Ecowrap

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CARD TRANSACTIONS REVEAL FUEL SPEND NOW CROWDING OUT DISCRETIONARY SPENDS ~ INFLATION AT 5% COMPARED TO CSO CPI AT 4.6%: LIQUIDITY TO REMAIN IN SURPLUS AS A RBI STRATEGY

Since the beginning of pandemic, the whole world has undergone significant behavioural changes at all levels and India is also not an exception. We expect the Union Budget to encompass such behavioral changes of public. What are such behavioral changes?

To begin with, spending habits of consumers changed significantly during pandemic within essential / non discretionary and non-essential / discretionary items. Interestingly, our most important finding based on SBI credit card spends are primarily two-fold. Firstly, the trends between Apr'20 and Nov'20. In principle, the share of discretionary spending of consumers that had reached as much as 35% of total cards spending in February crashed to 15% in April. Since April, the share of discretionary spends has, however, fluctuated wildly between 15% and 35%. But the most definitive conclusion during April and Nov is that when we re-estimated CPI headline by using Paasche's Index the April and May inflation numbers on an average were 120 bps lower than NSO inflation numbers. For Apr-Nov'20 our computed CPI average is at 6.3%, as compared with 6.9% as per NSO estimates. Secondly, in Dec'20 our CPI computed inflation is, however, higher at 5%, a sharp 40 basis point higher than CSO estimate at 4.6%. This has happened as spend on oil has crowded out in December the spending on other essential items, like health, grocery and utility services which was the trend in earlier months which is worrisome. In fact, the share of non discretionary spend has jumped to 65% in December, the same as before pandemic, but only because of fuel spend.

This demands an urgent cut in oil prices through tax rationalization otherwise consumers' non discretionary spending will continue to get distorted and crowd out discretionary expenses as has been the case in December. This will also impart an upward bias in inflation. Such trend is also deciphered from CSO inflation numbers that shows weighted contribution of spend on urban and rural education is down by around 20-30 basis points which will only go up as educational institutions open up.

Clearly, the budget must make announcements to continue to incentivise the move towards digital transactions. Our transaction data shows that even much **elderly men and women have been using the digital platform more and more frequently during and even long after the lockdown has ended and hence ideally it should be preserved.** Secondly, the budget must also incentivise the jump in household financial savings. This could be done by incentivizing the investments in PPF, Sukanya Samridhi Scheme and through new instruments like infrastructure bonds.

Meanwhile, one of the regulatory changes by the RBI is keeping liquidity in sufficient surplus this year, with the current outstanding level at Rs 5.0 lakh crore as on 20th Jan'21. One thing that is complicating further the liquidity management by RBI is the record dollar inflows to India. **The net excess supply of $ is thus now at a staggering $20.5 bn when we look at interbank and merchant segment.** Interestingly, despite no build-up of excess demand in the forward market RBI has turned into a purchaser of forward contracts as it is giving financial stability a priority. With the US and other advanced nations entering into stimulus programs and an era of easy liquidity looming ahead, RBI Governor has explicitly said that under an uncertain global economic environment, EMEs typically remain at the receiving end. In order to mitigate global spillovers, they have no recourse but to build their own forex reserve buffers perhaps anticipating a rise in the future import demand which had happened in 2009 and RBI had to shift its stance to meet the rising demand of foreign exchange on account of the widening trade deficit and capital outflows in the subsequent period and hence it is building up the reserves.

Ideally, we believe RBI should use MSS to manage liquidity instead of going for VRR as liquidity is lying with insurance companies and mutual funds. On the liquidity front, once a month Rs 20,000 crore OMO may be also required to remove the durable liquidity from the market with preference through SDL OMOs and Operation Twists.

BEHAVIOURAL CHANGES SINCE PANDEMIC

- Since the beginning of pandemic, the world has seen significant behavioural changes at all levels (Governments, Regulators, Individuals, etc.). India is also not an exception and has witnessed many behavioural changes of economic agents with initial lockdown and subsequent reopening of the economy in phases. Such behavioural changes have resulted in a much faster than anticipated economic recovery not only in India but across all other economies. One such behavioural change that could have significant ramifications for future policy making (including upcoming budget) is the penchant of ordinary public, particularly across the elderly, to experiment with digital modes of transaction.
- Let us first appreciate how the spending habits of consumers changed during pandemic within essential / non discretionary and non-essential /discretionary items. Interestingly, our most important finding based on SBI credit card spends is that such change in spending habits has resulted in inflation estimates that are much lower than NSO estimates during April-Nov'20. Owing to the constraints generated due to Covid-19, NSO published limited data of CPI inflation for April and May. However, that was a purely statistical exercise by NSO based on fixed weights of consumer spending (in statistical parlance, this is computed by Laspeyres Price Index) based on Consumer Expenditure Survey. The problem with this analysis, however, is that the share of non-discretionary and discretionary share in consumer spending have changed significantly during the lock-down and even subsequent period and that was not factored in. Our CPI computation exercise employed a variable weight methodology by employing Paasche Price Index technique.

NSO vis-à-vis SBI CPI Inflation (%)

Month	NSO CPI	SBI CPI*	Change in BPS (NSO-SBI)
Apr-20	7.22	5.93	129
May-20	6.27	5.17	110
Jun-20	6.23	6.03	20
Jul-20	6.73	5.94	79
Aug-20	6.69	6.47	22
Sep-20	7.27	6.81	46
Oct-20	7.61	7.41	20
Nov-20	6.93	6.72	21
Dec-20	4.59	4.99	-40

Source: SBI Research; using SBI Credit Cards data

- We re-estimated the CPI inflation since Apr'20 by using monthly credit card spends of SBI credit cards of a sufficiently large sample of customers on a recurring basis across all age groups gender wise and spending that we assiduously bifurcated into non-discretionary and discretionary spends. We used such changing weights for all the months starting from April. In principle, we followed the methodology as Cavallo (June 2020) had employed in his paper by constructing a Covid-19 consumption basket for India and estimate CPI inflation again.
- Our results reveal 2 distinct trends. Firstly, the trends between Apr-Nov'20. In principle, the share of discretionary spending of consumers that had reached as much as 35% of total cards spending in February crashed to 15% in April. Since April, the share of discretionary spends has, however, fluctuated wildly between 15% and 35% indicating consumers are still uncertain when to splurge on items of discretionary consumption, as uncertainty has prevailed in the minds of consumers with different phases of economy opening.
- But the most definitive conclusion during Apr-Nov'20 is that when we re-estimated CPI headline by using Paasche's Index the April and May inflation numbers on an average were 120 bps lower than NSO inflation numbers. For Apr-Nov, FY21 our computed CPI average is at 6.3%, as compared with 6.9% as per NSO estimates.
- But what is important to note is that the gap between the NSO and our computed inflation estimates has been narrowing down from October onwards even as the discretionary spend has not picked up. This signifies that people are still spending mostly on items of non-discretionary consumption. Herein is the importance of our December CPI inflation number, that has actually reversed the trend.
- In Dec'20 our CPI computed inflation is at 5%, a sharp 40 basis point higher than CSO estimate at 4.6%. This has happened as spend on oil in December **has crowded out the spending on other essential items, like health, grocery and utility services that was the trend in earlier months which is worrisome**. **In fact, the share of non discretionary spend has jumped to 65% in December, the same as before pandemic, but only because of fuel spend.**
- This demands urgent cut in oil prices through tax rationalization, otherwise consumers' non discretionary spending will continue to get distorted and crowd out discretionary expenses as has been the case in December. This will also impart an upward bias in inflation.
- Additionally, if we make distinction across gender classes, we find that even much **elderly men and women have been using the digital platform more and more frequently during and even long after the lockdown has ended**. There are also new areas of consumer spending like broadcasting services and even online education among others that can be clearly observed and directly attributed to staying and working from home! Thus, it is important that we don't fritter away such behavioural changes that happened during pandemic.

MEANWHILE LIQUIDITY MANAGEMENT BY RBI CONTINUES

- Liquidity has remained in surplus this year, with the current outstanding level at Rs 5.0 lakh crore as on 20th Jan'21. RBI has recently announced the variable reverse repo (VRR) of Rs 2 lakh crore. Following the announcement on 8th Jan'21, G-sec yield on 5-year has increased by 21 bps and 2-year by 32 bps. At the same time 5-year corporate bond yield has also increased by 15 bps. Meanwhile, 91-days T-bill yield has also increased by 28 bps after 8 Jan'21.
- RBI has to manage liquidity very carefully now as liquidity in the last quarter of a fiscal year generally turns tight owing to higher tax outflows and lower expenditure on the part of the Government to rein in fiscal deficit. So, RBI needs to tread systematically and carefully. We believe that the rollover of VRR is not required on 29th Jan'21.
- Interestingly, 3 categories of debt mutual fund, namely, short duration fund, corporate bond fund and banking and PSU fund have received an incremental flow of Rs 1.35 lakh crore between Jun'20 and Dec'20. Owing to the recent uptick in corporate bond yields, if the corporate treasuries start redemption then the situation will only get worse before it gets better with rollover of VRR or accepting a high cut-off again (3.55% earlier).
- Thus ideally, we believe RBI should use MSS to manage liquidity instead of going for VRR as liquidity is lying with insurance companies and mutual funds. With not much time gap between the Budget and RBI policy, we believe RBI can maintain status quo in liquidity till Jun'21 in both liquidity and regulatory policies as the markets are already spooked. In fact, an advance guidance will be welcome on this definitive time period. On the liquidity front, once a month Rs 20,000 crore OMO may be required to remove the durable liquidity from the market with preference through SDL OMOs and Operation Twists.

BUMPER CAPITAL INFLOWS AND RISING RUPEE

- One thing that is complicating further liquidity management by RBI is the record dollar inflows to India. India has already received $30.6 billion worth of FII inflows in this fiscal and RBI has been mopping up the excess dollars. In the current fiscal RBI has already accumulated $110.5 billion in forex reserves so far. In FY08, forex reserves increased from $200 billion to $309 billion, an accretion of $110 billion and RBI had made net purchases of $78 billion in spot market. However, despite that Rupee managed to appreciate by 7% in that fiscal. This year, too, despite the spot purchases of $58.1 billion, Rupee has appreciated by 3% so far.
- RBI has also been intervening in the forward market and the net outstanding forward sale of $1.7 billion in Mar'20 has turned to outstanding net forward purchase of $13.6 billion. When we juxtapose this with the merchant and inter-bank data we see that in the merchant market (in both spot and forward segment) there was an excess supply of $58.9 billion during Apr'20- Oct'20(till 29th). However in the interbank market the trend is quite opposite and there has been excess demand of $38.4 billion in the same period. Overall, merchant dollar supply is far higher than demand as imports were not picking up. **The net excess supply of $ is thus now at a staggering $20.5 billion.**

Turnover in the foreign exchange market ($ mn)

Month	Merchant			Interbank			Grand Total
	Forward Excess Demand	Spot Excess Demand	Total Excess Demand	Forward Excess Demand	Spot Excess Demand	Total Excess Demand	
Oct'20	-1,876	-12,300	-14,176	-1120	8785	7,664	-6,512
Sep'20	1,257	-7,174	-5,917	4303	2973	7,276	1,359
Aug'20	1,650	-13,461	-11,811	4595	3181	7,776	-4,035
July'20	2,239	-8,466	-6,227	341	7,248	7,589	1,362
Jun'20	1,726	-12,647	-10,921	943	6,354	7,297	-3,624
May'20	1,495	-7,603	-6,108	1,661	-202	1,459	-4,649
Apr'20	1,691	-5,476	-3,785	2,663	-3,326	-663	-4,448
Mar'20	9,343	-4,694	4,649	4,937	-9,601	-4,664	-15
Feb'20	3,053	-8,884	-5,831	1,875	3,693	5,568	-263
Jan'20	4,471	-8,532	-4,061	-628	4,109	3,481	-580
Dec'19	5,897	-11,599	-5,702	2,838	3,520	6,358	656

Source: RBI

- Interestingly, with no build-up of excess demand in the forward market RBI has turned into a purchaser of forward contracts as it is giving financial stability a priority. With the US and other advanced nations entering into stimulus programs and an era of easy liquidity looming ahead, RBI Governor has explicitly said that under an uncertain global economic environment, EMEs typically remain at the receiving end. In order to mitigate global spillovers, they have no recourse but to build their own forex reserve buffers, even at the cost of being included in currency manipulators list or monitoring list of the US Treasury. However, to what extent will RBI be able to prevent the Rupee from appreciating is difficult to ascertain in such a dynamic situation. RBI is perhaps anticipating a rise in the future import demand which had happened in 2009 and RBI had to shift its stance to meet the rising demand of foreign exchange on account of the widening trade deficit and capital outflows in the subsequent period and hence it is building up the reserves.

UNION BUDGET NEEDS TO ENCOMPASS BEHAVIOURAL CHANGES OF DIGITIZATION AND INCREASED FINANCIAL SAVINGS OF HOUSEHOLDS

- A logical corollary of such change in behavioural changes is that we must take steps to inculcate such habits on a permanent basis. To this end, the budget may just be the ideal opportunity to incentivise digital transactions.
- These could be done through a variety of incentives.
  - **First**, the Government may prohibit levying of any convenience fee and other charges on use of any digital mode for making payment to a merchant.
  - **Second**, enabling credit cards as a payment option on UPI platform for customers making payment to merchants (Peer to Merchant).
  - **Third**, expediting the Gazette Notification to allow Aadhaar based biometric authentication to non-bank entities.
- Separately, to fulfil the PM vision of Atmanirbhar Bharat, why not make RuPay as a default card option for all the Banks (including Public and Private Banks) operating in India? Given that the per capita credit card and debit card transactions has jumped by up to 1.4 times compared to pre-covid levels, all Utilities/Municipal Corporations/ULBs must also compulsorily offer digital payment options to citizens to make payments, especially in Tier-2 & Tier-3 Cities and further incentivise them. This has been already implemented by Oil Marketing Companies at fuel stations.

SOME TAX-RELATED SUGGESTIONS TO INCENTIVIZE JUMP IN HOUSEHOLD FINANCIAL SAVINGS

- Increase the limit of **Public Provident Fund Account** and **Sukanya Samriddhi Account** from the existing Rs 1.50 lakh per annum to Rs 3 lakh per annum. For the latter, the tenure of the account may be increased from the current 21 years to 25 years since several girls are going in for higher studies before marriage.
- The ceiling of investment in **Senior Citizens Savings Scheme** should be considered for upward revision to Rs 30 lakh from Rs 15 lakh as retirement benefits have gone up manifold. Moreover, there can be a provision for extending the scheme twice for a three-year block instead of once as is presently the case.
- **Tax Free Bonds:** Banks and Institutions should be allowed to raise tax free infrastructure bonds (preferred tenor 15-20 years) and the exclusive purpose of such resources should be for Infrastructure project finance.
- **Tax Paid Bonds:** Infrastructure financing companies may be allowed to issue tax paid bonds to tap funding from retail investors, wherein the tax on interest income of such bonds will be paid by the Bond issuer @ TDS i.e. 10% u/s 193. Such structure while being attractive to the retail investors, will also ensure that the Govt. is not losing on its tax revenue.
- **Infrastructure Bonds**: Government can consider issuing Infrastructure Bonds against the dues of the Government infrastructure financing companies (PFC, REC, IIFCL, IRFC, etc.) similar to Oil Bonds, fertilizer bonds being issued by Government and may be made part of SLR.

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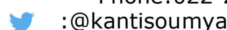
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