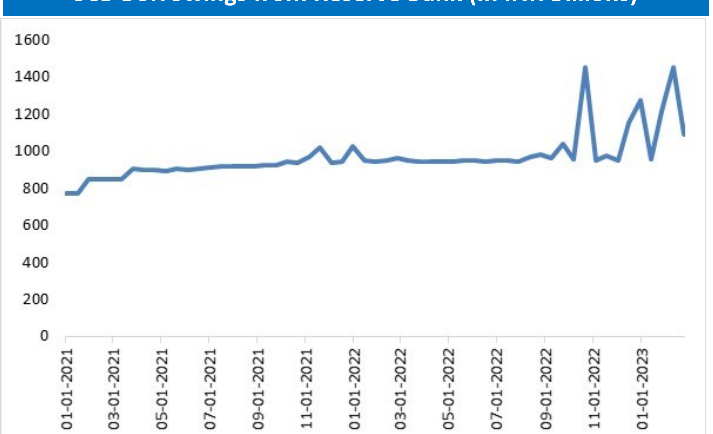
Source: CEIC, SBI Research

Corporate Performance



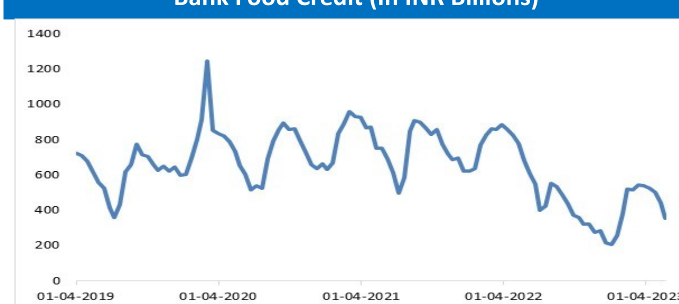
Source: CEIC, SBI Research

SCB Borrowings from Reserve Bank (In INR Billions)



Source: CEIC, SBI Research

Bank Food Credit (In INR Billions)



Source: CEIC, SBI Research

- SCB Borrowings from RBI has been showing consistent behaviour with around Rs 700-900 billion in the period of Jan 21 to Sep 22. However, Sep 22 onwards, Banks are facing liquidity constraints due to continuous rate hikes, and has to borrow uncertain amount from RBI.

SVB COLLAPSE AND FED RATE OUTLOOK

- The collapse of Silicon Valley Bank (SVB) has taken the financial markets by surprise. A major bank in start-up lending space, SVB saw surge in deposits after the COVID-19 lockdown which resulted in bank parking its excess liquidity in long maturity bonds.
- However, with sharp rise in inflation in advance economies since the Russia-Ukraine War, aggressive rise in interest rates accentuated the asset liability mismatch that had build up during the COVID-19 period. Large MTM losses on the long bonds created a liquidity crisis which resulted in bank put under FDIC receivership.
- The SVB case is one of many such cases in local area banks in the US. The SVB subsidiary in the UK was also put under bankruptcy by Bank of England and taken over by HSBC.

Comparing 2008 and 2023

- While the fall of SVB has been compared to that of Lehman Brothers there are some notable differences in 2023. The current crisis has originated in deposit taking banks unlike the investment bank in 2008 which depend on wholesale funding. Further the global presence of SVB is no match by that of Wall Street Banks.
- The approach to resolve the crisis is different with US government not inclined for bail out and wants all deposit liability to be paid with minimal haircut and open liquidity support to other similar banks.

Fed rate outlook

- Given the buildup of financial instability following sharp rise in funds rate, case is strong to minimize the damage to other fragile SVB- type local area banks in the US. Thus, we expect that Fed will slow down its rate hike while retaining its stance to withdraw accommodation.

*****

Disclaimer: The Ecowrap is not a priced publication of the Bank. The opinion expressed is of Research Team and not necessarily reflect those of the Bank or its subsidiaries. The contents can be reproduced with proper acknowledgement. The write-up on Economic & Financial Developments is based on information & data procured from various sources and no responsibility is accepted for the accuracy of facts and figures. The Bank or the Research Team assumes no liability if any person or entity relies on views, opinion or facts & figures finding in Ecowrap.

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