

JUMP IN RBI SURPLUS PRIMARILY DRIVEN BY A RECORD OMO~RS 3.3 TRILLION AND WRITE BACK OF INCOME FROM CF

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The slowdown in the Indian economy could be cyclical, with deep structural problems that requires urgent reforms, according to the annual report of the Reserve Bank of India (RBI) released today. The macroeconomic environment remains "unsettled and financial markets are experiencing considerable flux" as the financial year 2019-20 progresses, the report said. The report has highlighted that the trade channel has itself become the mode of transmission of global impulses to domestic manufacturing and investment. The close synchronisation across borders and the sluggishness in industrial production and 'reluctance to invest' has been highlighted as well. The falling investment rate (to ~ 32.3% in 2017-18) has been acknowledged as a point of concern.

If we closely analyze the balance sheet of RBI for 2018-19, it suggests the interest income from both domestic as well as foreign sources has seen a jump due to favourable market conditions resulting in record transfer to GOI in the current fiscal. For example, the interest income from domestic sources increased from ₹393 billion in 2017-18 to ₹610 billion in 2018-19 mainly on account of increase in coupon income with the RBI's holding of G-Secs as a result of net purchase jumping to a record ₹3,311 billion in 2018-19 (RBI Accounting Year). Apparently, there has also been an accounting change that has pushed up forex income of RBI. More importantly, other income of RBI has been bolstered by transfer of Rs 526 billion from Contingency Fund (CF) on recommendation of Jalan Committee report.

As far as currency composition is concerned, the value share of high denomination currency (500+2000) in overall currency composition is 82.2% at end-Mar'19 which albeit higher than last year (80.6%) is still much lower than it was in the pre-demonetization period (86.4%). The major push has been given to 500 denomination notes which now are more than half (51%) of the total value of banknotes at end-Mar'19. This share is even higher than the pre-demonetization level of 47.8%. The % share of small denomination notes upto Rs 100 has come down from 17.3% at end-Mar'18 to 14% at end-Mar'19. The major factor is the decline in 100 denomination notes' share which has come down from 12.3% at end-Mar'18 to 9.5% at end-Mar'19. This could be possibly due to RBI planning on introducing new 100 denomination notes. However, the share of 200 denomination notes has gone by 1.7 percentage points, thereby facilitating small value transactions.

According to RBI, the number of counterfeit notes has declined by 39% in FY19 to 3.17 lakh pieces. However if we deduct the number of Rs 500 (old) and Rs 1000 denomination notes (since these are now out of circulation), the number of circulating counterfeit notes has increased marginally by 8% to 3.15 lakh pieces. This is however a significant improvement that we had witnessed in past (CAGR of 13.2% between FY15-17).

RBI today released its Annual Report (AR) for the year July 1, 2018 to June 30, 2019.

CURRENCY COMPOSITION

- ◆ The value share of high denomination currency (500+2000) in overall currency composition is 82.2% at end-Mar'19 which albeit higher than last year (80.6%) is still lower than it was in the pre-demonetization period (86.4%).
- ◆ The % share of small denomination notes upto Rs 100 has come down from 17.3% at end-Mar'18 to 14% at end-Mar'19. The major factor is the decline in 100 denomination notes' share which has come down from 12.3% at end-Mar'18 to 9.5% at end-Mar'19. This could be possibly due to RBI planning on introducing new 100 denomination notes. However, the share of 200 denomination notes has gone by 1.7 percentage points, thereby facilitating small value transactions.
- ◆ The major push has been given to 500 denomination notes which now are more than half (51%) of the total value of banknotes at end-Mar'19. This share is even higher than the pre-demonetization level of 47.8%.
- ◆ Understandably the value share of 2000 denomination notes has come down as RBI is focusing on other denominations.
- ◆ As against the indent of 28,883 million pieces, BRBNMPL and SPMCIL in April-March'19 supplied 29,191 million pieces. The highest indent was placed for 500 (New design) notes.

Denomination	Banknotes in Circulation							
	Mar-16		Mar-17		Mar-18		Mar-19	
	Volume (bn pieces)	Value (Rs bn)	Volume (bn pieces)	Value (Rs bn)	Volume (bn pieces)	Value (Rs bn)	Volume (bn pieces)	Value (Rs bn)
SDN (upto 100)	68.2	2,235	91.0	3,501	81.6	3,140	80	2,968
% share	75.6	13.6	90.8	27	79.8	17.3	67.0	14.0
200	-	-	-	-	1.9	371	4.0	800
% share	-	-	-	-	1.8	2.1	3.7	3.8
500	15.7	7,854	5.9	2,941	15.5	7,734	21.5	10,759
% share	17.4	47.8	5.9	22.5	15.1	42.9	19.8	51.0
1000	6.3	6,326	0.1	0.1	0.1	0.1	-	-
% share	7.0	38.6	...	0.7	...	0.4	-	-
2000	-	-	3.3	6,571	3.4	6,726	3.3	6,582
% share	-	-	3.3	50.2	3.3	37.3	3.0	31.2
Total	90.3	16,415	100.3	13,102	102.4	18,037	108.8	21,109

Source: RBI, ... Negligible.

Indent and Supply of Banknotes by BRBNMPL and SPMCIL (April-March'19) (Million pieces)

Denomination	Indent	Supply
5	-	-
10	3,920	4,289
20	46	210
50	4,233	4,040
100	6,330	6,407
200	2,615	2,730
500 (New Design)	11,692	11,468
2000	47	47
Total	28,883	29,191

Source: RBI

ARITHMETIC OF RBI SURPLUS

- RBI's recent announcement of transferring ₹1.76 trillion to the Government this fiscal, which includes ₹1.23 trillion of surplus for 2018-19 and ₹526.37 billion of excess provisions has created lot of buzz in the public domain.
- If we closely analyze the balance sheet of RBI for 2018-19, it suggests the interest income from both domestic as well as foreign sources has seen a jump due to favourable market conditions. The interest income from foreign sources, increased from ₹345 billion in 2017-18 to ₹458 billion in 2018-19 mainly on account of the general rise in yield/interest rates across all currencies and movement in the exchange rates.
- Similarly, the interest income from domestic sources increased from ₹393 billion in 2017-18 to ₹610 billion in 2018-19 mainly on account of increase in coupon income with the RBI's holding of G-Secs as a result of net purchase jumping to a record ₹3,311 billion in 2018-19 (RBI Accounting Year)
- Earnings from "Provision no longer required and Miscellaneous Income" increased from ₹3.67 billion in 2017-18 to ₹526.18 billion in 2018-19 due to write back of excess risk provision from contingency fund to 'Provision no longer required'.

TREND ANALYSIS ON FRAUDS

- The number of cases on frauds reported by banks were generally hovering at around 4500 in the last 10 years before increasing to 5916 in 2017-18 and further increased to 6801 in 2018-19. Similarly, the amount involved in frauds was increasing gradually, followed by a significant increase in 2017-18 to Rs 410 billion and around doubled in 2018-19 to Rs 715 bn.
- In 2018-19, the number of frauds increased by 15%, while the amount involved rising by 73.8%, though mostly related to occurrences in earlier years. The average lag between the date of occurrence and its detection by banks was 22 months. The average lag for large frauds, i.e. Rs 1 billion and above, amounting to ₹522 billion reported during 2018-19, was 55 months.
- In terms of area of operations, frauds related to advances constituted the preponderant share of the total amount involved in frauds in 2018-19, while the share of frauds in off-balance sheet items declined from a year ago.
- To improve the fraud risk management framework for banks, a need for (i) better directions on frauds in the light of experience gained and big data analytics; (ii) comprehensive reviews to sensitise on fraud prevention, prompt/accurate reporting and follow up action; (iii) need for user-friendly fraud registry.

COUNTERFEIT NOTES

- According to RBI, the number of counterfeit notes has declined by 39% in FY19 to 3.17 lakh pieces. However if we deduct the number of Rs 500 (old) and Rs 1000 denomination notes (since these are now out of circulation), the number of circulating counterfeit notes has increased by 8% to 3.15 lakh pieces.

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OMO vis-à-vis RBI's Profit Transfer to Government (Rs Billion)

Year (July to June)	Net OMO*	Income				Expenditure	Profit/Transfer to Government	
		Interest Income			Other Income			
		Domestic	Foreign	Total				
RBI14	300	435	202	637	9	646	119	527
RBI15	-637	521	223	745	48	793	134	659
RBI16	1384	441	294	735	73	809	150	659
RBI17	300	375	285	661	-42	618	312	307
RBI18	-700	393	345	739	44	783	283	500
RBI19	3310	610	458	1068	862	1930	170	1759.91#

Source: SBI Research, RBI; * (Purchase - Sale), # includes write back of Rs 526.18 billion of excess risk provision from contingency fund to 'Provision no longer required'.

Interest Income of RBI from Domestic Sources (in Rs Billion)

	RBI14	RBI15	RBI16	RBI17	RBI18	RBI19
Interest on holding of Rupee Securities	471	436	431	542	480	583
Net Interest on LAF Operations	59	28	5	-174	-95	10
Interest on MSF Operations	17	2	1	1	1	1
Interest on Loans and Advances	37	14	4	7	8	15
Profit on Sale of Domestic Securities	331	139				
Depreciation	-480	-98				
Total Interest from Domestic Sources	435	521	441	375	393	610

Source: RBI, SBI Research

Fraud Cases - Bank Group-wise

Bank Group	No. of Frauds			Amt Involve (Rs bn)			Ticket Size (Rs Crore)	
	FY18	FY19	YoY %	FY18	FY19	YoY %	FY18	FY19
PSBs	2,885	3,766	30.5	383	645	68.6	13.3	17.1
% Share	48.8	55.4	-	92.9	90.2	-	-	-
Pvt Banks	1,975	2,090	5.8	25	55	122.5	1.3	2.6
% Share	33.4	30.7	-	6	7.7	-	-	-
Foreign Banks	974	762	-21.8	3	10	273.0	0.3	1.3
% Share	16.5	11.2	-	0.6	1.3	-	-	-
Others	82	183	123.2	2	6	227.7	2.1	3.1
% Share	1.4	2.7	-	0.4	0.8	-	-	-
Total	5,916	6,801	15.0	412	715	73.8	7.0	10.5

Source: SBI Research

Denomination-wise Counterfeit Notes

Denomination	No. of pieces			% YoY	
	2016-17	2017-18	2018-19	2017-18	2018-19
2 and 5	80	1			
10	523	287	345	-45	20
20	324	437	818	35	87
50	9,222	23,447	36,875	154	57
100	1,77,195	2,39,182	2,21,218	35	-8
200	-	79	12,728	-	16011
500 (Old)	3,17,567	1,27,918	971	-60	-99
500 (New)	199	9,892	21,865	4871	121
1000	2,56,324	1,03,611	717	-60	-99
2000	638	17,929	21,847	2710	22
Total	7,62,072	5,22,783	3,17,384	-31	-39
Total ex 500 (O) & 1000	1,88,181	2,91,254	3,15,696	55	8

Source: RBI; SBI Research

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