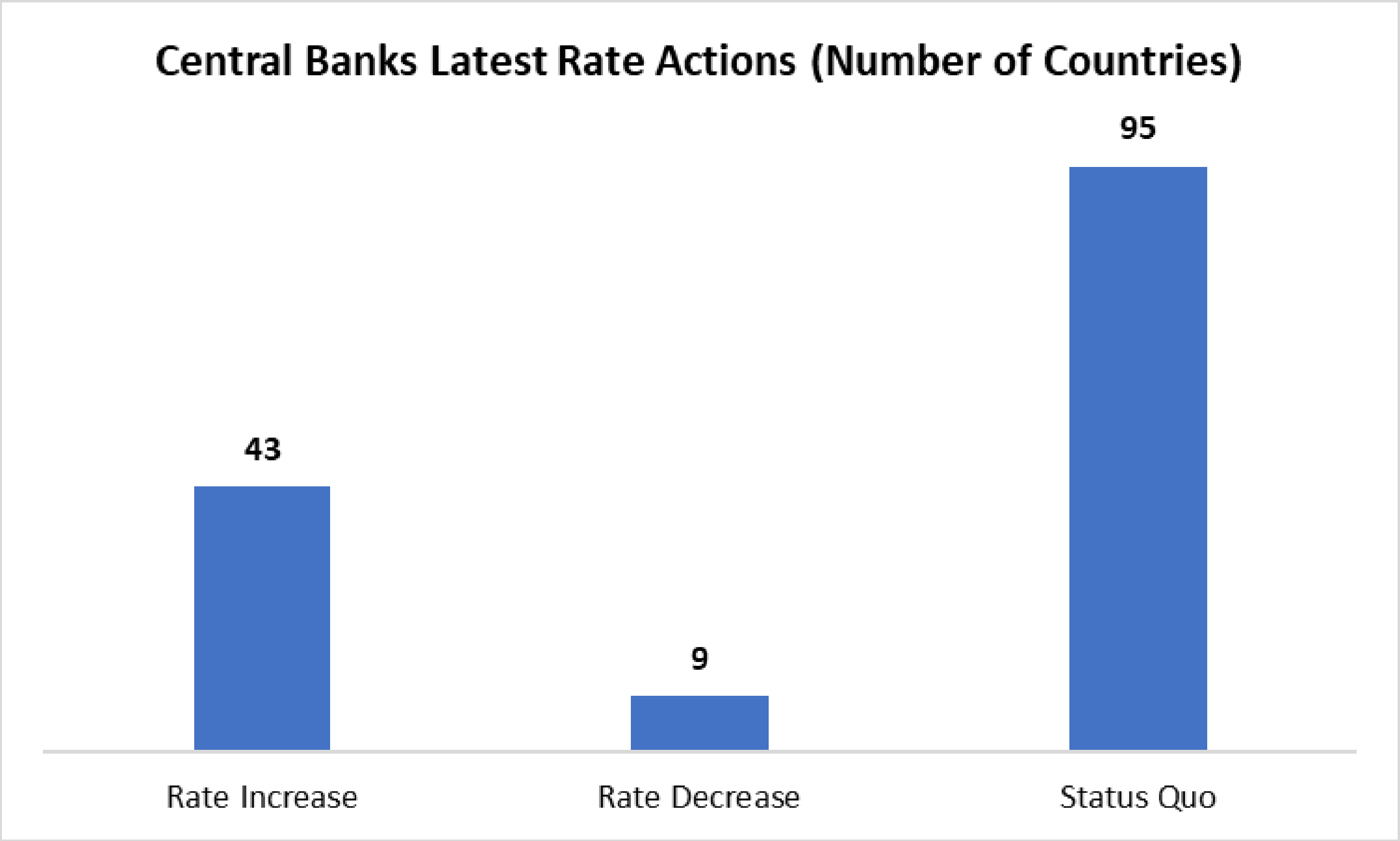
SBI Research

Prelude to MPC Meeting: June 6-8, 2023

05-June-2023

Global rate actions show Status Quo is becoming the norm….

- Country-wise central bank rate action data indicates that out of 147 countries, 95 economies paused their rates in the latest policy and policy rate increased in only 43 countries



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On a lighter note

On a Lighter Note…..

- An independent humorous study in USA shows that the height of FED chair is directly correlated with rate hikes….

- Taking this humour to Indian shores….we evaluated the term of RBI Governors for the last 2 decades…based on an overall Performance in fast changing economic scenario…

- Following four factors of their terms have been considered:

i. Growth in Nominal GDP
ii. Control in Inflation (below 6%)
iii. Adverse Global Economic Environment
iv. Number of Crisis Faced (None/Single/Poly)

Rate Cycles						
RBI Governors	Time Frame		No of Policies	Rate Action	Policy Rate	Change in bps
Dr. Y.V. Reddy	06-09-2003	05-09-2008	11	hike	6.0 % to 9.0 %	300
Dr. D. Subbarao	05-09-2008	21-04-2009	6	cut	9 % to 4.75 %	-425
Dr. D. Subbarao	21-04-2009	25-10-2011	13	hike	4.75% to 8.5%	375
Dr. D. Subbarao	25-10-2011	04-09-2013	4	cut	8.5% to 7.25%	-125
Dr. Raghuram G. Rajan	04-09-2013	28-01-2014	3	hike	7.25 % to 8 %	75
Dr. Raghuram G. Rajan	28-01-2014	04-09-2016	5	cut	8% to 6.5%	-150
Dr. Urjit R. Patel	04-09-2016	02-08-2017	2	cut	6.5 % to 6 %	-50
Dr. Urjit R. Patel	02-08-2017	11-12-2018	2	hike	6% to 6.5 %	50
Shri Shaktikanta Das	11-12-2018	08-04-2022	7	cut	6.5 % to 4 %	-250
Shri Shaktikanta Das	08-04-2022	06-04-2023	6	hike	4 % to 6.5 %	250

Methodology of Calculating Overall Performance Score

- **Growth in Nominal GDP**: Higher the increment in Nominal GDP from the Quarter in which Governor has joined office to the Quarter in which Governor has demitted office, the higher is the score…

- **Control in Inflation**: The average inflation during each rate hike/cut cycle is juxtaposed against the 6% inflation target. If the actual inflation (the average inflation during the rate hike/cut is considered) outstrips 6% it is taken as a negative score and when the 6% outstrips the actual inflation it is taken as a positive score

- **Adverse Global Economic Environment**: Using Asian Development Bank Financial Stress Index for India, we arrived at the Score of Financial Stress during the tenure of each Governor by estimating the ratio of Spread of Max to Min Financial Stress for each Governor to Spread of Max to Min Financial Stress. A higher ratio implies that the aforesaid Governor during his tenure faced relatively higher financial stress and hence is compensated by a higher score

$$\boldsymbol{Financial\ Stress_{Gov_i} = \frac{Maxstress_{Gov_i} - Minstress_{Gov_i}}{Maxstress_{Overall} - Minstress_{overall}}}$$

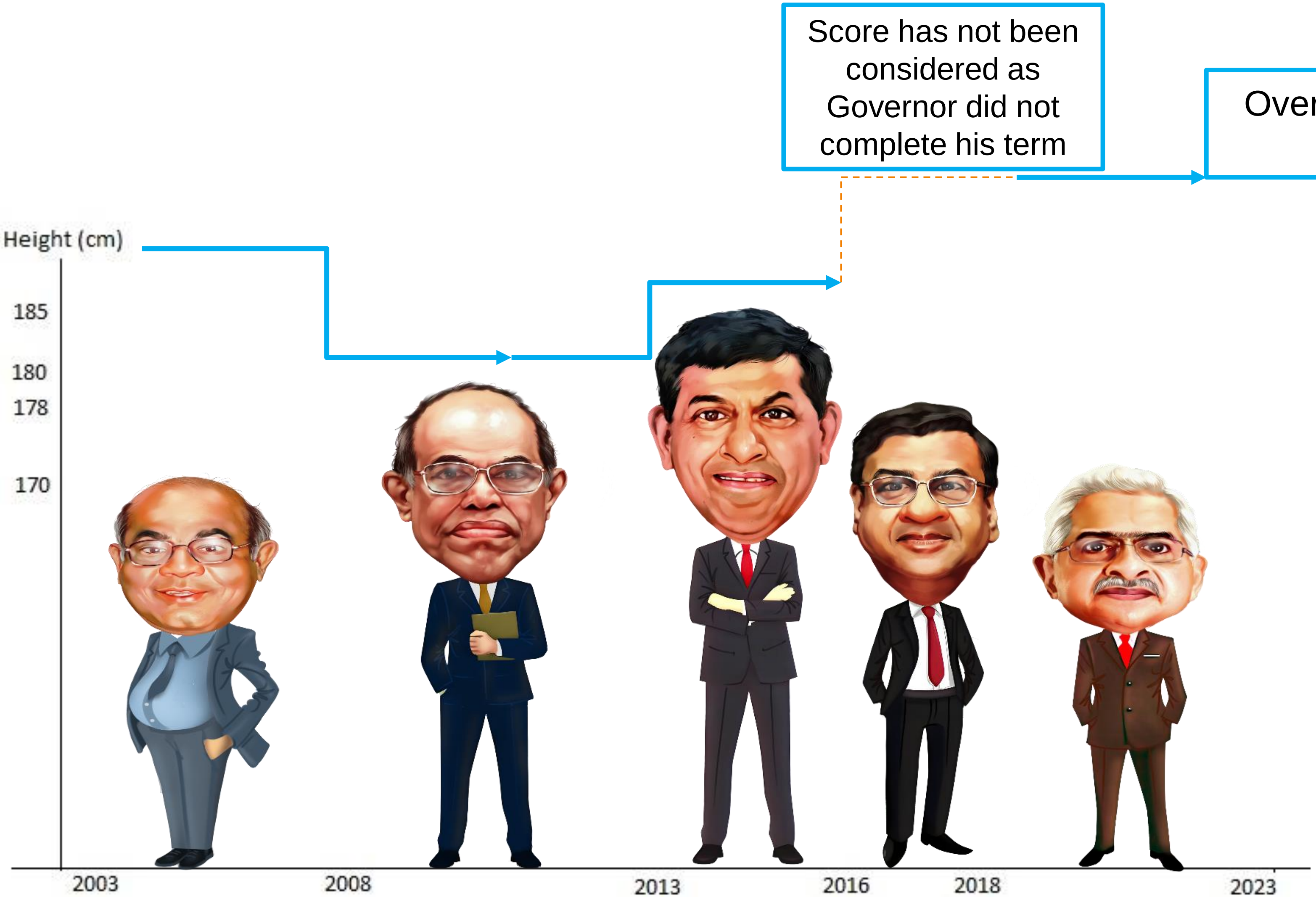
- **Number of Crisis Faced**: In present times, India facing poly-crisis in the form of Covid, Ukraine War, Fed Rate Hike. This factor we have included to incorporate the dimensionality of problems faced by Governors, where dimensions may require opposite actions and hence higher the no of crisis, the higher will be the overall performance score

- While the first 2 factors are hard macro-outcomes, the last 2 factors indicate the sheer relative toughness to face adverse economic outcomes that may happen once in a lifetime…

- **Overall Performance Score** = Product of Score earned in each of the aforesaid 4 factors

Governors with shorter heights are found to be performing better than the Governors with larger heights…. When the going gets tough….the height gets going…..

- Height of RBI Governors may be impacting the overall Performance

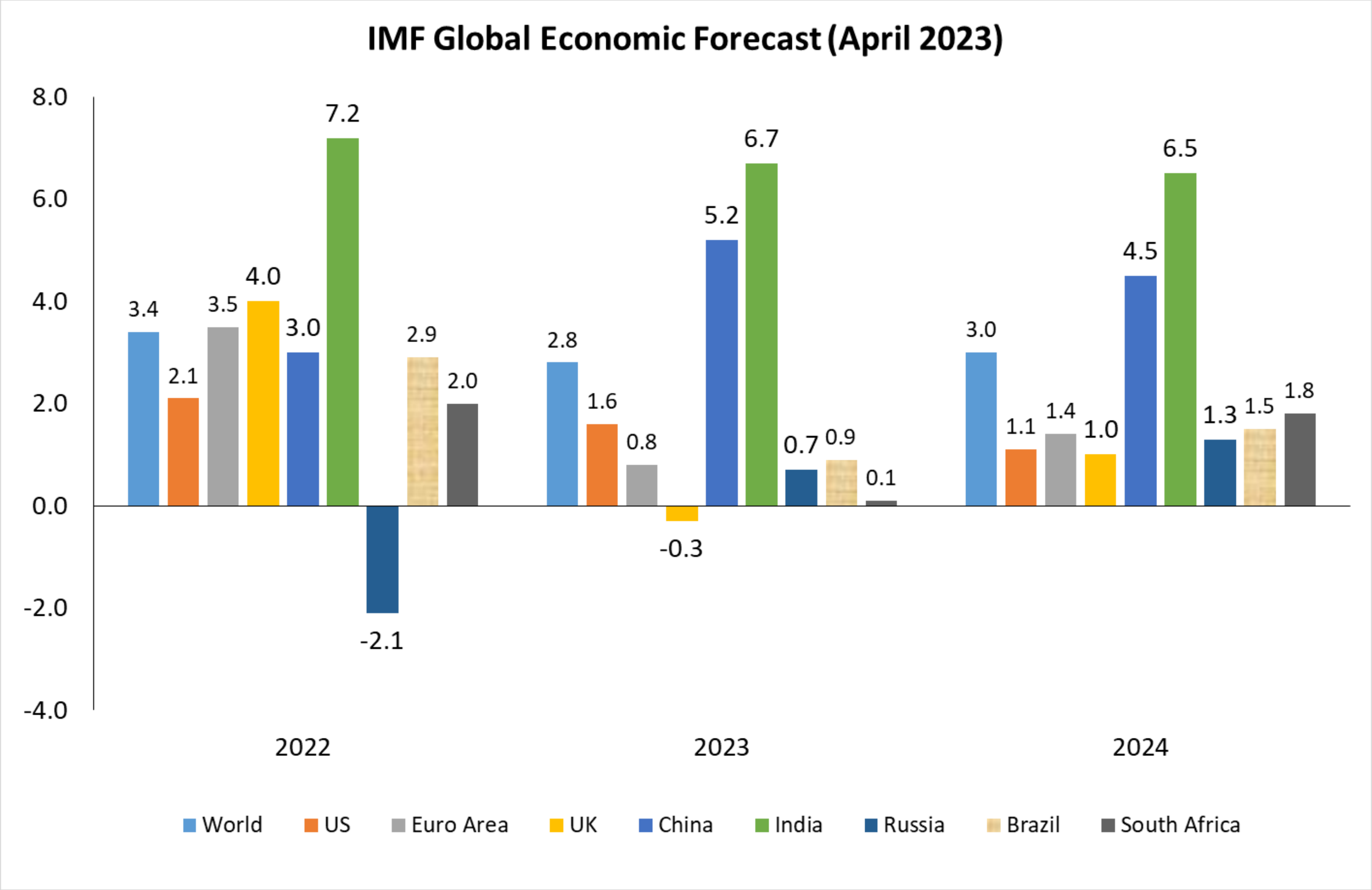


Overall Performance Score

We do not actually believe that performance is determined by Height of the RBI Governor, but it is an interesting coincidence, shared on a humorous note

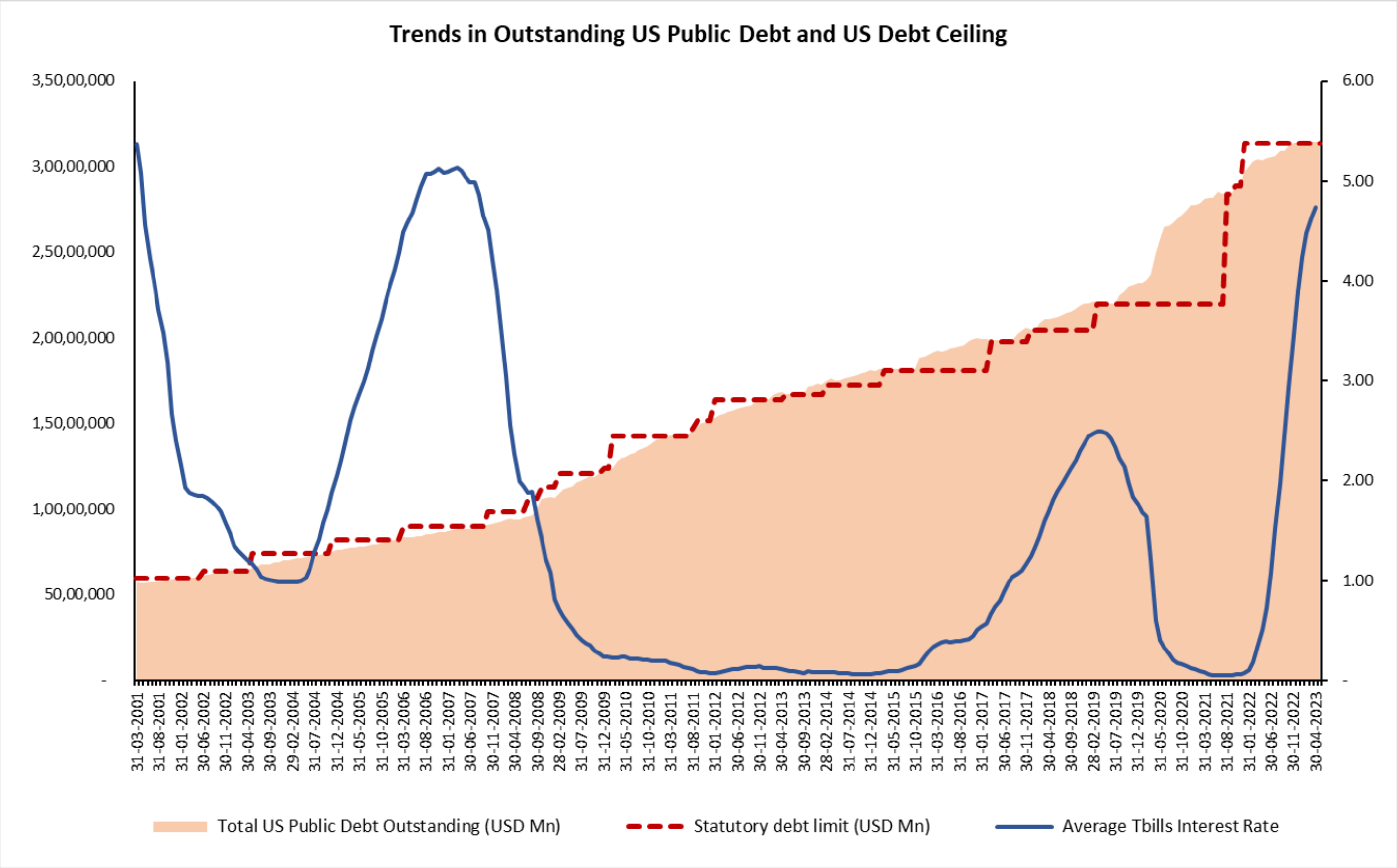
Global Economic Situation

Global growth to slowdown in general in 2023, India and China (a distant second!) holding fort



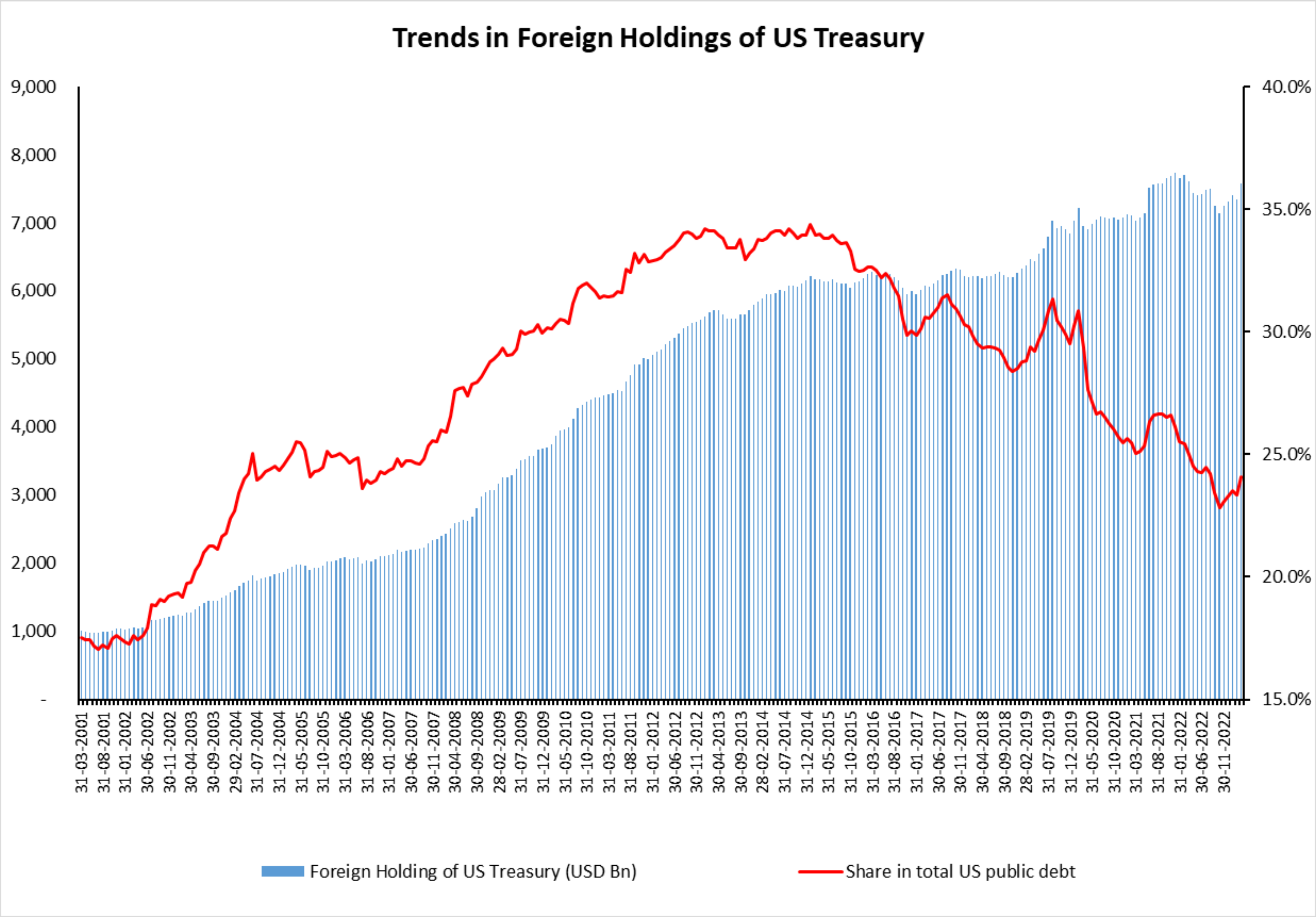
*For India, 2022 (FY23-NSO), 2023- FY24 (SBI) and 2024- FY25 (SBI) estimates

US debt ceiling suspended for time being, new limit remain critical for market dynamics

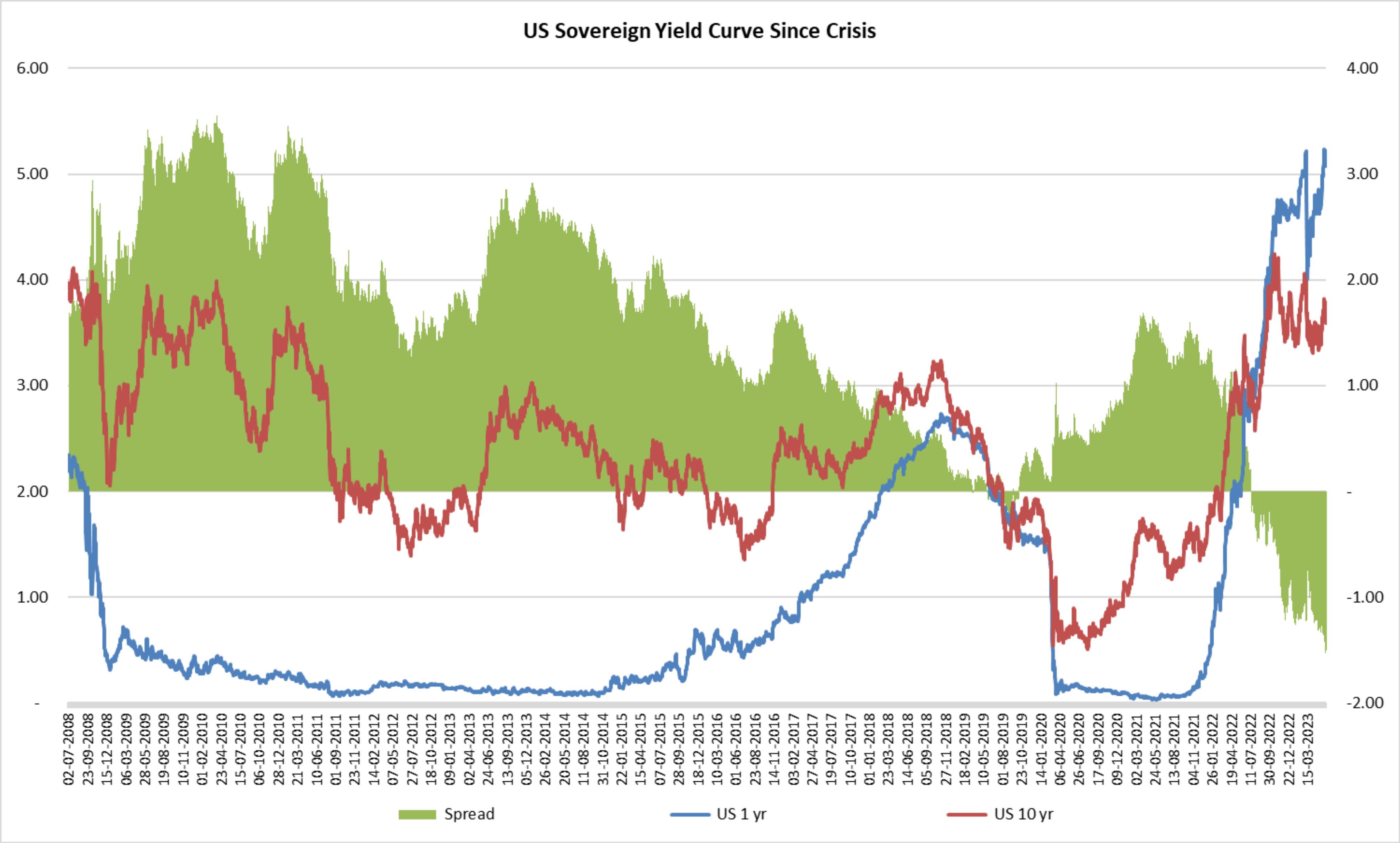


- U.S. House of Representatives passed a bill to suspend the $31.4 trillion debt ceiling until January 2025
- The current ceiling issue is different from previous episodes – high inflation, geopolitical risk and de-dollarization
- A shrinking Fed balance sheet and higher US government borrowing pose risk to wider dollar bond market outside US

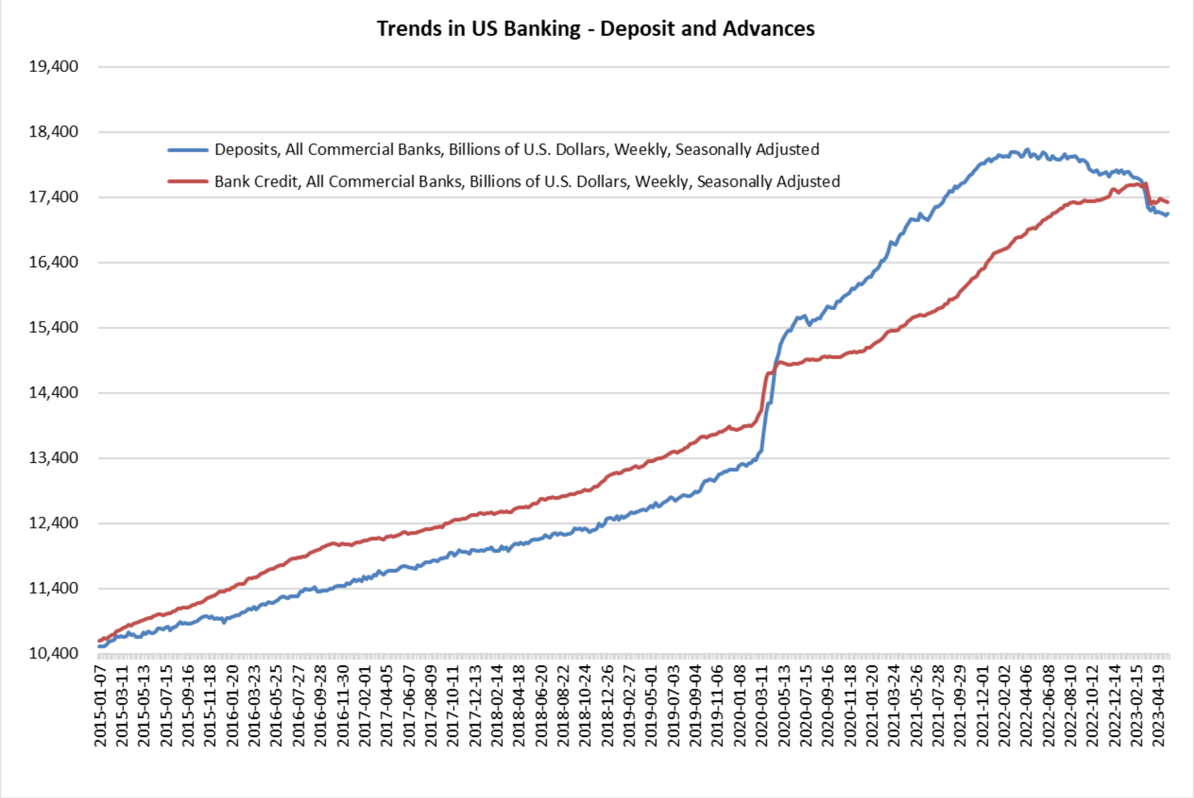
New public debt limits to face the headwinds of declining external demand for US treasury

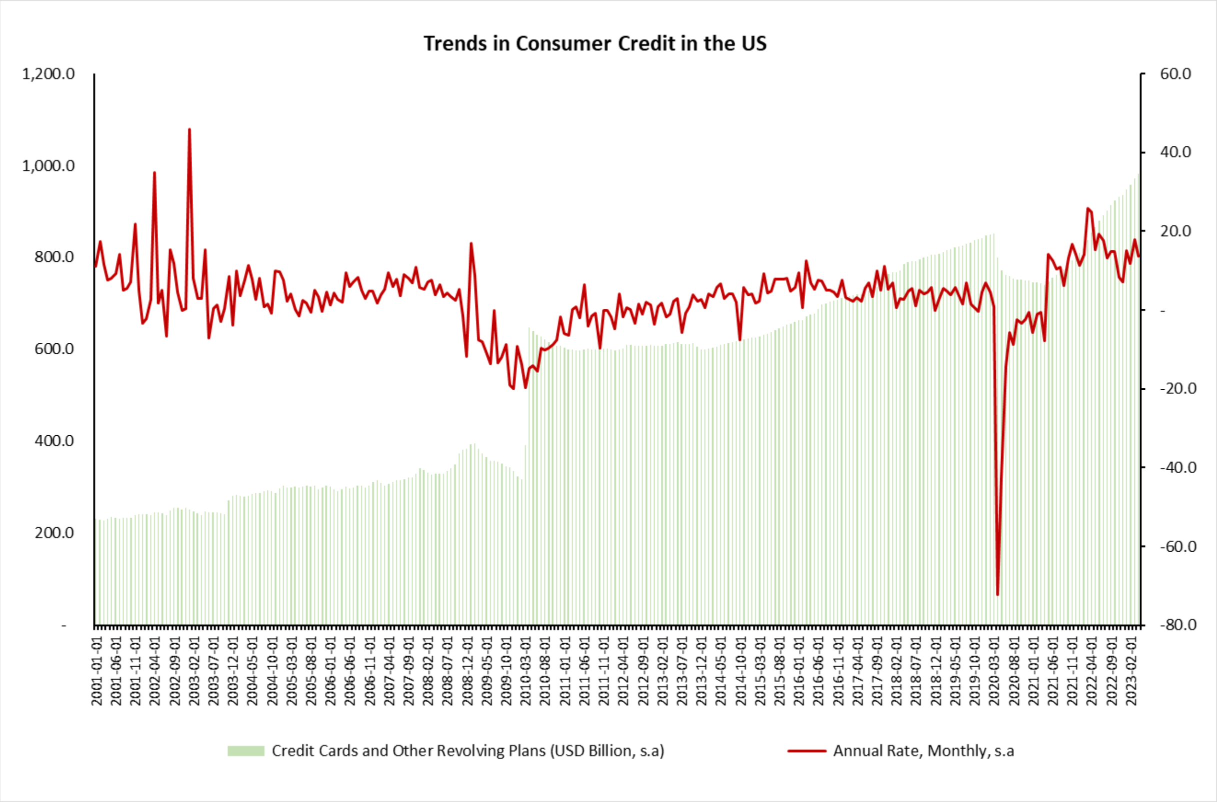


The US yield continues to be inverted since last assessment indicating a slowdown ahead



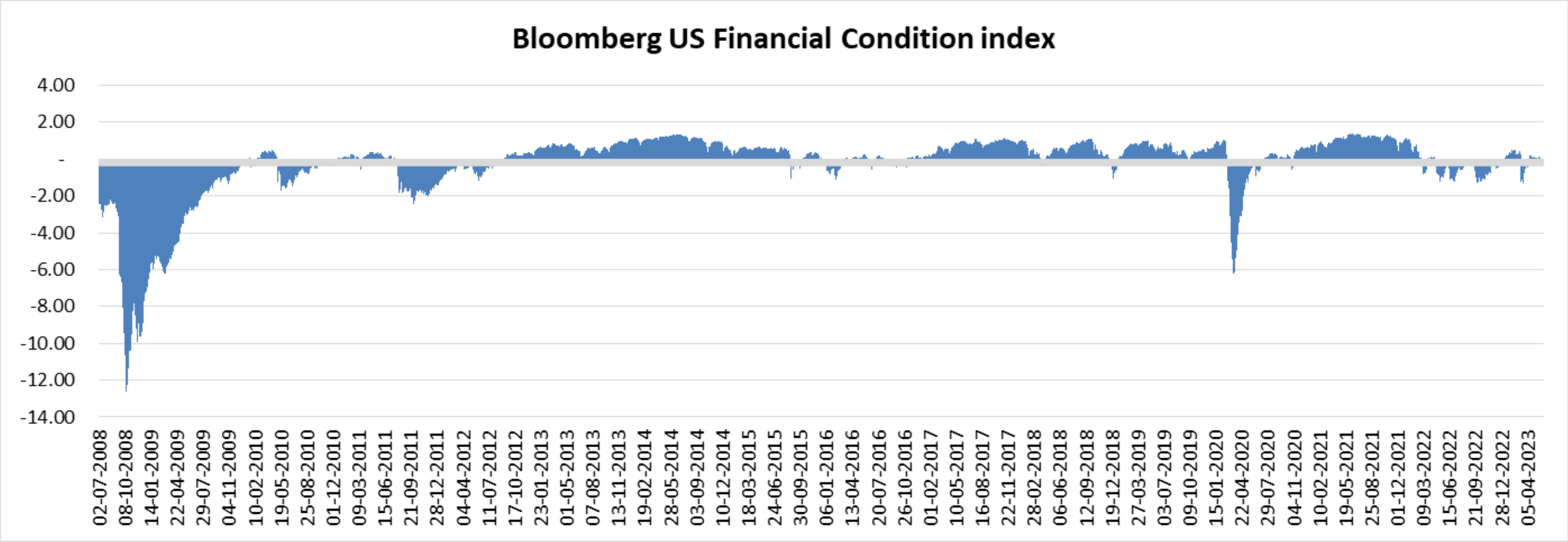
The US bank credit accretion outpaces deposit accretion indicating tight liquidity

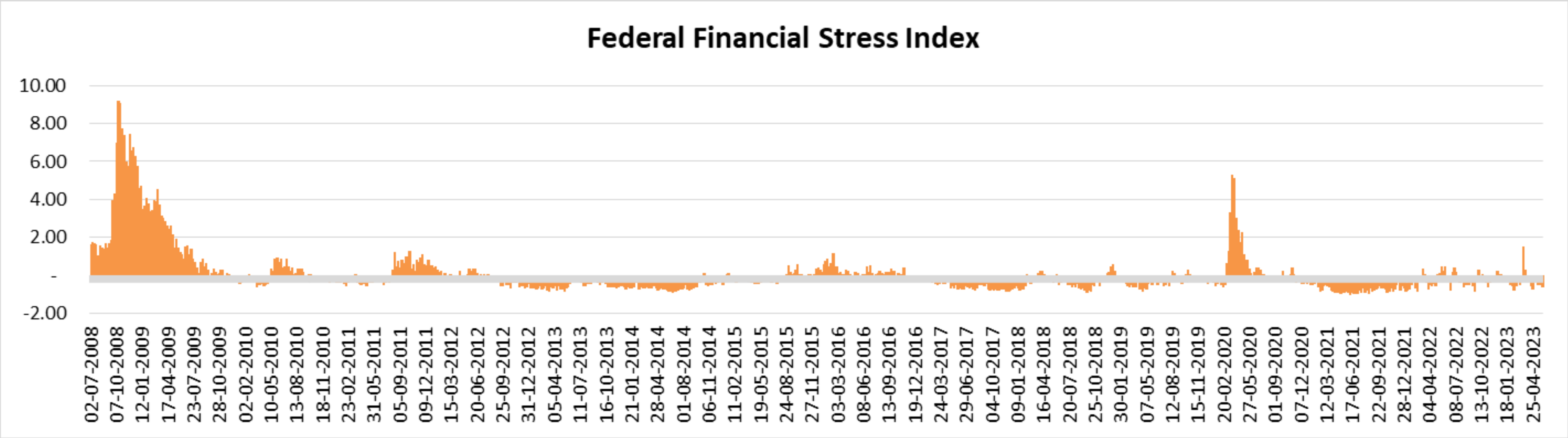




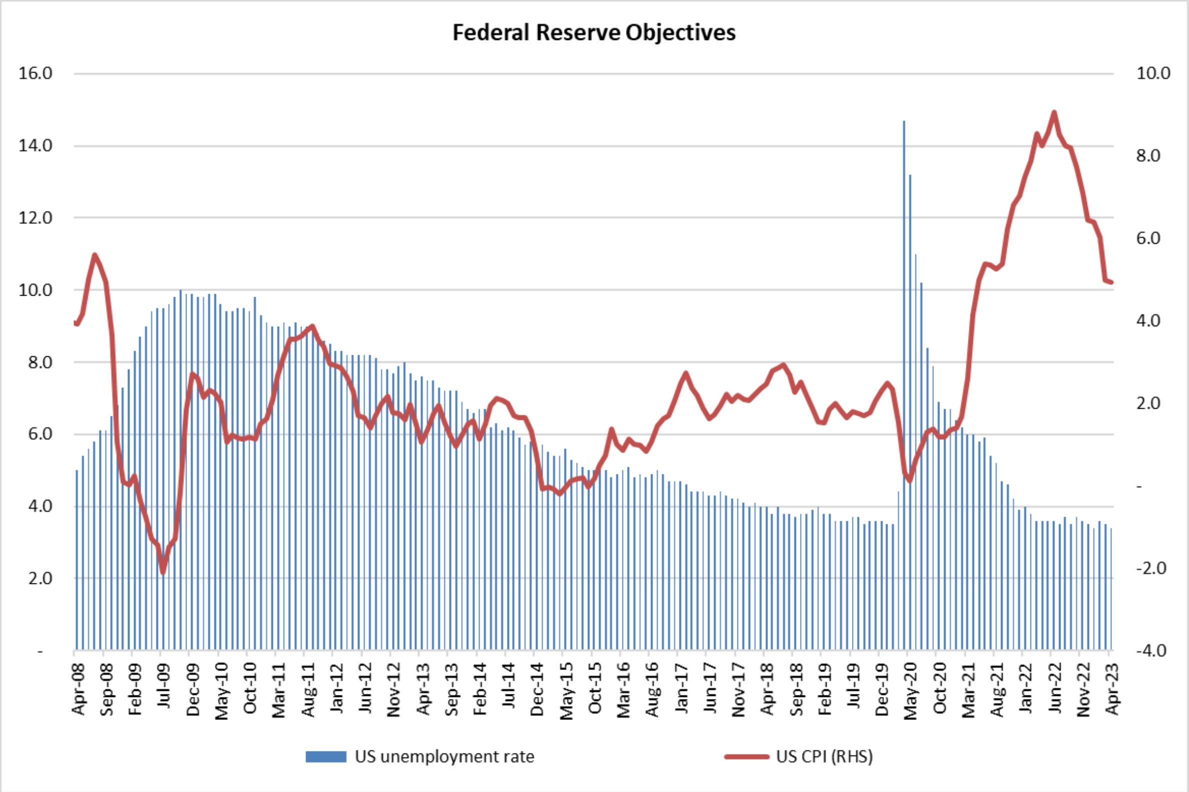
- Consumer spending remains robust, revolving credit and credit cards balances show strong growth pulling down deposits

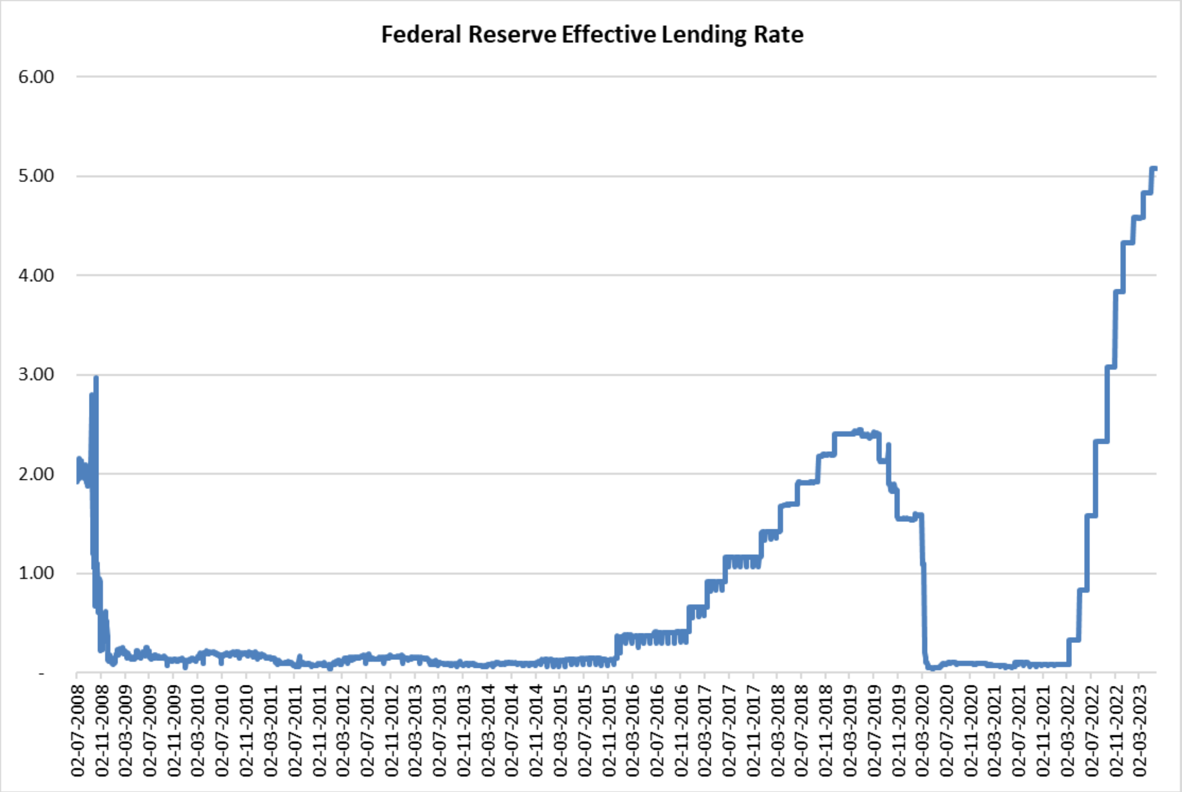
Overall, the US markets inching towards tight financial conditions but stress contained





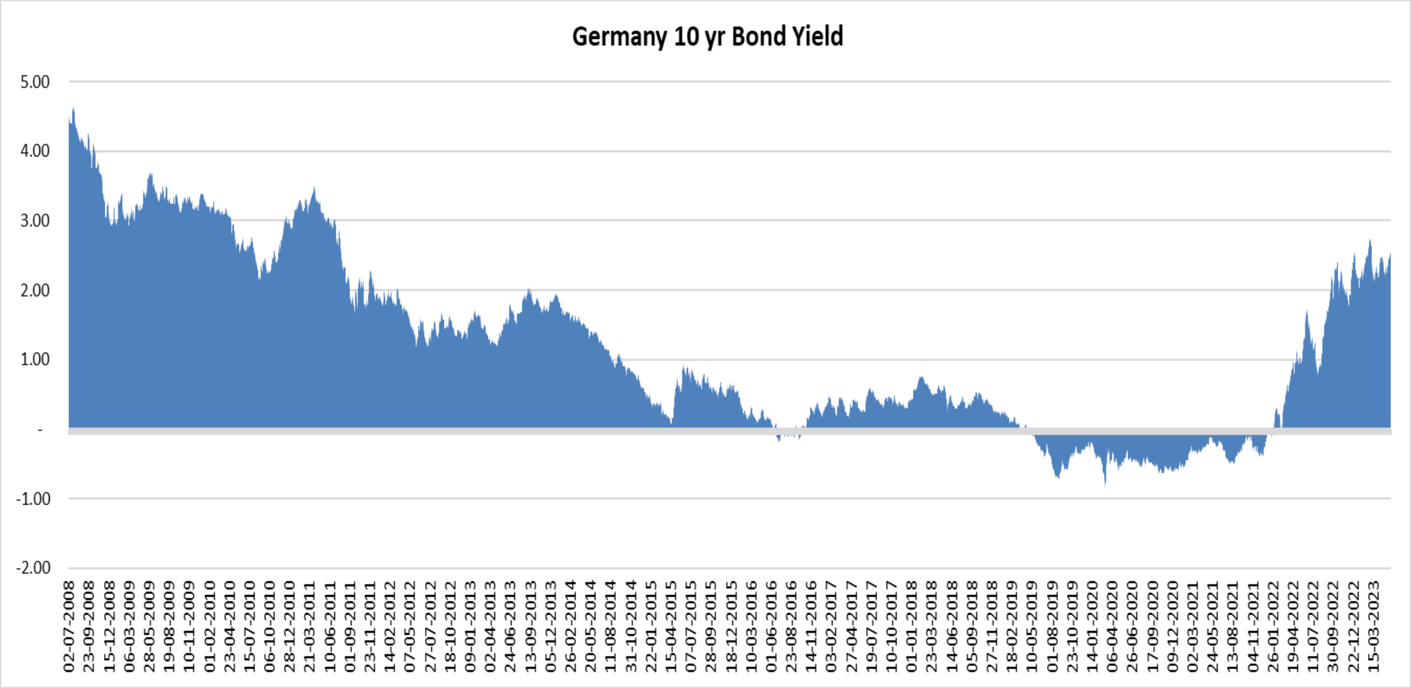
Federal Reserves objectives and lending rates through time

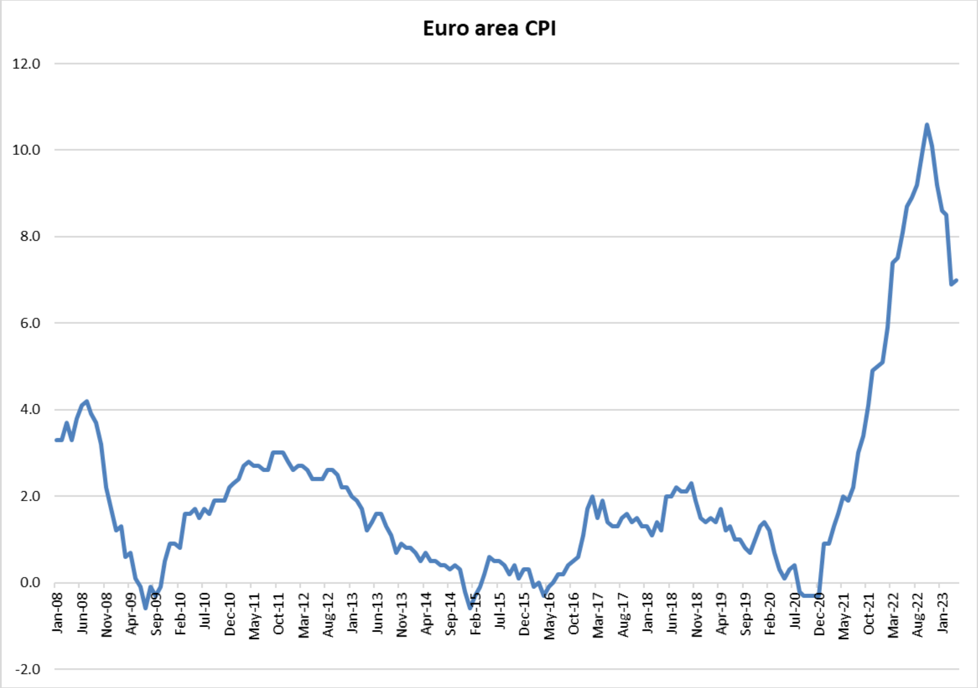




- Historical trends indicate no softening of stance in the near future although there might be some reduction in pace
- Drop in inflation significant but labour markets still showing strong activity though unemployment rate has climbed up to 3.7%

Euro area inflation and interest rates





- Inflation remains high by historical standards but declining from recent peak
- Pressure to withdraw liquidity given the strain on cost of living will stay indicating some more tightening
- Reversal of negative yields is growth negative

Federal Reserve and ECB rate outlook

- The current situation in the US clearly indicates slowdown in pace of hike in the US
- The deficit liquidity in the US banking system to feed into policy stance thus balancing stability and inflation objectives
- The stress in financial system is in early stage and can be contained

FED RATE OUTLOOK – Close call, pause in July a possibility

- The ECB will keep the stance as tightening as crisis in Swiss banking is now contained
- Possible resolution of Russia-Ukraine Conflict can alter the path of policy rates

ECB RATE OUTLOOK – Strong pace, hike in 25 bps steps

Does US Corporate Bankruptcy Indicate Something?

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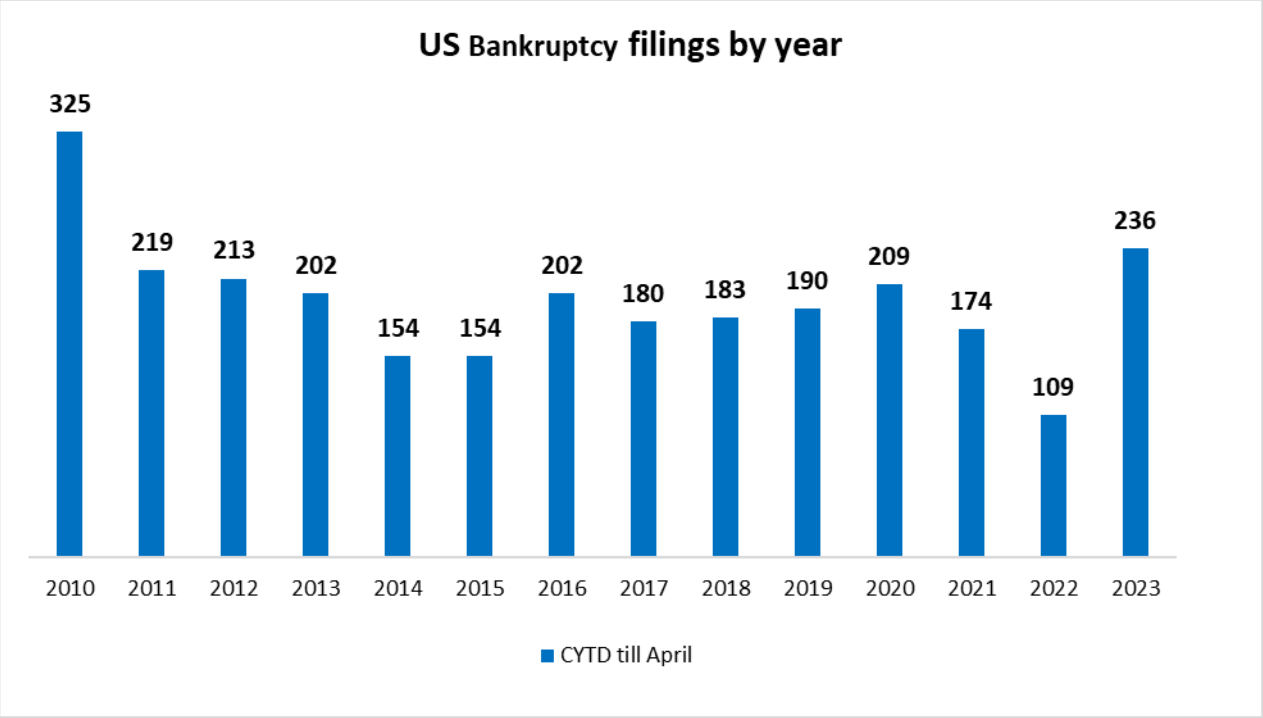
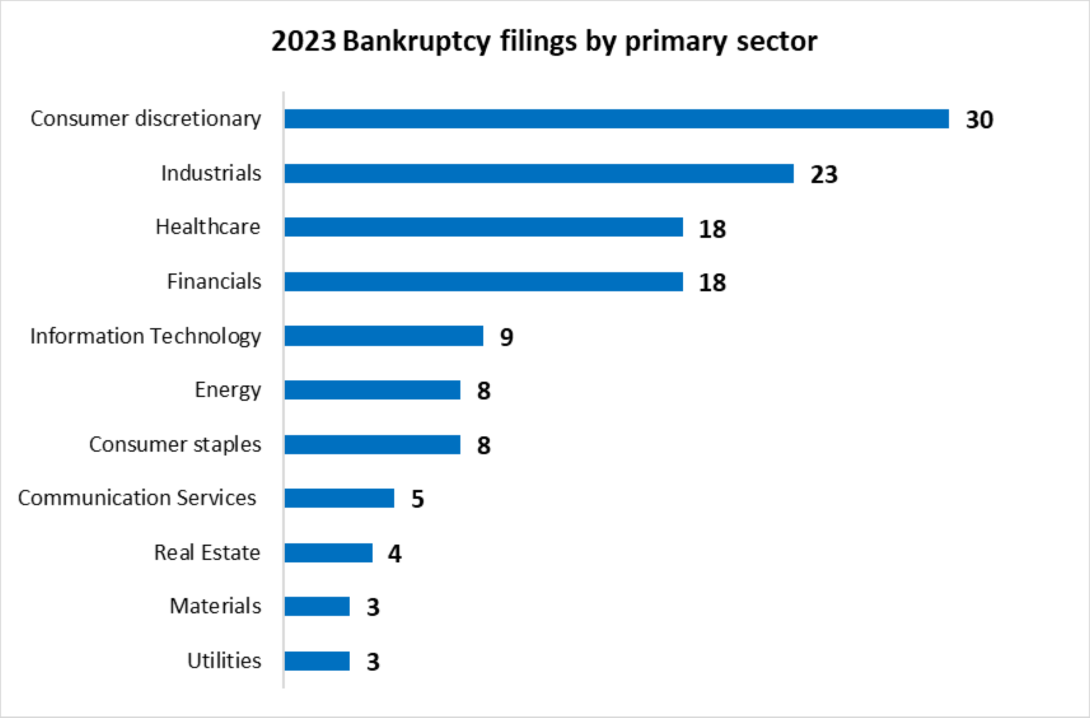
- US corporate bankruptcy filings slowed in April from a spike in March, though the tally of companies that have gone bankrupt so far in 2023 is higher than the first four months of any year since 2010
- S&P Global Market Intelligence recorded 54 corporate bankruptcy petitions in April, a drop from 70 in March. Those fresh filings have pushed the year-to-date count to 236, more than double the comparable figure a year ago and higher than any of the prior 12 years
- Consumer discretionary companies continued to record a higher number of bankruptcy filings than other sectors in 2023
- **Is this indicating that slowdown is coming???**





Domestic Economy Momentum

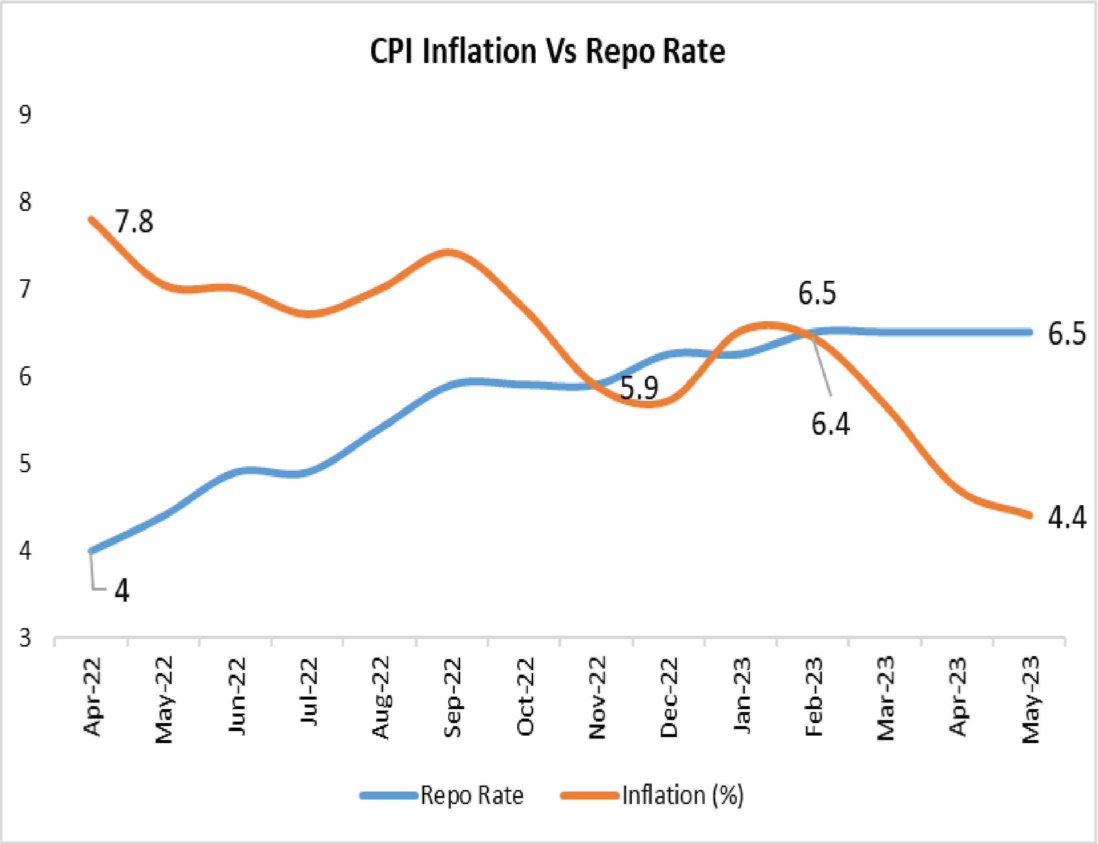
RBI sidestepped from synchronous movement with Fed in its April MPC meet

- In the last policy meet in April, RBI MPC **unanimously** favoured a pause in rate hikes, keeping key Repo rate **unchanged at 6.50**%. Repo rates are already up 250 bps from the lows of May'2022 and a full 135 bps higher than the pre-pandemic repo rate of 5.15%

- The MPC also decided to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth (with only one external member expressing reservation on this part of the resolution)

- The decision to pause in April policy meet, the RBI stated, was a temporary arrangement implying the future trajectory would be aligned with course of data emerging from various sources/points, domestic as also global

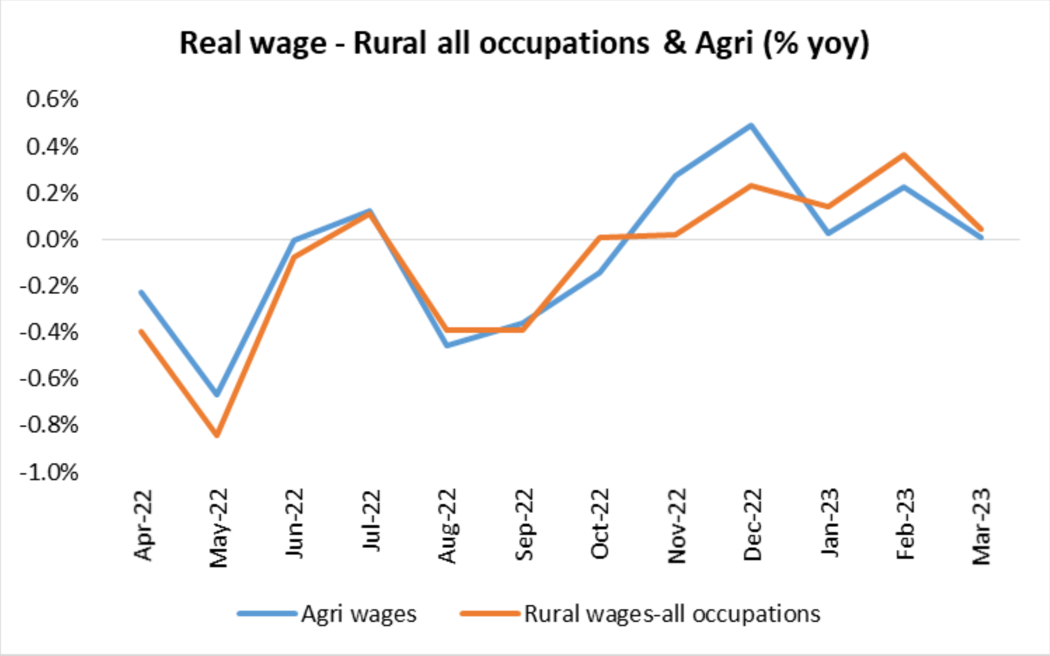
- With sizeable banking failures across AEs, and a fair probability of contagion spreading across markets despite concerted action from policy makers/regulators to check the same, RBI's endeavor to sidestep from synchronous rate hike was a courageous gambit, especially since climate risk could upend inflationary projections

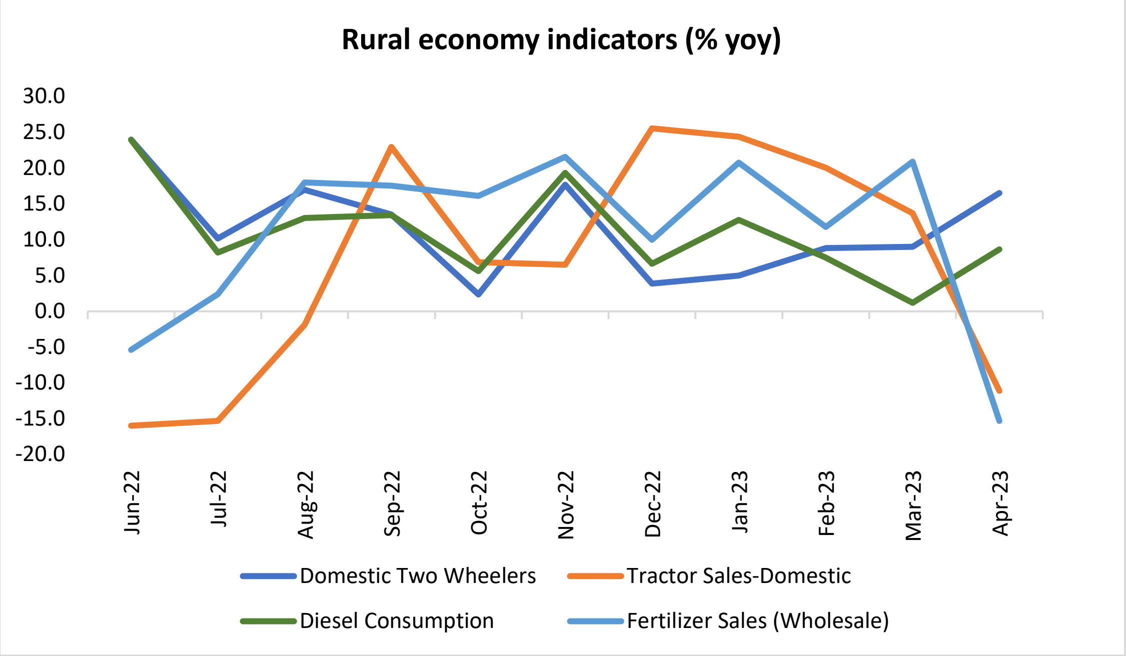


Rural Economy showing mixed momentum

- Momentum of real wages in rural areas (rural all occupations wages when deflated by CPI rural) as well as agri real wages (agricultural occupation wages when deflated by CPI AL) has moderately improved over the past year

- Other economic indicators of rural economy are showing mixed momentum, with domestic two-wheeler sales and diesel consumption showing higher growth while tractor sales and fertiliser sales slowing down





FMCG companies reported better number in Q4FY23, Urban perform better than Rural

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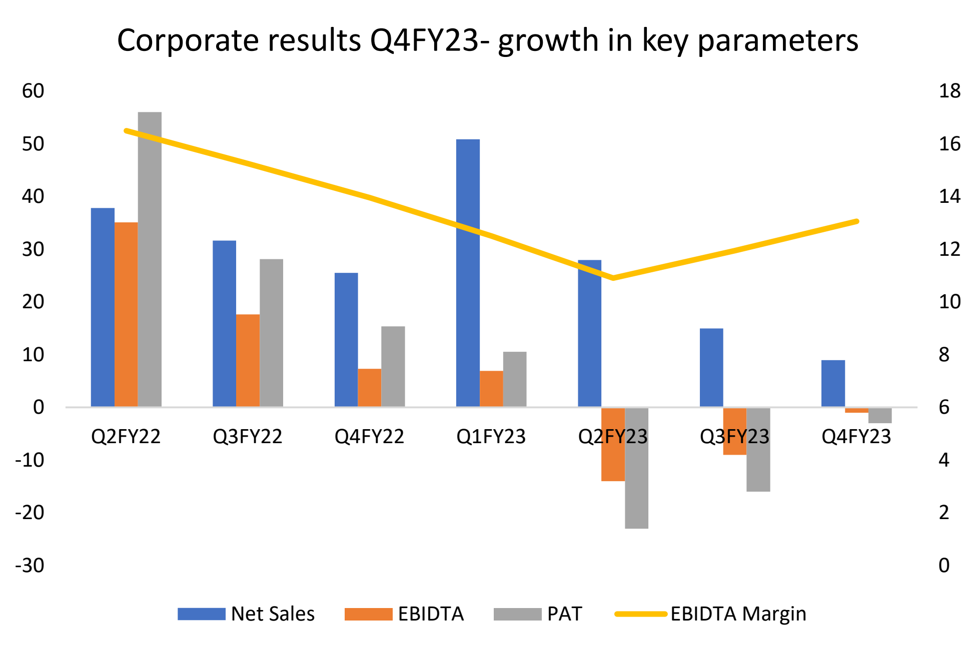
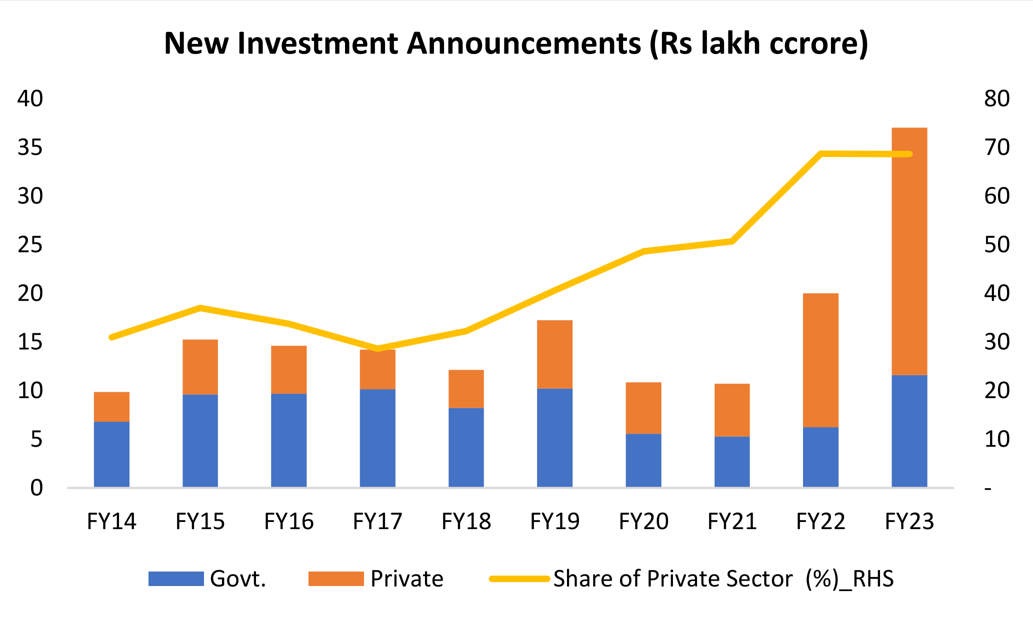
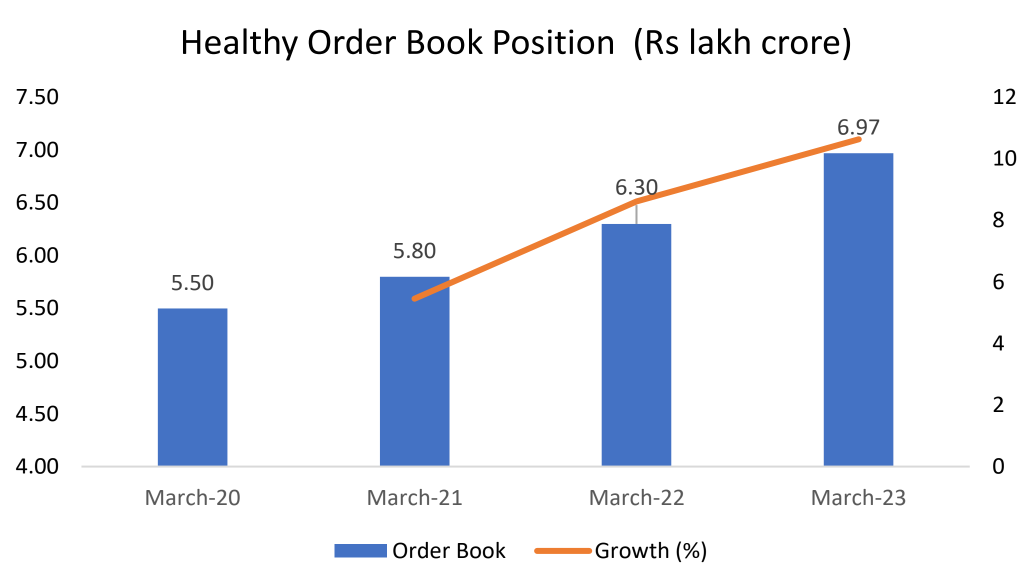
Results of Major Listed FMCG Companies (qtr. ended March '2023)			
Company	**Volume growth (%)**	**Value growth (%)**	**Remarks**
Hindustan Unilever Ltd.	4	11	Home care- 28% revenue growth, volumes grew close to double digit. Personel care- 12% revenue growth, volumes grew low single digit despite decline in market volumes; **Rural market volume declined to -3 % YoY**
Marico Ltd.	5	2	Domestic Revenue up by 2% due to price drops taken in Parachute Coconut Oil and Saffola Edible Oils in response to falling input prices; Parachute Coconut Oil volume growth is 9% and value growth is 3%; Value Added Hair Oils value growth is 13%, Foods value growth is 18%; Nielsen FMCG Vol. Gr (%) – **Urban Volume Growth is 5.3% and Rural is 0.3% in Q4 FY23**
Nestle India Ltd.	-	21.2	Net sales grew by 21% in March quarter; Prepared Dishes and Cooking Aids Delivered strong growth across all products in its food portfolio; Milk Products and Nutrition registered strong double-digit growth
Colgate-Palmolive (India) Ltd.	-	5.4	Domestic net sales growth reported is 5.4%; **toothpaste delivering high single digit growth; continuing sluggish demand trends in the category, especially in rural;** brush replacement in Urban ~ once every six month and in Rural ~ once every 15 months
Godrej Consumer Products Ltd.	11	12	India business sales grew by 12% yoy led by volume growth of 11%, Home Care grew by 14%, Personal Care grew by 17%
Varun Beverages Ltd.	25	38	Sales volume grew by 24.7% to 224 million cases in Q1 CY2023 from 180 million cases in Q1 CY2022 driven by strong demand across regions in India; domestic volumes grew by 28%
Dabur India Ltd.	5.0	6.4	Home Care growth is 10.3%, Beverages is 29% and Food is 22% in Q4 FY23. Contribution of Food and Beverages is 21.1 %, Home and Personal Care is 47.2% and that of Health care is 31.7% in Domestic growth FY23
Source: Company reports; SBI Research			



- In Q4FY23, around 3700 listed entities, reported 11% growth in top line while bottom line grew by 14%. However, ex-BFSI, around 3200 entities, reported top line growth of around 9%, with EBIDTA almost flat as compared to Q4FY22
- Further, corporate margin, under pressure for last few quarters, has shown signs of improvement in Q4FY23. As reflected in results of around 3200 listed entities ex-BFSI, EBIDTA margin, on aggregate basis, improved from 12% in Q3FY23 to 13.1% in Q4FY23
- FMCG companies reported 14% growth in top line while bottom line grew by 21%. However, some of the companies have reported decline in rural volume due to sluggish demand

New Investment announcements all time high, Corporates show improved intentions



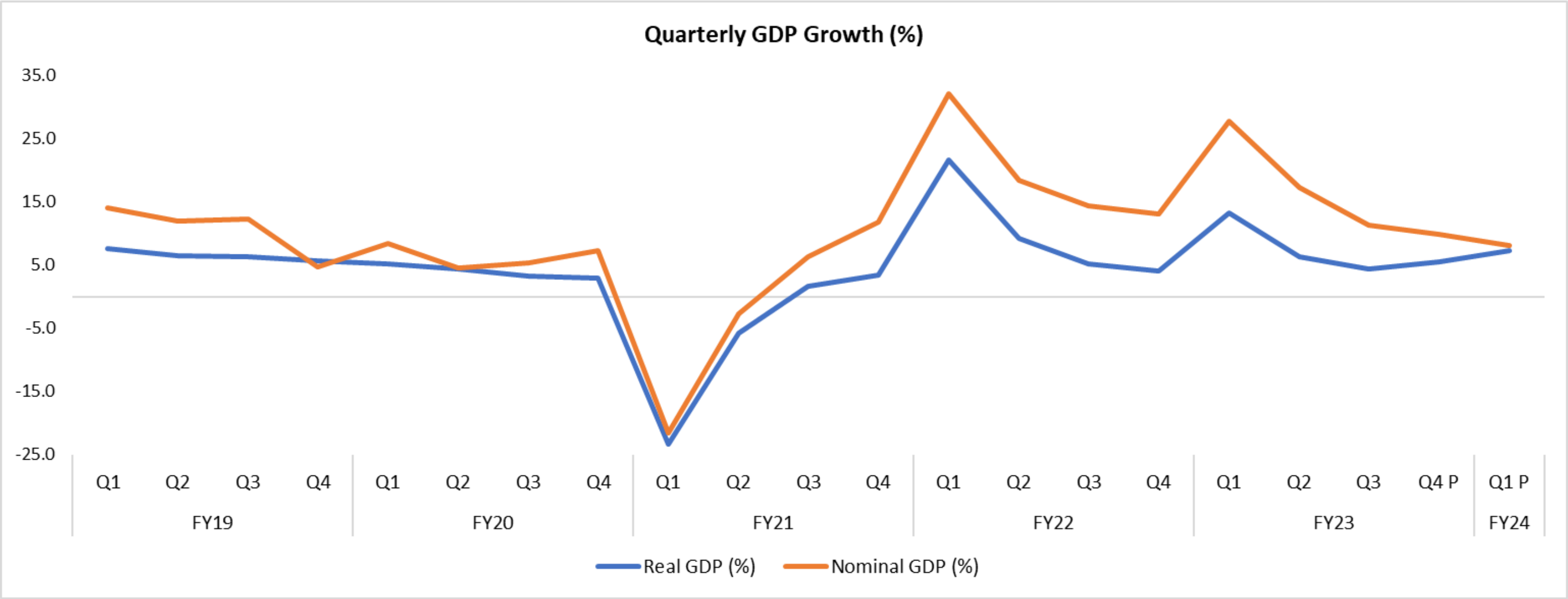


Source: Company PPT; for nine companies we are tracking in the construction space

- **Improved investment participation by Corporates** - Investment activities, driven by Government's capex push, is at all-time high
- Led by private sectors, new investment announcements in FY23, as per projects today, touched all time high of Rs 37 lakh crore as compared to Rs 20 lakh crore in FY22
- It is pertinent to mention that the share of private participation, in the investment announcements, has increased to around 68% from less than 50% in earlier years, indicating revival of capex in the private sector
- The construction sector remained upbeat due to sustained impetus on infrastructure spending by the Government
- Healthy order Book position of construction sector, aided by 11% growth in FY23 (to around Rs 7 lakh crore for nine construction players), reflects medium term revenue visibility

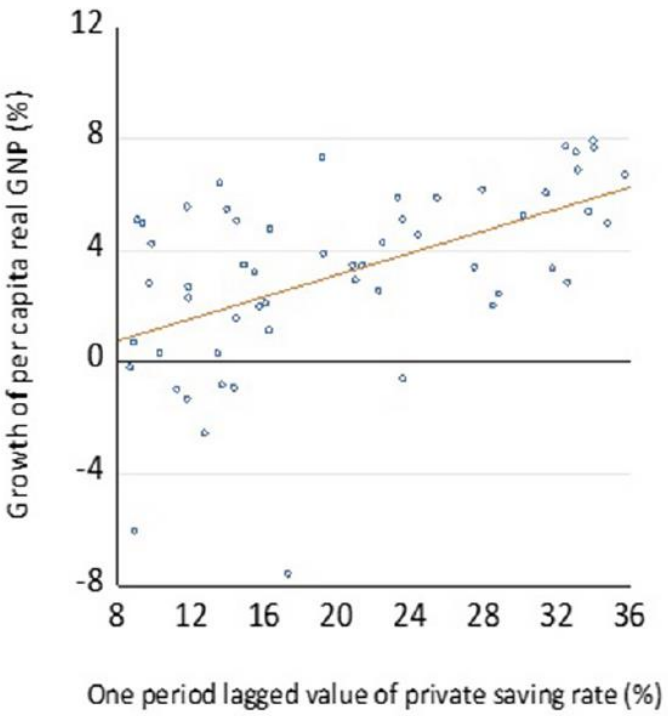
Q1 FY24 GDP: Nominal Growth <= Real Growth

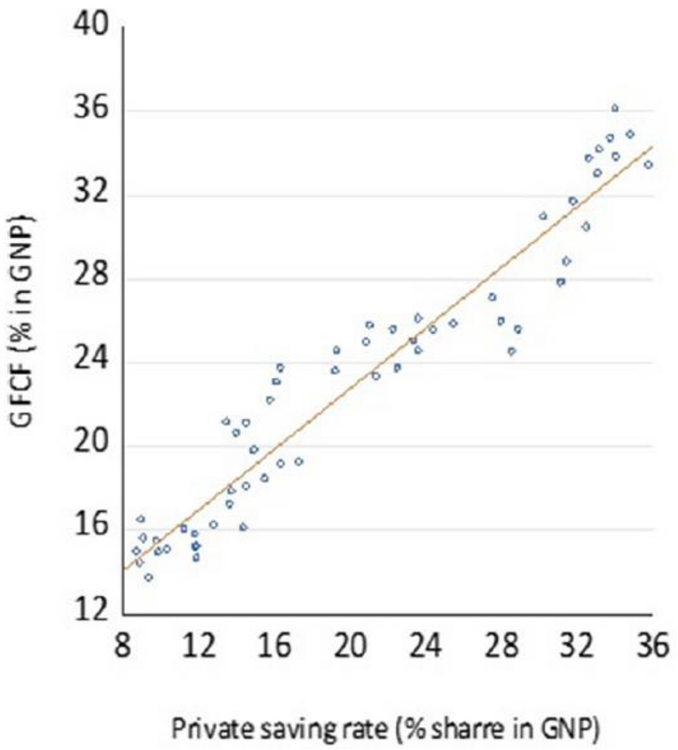
- In the GDP series (base=2012), there is only one instance (Q1 FY19) when Nominal GDP growth was less than the Real GDP growth
- The same type of situation may arise for Q1 FY24 also
- We believe that both the real and nominal GDP growth for Q1 FY24 would be in the range of 7.3-8.1%



What determines private and household savings in India……

- It has been long recognized that India's investment needs have been primarily satisfied by domestic saving of which private saving is the largest component
- Further, household saving has been the major source of private saving in India. Although its share has declined to about 60% in recent years, household saving accounted for as high as 90% of total private saving in the past, specifically in the late 1970s
- Since private and household savings seem to have played an important role in the process of economic growth, it is but natural to ask **what determines private and household savings in India?**





…Its certainly not Real Interest Rates.. as there is no empirical evidence to back this….
….It is per capita income, lower inflation and banking accessibility..

- **Ghosh and Nath (International Review of Economics and Finance, April 2023)** has examined the determinants of private and household saving behaviour in India using data from 1960 to 2016

- **The results indicate that:**
  - Per capita real income and access to banks are significant determinants with favourable impact on private as well as household saving rates in short as well as long run
  - As inflation accelerates, the uncertainty about the future value of their accumulated savings and expected real rate of return discourages households and other private agents from saving
  - **An increase in the proportion of dependent population reduces private and household saving rates in the short run** while it increases the private saving rate in the long run
  - A **rise in the real interest rate increases household saving rate in the short run** but reduces both private and household savings in the long run
  - **Real interest rate does not seem to have any significant impact on total private savings in the short run**

- **Overall, results seem to suggest that policies intended to increase per capita income, lower inflation, and increase accessibility to banking will go a long way in increasing private and household saving in India… A higher real interest rates does not boost household savings**

Liquidity surplus has increased……

- Liquidity surplus in the system has increased with the Net LAF absorption at Rs 2.4 lakh crore as on 01 June compared to surplus of Rs 2.1 lakh crore at the beginning of the fiscal year. Average core liquidity has reduced to Rs 0.90 lakh crore
- Liquidity is likely to increase further in coming months owing to deposit of Rs 2000 notes. Based on the current pattern of deposits/exchange of these notes, of the Rs 3.6 lakh crore of Rs 2000 notes, additional deposits in banks could be significant
- The decline in CIC or the consequent increase in banking liquidity will ensure that there is no immediate need for CRR cut. Even the need for OMO is reduced, now that RBI has provided greater than expected dividend of Rs 874 billion which will boost durable liquidity as and when the Government spends it
- Moreover, balance of payment surplus in FY24 is expected to the tune of $15-20 billion thus providing further liquidity support

Liquidity Position (Rs lakh crore)			
	Average in FY23	01-Jun-23	Average in FYTD24
Repo Outstanding	0.89	0.56	0.27
Reverse Repo Total	1.47	0.00	0.46
SDF statrted on 08.04.2022	1.42	3.02	1.21
MSF	0.04	0.02	0.10
Net LAF (+absorption)	1.57	2.40	1.05
Government Cash Balance	2.55	-1.36	-0.25
Core Liquidity (+Surplus)	4.15	0.90	0.82
Rates(%)	**FY23 end**	**01-Jun-23**	**Change in bps**
Call Rate	7.4	6.3	-105
Treps	6.8	6.2	-56
91-T bills Yield	6.9	6.7	-14
182- T Bills Yield	7.1	6.9	-25
364- T bills Yield	7.2	6.9	-29
1 Year Gsec	7.1	6.8	-36
5 Yrs Gsec	7.2	6.9	-27
10 Yrs Gsec	7.3	7.0	-34
Source: RBI, SBI Research			

....decline in yield more at the short end of the curve….RBI could use swap transactions as a strategy…to drain out liquidity and allow the rupee to find its level…

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- Currently merchant dollar demand is far higher than supply in the spot as well as forward market. However, in the interbank market dollar demand is higher in spot but there is excess supply in the forward market
- Importantly, the transitory change in the liquidity owing to deposits of Rs 2000 notes there would be decline in yields, more at the shorter end of the curve. The favorable position in Forward Premia, and the range bound movement in USD/INR also moots aggressive Dollar selling, preferably through S/B swaps in forwards, checkmating any unwarranted depreciation from these levels
- RBI might proactively do sell buy swaps as domestic liquidity swells up due to the Rs 2000 note discontinuation, surge in capital inflows and RBI dividend payments
- Accordingly, RBI may allow Rupee to find its own level though sell buy swaps…

Turnover in Foreign Exchange Market ($ mn)

Month	Merchant			Interbank			Grand Total	IB SWAP
	Forward Excess Demand	Spot Excess Demand	Total Excess Demand	Forward Excess Demand	Spot Excess Demand	Total Excess Demand		
Apr-23	709	3,251	3,960	-4,149	2,671	-1,478	2,483	-3,673
Mar-23	14,687	-8,021	6,665	-4,065	-19,657	-23,722	-17,056	-17,740
Feb-23	1,993	3,174	5,167	-1,504	-6,700	-8,204	-3,037	-13,116
Jan-23	10,766	1,044	11,809	-14,002	207	-13,795	-1,986	-19,780
Dec-22	345	-5,624	-5,279	2,067	2,259	4,326	-953	-30,126
Nov-22	11,718	1,862	13,580	-8,565	-1,531	-10,096	3,484	-5,468
Oct-22	15,750	4,004	19,754	-12,263	-7,229	-19,492	262	-9,726
Sep-22	14,000	2,438	16,439	3,764	-16,033	-12,270	4,169	5,203
Aug-22	9,874	4,906	14,780	-653	-8,703	-9,356	5,424	-27,576
Jul-22	15,818	7,246	23,064	-22,972	-5,637	-28,609	-5,545	-4,602
Jun-22	13,777	10,556	24,334	-16,048	-18,581	-34,628	-10,295	-18,578
May-22	2,739	11,031	13,770	-7,935	-24,871	-32,806	-19,036	-24,871
Apr-22	6,784	-1,201	5,583	-961	-46,517	-47,479	-41,896	-47,216

Source: RBI, SBI Research

Sale/Purchase of U.S. Dollar by the Reserve Bank of India

Month	Net Purchase/ Sale of Foreign Currency (US$ Million) (1.1–1.2)	Purchase (+)	Sale (–)	Cumulative (over end-March)		Outstanding Net Forward Sales (-)/ Purchase (+) at the end of month (US $ million)
				(US $ million)	(Rupees Crore)	
Mar-23	750	6906	6156	-25516	-217259	23600
Feb-23	254	4381	4127	-26266	-223142	20470
Jan-23	-384	12902	13286	-26520	-224276	21729
Dec-22	3842	12817	8975	-26136	-220407	10968
Nov-22	4361	22281	17920	-29978	-249702	8493
Oct-22	-922	24855	25777	-34339	-283631	241
Sep-22	-10361	23265	33626	-33417	-273554	10423
Aug-22	-4254	18858	23112	-23056	-188422	20164
Jul-22	-19049	19721	38770	-18802	-152816	22019
Jun-22	-3719	18960	22679	247	-551	30856
May-22	2001	10143	8142	3966	28850	49191
Apr-22	1965	11965	10000	1965	14061	63826

Final Thought: A PAUSE, BUT A GROWTH UPGRADE AND AN INFLATION DOWNGRADE COMING?

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- So, what will be the RBI's policy look like:

Indicator	Our View
Repo rate	❑ We expect the RBI to pause in June policy ❑ US corporate bankruptcy filings slowed in April from a spike in March, though the tally of companies that have gone bankrupt so far in 2023 is higher than the first four months of any year since 2010…drop in US inflation significant but still labor markets showing strong activity, though unemployment rate has climbed up to 3.7%...Global economic conditions are still evolving ❑ We believe at 6.50%, we are in for a prolonged pause….
Stance	❑ The stance could continue to be withdrawal of accommodation, as liquidity has turned into significant surplus mode ❑ The RBI could make a tactical shift in forward market intervention to sell buy swaps… neutralize liquidity and allow Rupee to find its own level…~ $12 bn forward maturity in 3-12 months bucket ❑ Frontloaded rate actions by RBI has resulted in frontloading inflation trajectory…Inflation data till October would be decisively below 5%...October inflation print to be known to RBI in December policy **indicating pause through 2023**…**Inflation estimates for FY24 could be downgraded in June policy….** ❑ Growth remains strong…**Possibility of growth upgrade for FY24 looks imminent**
Risks for growth/inflation	❑ Fed could hike in June…. then pause ❑ Monsoon pattern affecting kharif crops
Forward Guidance	❑ In an environment of rising rates, it is clearly not advisable to give a forward guidance

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