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RBI Annual Report

2020-2021

An initial view

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Key Takeaways from RBI's Annual Report

Economy update

RBI's Annual Report for 2020-21 came with a change. A 9-month account instead of 12 months as the RBI aligns its reporting with the financial year instead of the earlier July-June cycle. The broad headlines from the annual report include:

- Revision of GDP growth forecast with consensus towards 10.5% for 2021-22 **(still disappointing given last year's base at -8% indicating ~2% growth over 2 years)**
- MPC in 2021-22 would be supportive of growth while also ensuring inflation remains within target – **suggesting continued accommodative stance balancing growth and inflation**
- When measured by real GDP, aggregate demand contracted 8% Y-o-Y in 2020-21 (a first since 1980-81) and aggregate supply when measured by Gross Value Added (GVA) contracted by 6.5%. Within the supply side, industry contracted by 7.4% in 2020-21, the fifth year of reported sequential deceleration – **indicating the clear decline in both supply and demand**
- The 6.2% CPI in 2020-21 has largely been driven by (1) food and beverages contributing 54.8% to overall inflation and (2) transport and communication. **While fuel has relatively lesser weightage in the CPI, It does have a role in increasing transport pricing thereby impacting every sector**
- The money multiplier stood at 4.7 after adjustment, much below its decennial average of 5.5, **indicating a slowdown in money creation due to passive demand in credit.**
- Credit growth to agriculture accelerated to 12.3% in March 2021 to INR 13 lakh cr, whereas it decelerated marginally by 0.4% to ~INR 29 lakh cr for industry mainly due to **contraction in credit to the larger industries.**

RBI Financial Statements

Metric	YoY change	Reason / Implication and Our View
Loans and advances (Assets)	-59%	Primarily due to repayments of LTRO, TLTRO 1.0 and TLTRO 2.0 by Scheduled commercial banks during the year - July 2020 to March 2021. Repayments by banks helped RBI create base for more OMO operations but higher deposits and lower advances also imply a cautious approach towards consumer spending which could continue to potentially impact aggregate demand in the current year as well.
Loans and advances (Liabilities)	+27%	Primarily due to rise in deposits from Scheduled Commercial Banks by 49%. Increase in deposits may indicate a rising risk aversion among investors
Total Expenditures (Income Statement)	-63%	Reduced provisions allocations resulted in low expenditures thereby also contributing to dividends as high as ~INR 99,122 crores (for 9-month period). Thumb rule for provisions – 5.5% for total assets should be retained earnings while 20.8% of total assets should be the capital of the bank. The 9-month Balance Sheet grew only 7% this period (vs 30% for the full year in 2019-20) due to yoy INR appreciation and also given the reduced period
Other Income (Income Statement)	+69%	Interest income declined on account of fall in interest rates on GoI bonds and foreign securities, while there was a significant increase in 'Other income' due to increase in foreign exchange transactions of INR 20,636cr (potentially done to increase dividend outlay leveraging the change in accounting rule for forex transactions)

Our take on the overall outlook

- **A favorable base effect will come into play boosting FY22 estimates**
- **Revised gross deficit at 9.4% for FY 2022 indicates continued pressure on central and State finances**
- **High Reserves at 104% of debt indicates low risk of BOP crisis like 1991**
- **Capex impetus by the government, rising capacity utilization and the turnaround in capital goods industry can be the driving force behind GDP growth in 2022**
- **RBI will need to use unconventional techniques to strike a balance between (1) inflation, (2) keeping bond yields down and also (3) funding the fiscal deficit**