

Interest rate movements and Expectation of Credit Policy: Dec’15

The RBI is scheduled to undertake its fifth bi-monthly Monetary Policy review for FY16 tomorrow, December 1, 2015. CARE expects no change in the key interest rates as also retention of CRR and SLR at current rates.

Some of the key developments that have taken place in the financial year so far have been enumerated below.

A. Repo Rate

The RBI has been maintaining a rather dovish stance in the current fiscal year. With the inflation target within the RBI limits of around 5.8% in Jan’ 16, it has sought to boost the credit market by cutting the key repo rate by 75bps from 7.5% in March’15 to 6.75% in September ’15. This has helped the market to borrow at lower rates from both banks and debt/CP markets.

B. Base Rate

The base rate was in the range of 10-10.3% in March’15 has been moving downwards since then to stand in the range 9.30-9.70% on 26th Nov’15. On an average basis it has moved down from 10.15% to 9.5% during this period, a decline of around 65 bps – with October being the turning point. While this transmission was tardy to begin with, it may be observed that over a period of time, it has evened out.

The monthly base rate levels are given in table 1 below

Table 1 : Monthly Base Rate

Month	Base rate(in %)	
	Min	Max
Mar-15	10	10.3
Apr-15	9.8	10.3
May-15	9.8	10
Jun-15	9.7	10
Jul-15	9.7	10
Aug-15	9.7	10
Sep-15	9.7	10
Oct-15	9.3	9.7
Nov -15	9.3	9.7

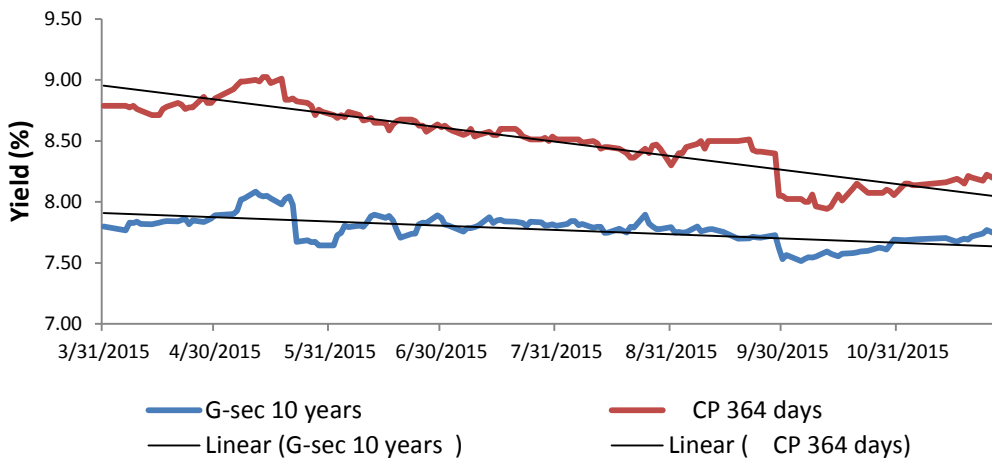
Source: RBI

C. 10-yr G-Sec Yields and Commercial Paper

The 75 bps cut by the Reserve Banks has been transmitted by the financial sector in terms of falling rates for 364 days CP as well as GSec yields. The graph looks at the yields of the two instruments since March’15 to Nov’15.

A continuous decline in yield for 364-days commercial paper suggests that debt market has reacted to the decline in the repo rate faster than banks. Companies also prefer to raise funds via CP as rates in the money market are lower than most banks' base rates. However, the difference did get reduced subsequently.

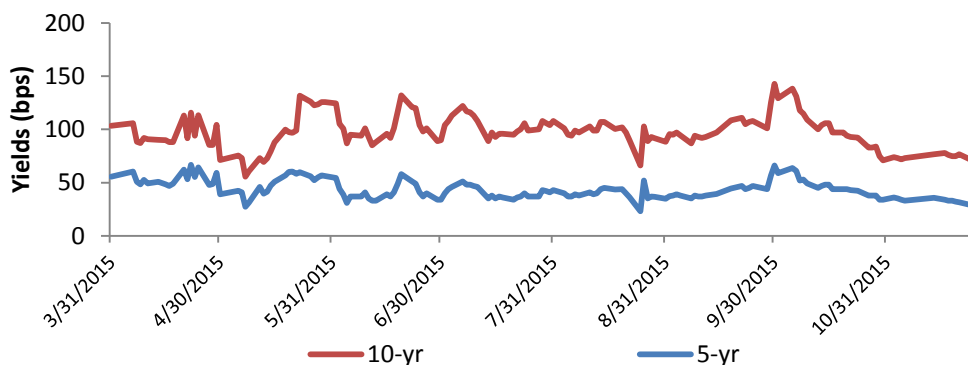
10-yr G-Sec yields have been showing a downward trend as well. However, in the last couple of weeks it has started moving up again, which can mainly be attributed to market expectations of the RBI not altering the policy rate in December as CPI inflation has increased mainly due to higher food prices and will probably also continue to do in the near future. Also, a rate hike decision by the Federal Reserve appears to have been factored in which will be announced next month.



D. Corporate Bond Spreads

A look at the corporate bond spread signals that the yields have been fluctuating to incorporate factors other than interest rate movements. The lowering of corporate spreads since September 2015 is a good sign as it reflects to an extent the improvement in risk perception of highly rated corporate bonds.

Corporate bond spreads for AAA 5-yr and 10-yr bond spreads is given below



Source: FIMMDA

E. Deposit and Credit Growth

A snapshot of the monetary conditions in the economy is given in the table below. The RBI has been trying to boost credit growth by lowering rates. However, the impact on growth in credit has been limited given that demand conditions have not improved significantly.

Table 2: Monetary Indicators-Incremental Growth (1st Apr'15-30th Nov'15)

	o/s 13th Nov'15	FY15 (% Growth)	FY16 (% Growth)
Aggregate Deposits	91.02	6.4	6.7
Bank Credit	68.31	3.8	4.5

Source : RBI

- Growth in deposits was at 6.7% in FY 16 compared with 6.4% in FY15. The incremental deposit stands at Rs. 5.69 lakh crore for the period Apr'15-Nov'15. The high rate of deposit in comparison to credit suggests comfortable liquidity in the economy.
 - However, if the same is reckoned over 13th Nov'14, then growth in deposit has declined y-o-y from 11.4% in 2014 to 11.0% in 2015.
- Growth in credit was higher in FY16 at 4.5% compared to 3.8% in last fiscal year. The outstanding credit stood at Rs 68.31 lakh crore as on 13th November, 2015. Incremental credit was Rs. 2.94 lakh crore for FY16 compared to Rs. 2.30 lakh crore in FY15.
 - On a y-o-y basis growth in credit was 9.7% compared with 10.5% last year.

F. Sectoral Distribution of Credit

A quick look at the sectoral distribution of credit suggests that credit growth in manufacturing and services has been negative despite low base from last year. Agriculture (5.5%) and personal loans segment (5.7%) are the only sectors to have registered positive growth in credit although in case of agriculture the growth is less than last year rate of 8.2%.

Overall, the credit scenario looks subdued in terms of bank lending although there is some substitution seen in lending from the debt market.

G. Inflation

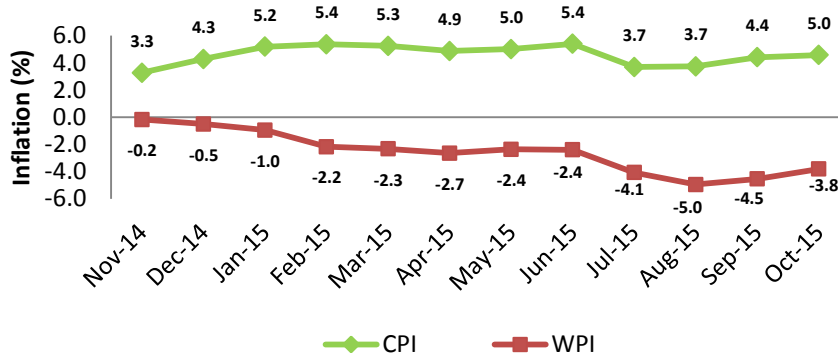
WPI continues to remain in the negative zone since November 2014, and was reported at -3.8% for October'15.

CPI inflation, which is the indicator being used for monetary targeting has been increasing although it remains in comfortable territory. Inflation has been advancing on account of higher food prices given a deficient monsoon for the second consecutive season. The increase in food prices is reflected in soaring prices of pulses and onions. Some respite to inflation numbers have been given by falling international commodity prices.

Table 2: Inflation rates in FY'16

	Aug'15(in %)	Sep'15(in %)	Oct'15(in %)
CPI	3.74	4.41	5.0
WPI	-4.95	-4.54	-3.81

Source : CSO,PIB



What can be expected from the forthcoming RBI policy?

The fifth monetary policy review of the Reserve Bank comes at a time when the global economy is still in a phase of a slowdown, international commodity prices are falling and domestic currency is depreciating amid rising inflationary expectations.

The Reserve Bank of India is unlikely to go for a rate cut in this policy review as it waits to see how inflation prevails in the economy. The key rate decision will be heavily influenced by the anticipated rate hike by the Federal Reserve. Markets have strong expectations of a rate hike by the U.S, already leading to large outflows of FIIs from the economy.

In light of the above, CARE expects that the RBI will maintain a status quo on interest rate levels with repo rate at 6.75%. Given the high liquidity, CRR and SLR will be kept at current levels of 4% and 21.5% respectively.

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