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Dr. Manoranjan Sharma
(Chief Economist)

Dr. Arun Kumar Misra
(Associate Professor, IIM, Sambalpur)

RBI MONETARY POLICY ON-EXPECTED LINES

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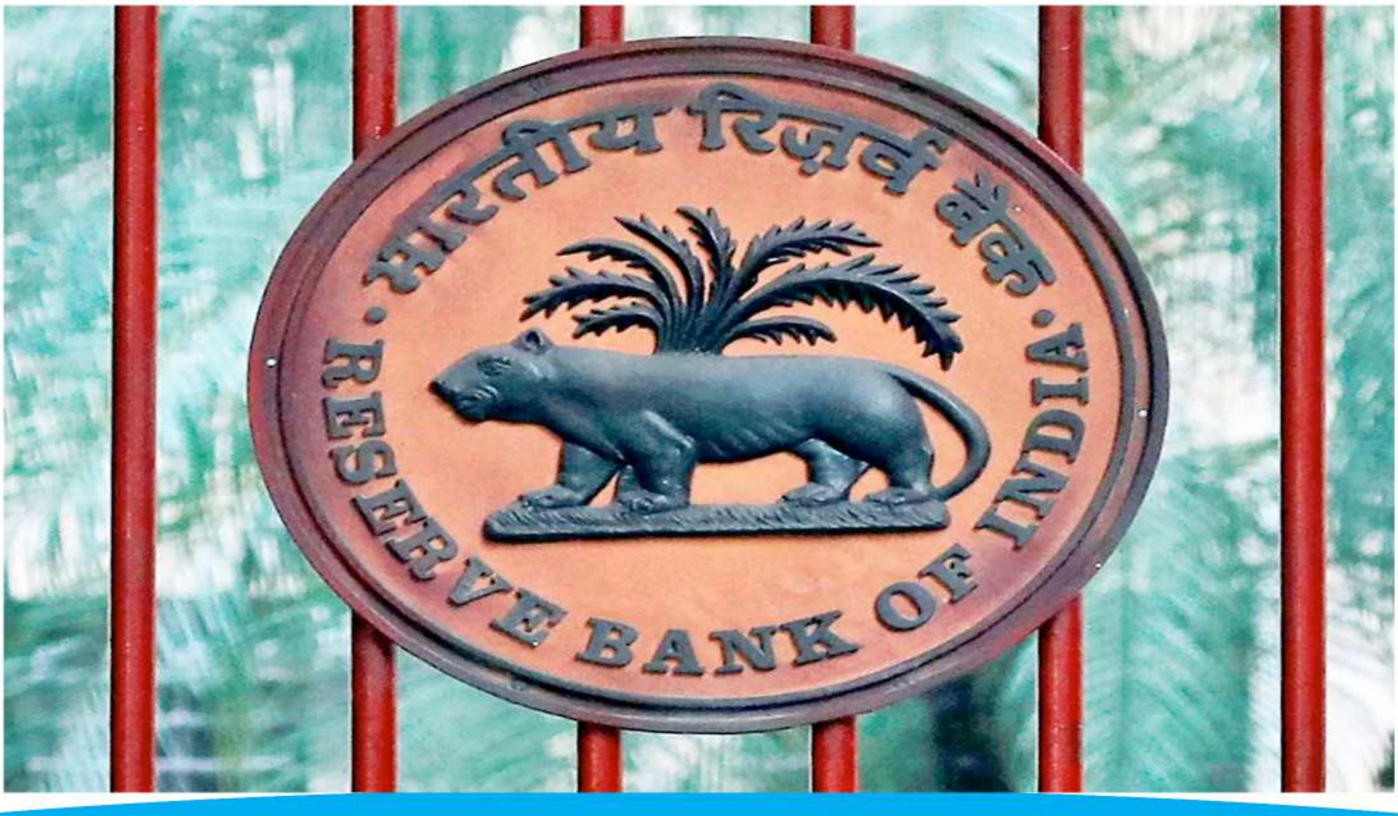
PERSPECTIVE

In line with our expectations, the RBI hiked the Repo rate by 50 bps to 4.90 per cent and withdrew the accommodative policy to contain inflation breaching the MPC mandated threshold of 4 per cent +/-2 per cent. Simultaneously, the standing deposits facility for liquidity absorption and marginal standing facility for extra-liquidity creation, beyond LAF, were revised to 4.65 per cent and 5.15 per cent, respectively.

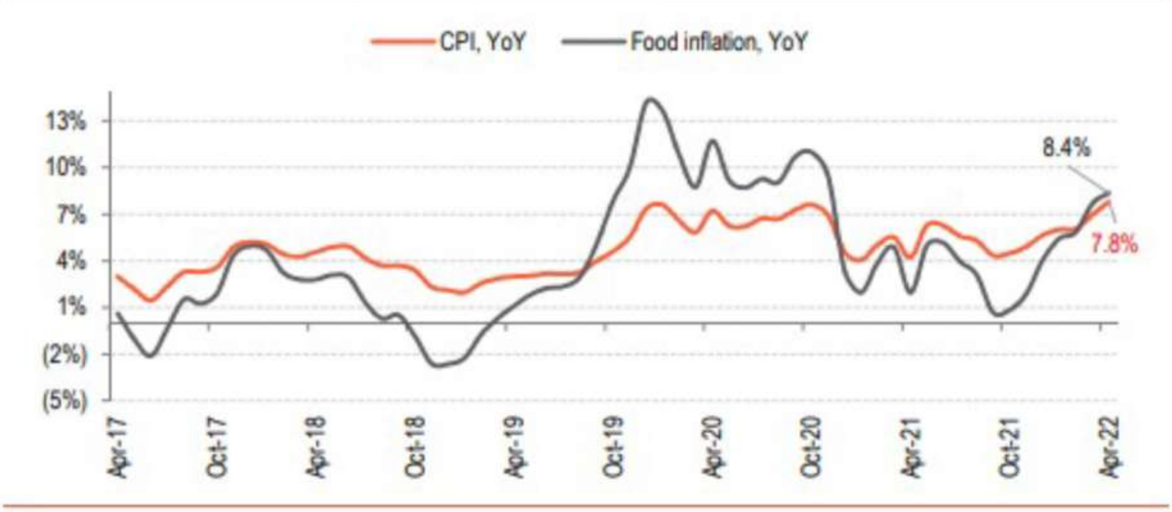
With COVID 19 almost over, India is on a high growth path once again. However, there are heightened geopolitical dynamics because of Russia-Ukraine war, high fuel prices, elevated logistics cost, volatile capital flows, exchange rate volatility, scramble for safe haven and attendant correction in asset prices.

Inflationary Spiral

Sticky CPI inflation, which rose for the seventh successive month from 7 per cent in March 2022 to a 95-month high of 7.8 per cent in April 2022 (15 per cent WPI inflation, the highest in 3 decades, stemmed primarily from higher global crude and primary commodity prices) was led by higher food and fuel-based inflation. This inflationary spiral reduced disposable incomes and exacerbated the pressure on individuals and industries. While the inflationary price spiral has been generalised, escalating food products, e.g., milk, fruits, vegetables, spices and cereals and fuel prices cause greater concern. Reducing inflation also requires supply-side measures.

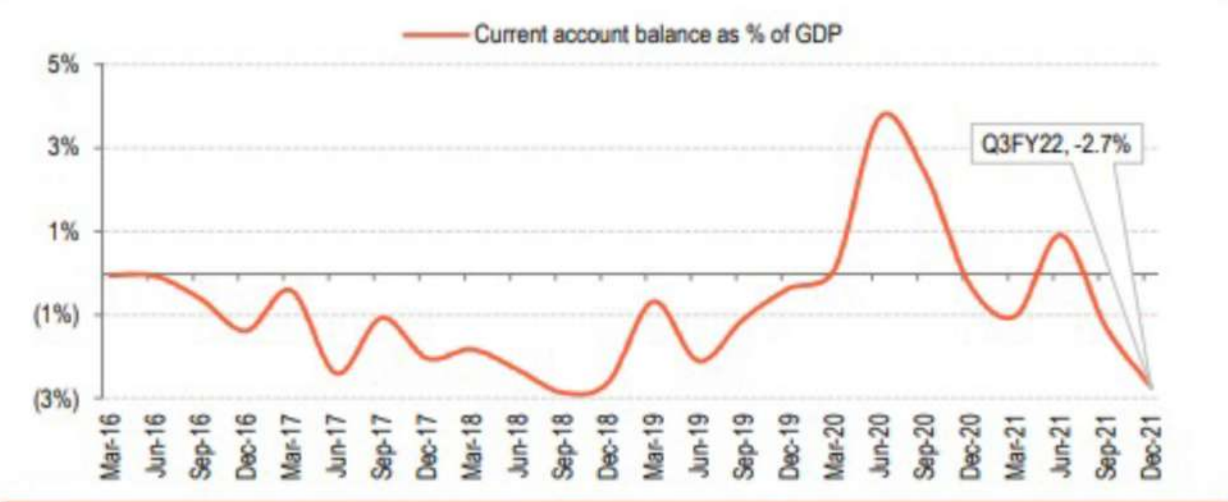


Headline CPI firmed up to its highest since May'14 to 7.8% in Apr'22 from 7% in Mar'22 (FY22:5.5%), led by food inflation



Inflation in the US rose to a 40-year high of 8.5 per cent; in UK to a 50-year high of 8.5 per cent. Many countries have changed their accommodative monetary policy with higher interest rate. Interest rate differential and the pressure of competing currencies has significantly lowered the rupee value and impacted the twin Current Account deficit and fiscal deficit.

India's current account deficit widened to a 13-quarter high of 2.7% of GDP in Q3FY22



Global prices, particularly for cereals, edible oils and crude prices, may further elevate inflation in the near-term. Domestically, unusually intense heat wave would reduce Rabi wheat production and edible oils could be hit because of adverse global supply conditions.

The Central Government slashed fuel taxes, subsidised gas cylinders, capped sugar exports and permitted duty free import of 20 lakh tonnes of crude soya-bean oil and sunflower oil. But this would soften price inflation only partially. Further, persistently high global oil prices risk further pass-through-"globalisation of inflation". Expectedly, RBI raised its inflation projections for 2022-23 by 100 bps to 6.7 per cent (Q1 at 7.5 per cent; Q2 at 7.4 per cent; Q3 at 6.2 per cent; and Q4 at 5.8 per cent, with risks evenly balanced), with its $105 per barrel crude oil forecast. But there are "known unknown" headwinds of commodity prices, revised electricity tariffs across states, high domestic poultry and animal feed costs, persisting trade and supply-chain bottlenecks, cascading impact of greater pass-through of input costs; volatile crude oil prices, etc.

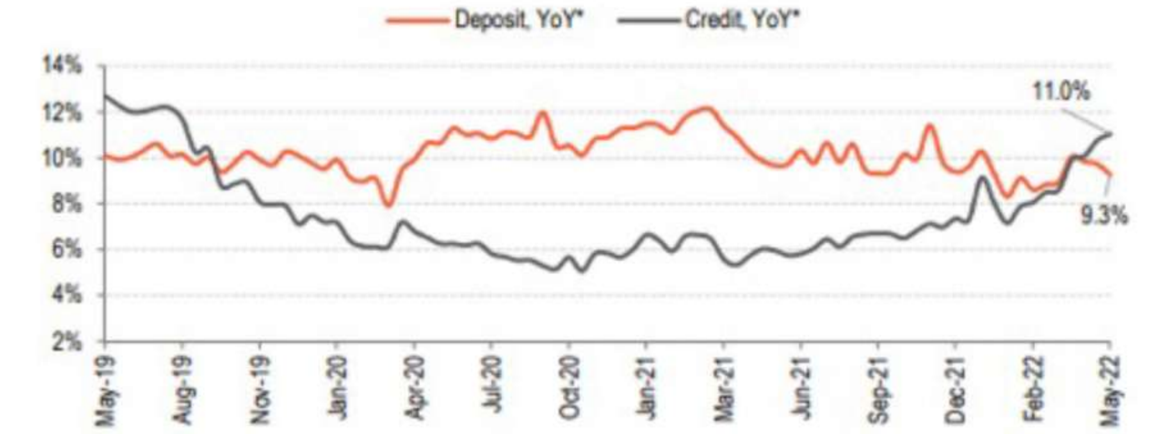
GDP Growth

India's real GDP growth in FY 22 was 8.7 per cent, i.e., 1.5 per cent above the pre-pandemic level (2019-20). The real GDP growth projection for 2022-23 is retained at 7.2 per cent, with Q1 at 16.2 per cent; Q2 at 6.2 per cent; Q3 at 4.1 per cent; and Q4 at 4.0 per cent, with risks broadly balanced.

Impact

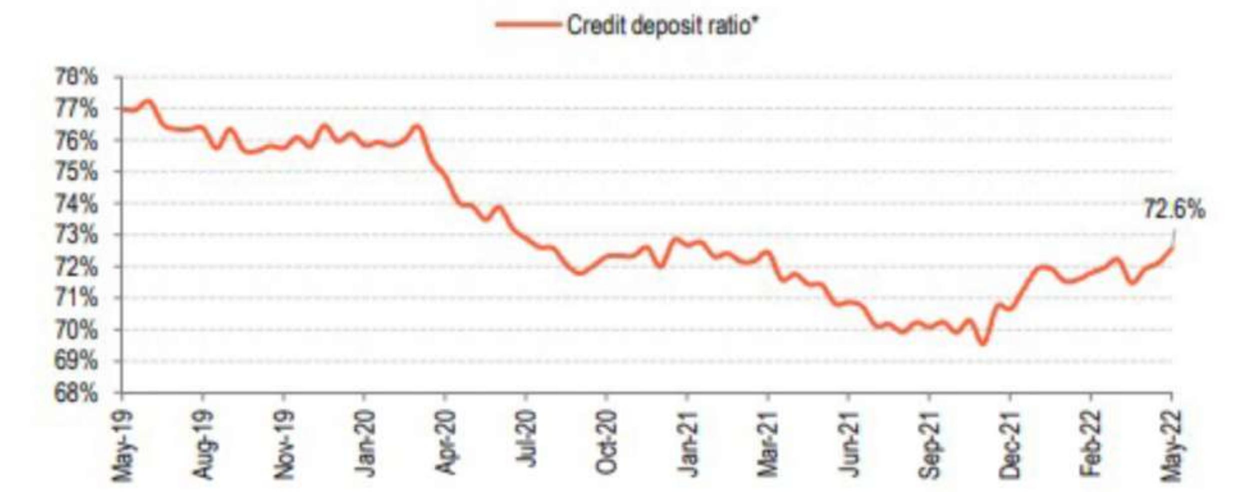
Despite credit-off take growing at 12.1 per cent (the key growth drivers being Retail and SME loans with corporate loans still to fully gain traction), the banking system's overall surplus liquidity is reflected in May's daily average liquidity absorption under LAF of about ₹5.5 lac crore. But this surplus moderated from ₹7.4 lakh crore during April 8 - May 3, 2022 because of calibrated withdrawal of accommodation. Further, adequate liquidity may dissipate with agriculture loans peaking during 2nd quarter. The government has increased the agricultural credit target to ₹ 18 lakh crore for FY 23 fiscal from ₹ 16.50 lakh crore in FY 23.

Credit demand rose to 11% in May'22 from 10.1% in Apr'22, deposit growth moderated to 9.3% from 9.8%



Note: *May'22 implies fortnight as of 20 May 2022

CD ratio was at 72.6%



Note: *May'22 implies fortnight as of 20 May 2022

Gross market borrowings through dated securities were pegged at ₹ 14.95 lac crore (about ₹ 9 lac crore-60 per cent to occur during first half-year) in FY 23 Budget. This may harden yield and raise borrowing cost of corporates. G-sec yield was impacted by 4.9 per cent revised repo rate and completion of the government borrowing calendar. RBI suggested chances of Operation Twist to manage government borrowing programme. Incidentally, post-pandemic, the RBI has ₹ 3.13 trillion and ₹ 2.14 trillion of government bonds in FY21 and FY22.

This Policy hike would trigger an interest rate hike by banks on loans to corporates, MSMEs and retail, particularly interest sensitive segments, such as, housing, vehicle, education, cement and steel. The interest rate on working capital loans will rise because short-term rates may rise higher and the capital market will be hit because of pronounced liquidity squeeze. But this hike could generate slightly higher interest rate for term deposits, debt funds may give higher returns and NAVs of existing debt investments may fall with rising yields.

Increased limits for individual housing loans of urban cooperative banks (UCBs) and rural cooperative banks (RCBs), by over 100 per cent, is positive for state and rural banks in boosting their loans; will help cooperative banks, which have a legacy and nation-wide presence, in enhancing their functions and working and boost affordable housing.

Doorstep banking services by UCBs will make banking services more accessible to senior citizens and disabled individuals. Guidelines for market participants regarding exchange of variation margin (VM) for NCCDs will improve safety of settlement of over-the-counter (OTC) derivatives that are not centrally cleared.

The Rupee dropped from ₹70 to about ₹78/Dollar in last few months. The Government of India and the RBI undertook several measures, e.g., spot dollar selling, accent on exports and Policy Rate hikes. Rupee value vis-à-vis US Dollar depends on various forces, including domestic macro-economy, current account deficit and inflation. The RBI has consistently maintained that its not targeting any particular exchange rate but its market interventions are limited to reducing the volatility in the Rupee value. To the extent that the successive Rate hikes will help to contain inflation, this measure will help to a limited extent in checking the fall in Rupee value.

Driving Digitization

The issues of disruptive innovations and domain knowledge together with big-picture issues facing industries and organizations have become commonplace. These competitive realities have blurred industry boundaries, transformed standard practice and rendered conventional blueprint of development obsolete making it necessary to leverage the power of the digital by extrapolating the unknown.

In this evolving socio-economic order, there have been game changing changes in data analytics, digitalization and disruption because of the confluence of innovation, big data, artificial intelligence (AI), machine learning (ML), deep learning (DL), robotics, analytics, internet and entrepreneurship.

Progressive digitalization is reflected in Direct Benefit Transfers (DBTs), the JAM Trinity (Jan Dhan, Aadhaar, Mobile- Rupay Cards) and Unified Payment Interface, Digital India initiative and literacy programmes. India is surging to a digital-first economy to meet the "revolution of rising expectations". This implacable process has significantly influenced employee empowerment, customer engagement, operational efficiency and business models. All four dimensions of technology- revenue, expense, experience and accuracy or compliance- impacting a company-have improved remarkably. Aadhar has become a unifying platform with performance transcending 'reach' and 'legacy'.

Digitization has transformed the entire financial sector because of reduced costs and unimaginably higher scale. Factors driving banking digitisation include digitally evolved consumers; smartphone penetration and low cost internet connectivity; cheaper products / services using M-banking and Wallet; government and RBI initiatives like Digital India, UPI, Bharat QR, Aadhaar, Point of Sale (PoS) and equipped market players.

The adoption and adaptation of new technology and digital payments have transformed conventional banking and significantly enhanced banking outreach. Progressively rising digitization has transformed lending processes, viz., credit assessment and loan approval, disbursement, repayment and customer services. But there is certainly a long road to traverse, as, for example, reflected in the fact that at end-March 2020, banks lent ₹ 1.1 lakh crore digitally vis-à-vis ₹ 53.1 lakh crore physically; NBFCs had ₹ 23, 000 crore digital loans as against ₹ 1.9 lakh crore loan physically. Enhanced mandates on recurring payments via credit and debit cards from ₹ 5,000 to ₹ 15,000 per transaction will foster digitization.

Electronic payments lead to convenience, discounts, tracking spends, lower risk and enhance gains. Linking of RuPay credit cards to UPI network could expand the credit market from the present level of 50 million to about 250 million users (at present UPI has 250 million users and 50 million merchants on-boarded), i.e., a massive five-fold rise.

With this game-changing development, the UPI's coverage would transcend debit cards and bank accounts to credit cards. While pricing remains an issue, permitting UPI-based payments to credit cards could divert some expenditure from CASA accounts to credit cards. This would drive boost card utilisation level and enhance spends per card for banks with a higher share of RuPay cards.

UPI-based payment more than doubled to ₹ 84.16 lakh crore in 2021-22 from ₹ 41.04 lakh crore in FY21. The overall credit outstanding against credit cards stood at nearly ₹1.5 lakh crore as on April 22, 2022. With this strategic measure, both convenience and short-term liquidity will be greatly facilitated. As Victor Hugo (1802-1885) said in a different context, this is "an idea, whose time has come".

Real time data on turnover, customer profile, lifestyle, spend, customers customer's instantaneous data can transform Indian fintech's rapidly expanding space. This is doable with convergence of data, technology and money to transform lives of borrowers, investors and businesses. But cyber security emerges as a key concern, particularly with data moving data offline to the cloud. Revamped digital ecosystem and the winds of change sweeping India provide an enabling environment to revolutionise India's socio-economic landscape, similar in its range and sweep perhaps only to the mobile or the internet revolution. This onward march would thus positively influence both growth and distributive equity.

Conclusion

In view of the evolving growth-inflation dynamics and the risks of un-anchoring of inflation and inflationary expectations to macro-economic stability, the MPC took the right call of hiking the Policy rate by a hefty 50 bps on top of (a) 40-bps unscheduled off-policy cycle hike of May 4, 2022 and (b) 50-bps hike in the CRR to contain inflationary spiral in a challenging setting and withdrew accommodative stance. Front-loading rate hikes (90 bps in a month largely offsetting 115 bps pandemic cut) will reduce persistent inflation partially but it may hurt fragile growth impulses.

The RBI was emboldened by 74.5 per cent (72.4 per cent in Q2FY22) capacity utilization rates, new investment announcement of ₹20 trillion in FY 22, resurgent manufacturing, reviving services sector and rural economy. But ultimately, monetary policy must move in tandem with fiscal policy to discernibly alter the ground-realities.