

UNCERTAIN TIMES REVEAL DIVERGENT VOTINGS: 25 BPS JUNE RATE CUT LIKELY

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The RBI decision to cut repo rate by 25 bps with a 4-2 majority was largely in consonance with market expectations. The decision not to change stance indicates RBI may still be a little uncertain about the path of inflation and believes inflation in India more of a political phenomenon / fiscal risk ?

Beginning October 2018, decision making across global central banks has been difficult with global uncertainties taking precedence and India is no exception. Interestingly, dissecting the MPC voting reveal interesting voting patterns that are divergent within RBI members but largely synchronous amongst external members and RBI. While, we are largely aligned with RBI inflation projections till Q3 (inflation projections have been cut by 30-40 basis points) we expect Q4FY20 inflation numbers could be more than 4%. Our growth projections are mostly in line with RBI expectations at 7.2%, but certainly with a downside.

We now expect that the RBI is likely to further cut rates in June by 25 bps (Q4GDP numbers due on May 31 along with FY19 GDP) rather than in August as weak growth numbers could force a frontloaded policy support.

The RBI decision to somehow align FALLCR and SLR rates beginning April'19 could mean build up of a better collateral of g-secs with banks (Rs 2.6 lakh crores) and thus the possibility of even using OMO as a liquidity tool in Q2FY20. The current swap transactions have sent the forex markets in a tizzy amidst a \$ selling frenzy, which is adding to rupee liquidity, the end use of which still not clear. The policy has a array of other developmental and regulatory measures. Benchmarking Indian payment systems with global practices will enable better policy regulations. Giving a fillip to Domestic Securitisation and Corporate Loan Market will align price discovery with risk appetite. The decision to extend priority sector benefits to RRB and SFBs will provide a boost to affordable housing. The steps to allow NBFCs in foreign exchange space will induce better competition. The decision to enable better customer delivery is most welcome.

RBI REDUCES REPO RATE BY 25 BPS

- ◆ The Monetary Policy Committee (MPC) decided to cut the Repo rate by 25 bps to 6.0% by 4-2 vote and decided to maintain the neutral stance.
- ◆ For FY20, RBI cut its GDP growth forecast by 20 bps to 7.2% owing to weak investment activity, moderation in global economy and its impact on domestic exports. The silver lining includes robust private consumption and optimistic business expectations.
- ◆ RBI has revised downwards the CPI inflation to 2.4% in Q4 FY19, 2.9-3.0% in H1 FY20 (earlier 3.2-3.4%) and 3.5-3.8% in H2 FY20 on the assumption of normal monsoon.
- ◆ Interestingly, a research by RBI indicates that the mean forecast error of RBI inflation forecasting for the sample (Apr'15 to Sep'18) is -70 bps and excluding the demonetisation period is -30 bp and that is largely aligned with other central banks.

INCREASING DIVERSION IN DECISION OF MONETARY POLICY COMMITTEE MEMBERS

- ◆ There has been an increase in the diversity in RBI's MPC voting pattern observed during Oct'18-Feb'19. This is also seen in some other central banks, with 16 meetings out of 41 meetings (34%) with dissents. RBI Deputy Governor who is the current member of the MPC has been in the past 14 meetings. He and other external MPC members have been on the same page on majority of occasions. However, there is more diversion in the decision of the DG and the Executive Director, particularly visible in the recent monetary policy decisions.

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
Apr'19 (1 st Bi-monthly)	2.4	2.8	3.0	3.4	3.8
Feb'19 (6 th Bi-monthly)	2.8	3.2	3.4	3.7	-
Dec'18 (5 th Bi-monthly)	3.2	3.8	4.2	-	-
Oct'18 (4 th Bi-monthly)	4.5	4.8	-	-	-
Real GDP Growth (%)	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
Apr'19 (1 st Bi-monthly)	6.5	6.8	7.2	7.3	7.5
Feb'19 (6 th Bi-monthly)	7.0	7.2	7.3	7.3	-
Dec'18 (5 th Bi-monthly)	7.0	7.0	7.2	-	-
Oct'18 (4 th Bi-monthly)	7.2	7.4	-	-	-

Source: RBI, SBI Research; * Actual

Inflation Forecast Errors (Percentage points)

Item	India		UK	Czech Republic	Sweden	Hungary
	Full sample	Full sample (ex Oct'16-Jun'17)				
Mean Error (ME)	-0.7	-0.3	0.0	0.0	0.0	-0.4
Standardised ME	-18.4	-7.7	-0.2	0.5	0.6	-12.6
Mean Absolute Error (MAE)	0.8	0.4	0.2	0.4	0.3	0.6
Standardised MAE	20.7	10.7	11.6	19.3	14.6	19.6
Root Mean Squared Error (RMSE)	1.1	0.6	0.3	0.5	0.4	0.8
Standardised RMSE	27.6	13.8	14.2	24.3	17.6	27.2

Source: RBI Monetary Policy Report April 2019

Decision of MPC Members (14 Meetings)

	External/Internal interface			RBI interface
	DG & Dr. Chetan Gbate	DG & Dr. Pami Dua	DG, Dr. Pami Dua & Dr. Chetan Gbate	DG & ED
# of times same decision	13	12	11	10

Source: RBI, SBI Research

DEVELOPMENTAL AND REGULATORY POLICIES

- ◆ **Liquidity and LCR:** The increase in FALLCR for computing LCR by 2% in a phased manner till 1 Apr'2020 is a welcome step. It will let banks use mandatory SLR further upto 2% of NDTL as High Quality Liquid Assets. This will release minimum additional securities around Rs 2.6 lakh crore, with Rs 66,000 crore every four months based on current NDTL. This in turn implies build-up of securities till Aug'19 and higher probability of OMO thereafter.
- ◆ **Housing Finance Securitisation Market:** Domestic securitisation market is very small in India (less than Rs 1 lakh crore in FY18), though it has increased last year due to liquidity issues in NBFC space in the second half. With the considerable potential that the housing sector has to offer (housing finance market size is around Rs 22 lakh crore and growing in double digits) and banks and NBFCs increasing exposure to retail housing, RBI is setting up a Committee on the Development of Housing Finance Securitisation Market.
- ◆ **Development of Secondary Market for Corporate Loans:** As per the data available with SEBI, annual bond trades market is only Rs 15-18 lakh crore but with outstanding corporate bond of around Rs 30 lakh crore and there is a strong need for a robust secondary market. This will also serve as an enabler towards RBI guidelines on enhancing credit supply for large borrowers though market mechanism whereby 50% of the incremental funds raised by the specified borrower is to be through market instruments beginning April 1.
- ◆ **Permitting G-sec trading through International Central Securities Depositories (ICSDs):** Permitting non-resident clients to trade through ICSDs will enable investors to transact in Indian securities but settle in dollars or other international currencies, thereby increasing access and flexibility in order to widen the investor base. Overseas settlement is also expected to result in a reduction in bond yields and an increase in liquidity in domestic bond markets.
- ◆ **NBFCs get a thumbs up:** Apart from setting up a Committee on Securitisation market, to ease undertaking forex transactions to sell foreign exchange for non-trade current account transactions, RBI has indicated that non-deposit taking systemically important NBFCs' in the category of investment and credit companies would be made eligible to apply for authorised dealer category II licence. RBI has also announced extension of NBFC ombudsman scheme to cover non-deposit taking NBFCs with customer interface and asset size of Rs 100 crore and above. Though small, this would lead to effective supervision.
- ◆ **External Benchmark on hold:** The RBI has decided to hold further consultations before rolling out the External Benchmark. However, SBI has taken the lead and announced to link its Savings Bank (SB) Deposits and Short Term Loans (over Rs 1 lakh) to the Repo Rate in order to address the concern of rigidities in the balance sheet structure and address the issue of quick transmission of changes in RBI's policy rates beginning May 01.

**Monetary Policy Committees and Voting Pattern
(Policy Meetings: October 2018 - March 2019)**

Country	Total Meetings	Meetings With Full Consensus	Meetings With Dissents
Brazil	4	4	0
Chile	4	4	0
Colombia	4	4	0
Czech	4	0	4
Hungary	5	5	0
Israel	4	2	2
Japan	4	0	4
South Africa	3	2	1
Sweden	3	1	2
Thailand	4	1	3
UK	4	4	0
US	4	4	0
Total	47	31 (66%)	16 (34%)

Sources: Central bank websites

LCR and Liquidity

Effective Date	FALLCR (% of NDTL)	Total HQLA carve out from SLR (% of NDTL)	Additional securities released (Rs lakh crore)
4 Apr'19	13.5	15.5	2.6
1 Aug'19	14	16	
1 Dec'20	14.5	16.5	
1 Apr'20	15	17	

Source: RBI, SBI Research

Secondary Market : Corporate Bond Trades

Year		2016-17	2017-18
BSE	No of Trades	24372	29198
	Amount (Rs Lakh cr)	2.92	4.75
NSE	No of Trades	64123	62215
	Amount (Rs Lakh cr)	11.78	13.21
Total	No of Trades	88495	91413
	Amount (Rs Lakh cr)	14.70	17.96

Source: SEBI Annual report; SBI Research

Corporate Bond Issuance during the Period

Period	No. of Issues	Amount in (Rs Crores)
FY11	4280	270946
FY12	5565	310070
FY13	5578	388026
FY14	4911	388151
FY15	10941	478962
FY16	8334	584592
FY17	8723	702567
FY18	6706	677064
9MFY19	4660	469789

Source: SEBI; SBI Research

◆ **Harmonizing Turn Around Time for customer complaints**

To have prompt and efficient customer service in electronic payment system, RBI has proposed a framework for Turn Around Time for the Resolution of Customer Complaints and Compensation across all payment systems.

◆ **Benchmarking India's Payment Systems**

Indian market for digital payment system is quite competitive with both private payment service providers competing with public sector entities. The orderly development of payments system requires that Indian market is benchmarked to best markets where digital payment penetration is at advanced stage. Such an exercise will have many benefits not only in rationalizing and consolidation of offerings but also drafting of better laws and regulations.

◆ **Priority Sector Guidelines**

The housing loan limits for eligibility under Priority Sector Lending were revised to Rs 35 lakhs (Metro) and Rs 25 lakhs (other centres) during June 2018 for Scheduled Commercial Banks, however, the RRBs and SFBs were not given this benefit. By extending the same regulation to the Regional Rural Banks and Small Finance Banks now, the affordable housing and the Government plan of 'Housing for all' by 2022 would get a boost.

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