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RBI OPENS UP SPACE FOR RATE CUTS

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The RBI decided to cut Repo rate by 25 bps with a unanimous vote of 6-0. The RBI also changed its stance to " accommodative" which will more likely than not help the financial system to navigate to a lower term structure of interest rates and also accommodate growth concerns at the same time. For FY20, GDP growth forecast has been cut by 20 bps to 7.0%, which could be a tad optimistic. It remains to be seen whether the liquidity, that is currently in surplus mode, is sufficient for the banks to push down deposit rates, as that will purely dictate the trajectory in lending rates even as more rate cuts are in the offing (upto 50-75 bps we are re expecting in the current cycle).

On the developmental and regulatory policies, there are a lot of positives. The decision to adjust the Leverage Ratio could add a potential Rs 1 lakh crores to the lendable resources of the banks. RBI has also scrapped transaction charges for RTGS & NEFT. In a positive development for small & medium forex clients, RBI has also announced the launch of the online trading platform for retail participants. Decision to issue draft for " on-tap" licensing of small finance banks is likely to add depth to this sector. As per the estimates, one ATM transaction costs around Rs 30 (based on 120 transaction/per day), while banks charges customers a max of Rs 20 per transaction. Against this backdrop, RBI's decision to review entire gamut of ATM charges and fees is very timely.

The markets may be however a tad disappointed that there was no comprehensive package for NBFCs. We however find that NBFCs have significantly increased their cash holdings and it clearly seems that the current RBI policy of better regulations for the sector is working well. Any attempt in AQR could elongate pain in the economy when growth is losing definite momentum. However, on a more serious note, it would now be pertinent to ponder for NBFC whether financial instability should be thought of only as something that impedes the attainment of the inflation goals over time, or does society directly care about financial stability for other reasons? For example, in the US, frequent mentions of financial instability terms at the FOMC, particularly during bust periods, resulting in a statistically significant reduction in the funds rate relative to that implied by a simple Taylor rule, miss actual FOMC behaviour. We also expect some radical thinking in the forthcoming Union Budget like a "Well Being Budget" implemented recently by New Zealand Government.

RBI REDUCES REPO RATE BY 25 BPS TO 5.75%

- The Monetary Policy Committee (MPC) decided to cut the Repo rate by 25 bps to 5.75% unanimously and decided to change the monetary policy stance from neutral to accommodative.
- For FY20, RBI again cut its GDP growth forecast by 20 bps to 7.0% (H1: 6.4-6.7%, H2: 7.2-7.5%) owing to weak investment activity, weak global demand and moderation in private consumption. The silver lining includes political stability, high capacity utilization and uptick in business expectations. In the last two policies RBI cut its growth forecast by 40 bps. The fan chart indicate that RBI revised downward Q2 growth sharply.
- RBI kept CPI inflation for FY20 at the same level with 3.0-3.1% in H1 FY20 (earlier 2.9-3.0%) & 3.4-3.7% in H2 FY20 (earlier 3.5-3.8%). However there are risks related to monsoon, vegetable prices, crude oil, geo-political tensions, financial market volatility & the fiscal scenario.
- Global economic growth has lost pace after Q1:2019, reflecting further slowdown in trade and manufacturing activity. Loss is growth is fairly widespread across both advanced and emerging economies. The loss in momentum in Q4 growth can be attributed partly to slowdown in exports. Weak global demand due to escalation in trade wars may further impact India's exports and investment activity. Thus a rate cut at this juncture was warranted.

LIQUIDITY AND DEPOSIT RATES

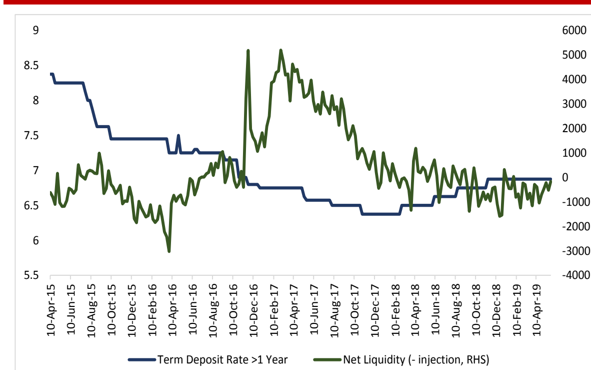
- The relationship between system liquidity and deposit rates is clearly visible in the historical data. Liquidity was in surplus mode between Nov'16 and Dec'17 and at the same time average term deposit rate (> 1 year) declined by 525 basis points. Meanwhile, when the liquidity started declining and moved to deficit mode during Apr'18 to Dec'18, banks increased the deposit rates by 375 basis points.

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
Jun'19 (2nd Bi-monthly)	2.9	3.2	3.4	3.7
Apr'19 (1st Bi-monthly)	2.8	3.0	3.4	3.8
Feb'19 (6th Bi-monthly)	3.2	3.4	3.7	-
Dec'18 (5th Bi-monthly)	3.8	4.2	-	-
Real GDP Growth (%)	**Q1 FY20**	**Q2 FY20**	**Q3 FY20**	**Q4 FY20**
Jun'19 (2nd Bi-monthly)	6.5	6.8	7.3	7.4
Apr'19 (1st Bi-monthly)	6.8	7.2	7.3	7.5
Feb'19 (6th Bi-monthly)	7.2	7.3	7.3	-
Dec'18 (5th Bi-monthly)	7.0	7.2	-	-

Source: RBI, SBI Research

Liquidity (Rs billion) and term deposit rates (%)



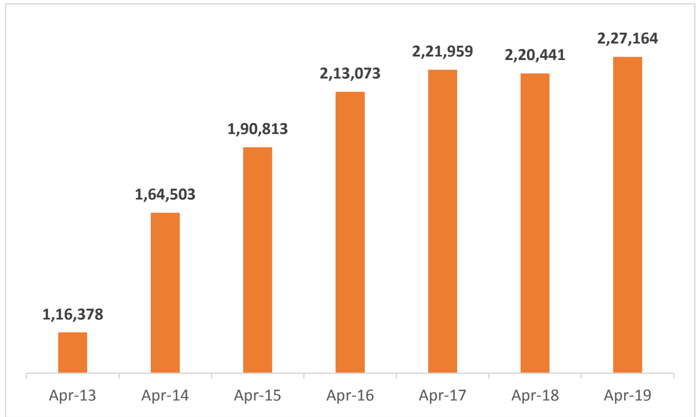
Source: RBI; SBI Research

- It remains to be seen whether the liquidity that is currently in surplus mode is sufficient for the banks to push down deposit rates, as that will purely dictate the trajectory in lending rates.

DEVELOPMENTAL AND REGULATORY POLICIES

- ***Leverage Ratio***: This is a non-risk-based leverage ratio (LR). As per the framework on LR put up by RBI, the banks were monitored against an LR of 4.5% as the final guidelines were not announced. Now, BCBS has come out with the guidelines which require the banks to maintain a minimum of 3% LR requirements. In order to harmonise our standards with Basel III, RBI has decided to keep the minimum requirement of 4% for DSIBs and 3.5% for other banks.
- Since most of the banks are maintaining a higher LR requirement, the bringing down of the ratio would give scope of further enhancing exposure in assets and non-balance sheet items. If the LR ratio of 3.5%, which is to be maintained by banks (other than D-SIBs) in general is compared with the Tier I Leverage Ratio of 4.8% for all banks (source: FSR Sep'18) on a Tier I capital base of Rs 11,14,700 Cr (Mar'18), the gap of 1.3% would allow the banks to increase their lendable resources by at least Rs 1 lakh crores provided they have low risk weight assets and enough capital to meet the capital adequacy norms.
- RBI currently manages systemic liquidity based on the guidelines of Liquidity Management Framework 2014. Given the focus that liquidity management has generated in the recent times and RBI's tinkering with new ways of injecting durable liquidity, the time is right for putting in place a comprehensive policy which is easily accessible to all the market participants and will help in uniform assessment of systemic liquidity needs.
- ***Framework for Core Investment Companies (CICs)***: Recently in February'19 policy announcement, rated exposures of banks to all NBFCs, excluding CICs, were to be risk-weighted as per the ratings assigned by the accredited rating agencies, in addition to Asset Finance Companies (AFCs), Non-Banking Financial Companies – Infrastructure Finance Companies and Non-Banking Financial Companies – Infrastructure Development Fund (NBFCs-IDF), which are already risk weighted as per the ratings assigned.
- Further, with corporate group structure having become more complex involving multiple layering and leveraging, strengthening the corporate governance framework of CICs, by setting up a Working Group to review the regulatory guidelines and supervisory framework, is a welcome move.
- **NBFCs have increased cash holdings:** While analyzing data, for 64 NBFCs with loans and advances above Rs.100 cr, reporting their cash and bank balance, we observed that, while loans and advances have increased by around 8% from Sept'18 level, cash and bank balance increased by around 53% as on March'19. Moreover, the growth is mainly seen in Government backed NBFCs like Power Finance, REC, LIC housing Finance etc. and it seems some of the NBFs are holding back cash and cash equivalent and slowed disbursements.
- ***On Tap Licensing of Small Finance Banks***: After monitoring and observing the successful achievement of the small finance banks, especially towards financial inclusion the RBI now intends to add more players in this segment. The Draft guidelines would be issued by August 2019. We believe that having some more banks in this space would help in meeting the growing credit requirements of the small business and agriculture segment
- ***Review of ATM Interchange Fee Structure:*** In the last one year (Apr'19 over Apr'18) the number of ATMs increased by 6,723 to 2,27,164 while debit cards transactions at ATMs increased by 7.4% to Rs 2.8 trillion (last year the growth was 22.1%). Since Apr'18, the figure for per debit card transaction at ATM has also increased marginally by on an average Rs 300 to Rs 3,200.
- Against this backdrop, RBI's decision to review entire gamut of ATM charges and fees is very timely. We believe that ATM charges should be rationalised to benefit all the stakeholders of the ATM industry. The growing cost of ATM deployment and maintenance incurred by banks on the one hand as well as the rising interchange out-go should be considered by RBI before taking any decision. As per the estimates, one ATM transaction costs around Rs 30 (based on 120 transaction/per day), while banks charges customers at max of Rs 20 per transaction.
- With the rise in card issuance powered by Jan Dhan scheme and other Government initiatives, there is a need for a sustainable business model for the ATM industry.

Number of ATMs in India



Source: RBI; SBI Research

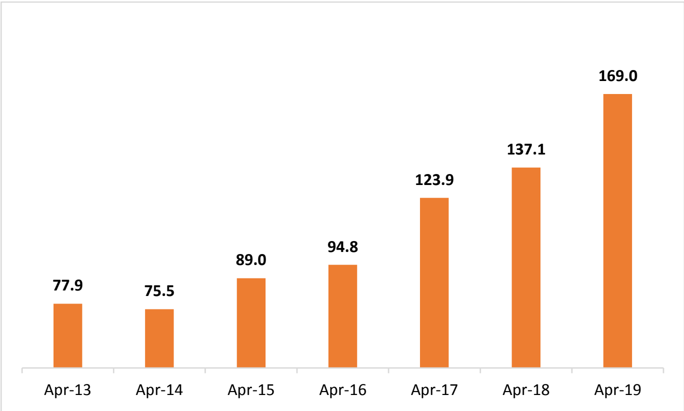
Growth in NBFCs Cash and Bank balance in Mar'19 over Sep'18

Description	Sep'18	Mar'19	Growth over Sep'18	
	Rs crore	Rs crore	Rs crore	%
Loans & Advances	2118095	2294845	176750	8.3%
Cash & Bank Balance	59564	91627	32063	53.8%

Source: CLIne; SBI Research; 64 NBFCs with loans & advances above Rs100 cr

- ***Forex Trading Platform for Retail Participants***: Retail participants have been demanding a platform where they can do direct trading without any third party intermediation. RBI's decision to launch this facility from early August 2019 will meet this long standing demand. It is a positive development for small & medium forex customers. It is expected to go a long way in attracting the retail players to active forex trading fold.
- ***Review of Money Market directions***: The absence of uniform market hours across all money market segments which are not in sync with RTGS timings often have a destabilising impact on the weighted average overnight call money rate towards the market's closure. The RBI decision of comprehensive reviewing of money market will remove the various anomalies currently prevailing in the market.
- ***Charges for RBI-operated Payment Systems:*** Transactions from RTGS+NEFT channel has increased from Rs 75.5 trillion in Apr'14 to Rs 169.0 trillion in Apr'19. Now the decision to do away with the charges levied by the RBI for transactions processed in the RTGS and NEFT systems is a welcome step and will give further boost to the digital fund transfers. This move will cost around Rs 2000 crore to RBI.

RTGS+NEFT Transactions (Value in Rs Trillion)



Source: RBI; SBI Research

INDIA COULD EMULATE NEW ZEALAND BUDGET!

- New Zealand's Government raised its expenditure plan amid slower growth outlook in the 2019-20 budget, dubbed the "Well Being Budget." By doing so, New Zealand has become the first country to introduce the "Wellbeing Budget designed to address the growing disparity between the haves and have-nots. The country's entire budget is based on wellbeing priorities with instruction to its ministries to design policies to improve wellbeing. A significant amount has been allocated to mental health services, child poverty and measures to tackle family violence. Mental health received the biggest funding and investment boost on record, receiving NZ$1.9bn (£980m). Child wellbeing will receive more than $1bn while measures to combat family violence also received a record investment of $320m, in a bid to tackle the country's entrenched family and sexual violence statistics, which see the police respond to a domestic violence incident every four minutes.
- Along this line, the Indian Government should increase its focus on social welfare and try to pull up economic growth. The Government should not stress on being on fiscal consolidation path trying to achieve the fixed fiscal deficit target as defined by the FRBM committee, instead say keep the deficit numbers constant for the next two years before reducing it further and revive growth. The Government should strive to make credible, transparent fiscal rules that are achievable. We believe that the Government should target structural deficit as an alternative to targeting fiscal deficit. Such structural deficit acts as an automatic counter-cyclical stabilizer unlike the current target that has been set from the outset as a fixed percentage of GDP and is a statistical artefact!

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