SBI ECOWRAP

भारतीय स्टेट बैंक
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'Be the Bank of Choice for a Transforming India'

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MORE RATE CUTS IN OFFING

RBI cut the Repo rate by 25 bps to 6.25% by 4-2 vote. The MPC also revised the stance of monetary policy from calibrated tightening to neutral. The RBI decision to cut rates was a recognition of benign inflation numbers and growth slowdown pangs. The bouquet of policy announcements on developmental and regulatory front underlines RBI's attempt to further fine tune the linkage of monetary policy and market microstructure.

The policy is cognizant of recent global headwinds and domestic growth hitting soft patch. To this end, the inflation projections at 3.9% for Q3FY20 clearly indicates that RBI rate action will be data dependent.

The policy is rich in content and has several regulatory measures for market development.

For example, RBI has eased the overseas borrowing norms for bidders of stressed assets under the IBC. The resolution applicants under Corporate Insolvency Resolution Process can now utilize the ECB proceeds for rupee-loans of the insolvent company that they wish to buy. This is expected to help in quick and faster resolution of domestic stressed assets.

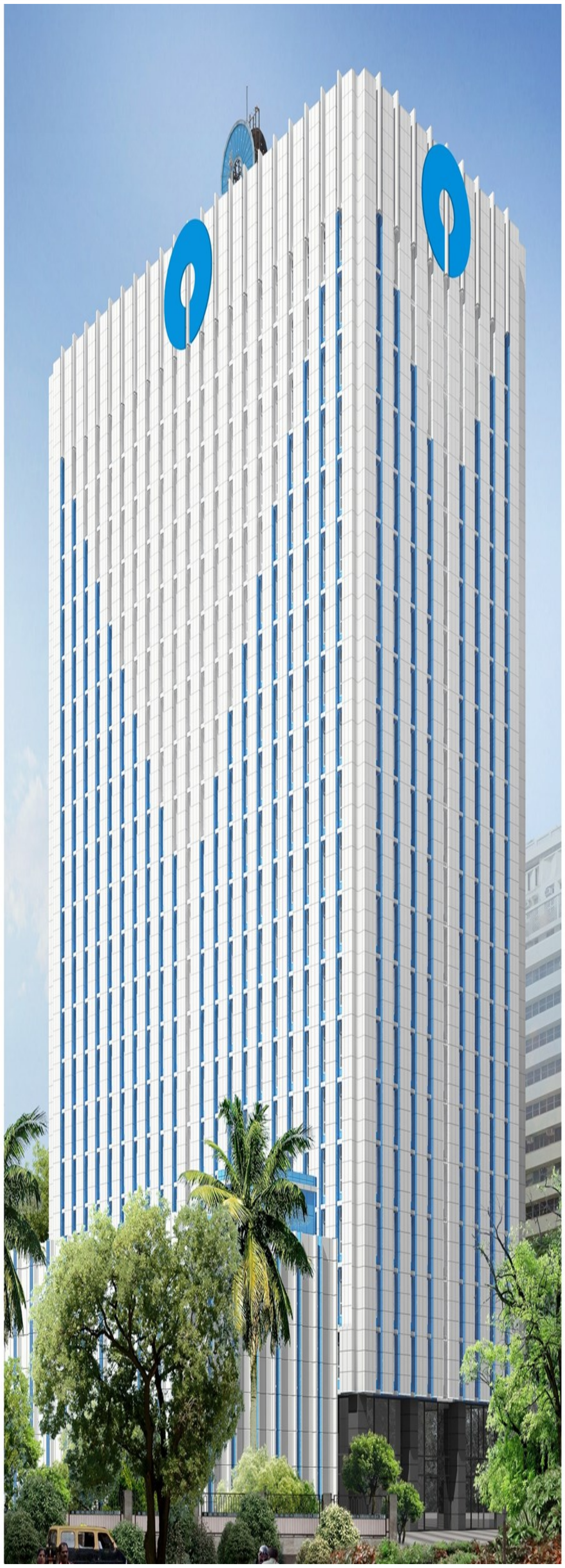
With RBI raising the threshold for 'bulk deposits' for banks to Rs 2 crore from the current Rs 1 crore, around Rs 1 lakh crore of bulk deposits will be now termed as retail deposits. Thus the share of retail deposits will increase which will result in better price discovery.

In addition to the budget announcement for the Agriculture sector, RBI today raised the limit of collateral-free agricultural loans to Rs 1.6 lakh from the current Rs 1 lakh since 2010, with a view to help small and marginal farmers. This enhancement will help 75% of eligible farmers to get the benefit without any collateral.

The intent to reward the well-rated NBFC by giving them opportunity to tap the funds at the rate based on their credit ratings is an excellent move. For the NBFCs, it would optimise their funding cost but the larger picture lies in the freeing of capital for the banks. As per our calculations, the change of risk weights as per rating distribution would lead to capital saving equivalent to 7.58% of the assets under consideration, thereby releasing an amount of Rs 19000 crore of capital.

One announcement which is of great importance is the proposal to constitute a Taskforce on Offshore Rupee Markets. The RBI decision on FPI investments in corporate bonds will establish connect with wider foreign investor audience to rake in the inflows. The ECB decision will hasten the process under IBC.

On the whole, the policy announcements will facilitate synergy between monetary policy and market microstructure. In addition, a clear and persuasive communication of inflation projections till Q3FY20 will anchor market expectations of further rate cuts!



RBI REDUCES REPO RATE BY 25 BPS

- The Monetary Policy Committee (MPC) decided to cut the Repo rate by 25 bps to 6.25% by 4-2 vote. The MPC also revised the stance of monetary policy from calibrated tightening to neutral.
- RBI revised downwards the CPI inflation to 2.8% in Q4 FY19, 3.2-3.4% in H1 FY20 (earlier 3.8-4.2%) and 3.9% in Q3 FY20 on the back of assumption of normal monsoon, moderation in fuel prices and dissipation of HRA increase. The results of Dec'18 indicate that inflation expectations of households softened by 80 basis points for the three-month ahead horizon and by 130 basis points for the twelve-month ahead horizon over the last round, reflecting the continued decline in food and fuel prices. However, as per our estimates RBI's H1 FY20 inflation numbers are undershooting by around 30 bps.
- For FY20, GDP growth is projected at 7.4% (7.2-7.4% in H1 and 7.5% in Q3). The risks include slowing global demand particularly trade tensions and associated uncertainties.

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20
Feb'19 (6th Bi-monthly)	2.6*	2.8	3.2	3.4	3.7
Dec'18 (5th Bi-monthly)	2.8	3.2	3.8	4.2	-
Oct'18 (4th Bi-monthly)	4.0	4.5	4.8	-	-
Aug'18 (3rd Bi-monthly)	4.7	4.8	5.0	-	
Jun'18 (2nd Bi-monthly)	4.7	4.7	-	-	-
Real GDP Growth (%)	**Q3 FY19**	**Q4 FY19**	**Q1 FY20**	**Q2 FY20**	**Q3 FY20**
Feb'19 (6th Bi-monthly)	7.5	7.0	7.2	7.3	7.3
Dec'18 (5th Bi-monthly)	7.1	7.0	7.0	7.2	-
Oct'18 (4th Bi-monthly)	7.3	7.2	7.4	-	-
Aug'18 (3rd Bi-monthly)	7.6	7.3	7.5	-	-
Jun'18 (2nd Bi-monthly)	7.2	7.3	-	-	-

Source: RBI, SBI Research; * Actual

CPI Inflation Projections (%)

	RBI	SBI
Q4 FY19	2.80	2.86
H1 FY20	3.2 to 3.4	3.1 to 3.7
Q3 FY20	3.90	3.94

Source: RBI; SBI Research

DEVELOPMENTAL AND REGULATORY POLICIES

Relaxation of External Commercial Borrowing (ECB) framework for Resolution Applicants

- RBI has eased the overseas borrowing norms for bidders of stressed assets under the IBC. The resolution applicants under Corporate Insolvency Resolution Process can now utilize the ECB proceeds for rupee-loans of the insolvent company that they wish to buy. Though Indian banks' overseas branches or their subsidiaries are not eligible under this, however, this move is positive as it has opened up a new source of funds for the bidders. Earlier the amount that the prospective bidders could raise was constrained by the large exposure framework applicable to Indian lenders. However, the ECB route has now put another group of lenders (foreign banks) into picture. This in turn might help in quick and faster resolution of domestic stressed assets.

Bulk Deposits Limit Raised

- RBI has raised the criteria for 'bulk deposits' for banks to Rs 2 crore from the current Rs 1 crore, to provide more operational freedom to the banks to raise funds. So, now banks would treat deposits upto Rs 2 crore as retail deposits, where the interest rate is fixed for a given maturity, irrespective of the amount deposited.
- Further, the bulk deposits (including card & DIR) are only around 20% of the total time deposits of the banks. So, with this change in criteria, around Rs 1 lakh crore of bulk deposits will now be termed as retail deposits. As bulk deposits are sensitive deposits, the reduction in their share will help the banks to have better ALM management and better price discovery.

Financial Inclusion

- In addition to the budget announcement for the Agriculture sector, RBI also raised the limit of collateral-free agricultural loans to Rs 1.6 lakh from the current Rs 1 lakh , with a view to help small and marginal farmers. This enhancement will help the farmer to get the benefit without any collateral. However, the loan limits depend on the area of land holding by the farmer.
- In addition to that, RBI also decided to set up an internal working group (IWG) to review agricultural credit in the country. We believe the committee will recommend to amend the old practices in relation to land records, as 90% of the land records are digitalized in the country.

Risk Weights for rated exposures to Non-Banking Financial Companies (NBFCs)

- The intent to reward the well-rated NBFC by giving them opportunity to tap the funds at the rate based on their credit ratings is a welcome move. For the NBFCs, it would optimise their funding cost but the larger picture lies in the freeing of capital for the banks, which ultimately would benefit the industry including the NBFCs.
- As per the policy announcement, rated exposures of banks to all NBFCs, excluding Core Investment Companies (CICs), would be risk-weighted as per the ratings assigned by the accredited rating agencies. This is in addition to Asset Finance Companies (AFCs), Non-Banking Financial Companies – Infrastructure Finance Companies (NBFCs-IFC) and Non-Banking Financial Companies – Infrastructure Development Fund (NBFCs-IDF), which are already risk weighted as per the ratings assigned.
- As per the latest available RBI data of Sept 18, The NBFC-ND-SI have a total borrowing of Rs 15.72 lakh crore, out of which Rs 4.11 lakh crore and Rs 1.53 lakh crore is through bank borrowings and CPs respectively. Assuming all the CPs being subscribed by the banks, the total exposure works out to Rs 5.64 lakh crore, which is 36% of the total borrowings by the NBFCs. An amount worth of Rs 7.01 lakh crore falls under the category viz, Loan company, investment company, Factoring NBC and NBFC – MFI, which presently are not getting rating benefits.
- The amount of borrowing from banking system, which, as per the new announcement would get rating benefit is Rs 2.52 lakh crore. In the rating calculation, given below, the change of risk weights, as per rating distribution would lead to capital saving equivalent to 7.58% of the assets under consideration, thereby releasing an amount of Rs 19000 Cr of capital.

Sources of Borrowings	
Category	**Amount (Rs. Lkh crs)**
Debentures	6.68
Bank Borrowings	4.11
Borrowings from Fis	0.28
Inter Corporate Borrowings	0.70
Commercial paper	1.53
Borrowings from Government	0.00
Subordinated Debt	0.36
Other Borrowings	2.06
Total	**15.72**
Borrowings from Bank/CP out of Total	**5.64**
Percentage to Total (%)	**35.85**
Source: SBI Research	

Categorywise Classification of Borrowings (Rs Lakh Crore)		
Sl No	**Category**	**Amount**
1	Asset Finance Company (AFC)	1.49
2	Core Investment Company	0.18
3	Factoring - NBC	0.02
4	Infrastructure Debt Fund- NBFC	0.2
5	Infrastructure Finance Company	6.84
6	Investment Company	1.44
7	Loan company	5.25
8	NBFC – Micro Finance Institutions	0.31
A	**Total**	**15.72**
B	NBFCs not getting rating benefit (B= A - (1+2+4+5)	**7.01**
C	Out of above borrowed from banks C = 7.01 * 35.85%	**2.52**
Source: SBI Research		

Rating-wise Distribution and Capital saved							
Rating	**AAA**	**AA**	**A**	**BBB**	**< B**	**Unrated/ Suspended**	
Rating Distribution (Source: Crisil NBFC-ND)	41%	42%	15%	1%	-	1%	
Risk Weights under Basel	20%	30%	50%	100%	150%	100%	
Bucketwise distribution	41.00	42.00	15.00	1.00	-	1.00	100.00
Risk Weighted Assets	8.20	12.60	7.50	1.00	-	1.00	30.30
Capitla requireement under Basel Standardised Approach - 10.875% (9%+1.875% CCB)							3.30
Capital requirement without rating benefit i.e. @ 100% RW							10.875
Capital Saving							7.58
On a total bank borrowings by the NBFS-ND-SI capital saving					Rs. 2. 52 lakh cr x 7.58		**0.19**
Or Say Rs 19000 crore							
Source: SBI Research							

Investment by Foreign Portfolio Investors (FPI) in Corporate Debt

- In order to attract foreign investors in debt market, the restriction on stipulated 20% limit (FPI's corporate bond portfolio) on investment in corporate bonds has been done away with. As per June 2018, SEBI circular some operational changes were announced for FPI in corporate bonds. Limits were prescribed on investments by FPIs and the time line to meet these limits. RBI is expected to announce the changes by mid-February 2019.
- As on 6th February 2019, the upper limit (limits of foreign investment in corporate bonds as per SEBI) for FPI stood at Rs 2,89100 crore. The investment by FPIs as on 6th February 2019 stood at Rs 203029 crore which is about 70% of the total upper limit. In year 2019 (upto 6th February 2019) the net investment outflow of FPI / FII Investment was Rs 3314 crore, as against net inflow Rs 4573 crore from 1st Jan 2018 to 6th February 2018. In calendar year 2018, the net investment in debt by FPI / FIIs was an outflow of Rs 47796 crore.
- The recent RBI monetary policy now aims to establish connect with wider foreign investor audience to rake in the inflows.

INCOME VELOCITY OF CURRENCY WITH PUBLIC DECLINING

- The income velocity after showing a spike in the demonetization period (FY17 velocity:12.1) has again gone back to its normal level of around 9.5 in FY18 and is estimated to come down further to 9 in FY19. The decline in velocity means that increasing currency with public has failed to cause proportional increase in nominal gross domestic product (GDP). Mathematically, declining velocity suggests that GDP is not responding in the same way to monetary stimulus. This shows that there is still some slack in the economy.

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ABOUT US

The Economic Research Department (ERD) in SBI Corporate Centre is the successor to the Economic and Statistical Research Department (E&SRD). The latter came into being in 1956, immediately after the State Bank of India was formed, with the objective of "tendering technical advice to the management on economic and financial problems in which the Bank has interest and which required expert analysis".

After the first reorganization of the Bank, when specialized departments like Management Science, Management Information Systems, Planning and Market Segment Departments took over the statistical work of E&SRD, the Department was renamed as ERD.

However, with the ERD team now taking on multidimensional functionalities in the area of risk management , corporate analytics, strategy and so on, who knows, the time may have come to rename it again!

DISCLAIMER

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