Ecowrap

'Be the Bank of Choice for a Transforming India'

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COMETH THE TIME, COMETH THE RBI!

As widely expected, RBI's Monetary Policy Committee unanimously decided to keep policy Repo rate unchanged at 4% with accommodative stance (as long as necessary). The policy was overwhelmingly positive with a host of regulatory and development policies that is in sync with a coordinated approach of the Government and RBI to revive the economy. These measures emphasize the RBI fixation of ensuring financial market stability against a tail event of unprecedented nature!

In this policy RBI has also provided real GDP estimates for FY21. Based on the rural/urban demand with muted external situations, RBI has projected a decline of 9.5% for FY21 with 9.8% decline in Q2, 5.6% decline in Q3 and tad positive growth of 0.5% in Q4. For Q1 FY22, RBI projected growth rate of 20.6% due to huge base effect. We, however, believe that all the four quarters of this fiscal might remain in negative territory and any positive growth will be seen only in FY22. The good thing is, however, looking at the spread of Covid infection, India seems to have reached a peak with maximum daily cases on 16 Sep'20. The penetration in rural areas which increased since July has now moderated. However, the cases are increasing in urban areas which in turn raises questions on the sustainability of economic recovery going forward.

There are several regulatory measures that have been unveiled by RBI in the policy. First, in order to reduce the cost of credit for the regulatory retail portfolio (RRP/75% risk weight) consisting of individuals and small businesses (i.e. with turnover of up to Rs 50 crore), and in harmonisation with the Basel guidelines, RBI has increased the threshold to Rs 7.5 crore from Rs 5 crore, in respect of all fresh as well as incremental qualifying exposures. Given that working capital limits such as CC/OD etc. are being treated as new loan on renewal and considering 25%-50% of the total outstanding as working capital limits , banks can still save capital of Rs 1250-2500 crore.

RBI's countercyclical measure to link risk-weights with LTV ratio, for all new housing loans sanctioned up to March 31, 2022 is a welcome move. This measure is expected to give relief to big ticket loans say above Rs 75 lakh, present share of which is around 12-15% of the total housing loan portfolio, where risk weight is higher. Assuming a growth of 20% for next 18 months this could reduce the capital requirement of around Rs 500 crore, which could enable banks to ease rates to boost demand.

Allowing OMO on SDLs is also a much appreciated move. The condition of the States is worrisome with the states already borrowing Rs 3.75 lakh crore in FY21 so far compared to Rs 2.43 lakh crore during the same period last year. The average cost of borrowing has declined to 6.5% from 7.1% in FY20. At present the spread between SDL and G-sec is around 53 bps (65 bps in 04 Aug). With RBI conducting OMO in SDLs, the liquidity of SDLs will increase, and the spread will reduce.

Other notable measures include on tap TLTRO, extension of the dispensation of enhanced HTM limits of 22% up to March 31, 2022 for securities acquired between Sep 1, 2020 and Mar 31, 2021, round-the-clock availability of Real Time Gross Settlement System (RTGS), Perpetual Validity for Certificate of Authorisation (CoA) issued to Payment System Operators (PSOs) and review of the Co-origination Model among others.

In Dec'19, RBI had made round the clock NEFT transaction. With this, there was a surge in transactions to 23.36 crore (Rs 17.3 lakh crore) in Dec'19 from 21.94 crore transactions (Rs 17.3 lakh crore) in Nov'19. With the round the clock RTGS, we thus expect transactions under RTGS will increase significantly . Additionally, the co-origination model being extended to HFC will significantly benefit the HFCs, with housing loans under priority sector currently at Rs 13. 5 lakh crores!

Interestingly, the new MPC members have voted for the first time and there was a dissent by Prof. Jayanth Varma regarding the stance of the policy. However, in the past although the external members have talked about the overall conditions in the economy, the various nuances on aspects like liquidity, width of the LAF corridor, and other aspects of practical financial management were not elaborated upon. This lack of linkage between the more practical approach to things and theoretical knowledge possibly makes the weightage of internal RBI members' opinion heftier, concise and pragmatic! We need to wait though!

RBI HOLDS THE RATES, AS EXPECTED

- As widely expected, RBI's Monetary Policy Committee unanimously decided to keep policy Repo rate unchanged at 4% with accommodative stance (as long as necessary). One of the MPC members voted against the accommodative stance. Reverse repo rate remains unchanged at 3.35% and MSF and the Bank Rate remain at 4.25%.
- In this policy RBI also provided real GDP estimates for FY21. Based on the rural/urban demand with muted external situations, RBI projected a decline of 9.5% for FY21 with 9.8% decline in Q2, 5.6% decline in Q3 and tad positive growth of 0.5% in Q4. For Q1 FY22, RBI projected growth rate of 20.6% due to huge base effect. We, however, believe that all the four quarters of this fiscal will remain in negative territory and any positive growth will be seen only in FY22.

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	*Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22
Oct'20(3rd Bi-monthly)	6.6	6.8	5.4	4.5	4.3
Feb'20(6th Bi-monthly)	5.4	5	3.2	-	-
Dec'19(5th Bi-monthly)	4.0	3.8	-	-	-
Oct'19(4th Bi-monthly)	3.6	-	-	-	-
Real GDP Growth (%)	***Q1 FY21**	**Q2 FY21**	**Q3 FY21**	**Q4 FY21**	**Q1 FY22**
Oct'20(3rd Bi-monthly)	-23.9	-9.8	-5.6	0.5	20.6
Feb'20(6th Bi-monthly)	5.5	6.0	6.2	-	-
Dec'19(5th Bi-monthly)	5.9	6.3	-	-	-
Oct'19(4th Bi-monthly)	7.2	-	-	-	-

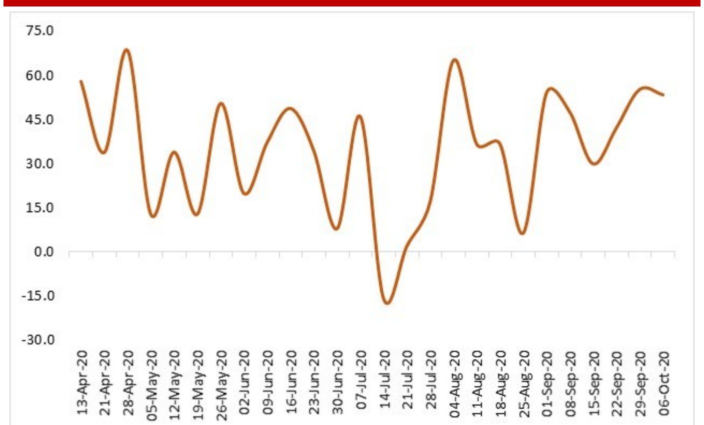
Source: RBI, SBI Research; *actual

- RBI has also provided CPI inflation expectations for FY21. CPI inflation is projected at 6.8% for Q2 FY21, at 5.4-4.5% for H2 FY21 and 4.3% for Q1 FY22 with balanced risks. Weak pricing power, subdued demand, supply disruptions, labour shortages and high transportation costs are some of the major risks for CPI, going forward.

IMPACT OF DEVELOPMENTAL & REGULATORY MEASURES

- **Regulatory Retail Portfolio – Revised Limit for Risk Weight:** Presently, among others, threshold limit is of Rs 5 crore, for retail exposure to one counterpart, to qualify as Regulatory Retail Portfolio (RRP), which attracts risk weight of 75%. And above Rs 5 crore, under standardised approach, shall be risk weighted as per the ratings assigned by the rating agencies registered with the SEBI and chosen by the Reserve Bank of India.
- In order to reduce the cost of credit for this segment consisting of individuals and small businesses (i.e. with turnover of up to Rs 50 crore), and in harmonisation with the Basel guidelines, RBI has now increased this threshold to Rs 7.5 crore in respect of all fresh as well as incremental qualifying exposures.
- If this would have been permitted on existing portfolio, as we had suggested earlier (*Ecowrap Dt.22.07.2020*), additionally approx. Rs 2 lakh crore might have been classified under RRP. Assuming presently 100% risk weight for this amount, Banks could thus have saved capital of around Rs 5000 crore on such existing portfolio.
- However, we feel working capital limits such as CC/OD etc. may be allowed to be treated as new loan on renewal and accordingly can be classified under RRP. Considering 25%-50% of the total outstanding as working capital limits Banks can thus still save capital of Rs 1250-2500 crore.
- **Individual Housing Loans-Rationalisation of Risk Weights:** RBI's countercyclical measure to link risk-weights with LTV ratio (35% where LTV is less than or equal to 80%, and a risk weight of 50% where LTV is more than 80% but less than or equal to 90%) is a wise decision. However, the impact needs to be seen and will depend on demand. Countercyclical measures refer to the monetary and fiscal measures that stabilize the business cycle by reining in economic activity during booms and bolstering it during downturns. The good thing is that RBI's relaxation applicable till Mar-22 and hence banks will be benefitted on all new housing loans that will be sanctioned for next 18 months period.
- This measure is expected to give relief to big ticket loans say above Rs 75 lakh, present share of such loan is around 12-15% of the total housing loan portfolio, where risk weight is higher. Assuming a growth of 20% for next 18 months this could reduce the capital requirement of around Rs 500 crore, which could enable banks to ease rates to boost demand.
- **Open Market operations (OMOs) in State Developments Loans (SDLs)**: The condition of the States is worrisome with the states already borrowing Rs 3.75 lakh crore in FY21 compared to Rs 2.43 lakh crore during the same period last year. The average cost of borrowing has now reduced to 6.5% from 7.1% in FY20. At present the spread between SDL and G-sec is around 53 bps (65 bps in 04 Aug). With this move, the liquidity of SDL will increase, and the spread will reduce.
- The States have been suffering due to lower revenue with the SGST collection for states 28% lower at Rs 1,08445 crore in Apr-Sep'20. The Allocated IGST is also 26% lower at Rs 72,355 crore. The combined amount of SGST, Allocated IGST and Cess stands at Rs 216281 crore, which is 27% lower than last year's collection in the same period.
- Government has given two options to finance the gap – Under option 1 the states can raise Rs 1.1 lakh crore through RBI and secure their GST shortfall, while also borrowing 0.5% extra under FRBM limits. So, overall state fiscal deficit financing can reach maximum 5.5% of GDP (3% standard + 1% unconditional + 1% conditional + 0.5% for compensation cess) under this option. Under Option 2, states can raise the entire GST shortfall of Rs 2.35 lakh crore (1.3% of GDP) from the market. So, in this option the state fiscal deficit financing can reach maximum 5.3% of GDP (3% basic eligibility + 1% conditional + 1.2% for compensation cess). The issue is still undecided, and another meeting is expected to take place next week.
- The current decision of OMO for SDL will thus help in improving the liquidity and facilitate efficient pricing.

SDLs Spread (in bps)



Source: SBI Research

Individual Housing Loans – Rationalisation of Risk Weights		
Existing Regulation		
Outstanding loan	LTV ratio (%)	Risk Weight (%)
Up to Rs 30 lakh	≤ 80	35
	> 80 and ≤ 90	50
Above Rs 30 lakh and up to Rs 75 lakh	≤ 80	35
Above Rs 75 lakh	≤ 75	50
Revised Regulation (for new loans)		
Any loan amount	≤ 80	35
	> 80 and ≤ 90	50
Source: SBI Research		

- **SLR Holdings in HTM Category:** Enhanced HTM limit (22% of NDTL from 19.5%) for banks to continue till 31st March 2022 for securities acquired between September 1, 2020 and March 31, 2021. HTM limit will be restored from 22% to 19.5% in phased manner starting June 30, 2022.
- **On Tap TLTRO:** Since 6 Feb, RBI has conducted Rs 2 lakh crore worth LTRO, Rs 1 lakh crore worth TLTRO and Rs 50,000 crore worth of TLTRO (2.0). All this has improved the system liquidity. Furthermore, to revive certain sectors, RBI has announced to conduct Rs 1 lakh crore worth of 3-year TLTROs till March 2021 at floating rate linked to repo rate. This will give option of reversal of old TLTRO and TLTRO 2.0 before maturity. Banks are 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. Thus, it will help to push up credit growth. Furthermore, investments made under this facility to 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.
- **Round-the-Clock availability of RTGS:** Given the coronavirus pandemic and to ensure safe banking, RBI has extended RTGS facilities round the clock. The measures are in line with promoting minimum handling of cash and avoiding social contact. The non-cash options for payment such as NEFT, IMPS, UPI and BBPS are made available round-the-clock for fund transfers, paying utility bills and for purchase of goods and services.
- In Dec'19, RBI had made round the clock NEFT transaction. With this, there has been surge in transactions to 23.36 crore (Rs 17.3 lakh crore) in Dec'19 from 21.94 crore transactions (Rs 17.3 lakh crore) in Nov'19. With the round the clock RTGS, we expect transactions under RTGS will increase significantly .

A NEW MPC

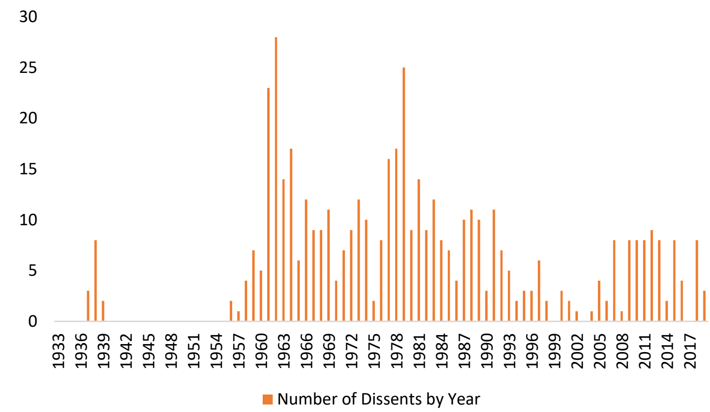
- The Government has filled the position of three external members to the Monetary Policy Committee by the appointment of Ashima Goyal, Jayanth R Varma and Shashanka Bhide for a period of four years.
- **Dr. Ashima Goyal** is currently professor in Economics at IGIDR with wide experience in open economy macroeconomics, international finance and governance. Earlier, she served as member of the Technical Advisory Committee (TAC) on Monetary Policy from August 4, 2011 to August 9, 2016. As TAC minutes were not published member-wise it is difficult to know Dr. Goyal views regarding monetary policy. Though Dr. Goyal published many newspaper articles during this period on conduct of monetary policy. In most of the articles Dr. Goyal defend RBI's action and stance (for e.g. 'Does monetary policy work in India?' The Hindu Business Line, November 18, 2013, 'Time for flexible monetary policy', Livemint, December 28, 2014, 'Rate-cutting consistent with reducing inflation', Business Standard, October 31, 2015, etc.). However, post-2016, Dr. Goyal became critic of RBI/MPC working ('The MPC will be walking on eggshells', Hindu Business Line, June 1, 2018, 'Monetary policy in times of a slowdown', Hindu Business Line, October 6, 2019, etc.). She is a proponent of accommodative monetary policy.
- Prof. Jayanth R. Varma is currently professor of Finance and Accounting at IIM-Ahmedabad. He has carried out consulting assignments for several government, multilateral and private sector organizations in a wide range of areas including financing choices, risk management, management information and control systems, and corporate strategy. This appointment indicates that RBI is interested to know the implications of monetary policy decisions on corporate balance-sheets and wants a committee member who can provide a holistic view based on the inter-linkage between economic decisions and financial markets. As his publications have centered more on the financial markets, the stance he is going to take on matters of monetary policy are not clear. However, he is the only member who has voted against the accommodative stance and he has more published record on the conduct of financial markets in particular.
- **Dr. Shashanka Bhide**: He is currently Senior Advisor, National Council of Applied Economic Research and has been associated with NCAER for the longest time. His research areas include agriculture, land, housing, macromodelling, infrastructure among others. His extensive work in Indian economy is expected to result in very well-thought out decisions and possibly more relevant for policy making. It is a common knowledge that macromodelling is a rarity in India!
- Even though the MPC is a very young entity in case of India, the history of MPC in India shows that there has not been significant dissent among the members, and barring a few incidents almost all the members have agreed on the MPC decision. So it is difficult to say which member group is the driving force. However, in the past although the external members have talked about the overall conditions in the economy, the various nuances on aspects like liquidity, width of the LAF corridor, and other aspects of practical financial management were not elaborated upon by them. This lack of linkage between the more practical approach to things and theoretical knowledge makes the weightage of internal RBI members' opinion heftier.

- Non-dissent, however, is not unique to India. In the US Fed, which has a long history of meetings, the decisions taken by the head and other members is mostly in sync. The FOMC holds eight regularly scheduled meetings per year and there are 12 voting members. But the number of dissents per year in the recent years has been in single digits. In the initial meetings, between 1933 and 1954, there was hardly any dissent among the members. With passing time, in India, we will come to know, how much the external members dissent, and if there is a conflict between the internal and external members' opinion which one will hold more power.

GOING FORWARD

- Economic activity in India continued to improve gradually in September with various indicators including RTO transactions, electricity consumption, PMI manufacturing, services, petrol consumption, vehicle sales all showing improved momentum over past month. GST e-way bills have also hit a record high of 5.74 crore in Sep'20 which is 9.3% more than a year ago level.
- Looking at the spread of Covid infection, India seems to have reached a peak with maximum daily cases on 16 Sep'20. The good thing is that the penetration in rural areas which increased since July has now moderated. However, the cases are increasing in urban areas which in turn raises questions on the sustainability of economic recovery going forward. Also, States which celebrated festivals have witnessed rising cases which raises the worry about jump in cases in states like West Bengal post Durga Puja in October. However, when compared to other countries, Indian States have managed to do better in containment.

Number of Dissents per Year in FOMC Meetings



Source: SBI Research

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Contact Details:
Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India, Corporate Centre
Nariman Point, Mumbai - 400021
Email: soumya.ghosh@sbi.co.in
gcea.erd@sbi.co.in
Phone:022-22742440
:@kantisoumya