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NAVIGATING THROUGH GLOBAL TURMOIL: RATE CUT OR CUTTING FUEL / INDIRECT TAXES OR BOTH?

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Global markets are in a complete rout. In an unprecedented development, global crude prices declined to a record low of $31/bbl before recovering marginally with sudden emergence of price war between the OPEC and the non-OPEC members of the oil producing countries. First Russia didn't agree to a further output cut (for OPEC+) over & above the current output cut applicable till 31st March. Simultaneously, the Saudi offer to reduce price and increase the production when the demand negating impact of coronavirus is still uncertain has taken markets by surprise. What it now implies is all OPEC & OPEC+ countries are free to explore independent outputs till next OPEC meeting in June, implying that oil prices could go down even further.

Against this, the chorus of rate cuts by RBI to stimulate demand is only getting louder. We however believe that even though RBI might bite the bullet of cutting rates in forthcoming policy, it is unlikely to result in any material impact on invigorating demand. Our analysis of credit data of top 6 banks, constituting three public sector banks and three Private Banks sector banks which are 52% of total bank credit (as on Mar'19) over the last one year (Dec'19 over Dec'18) reveal interesting results. **First,** both Private Banks and PSBs are exhibiting robust growth in retail segment, 15.7% and 12.8% respectively, **indicating portfolio switch of retail loans is working both ways (Private Banks to PSBs and PSBs to Private Banks) as well as new retail credit.**

Second, In case of top 8 PSBs, Corporate credit has exhibited decline of Rs 81,535 crore during Dec'19 over Dec'18, while during the same period top 3 private banks' corporate pie grew by Rs 1.04 lakh crore. This clearly explains portfolio switch in corporate credit portfolio from PSBs to Private Banks as PSBs. **This indicates that incremental credit demand is largely in retail segment, but in Corporate segment it is largely portfolio switch from PSBs to Private Banks.**

We believe, a combination of a larger rate cut (notwithstanding the dangers of further cut in deposit rate) and/or indirect tax rate cut could be the policy options with financial markets in an unprecedented global meltdown.

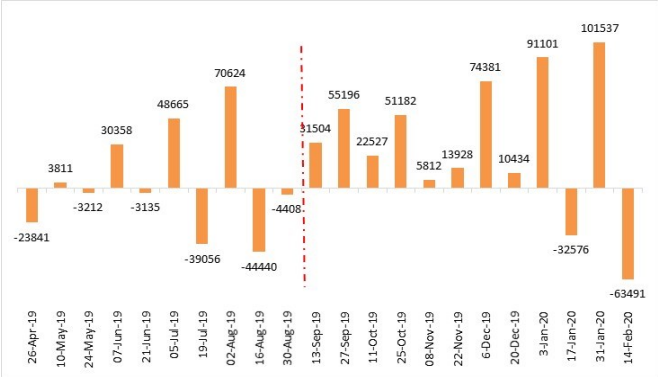
Our analysis shows that, the nearly 30% fall in crude oil prices could lower the petrol prices by Rs12/litre and diesel prices by Rs10/litre in India from their present prices. However, both Centre and States may not be willing to do so, as it may impact their overall revenue projection for FY20 given the fiscal constraints. Between FY18 and FY19, average crude oil prices increased from $56.43/barrel to $69/barrel, generated additional revenue of Rs 20,700 crore for States and Rs 11,800 crore for Centre.

An interesting anecdote for those who typically question the huge decline in PSBS credit in recent times. **In 2008-09, the share of PSBs in incremental credit was at 86.4%, while private sector banks (Pvt Banks) share was only 9.8%. In the post crisis period (FY09-FY14), PSB total incremental credit leading to a total credit offtake of Rs 28.7 lakh crores, whereas Private Banks incremental credit was at Rs 7.4 lakh crores. "** *It was an anomalous case of private sector growth without private sector bank financing prior to FY08"!* By this logic, how we will define the current growth downturn then? For the record, **post FY14, PSBs incremental credit offtake is estimated to be Rs 13 lakh crore, while for private sector banks it is at Rs 24 lakh crore.**

CREDIT GROWTH IS LARGELY IN RETAIL: CORPORATE IS SHOWING PORTFOLIO SWITCH FROM PUBLIC TO PRIVATE

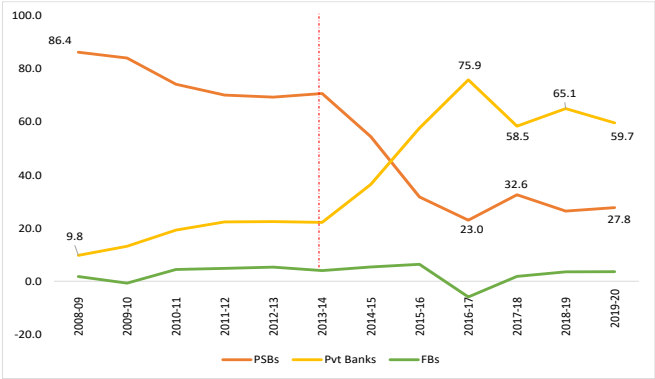
- In in the current year 2019 so far (up to 14 Feb'20), the ASCBs YoY credit growth data indicate a downward journey and has touched 6.4% (vis-à-vis 14.8% in corresponding period previous year). Even on an YTD basis the ASCBs advances declined to 2.8% (Rs 2.69 lakh crore) in FY20, compared to last year YTD growth of 9.4% (Rs 8.1 lakh crore). Thus, this year's incremental credit growth is merely 33% of previous year. Based on the trend growth, in FY20 ASCBs credit may incrementally increase by Rs 6 lakh crore, with a YoY growth of 6.3%. This would be the lowest growth in the last 57-years (5.4% in FY62).
- However, the bank-group wise incremental credit data is indicating some interesting trend. In 2008-09, the share of PSBs in incremental credit was at 86.4%, while private sector banks (Pvt Banks) share was only 9.8%. **In the post crisis period (FY09-FY14), PSB total incremental credit leading to a total credit offtake of Rs 28.7 lakh crores, whereas Private Banks incremental credit was at Rs 7.4 lakh crores. Post FY14, PSBs incremental credit offtake was estimated to be Rs 13 lakh crore, while for private sector banks it was at Rs 24 lakh crore.**
- **The most interesting aspect that is that the incremental lending by PSBs that was at 71% in FY14, had sharply declined to 23% in FY17, revived in FY18 to 33%, but declined again post FY18 with the advent of NBFC crisis**. This decline in credit growth of PSBs was primarily because of initiation of AQR in 2015.
- **There is an interesting anecdote in this credit expansion story. During FY04-FY08, incremental credit expansion by PSBs was at Rs 11.8 lakh crores, while Private Banks were at Rs 3.3 lakh crores. "***Such a rapid growth was also a paradox as the share of the private sector in overall banking aggregates barely increased at a time when the country witnessed its most rapid growth and one that fuelled by the private sector. It was an anomalous case of private sector growth without private sector bank financing".*

Fortnight Movement of Credit growth (Rs crore)



Source: SBI Research

Share (%) of Incremental Credit Growth: Bank Group Wise



Source: SBI Research

CREDIT GROWTH IS LARGELY IN RETAIL, CORPOPRARTE IS PRIMARILY PORTFOLIO SWITCH FROM PSBS TO PRIVATE BANKS

- Now fast forward to current year. The overall credit growth of ASCBs has reduced significantly recently and there has also been a change in growth amongst various segments. All the banks have started shifting their focus on retail sector with RBI also emphasizing the need to push up credit growth in retail sector and MSME sector.
- Our analysis of credit data of top 6 banks, constituting three public sector banks and three private sector Banks which are 52% of total bank credit (as on Mar'19) over the last one year (Dec'19 over Dec'18) reveal interesting results. The sectoral distribution (Retail including Agri, SME and Corporate or industry) of the three private sector banks when compared with the top 3 PSBs' reveal some interesting results:
- Credit of top 3 private banks' grew by 15.8% vis-à-vis 3.5% credit growth in respect of top 3 PSBs
- **Both Private and PSBs are exhibiting robust growth in retail segment, 15.7% and 12.8% respectively, indicating portfolio switch of retail loans is working both ways (Private to PSBs and PSBs to Private)**
- **In case of top 8 PSBs, the Corporate or industry exhibited decline of Rs 81,535 crore during Dec'19 over Dec'18, while during the same period top 3 private banks' corporate pie grew by Rs 1.04 lakh crore. This clearly explains portfolio switch in corporate credit portfolio from PSBs to Private Banks.**
- **Against this background, a rate cut is unlikely to work in isolation.**

TRANSMISSION HAS PICKED UP RAPID PACE

- Regarding bank transmission, during Feb-Oct' 2019, RBI has reduced 135 bps cumulative. Taking this into account, the transmission in the 1-year median MCLR till Feb'20 is 59 bps. WALR on fresh rupee loans sanctioned by banks has declined by 45 bps till Jan'20, while the WALR on outstanding rupee loans decreased by 11 bps Feb'19-Jan'20. Looking at the pace of WADTDR on O/s Rupee Term Deposits, it has gone down by 38 bps.
- When we look at 2015 data, the WADTDR on O/s Rupee Term Deposits for Jan'15-Dec'15 was 78 bps. **This is perhaps one of the big reasons that a 135 bps rate cut in this time translated into WALR on outstanding rupee loans decreasing by 54 bps and WALR on fresh rupee loans sanctioned by banks declining by 63 bps at that time.**
- **With the pace of deposit rate cuts picking pace, transmission could be faster. Most banks, including private are now cutting aggressively**.
- **The spread between the term deposit rates and savings rate limits the scope, however of increased cuts in term deposits rate. Had the Government followed the formulas strictly, rates on different small savings instruments would now have been lower by 80-160 bps. In FY19, the incremental Small savings deposits was 24% of incremental ASCB deposits.**

Transmission of Policy Repo Rate to ASCBs Lending and Term Deposit Rate

	2019 Rate Cut Cycle			2015 Rate Cut Cycle		
	Feb'19	Jan'20	Change in bps	Jan'15	Dec'15	Change in bps
1Yr Median MCLR*	8.8	8.21	-59	-	-	-
WADTDR O/s Rupee Term Deposits	6.9	6.52	-38	8.61	7.83	-78
WALR O/S Loans	10.26	10.15	-11	11.85	11.31	-54
WALR Fresh Loans	9.81	9.36	-45	11.22	10.59	-63
Memo						
Repo Rate	6.5	5.15	-135	8.0	6.75	-125

Source: RBI, SBI Research, * MCLR is for Feb'20

Term Deposit rate cut between Feb'19-Nov'19 & Nov'19-Feb'20 for 1 year retail deposit rates

Feb'19-Nov'19	SBI	PNB	CANARA BANK	BOB	INDUSIND BANK	AXIS BANK	HDFC BANK	ICICI BANK
Deposit Rate(%)	6.8	6.75	7	6.7	8	7.3	7.3	6.9
Cut in rates(bps)	55	35	60	45	75	85	100	55
Nov'19-Feb'20	SBI	PNB	CANARA BANK	BOB	INDUSIND BANK	AXIS BANK	HDFC BANK	ICICI BANK
Revised Deposit Rate(%)	6.0	6.3	6.3	6.0	6.8	6.4	6.3	6.2
Cut in rates (bps)	25	10	10	25	50	5	0	15
Total (bps)	**80**	**45**	**70**	**70**	**125**	**90**	**100**	**70**

Source: SBI Research

Small Savings Rates: Actual vs Formula Based Rates

Items	Formula Based Interest Rate	Govt. Announced Q4 Rates	Difference (Actual minus Formula Based)
Savings Deposits	-	4	-
PPF	7.04	7.9	0.86
5 year Recurring Deposit	5.85	7.2	1.35
1-Yr Term Deposit	5.3	6.9	1.6
2-Yr Term Deposit	5.57	6.9	1.33
3-Yr Term Deposit	5.85	6.9	1.05
5-Yr Term Deposit	6.65	7.2	0.55
Sr. Citizen Savings Scheme	7.4	8.6	1.2
Post Office Monthly Income Scheme	6.62	7.6	0.98
NSC	6.81	7.9	1.09
Sukanya Samriddhi A/C	7.54	8.4	0.86

Source: SBI Research

Sectoral Credit Distribution of Top 6 Banks (Rs crore)

	Top 3 PSBs				Top 3 Pvt. Banks			
	Dec-18	Dec-19	Incremental	% YoY	Dec-18	Dec-19	Incremental	% YoY
Domestic Credit	2915073	3018301	103228	3.5	1747892	2024581	276689	15.8
of which, Retail	1161592	1310765	149173	12.8	1010377	1169334	158957	15.7
SME	473660	444405	-29255	-6.2	163756	177088	13332	8.1
Corporate	1256106	1240234	-15872	-1.3	573758	678159	104401	18.2
Corporate (other 5 PSBS showing maximum contraction)	458068	392405	-65663	-14.3				

Source: SBI Research

FURTHER CUTS IN DEPOSITS RATES LOOKS INCREASINGLY DIFFICULT : LIQUIDATION OF YES BANK AT1 COULD PUT PRESSURE

- The Draft 'Yes Bank Ltd. Reconstruction Scheme, 2020' states that the instruments qualifying as Additional Tier 1 capital, issued by the Yes Bank Ltd. under Basel III framework, shall stand written down permanently, in full, with effect from the Appointed date.
- BASEL III documents state that the Additional Tier 1 Capital is subordinated to depositors, general creditors and subordinated debt of the bank.
- In the investors' mind, the distinction between the various forms of financial savings get muddled and rightly so when a bank starts renegading on its promises and this hit on AT1 investments can have cascading impact on the retail deposit products, which at least are technically more secure than AT1 bonds.
- At this time, if further deposit rate cuts also happen, this effect can multiply leading to clamour for withdrawals and exacerbate the situation. With the financial savings rate already not very high and this negativity around deposits, the tax concessions that the recent budget proposes to eliminate might also fuel to the fire. Already retail investors have gone searching for better returns and have burnt their fingers.

OIL PRICE TRENDS

- The most unexpected development in the global economy has been the sudden emergence of price war between the OPEC and the non-OPEC members of the oil producing countries. The Saudi offer to reduce price and increase the production when the demand negating impact of coronavirus is still uncertain has taken markets by surprise. The oil prices have corrected sharply by 25%.
- What triggered the price war is unclear. However the markets largely missed the brewing discontent and that transpired the steep fall. Low levels of oil price may be good story in part, but it also has con side: high financial market volatility, abrupt corrections in inflation and impact on government finances.
- Unless there is some truce coming oil, price is expected to stay low. With no signs of slowdown in spread of coronavirus, an increase in oil supply will keep the prices depressed.

IMPACT ON RETAIL PRICES

- Global crude oil plummeted to as low as $31.02 a barrel from $50 per barrel a few days back. As a result it will reduce the import bill of India and therefore the current account deficit by a big margin. However, with deregulation, petrol and diesel prices across the country since June 2017, there is a question arises, whether this decline in crude oil prices will be transmitted to consumer or not and if yes then how much?
- If we look at the build up cost of retail prices of petrol and diesel in India, the Centre charges a fixed excise duty of Rs 19.98 per litre on petrol and Rs 15.83 per litre on diesel. Apart from this, there are transportation costs, commission costs and other charges which contribute Rs 10 in Petrol and Rs 13 in diesel. On top of these, the state tax/VAT is levied along with additional Cess that ranges around Rs 15-20 in petrol and Rs 10-15 in Diesel.
- **Our analysis shows that, the nearly 30% fall in crude oil prices could lower the petrol prices by Rs12/litre and diesel prices by Rs10/litre in India from their present prices.** In other words, we can say a $10/bbl decrease in crude oil price on an average will lower retail price of petrol by Rs 6.50 and retail price of diesel by Rs 5.28 ($1 decline in crude oil will lead to 65 paisa decline in petrol prices and 52 paisa decline in diesel prices).
- **However, both Centre and States may not be willing to do so, as it may impact their overall revenue projection for FY20 given the fiscal constraints. Between FY18 and FY19, average crude oil prices increased from $56.43/barrel to $69/barrel, generated additional revenue of Rs20,700 crore for States and Rs11,800 crore for Centre.**

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