SBI RESEARCH

ECOWRAP

FROM STICKY TO UNYIELDING: HOW RBI'S DEFT DIVERGENCE ON RATE FRONT COULD HERALD GROWTH AGNOSTIC TO EVOLVING MACROS AMIDST GLOBAL UPHEAVALS

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The surprise (for large sections of broader markets) move by RBI to pause on rate front today though absolutely gelled with our expected take on RBI stance given the unfolding and evolving situation as key rates remained unchanged, in a not so veiled sign that the decoupling of Central Banks, propagated by us for some time, has reached a point of no return. And, for good, we believe.

Today's unanimous policy decision reminds us of the "cacophony problem," as pointed out by Allan Blinder. In the words of Blinder, "A central bank that speaks with a cacophony of voices may, in effect, have no voice at all.". RBI has, quite fortunately, been able to avoid the trap, a characteristic embedded in many prominent Central Banks of late, fogging the dot plots.

Consequently, the inflation trajectory for FY24 would be shaped by both domestic and global factors, though in varying measures. The expectation of a record rabi food grains production bodes well for the food prices outlook. Milk prices could remain firm due to high input costs and seasonal factors. Crude oil prices outlook is subject to high uncertainty. Easing cost conditions are leading to some moderation in the pace of output price increases in manufacturing and services. Against this backdrop, CPI inflation is projected at 5.2% for FY24 (earlier: 5.3%), with Q1 at 5.1% (earlier: 5.0%), Q2 & Q3 at 5.4%, and Q4 at 5.2% (earlier: 5.6%).

RBI also increased its real GDP projection by 10 bps to 6.50% for FY24 with Q1 at 7.8%, Q2 at 6.2%, Q3 at 6.1% (earlier: 6.0%) and Q4 at 5.9% (earlier: 5.8%). The reasons for growth being robust rural demand, government's thrust on capital expenditure, above trend capacity utilisation in manufacturing, double digit credit growth and the moderation in commodity prices. However, protracted geopolitical tensions, tight global financial conditions and global financial market volatility pose risks to the growth. RBI was sanguine in recognising the impact through Government's focus on capital expenditure in the recent budgets, including the Union Budget 2023-24, being effective in stimulating private investment and domestic demand with beneficial effects accruing over time. A 1 percentage point increase in public investment increases private investment by 0.6 percentage point in the first year and the cumulative impact over a 3-year period is over 1.0 percentage point. The multiplier for public investment on private investment is 1.2 and on overall GDP is 1.7 over a three-year period.

Liquidity has turned back into moderate surplus with average net LAF at Rs 2.7 lakh crore (as on 4 Apr'23) from slight deficit at the time of the last policy. Net durable liquidity surplus is only Rs 1.0 lakh crore. RBI has been successfully managing liquidity by conducting operations at either side of the LAF. Surplus liquidity at the beginning of the FY23 has been progressively brought down by OMO sales and increase in CRR. The VRR auctions have also been used to adjust liquidity. **RBI has made a clear distinction between policy strategy and policy stance once again and asserted that these can coexist simultaneously. While it has kept the stance same as 'withdrawal of accommodation' to calibrate liquidity and ensure that government borrowings face no disruption, its strategy has been changed by hitting the pause button on rate hike. The policy strategy may still indicate rate adjustment to quell inflation expectations, should inflation surprise on the upside beyond tolerance. An interesting anecdote is the switch to unyielding core inflation from the sticky one! However, we expect that RBI may have just hit the pause button as inflation trajectory looks below 6% for rest of FY24!**

Although there are a few divergent paths, the course of monetary policy tightening is clearly not over. The pause stance adopted by Reserve Bank of Australia (RBA) and RBI do indicate that balancing inflation objectives with financial stability is proving to be delicate task. With cut in oil output by major oil producing countries, the cost push pressure will make any relaxation in policy stance form tightening difficult. Thus, Federal Reserve may continue with token 25 bps rate hike for once. The pause adopted by RBA and RBI appears to be a wait and watch strategy to read Federal Reserve's mind in next cycle.

Credit growth continued to grow in double digits and became broad based across sectors. As per the fortnightly bank credit data, during FY23, incremental bank credit grew by Rs 17.8 lakh crore (15.4% YoY), as against Rs 10.4 lakh crore (9.7% YoY) in FY22. While, aggregate deposits of ASCBs grew by Rs 15.7 lakh crore (9.6% YoY) compared to last year growth of Rs 13.5 lakh crore (8.9% YoY). With credit growth outpacing growth in aggregate deposits, the incremental CD ratio is at 113%, raising concerns about the long-term sustainability of double digit credit growth.

On other policy action fronts, with crisis brewing in global financial system and the opaqueness of the offshore dealings sans much regulatory insights or control, it is a prudent move indeed to permit banks with IBUs to offer NDDCs involving INR to resident users (corporates/institutions from different territories to begin with) in the onshore market (chiefly GIFT city further facilitating internationalisation of domestic currency plans) while saving big on transaction fees being paid in overseas jurisdictions.

Digitalisation of license/ authorization to carry out activities regulated by RBI through Platform for Regulatory Application, Validation and Authorisation not only reduces the substantially higher cost of compliance (~5% of operational cost) for regulated entities, it is also a major green initiative since compliance is highly paper intensive.

Similarly, RBI's move to further strengthen the resolution framework for complaints against CICs by end customers should invigorate the credit culture, removing the biases inherent as the country should witness a great drive for credit saturation of 'thin-file' customers now. Further, the development on UPI front should drive innovation and revolutionize the way customers access credit as also enabling SMEs to access credit in a hassle-free manner while boosting micro-credit. The web portal for searching unclaimed deposits transferred to DEA Fund across multiple banks should lessen the woes of customers, reinforcing trust in the ecosystem as also in the regulator.

RBI HALTS RATE HIKE CYCLE

- As expected by SBI, RBI today kept repo rate unchanged at 6.50% as MPC decided to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth. One of the members voted against the withdrawal of accommodation.
- The inflation trajectory for FY24 would be shaped by both domestic and global factors. The expectation of a record rabi foodgrains production bodes well for the food prices outlook. Milk prices could remain firm due to high input costs and seasonal factors. Crude oil prices outlook is subject to high uncertainty. Easing cost conditions are leading to some moderation in the pace of output price increases in manufacturing and services. Against this backdrop, CPI inflation is projected at 5.2% for FY24 (earlier: 5.3%), with Q1 at 5.1% (earlier: 5.0%), Q2 & Q3 at 5.4%, and Q4 at 5.2% (earlier: 5.6%).
- RBI said that the adverse climatic conditions (like El Nino, etc.) are a risk to the future inflation trajectory. However, even if there are deficient rains owing to the El Nino effect this year, surplus rainfall areas, especially southern India may not be impacted much in terms of crop loss.
- RBI increased its real GDP projection by 10 bps to 6.50% for FY24 with Q1 at 7.8%, Q2 at 6.2%, Q3 at 6.1% (earlier: 6.0%) and Q4 at 5.9% (earlier: 5.8%). The reasons for growth are: robust rural demand, government's thrust on capital expenditure, above trend capacity utilisation in manufacturing, double digit credit growth and the moderation in commodity prices. However, protracted geopolitical tensions, tight global financial conditions and global financial market volatility pose risks to the growth.
- RBI has indicated that the Government's focus on capital expenditure in the recent budgets, including the Union Budget 2023-24, could be effective in stimulating private investment and domestic demand with beneficial effects accruing over time. A 1 percentage point increase in public investment increases private investment by 0.6 percentage point in the first year and the cumulative impact over a 3-year period is over 1.0 percentage point. The multiplier for public investment on private investment is 1.2 and on overall GDP is 1.7 over a three-year period.

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24	FY24
Apr'23	6.2	5.1	5.4	5.4	5.2	5.2
Feb'23	5.7	5.0	5.4	5.4	5.6	5.3
Dec'22	5.9	5.0	5.4	-	-	-
Sep'22	5.8	5.0	-	-	-	-
Real GDP Growth (%)	**Q4 FY23**	**Q1 FY24**	**Q2 FY24**	**Q3 FY24**	**Q4 FY24**	**FY24**
Apr'23	5.1	7.8	6.2	6.1	5.9	6.5
Feb'23	4.5	7.8	6.2	6	5.8	6.4
Dec'22	4.2	7.1	5.9	-	-	-
Sep'22	4.6	7.2	-	-	-	-

Source:RBI, SBI Research,

LIQUIDITY—DISTINCTION IN STANCE AND STRATEGY

- Liquidity has turned back into moderate surplus with average net LAF at Rs 2.7 lakh crore as on 4 Apr'23 from slight deficit at the time of the last policy. Net durable liquidity surplus is only Rs 1.0 lakh crore. RBI has been successfully managing liquidity by conducting operations at either side of the LAF. Surplus liquidity at the beginning of the FY23 has been progressively brought down by OMO sales and increase in CRR. The VRR auctions have also been used to adjust liquidity.
- The RBI has made a clear distinction between policy strategy and policy stance once again and asserted that these can coexist simultaneously. While it has kept the stance same as 'withdrawal of accommodation' to calibrate liquidity and ensure that government borrowings face no disruption, its strategy has been changed by hitting the pause button on rate hike. The policy strategy may still indicate rate adjustment to quell inflation expectations, should inflation surprise on the upside beyond tolerance.
- Furthermore, there has been a change in the communication by the RBI. *Sticky core inflation* which suggested that prices were taking longer time to adjust to demand and supply changes and an unpleasant situation has now been replaced by *unyielding core inflation.* It seems that RBI has now accepted it that it will remain resolute at higher level at least in the medium term. We expect core inflation to decline to 5.5% by end of 2023.

DEVELOPMENTAL AND REGULATORY MEASURES

- **Developing an Onshore Non-deliverable Derivatives Market:** Much water has flown since RBI permitted offshore units of Indian banks to participate in the NDF market in mid-2020, to curb the volatility induced on rupee through heightened activity taking place in offshore markets. The recent stability in rupee, notwithstanding a tumultuous phase for currencies stuck in a dollar trap globally, has also been attributed to RBI's ability to manoeuvre successfully through both offshore, as also onshore NDF markets apart from having a say in the spot market too.
- Further, with crisis brewing in global financial system and the opaqueness of the offshore dealings sans much regulatory insights or control, it is a prudent move indeed to permit banks with IBUs to offer NDDCs involving INR to resident users (corporates/ institutions from different territories to begin with) in the onshore market (chiefly GIFT city which, with some luck on its side, should be able to push through in the league of major global financial centres as a credible alternative to not only meaty neighbours like Hong Kong or Singapore but also taking a slice from established names like London or NY further facilitating internationalisation of domestic currency plans) while saving big on fees paid in overseas jurisdictions.
- **Enhancing Efficiency of Regulatory Processes**: Financial sector regulation has grown significantly, both in terms of scale and complexity, since the global financial crisis. Specifically, during the last 15 years, regulation has become more comprehensive and broader in scope. This has increased the cost of financial institutions to comply with the supervisory reporting/approval requirements. Thus, there is effort to improve the efficiency of regulatory process (measured in terms of cost compliance) by reducing the cost of reporting and approval in regulatory process.
- **Survey done over last 10 years show that bank's cost of compliance is roughly 5% of the operating cost. Further cost under this head, consisting of KYC/AML, supervisory reviews, audits etc; is growing at 15-20% y-o-y. Establishment cost of compliance is the highest in banks across countries.**
- In this backdrop of today's announcement is proposing digitalisation of license/ authorization to carry out activities regulated by RBI through Platform for Regulatory Application, Validation and Authorisation. Besides reducing the cost, the proposal is also major green initiative as compliance is highly paper intensive. The proposed centralised portal will be extended gradually to all types of applications made to RBI across all functions.
- **Grievance Redress Mechanism relating to Credit Information Reporting:** There have been regular complaints of the customers against the credit bureaus regarding the wrong reporting as entries of unpaid credit card dues and loans for which they never applied, or loans or credit card dues already paid being shown as unpaid which leads to rejection of loan application by banks. In order to provide a cost free alternate redress mechanism to customers of regulated entities (scheduled commercial banks, NBFCs and non-scheduled primary co-operative banks with a deposit size of ₹50 crore and above) for grievances against Credit information Companies (CICs), RBI had brought them under the ambit of Reserve Bank Integrated Ombudsman Scheme (RB-IOS) in Aug'22.
- **RBI has now taken a number of measures including a compensation mechanism for delayed updation/ rectification of credit information; a provision for SMS/ email alerts to customers when their credit information are accessed from CICs; a timeframe for ingestion of data received by CICs from Credit Institutions; and disclosures relating to number and nature of customer complaints received on the website of CICs, all of which are directed to further strengthen the grievance redressal and make it more efficient.**
- **Operation of Pre-Sanctioned Credit Lines at Banks through the UPI:** RBI has proposed to expand the scope of UPI by enabling transfer to / from pre-sanctioned credit lines at banks, in addition to deposit accounts. In March 2023 UPI recorded its highest ever number of transactions at 8.7 billion with a y-o-y growth of 60%. We believe that this new measures will drive innovation and revolutionize the way customers access credit. Further, it will enable SMEs to access credit in a hassle-free manner and boost micro-credit.

Unclaimed Deposits with SCBs (Dec-21)												
Bank	Current Account		Savings Account		Fixed Deposits		Other Deposits		Total Deposits			
	No. (lakh)	Amount (in cr)	No. (lakh)	Amount (in cr)	No. (lakh)	Amount (in cr)	No. (lakh)	Amount (in cr)	No. (lakh)	Amount (in cr)	Amount per a/c
Public Sector Banks	14	1340	618	18276	18	1699	165	4448	815	25799	3165
Private Sector Banks	18	669	74	2238	3	274	15	383	109	3566	3269
Foreign Banks	1	137	3	329	0	89	4	175	8	730	9335
Regional Rural Banks	0	16	50	712	2	93	2	153	54	976	1792
Total	**33**	**2162**	**745**	**21562**	**22**	**2156**	**186**	**5160**	**987**	**31078**	**3148**

Source: RBI; SBI Research

- **Development of Centralised Web portal for Public to Search Unclaimed Deposits:** The deposits remaining unclaimed for 10 years in a bank are transferred to the "Depositor Education and Awareness" (DEA) Fund maintained by RBI. The total amount of unclaimed deposits transferred to RBI by PSBs was Rs 35,012 crore till February 2023 as compared to Rs 25,799 crore in Dec'21 (average deposit per account is around Rs 3,000). The large amount of unclaimed deposits are primarily the result of depositors failing to close their current or savings accounts when they no longer want to use them or failing to notify banks of their desire to redeem matured fixed deposits. In this regard, RBI decided to develop a web portal to enable search across multiple banks for possible unclaimed deposits based on user inputs.

GLOBAL ECONOMY & FINANCIAL STABILITY

- Global economic activity remains resilient amidst the persistence of inflation at elevated levels. However, the global economy is slowing under the impact of tighter financial conditions, high inflation, and the lingering conflict in Ukraine. The global output is expected to growth by 2.9% in 2023.
- The collapse of two banks in the US and subsequent negative outlook on entire US banking has further clouded the outlook global growth. Financial stability risks and global spillovers have imparted significant uncertainty to the economic outlook, as policymakers juggle between sticky inflation on the one hand and financial stability risks on the other. The current situation clearly put in dock the central bank's ability to address two objectives through one instrument namely interest rate.

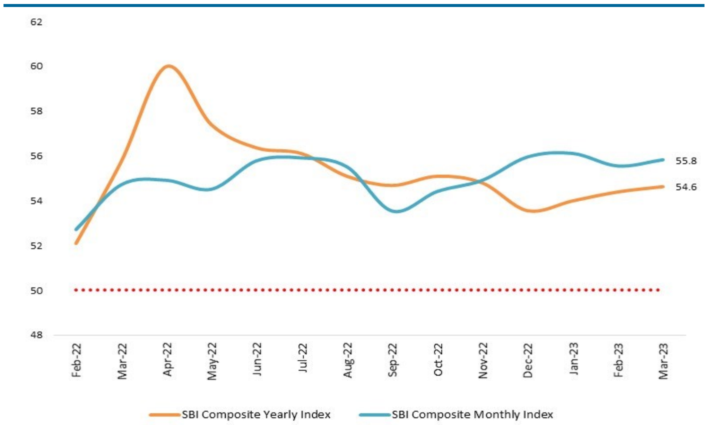
INTEREST RATE TRAJECTORY – DOMESTIC & FOREIGN

- Although there are a few divergent paths, the course of monetary policy tightening is clearly not over. The pause stance adopted by Reserve Bank of Australia (RBA) and RBI do indicate that balancing inflation objectives with financial stability is proving to be delicate task. With cut in oil output by major oil producing countries, the cost push pressure will make any relaxation in policy stance form tightening difficult.
- Thus, Federal Reserve may continue with token 25 bps rate hikes for one last time. The pause adopted by RBA and RBI appears to be a wait and watch strategy to read Federal Reserve's mind in next cycle.

SBI COMPOSITE INDEX : MARCH 2023

- The monthly SBI Composite Index has continued to increase and is at 55.8 (High Growth) in March 2023, compared to 55.5 (High Growth) in February 2023. The yearly index increased to 54.6 (Moderate Growth) in March 2023 from 54.4 (Moderate Growth) in February 2023.

SBI Yearly and Monthly Composite Index Trend



Source: SBI Research

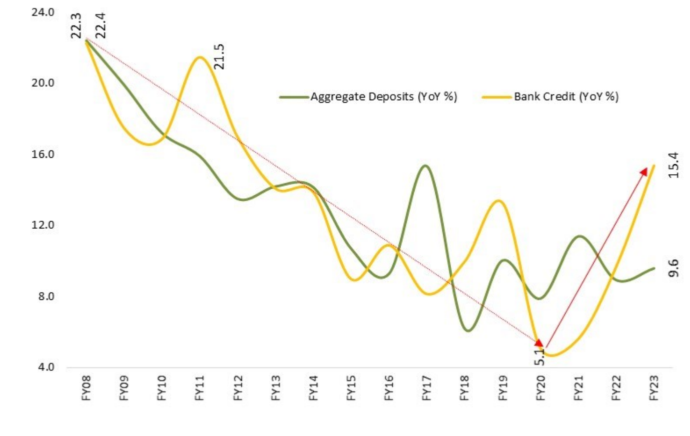
ASCB'S CREDIT GROWTH (YOY) AT 9-YEAR HIGH OF 15.4% IN FY24

- The Indian financial sector has remained resilient building on the consolidation of the banking sector's balance sheet, the ongoing reduction in bad loans and the buffering of risk absorbing capacity. Credit growth continued to grow in double digits and became broad based across sectors.
- As per the fortnightly bank credit data, during FY23 incremental bank credit grew by Rs 17.8 lakh crore (15.4% YoY), as against Rs 10.4 lakh crore (9.7% YoY) in FY22. While, aggregate deposits of ASCB grew by Rs 15.7 lakh crore (9.6% YoY) compared to last year growth of Rs 13.5 lakh crore (8.9% YoY).
- With credit growth outpacing growth in aggregate deposits, the incremental CD ratio is at 113%, raising concerns about the long-term sustainability of double digit credit growth.
- Though, Pvt banks (18.4%) credit grew at a higher rate compared to PSBs (13.7%) in 2022-23 but PSBs were the major driver of the incremental credit extended by ASCBs (PSBs: 52.7% and Pvt Banks:46.7% in incremental credit).
- As demand for credit continues, we expect credit may grow up by 13-14% and deposits by 10-11% in FY24.
- With the rise in repo rate, banks have transmitted it to both deposit and credit rates. In the present rate rising regime, lending rates transmitted in the range o 130-250 bps (250 bps in EBLR, 95 bps in WALR Outstanding loans and 173 bps in fresh loans), while 130-170 bps transmitted to deposit rates.

CORPORATE RESULTS—TOP LINE GROWTH CONTINUES, MARGIN RECOVERY VISIBLE

- In Q3FY23, corporate results, ex BFSI, reported top line grew at a healthier pace of around 15%, though the EBIDTA declined by around 9% on YoY basis.
- However, what is important to mention is, corporate margin which was under pressure since last 5-6 quarters, showing sign of recovery in Q3FY23. **For more than 3000 listed entities ex BFSI, aggregate operating margin improved by 104 bps to 11.95% from 10.91% in previous quarter.**
- Further, demand outlook across businesses appears to be positive, especially on domestic front, coupled with increased private participation in capex/ investment announcements, will drive the growth.
- With positive demand outlook domestically, we believe corporates are adjusting their margins accordingly, which is already visible since last quarter, and likely to improve going forward.

ASCBs Credit Growth at 9-Year High

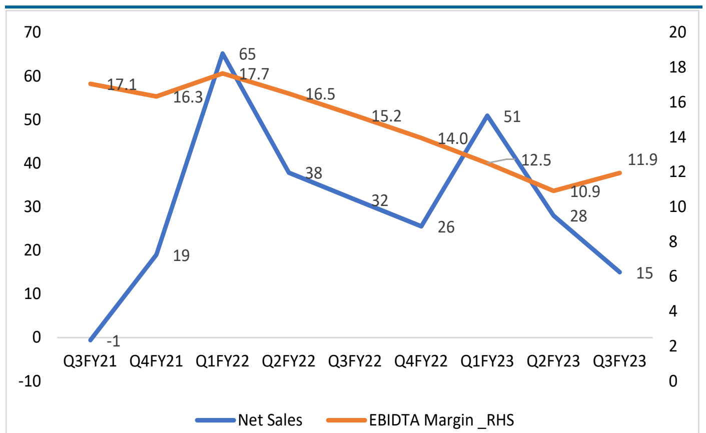


Source: SBI Research

Transmission of Policy Rate			
Interest Rate	Apr-22	Latest	Change (in bps)
Repo Rate	4.00	6.50	250
Wt Avg. Lending Rate (WALR) on O/S Rupee Loans	8.72	9.67	95
WALR on Fresh Rupee Loans	7.51	9.24	173
Wt Avg. Domestic Term Deposits (WADTDR) on O/S Deposits	5.03	6.02	99
ASCB-MCLR (1 Year)	7.25	8.55	130
SBI Retail Term Deposit rate (1 Yr)	5.10	6.80	170
SBI EBLR	6.65	9.15	250
SBI MCLR –6 Months	7.05	8.40	135
SBI MCLR –1 Year	7.10	8.50	140

Source: RBI, SBI Research

Corporate Revenue and Margin Growth



Source: SBI Research; Cline

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