

In consonance with broader market expectations, the newly constituted MPC kept the policy rates unchanged at 6.50% (tenth-time in a row). It is interesting to note that the change in stance decision was unanimous MPC decision. Also, the first meeting of the MPC in all earlier terms has started with unanimous decisions with a rate cut or pause. **Glancing back, it has been 30 odd months since the RBI first used the “Withdrawal of accommodation” stance.**

RBI retained its inflation projection for FY25 at 4.5%. The outlook for inflation will largely be shaped by food inflation trajectory and base effect. Further, the recent uptick in metal and crude oil prices due to geopolitical tensions (Israel-Iran conflict) may pose upside risks to inflation and need close monitoring. RBI retained its real GDP growth projection for FY25 at 7.2% with risks evenly balanced. The agriculture sector is expected to perform well on the back of above normal rainfall and robust reservoir levels (leading to healthy kharif sowing). **RBI projections indicate that economic growth is robust and may remain above 7% for next couple of quarters. This raises an interesting question as to whether RBI is preparing the grounds for an ensuing rate cut harmonizing with current momentum in growth. “Perhaps a 7% growth with a rate cut has never happened in India’s history or the world history”, but for 2016 when a new MPC had taken over! Country-wise experiences indicate that that barring Philippines, the GDP growth at the time of rate cut was lower than the average growth of preceding four quarters. With the fortitude of foresight, RBI has clearly offered sufficient time to markets to prepare for the eventual pivot.**

However, we estimate that Government growth projection of 6.5%-7% looks more reasonable. Leading indicators are showing mixed signals. For instance, domestic passenger vehicle sales which is an indicator of urban demand as well as other indicators of consumption and demand as diesel consumption, electricity demand and bitumen consumption have eased. Transport and communication indicators as passenger and freight traffic at airports and toll collection are showing traction, however, e-vehicle registration continues to lose steam in Aug’24 and Sep’24. Thus growth seems to be entering a softer patch. Capital expenditure has also slowed down in current fiscal.

Additionally, the credit deposit differential has now narrowed down to 150 basis points, the lowest since May 2022 and down from the high of 810 basis points in Dec’22. Interestingly, the year-to-date growth rate in the current fiscal shows that credit growth after adjusting for the merger is still lower by Rs 3 trillion (as on Sep’20), but more interestingly higher by Rs 3.4 trillion compared to deposit. There is also a slowdown in leading indicators of consumption. Perhaps the months of October and November could script a different story.

The other regulatory / developmental announcements mirror the RBI’s penchant to reinforce the B&FS structural architecture.

Firstly, as of March 2023, there are 1502 UCB. Of this, 79 UCB have capital adequacy less than 9%. The proposal to explore alternate avenues to raise capital for UCBs is to address this inherent contradiction in UCB. The proposal is chain of long drawn reform process in the segment and will increase the stability of the sector and protect depositor interest.

Secondly, smoothening data asymmetry for tackling climate related funding through proposed 2-stage RB-CRIS platform, enhancement of UPI Lite wallet limit to Rs 5,000 (while the per-transaction limit in feature phone centric UPI123Pay stands enhanced from Rs 5,000 to Rs 10,000), introducing name look-up facility in inter-Bank transfers to mitigate customers’ woes and reduce frauds all going a long way in cementing the cogs that make the banking forward looking yet connected to the grounds.

Thirdly, a ‘compliance first’ culture, a strong risk management framework and strict adherence to fair practices code coupled with sincere approach to customer grievances is the clear prescription from the regulator to the NBFCs.

The fine balancing act of the Central Bank, a clear audacity defying odds and orbit of other big boys club members to take an independent and appropriate rate cut call shows its maneuverability to ensure inflation remains aligned to a narrow target framework, duly factoring in the vulnerability of base effects and supply shocks. The fine balancing act, assiduously choosing the Middle Path, gives a raw finesse to the Mint Street actions in these checkered times. Echoing Governor, one can only expect the calibrated bringing back of inflation horse to stable is symbolic of the ages old Indian practice with the coming home of the horse reinforcing the sovereign’s reigning supremacy.

REPO RATE KEPT AT 6.5%; CHANGED STANCE TO NEUTRAL

- ◆ As widely expected, MPC decided to keep repo rate at 6.50% (tenth-time in a row), however, this time also not unanimously. One of the newly inducted members voted to reduce the policy repo rate by 25 bps. However, MPC unanimously decided for a change in stance from withdrawal of accommodation to ‘neutral’ and to remain unambiguously focused on a durable alignment of inflation with the target, while supporting growth.
- ◆ RBI retained its inflation projection for FY25 at 4.5% with Q2 at 4.1%, Q3 at 4.8%, and Q4 at 4.2%. The outlook for inflation will largely be shaped by food inflation trajectory and base effect. Further, the recent uptick in metal and crude oil prices due to geopolitical tensions (Israel-Iran conflict) may pose upside risks to inflation and need close monitoring.
- ◆ RBI retained its real GDP growth projection for FY25 at 7.2% (Q2: 7.0%, Q3: 7.4%, and Q4: 7.4%) with risks evenly balanced. The agriculture sector is expected to perform well on the back of above normal rainfall and robust reservoir levels (lead to healthy kharif sowing). The manufacturing and services activities remain steady owing to consumer spending in the festival season, resilient bank credit growth and elevated capacity utilisation. **We believe that GDP growth for FY25 will be lower than the RBI’s estimate due to 6.7% growth in Q1 and thus 7.0% growth looks more reasonable.**
- ◆ RBI projections indicate that economic growth is robust and may remain above 7% for next couple of quarters. This raises an interesting question as whether RBI will cut the rates when growth is already in momentum. Country-wise experiences indicate that that except Philippines, the GDP growth at the time of rate cut was lower than the average growth of preceding four quarters.

LIQUIDITY REMAINS ADEQUATE

- ◆ RBI has ensured that system liquidity remains comfortable by conducting two-way market operations. After remaining in surplus for around first 3 fortnights in April, system liquidity turned to deficit till end-Jun’24. However, it turned the corner again in July and has been in surplus mode since then. Overall, surplus liquidity stands at an average of 0.41 lakh crore with government surplus cash balances at Rs 2.9 lakh crore in FY25. Post last MPC held on 8th August, the average surplus liquidity as given by absorption through LAF comes at Rs 1.26 lakh crore. Government surplus cash balances which increased to Rs 4.4 lakh crore through the mid of Sep owing to GST cash flows have now reduced to at Rs 2.7 lakh crore as on 8 Oct’24.
- ◆ After JP Morgan and Bloomberg, FTSE Russell will be the third global bond index to include Indian bonds in their Emerging Markets Government Bond Index and regional Asian government bond indices over a six-month period from Sep’25 with inflows expected by about \$4.6 bn of inflows, thereby providing further support to liquidity.

RBI Growth & Inflation Outlook for India					
CPI Inflation (%)	Q2 FY25	Q3 FY25	Q4 FY25	FY25	Q1 FY26
Oct'24	4.1	4.8	4.2	4.5	4.3
Aug'24	4.4	4.7	4.3	4.5	4.4
Jun'24	3.8	4.6	4.5	4.5	-
Apr'24	3.8	4.6	4.5	4.5	-
Feb'24	4.0	4.6	4.7	4.5	-
Real GDP Growth (%)	Q2 FY25	Q3 FY25	Q4 FY25	FY25	Q1 FY26
Oct'24	7.0	7.4	7.4	7.2	7.3
Aug'24	7.2	7.3	7.2	7.2	7.2
Jun'24	7.2	7.3	7.2	7.2	-
Apr'24	6.9	7.0	7.0	7.0	-
Feb'24	6.8	7.0	6.9	7.0	-

Source: RBI, SBI Research

GDP Growth at the time of rate cut			
Countries	Rate cut magnitude	GDP Growth (% yoy)	
		At the time of rate cut	Last 4 Quarters Average
Brazil	50 bps	2.5	2.9
Mexico	25 bps	1.5	3.2
Philippines	25 bps	6.3	5.4
US	50 bps	3.0	3.0
UK	25 bps	0.2	0.5
China	30 bps	4.7	5.4
Indonesia	25 bps	5.0	5.1
UAE	50 bps	3.4	3.6

Source: SBI Research

Average Liquidity Position (Rs lakh crore)			
Indicator	FY25 Average	Post policy (08th Aug -till date) average	8-Oct-24
Repo Outstanding	0.66	0.17	0.03
Reverse Repo Total	0.38	0.58	0.90
SDF	0.87	0.99	0.89
MSF	0.07	0.05	0.05
Net LAF (-absorption)	-0.41	-1.26	-1.64
Government Cash Balance (net LAF-core liquidity)	2.92	2.80	2.68
Core Liquidity (-Surplus) system liquidity adjusted with GOI Balances	-3.31	-4.06	-4.18

Source: SBI Research, RBI

RURAL ECONOMY SHOWING BETTER PROSPECTS

- ◆ RBI Governor has emphasised that growth remains healthy and stable. Domestic demand remains resilient while investment continues to remain improve with rebound in government capex and private investment gaining momentum against the backdrop of higher capacity utilisation (75.8% sa in Q1 FY25) and increasing investment intentions. Above normal monsoon and reservoir levels indicate improved prospects of rural economy.
- ◆ **However, leading indicators are showing mixed signals. For instance, domestic passenger vehicle sales which is an indicator of urban demand as well as other indicators of consumption and demand as diesel consumption, electricity demand and bitumen consumption have eased. Transport and communication indicators as passenger and freight traffic at airports and toll collection are showing traction, however, e-vehicle registration continues to lose steam in Aug'24 and Sep'24.**
- ◆ **Even the Jacota Sumpoorn index of MSME stayed in the mild expansion zone of 0.55-0.60 in the zone of mild expansion Thus growth seems to be entering a softer patch.**
- ◆ RBI has kept GDP growth for FY25 at 7.2% with Q2 growth revised down to 7.0% from 7.2% earlier. Liquidity also remains comfortable. At the same time RBI remains committed to keep inflation rate around 4% target. Thus, is the change in stance to neutral at this juncture an indicator of future policy action?

GAP BETWEEN CREDIT & DEPOSIT GROWTH HAS NARROWED DOWN—WILL DEPOSIT OVERTAKE CREDIT GROWTH?

- ◆ Credit growth continues to outpace deposit growth as shown by the latest fortnightly data with credit growth at 13.0% yoy as on 20 Sep'24 (20% during the same period in FY24) and deposit growth at 11.5% (13.2% during the same period in FY24).
- ◆ On YTD/incremental basis, deposits grew only by 5.0% (₹10.3 lakh crore), compared to last year YTD growth of 6.9% (₹12.4 lakh crore). Credit grew by 4.2% YTD (₹6.93 lakh crore), compared to last year growth of 10.8% (₹14.7 lakh crore).
- ◆ Incrementally, deposits declined by ₹44,755 crore during the fortnight while credit grew by ₹78,769 crore.

- ◆ However, interestingly the yearly gap between credit and deposit growth has narrowed down to 150 bps during the latest fortnight which is lowest since 6 May'22. This indicates that deposit growth will soon outweigh credit growth. During the opposite cycle when credit growth was lower than the deposit growth, the gap was lowest at 20 bps during the fortnight ended 8 Apr'22.

ENDOGENEITY OF MONEY

- ◆ The apparent slowdown in deposits has also ensured misplaced narratives gaining crescendo with a lower money supply growth being cited as a potent reason for lower reserve money creation and hence lower deposit growth. However, in an inflation targeting framework, money is endogenous and also the link between money supply and reserve money is agnostic as digitization has resulted in an increasing money multiplier with much lower currency leakage.
- ◆ In the IT framework, the central bank targets inflation, through policy rate to bring price stability, with due consideration to the objective of growth. So, the central bank don't target monetary aggregates like M0, M3 etc., but uses interest rate as the instrument variable. **In an IT framework money evolves endogenously in tune with the structural changes in the economy** as well as the evolution of the payment system landscape. Endogeneity ensure that bank credit creates deposits and not reserves. Results from our Granger Casualty analysis also indicate that credit granger cause deposits and hence a decline in credit will lead to decline in deposits going forward.

DEVELOPMENT AND REGULATORY MEASURES

- ◆ **Levy of Foreclosure Charges/ Pre-payment Penalties on Loans:** RBI has been mindful of hidden charges and other penalties that affect the cost financial services. RBI has already rationalized many of Fair practices code in recent years. The present measure is continuum from the past. Current proposal has decided to broaden the scope of foreclosure charges/ pre-payment penalties regulations and to cover loans to Micro and Small Enterprises (MSEs). This measure reduces the cost of financial intermediation for MSMEs as foreclosure charges/ pre-payment penalties can range from 1-4%.

- ◆ **Capital Raising Avenues for Primary (Urban) Co-operative Banks:** The notion of capital in cooperative bank is different from normal a commercial bank. Co-operatives were established on the principles of mutuality and by questioning the primacy of capital. The principles of co-operation do not provide enough incentives or the glue to ensure long horizon commitment of members. With member share capital being withdrawable and return on capital being limited, there is no incentive to keep the capital if it is not used as a leverage for the member to borrow. This makes the co-operatives weakly capitalised by design.
- ◆ As of March 2023, there are 1502 UCB. Of this, 79 UCB have capital adequacy less than 9%. The proposal to explore alternate avenues to raise capital for UCBs is to address this inherent contradiction in UCB. The proposal is chain of long drawn reform process in the segment and will increase the stability of the sector and protect depositor interest.
- ◆ **Creation of Reserve Bank Climate Risk Information System:** The discussion paper on climate related risk and the climate risk survey by RBI had highlighted data constraints faced banks in making climate related disclosures. The available climate related data is characterised by various gaps such as fragmented and varied sources, differing formats, frequencies and units. Addressing gaps in climate data has also been highlighted by NGFS. The proposed measure is good move by standardising important datasets and bringing the available public data sets on one platform. This enables banks for transparent climate disclosures by clearly stating the source of climate data and also allows for comparability across financial institutions.
- ◆ **UPI - Enhancement of limits:** UPI has transformed India's financial landscape by making digital payments accessible and inclusive through continuous innovation and adaptation. To further encourage wider adoption of UPI and make it more inclusive, RBI has enhanced: (i) per-transaction limit in UPI123Pay from Rs 5,000 to Rs 10,000; and (ii) increase the UPI Lite wallet limit from Rs 2,000 to Rs 5,000 and per-transaction limit from Rs 500 to Rs 1,000. The hike in transaction limits will help users make digital payments easier.
- ◆ UPI lite helps in faster transaction processing, with lesser chance of failed UPI transactions. It also helps in reducing cluttering of bank passbooks with small value transactions. The transactions done via UPI Lite does not reflect in the individual's bank passbook, as money stored in the UPI Lite wallet.
- ◆ So, the UPI lite transactions can check their UPI app transaction history. UPI Lite has features like auto top-up, when the UPI Lite balance falls below a minimum limit set by customer.
- ◆ UPI 123Pay is designed to enable digital transactions for India's 400 million feature phone users. It allows users to make UPI payments without needing a smartphone or an internet connection, making digital payments accessible to a wider population. To set up UPI 123Pay, users create a UPI ID on their feature phone by dialing *99#, selecting their bank, entering their debit card details, and setting a UPI PIN. This system allows secure transactions without internet access, supporting financial inclusion for those without smartphones.
- ◆ **Introduction of beneficiary account name look-up facility:** RBI has also introduced a beneficiary verification system in RTGS and NEFT systems. This was earlier only available in UPI and IMPS services. This facility will enable the remitter to verify the name of the account holder before effecting funds transfer to him/her through RTGS or NEFT. This will also reduce the possibility of wrong credits and frauds.

GLOBAL ECONOMIC OUTLOOK

- ◆ Global economy has remained resilient and is expected to maintain stable momentum over the rest of the year, amidst downside risks from intensifying geopolitical conflicts. The IMF retained the global growth estimate for 2024 at 3.2 per cent and. Global commodity prices declined on the back of softening prices of base metals, agricultural products, and energy, however, price pressures have increased recently amidst heightened geopolitical tensions. Further domestic situation in the US and China will have their separate impacts.
- ◆ The US elections due on 5-Nov are expected to significantly impact the global economy. On both the aspects economy and geopolitics, there is wide divergence of the course of action that should be taken. However. As Federal reserve has already started easing rates US growth is poised for favorable outlook despite the election outcome.
- ◆ After a round of monetary stimulus, China has undertaken fiscal stimulus to contain the damage caused by collapse of property market. China is facing weak rise in prices amidst a property slump and subdued consumer confidence. The current stimulus package address issue of local government finances, financial measures for SME and infrastructure. However, opinion is divided on efficacy of the plan and ability to boost growth rates significantly.

NBFC TO ADOPT COMPLIANCE FIRST CULTURE, SELF-CORRECTION 'THE DESIRE BEFORE DICTAT'

- ◆ Rates on CPs issued by non-banking financial companies (NBFCs), remained elevated reflecting, inter alia, the increase in risk weights on bank lending to NBFCs announced by the Reserve Bank on November 16, 2023. Commercial Paper Weighted Average Yield (WAY) increased by 323 bps as compared to April'2022 mainly because of increased in WAY in NBFCs sector which increased by 337 bps during the same period.
- ◆ Further, credit growth to services and personal loans segments at 15.6 per cent and 16.9 per cent, respectively, in August 2024 displayed gradual moderation. Within the services sector, NBFCs were the main driver of overall growth.
- ◆ Increasing dependency of NBFCs on bank borrowings triggered regulatory concerns. Similarly, certain components showed higher growth in the personal loans segment, which led to concerns about incipient stress.
- ◆ To address the build-up of any potential risk, the Reserve Bank tightened lending norms in November 2023. Consequently, total consumer loan growth in the sub-segments where risk weights were increased, moderated to 13.9 per cent (25% last year) while their share in incremental credit to the sector declined to 29.7 per cent in August 2024 which was 45.6% a year ago.
- ◆ Growth in bank credit to NBFCs moderated to 12.2 per cent (which was more than 20% last year), bringing down its share to 26.9 per cent (34% in August'2023) of incremental credit extended to services during the same period.

- ◆ While RBI has mentioned about the strong health parameters in NBFC space, it also cautioned regarding stress buildup in a few unsecured loan segments like loans for consumption purposes, micro finance loans and credit card outstandings. Below are the three prescriptions from RBI for the outliers in NBFC space: -
 - ◇ Sustainable business practices and risk management frameworks, commensurate with the scale and complexity of their portfolio is the prescription before pursuing growth
 - ◇ Not to chase excessive returns on their equity. Business targets drive retail credit growth rather than its actual demand and consequent high-cost and high indebtedness could pose financial stability risks
 - ◇ To review prevailing compensation practices, variable pay and incentive structures. Target driven incentive practices may result in adverse work culture and poor customer service
- ◆ **To conclude, a 'compliance first' culture, a strong risk management framework and strict adherence to fair practices code coupled with sincere approach to customer grievances is the clear prescription from the regulator to the NBFCs.**

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