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RBI INDEPENDENCE OFTEN MISUNDERSTOOD BY INTELLIGENTSIA: FISCAL DEFICIT SET TO BE AT 3.3% IN FY20

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RBI has decided to transfer a sum of Rs 1,76,051 crore to the Government comprising of Rs 1,23,414 crore of surplus for FY19 and Rs 52,637 crore of excess provisions identified as per the revised Economic Capital Framework (ECF).

On a lighter note, the sagacity of Dr. Bimal Jalan and others was palpably evident from the dexterity with which RBI managed the Asian Financial Crisis of 1997 and steered the economy through the turbulent post-Pokhran period. Once again, his wisdom has come to the fore in the report on Economic Capital of the RBI. The fears stoked about "heavens would fall" propounded by scholars has been given a quite burial, given that the dig into contingency reserves to be transferred to the Government is much lower than market expectations.

On a more serious note, questions on central bank independence in India are often misunderstood, as is being currently interpreted in the market. For example, policy independence of central banks refers to goal independence and instrument independence. Goal independence refers to a situation where the central bank itself can choose the policy priorities for stabilising output or prices at any given point of time, thus setting the goal of monetary policy. Instrument independence implies that the central bank is only free to choose the means / interest rate to achieve the objective set by the government. In case of India, the RBI has goal independence as the inflation target, though set by the Finance Ministry (currently 4% +/- 2 per cent), was actually an input provided by the RBI. The RBI also has instrument independence as the repo rate is decided by the MPC only through voting. Globally, most central banks including the Federal Reserve Bank and the European Central Bank have full instrument independence, but not goal. **In effect, the RBI is perhaps the only central bank in the world to have both goal and instrument independence.**

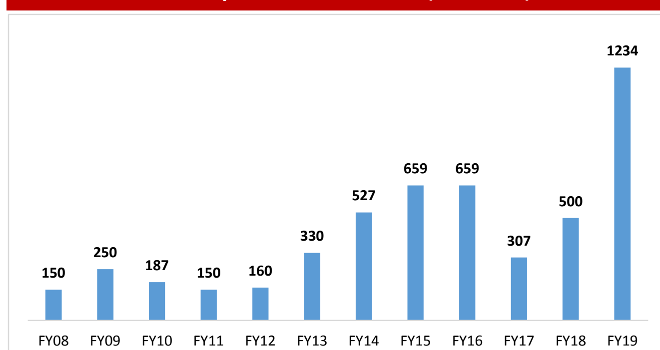
Interestingly at the level of the Constitution, **RBI finds a place in Entry 38 of List 1 of Schedule VII of the Constitution of India "subjecting the Bank's policies to the wisdom of the executive and legislative wings of the Union" (Prasad. R, 2001) .**

Meanwhile, post RBI transfer, we are now increasingly confident that Government will comfortably meet 3.3% fiscal deficit target in FY20, without cutting capital expenditure and this could be growth positive. This can be done through pro rata expenditure adjustments. For example, the PM KISAN scheme could cover 9 crore farmers at the end of FY20 with the validation of data received from states and given that states like WB are still not a part of scheme. **Interestingly, even at 9 crore, the scheme is 24,000 times larger in terms of coverage than any comparable income support scheme across the world!**

RBI SURPLUS

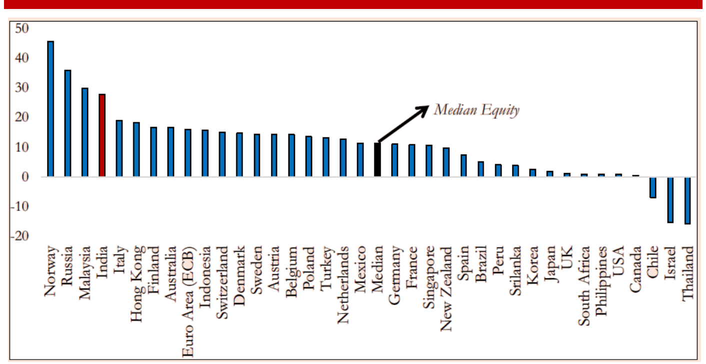
- RBI decided to transfer a sum of Rs 1,76,051 crore to the Government comprising of Rs 1,23,414 crore of surplus for FY19 and Rs 52,637 crore of excess provisions identified as per the revised Economic Capital Framework (ECF).
- The 2016-17 Economic Survey showed that RBI's holding of shareholder equity to its balance sheet size is fourth only to Norway, Russia and Malaysia. RBI's share (around 30%) is way above the median level (around 10%) and most of the Emerging market economies and hence it is one of the most highly capitalized central banks in the world.
- Given the transfer of Rs 28,000 crore as interim dividend in Feb'19, the amount that is left for this fiscal is Rs 95,414 crore as RBI surplus. Since Rs 90,000 crore (estimated) has already been budgeted in Budget 2019-20 as RBI surplus, this means that Government will receive only Rs 5,000 crore as extra surplus. This along-with Rs 52,637 crore of economic capital, accumulates to Rs 58,051 crore as extra fiscal space for Government, equivalent to 0.3% of GDP.
- In the RBI balance sheet, the liabilities side will see some change in the other liabilities and provisions component with some rejigging in the nomenclature. Currency in circulation can go up if the Government spends this money in the short term, thereby boosting demand.

RBI Surplus to Government (Rs Billion)



Source: SBI Research

Equity as % of Central Bank Balance Sheet



Source: Economic Survey 2016-17, SBI Research

EXPECT RBI TRANSFER TO ACT AS A CUSHION FOR GOVERNMENT TO MEET FISCAL DEFICIT TARGET COMFORTABLY

- As per CGA, the Government tax collections for Q1 FY20 show lower collections, specially in case of Corporation Tax and GST collections. However, if we see growth of Q1 FY19 collections compared with Q1 FY18 revenue collection, it was also lackluster. Thus the situation does not seem to be too worrisome. But nevertheless, given the current weak economic conditions tax revenue collection is likely to remain low going forward.
- In case of GST, the collection for the month of Jul'19 has been revised downwards to Rs 93,960 crore from Rs 1,02,083 crore earlier, primarily on account of supply side disruptions owing to natural calamities.
- Going by the GST collected between Apr'19 to Jul'19, GST revenue is likely to fall short of FY20BE by around Rs 70,000 crore, assuming IGST gets divided in 45:55 proportion between the Center and the State.
- **In all, the total tax revenue of the Government might fall of the budget estimates by upto Rs 90,000 crore** given the current economic slowdown.

CAPITAL EXPENDITURE

- The trend of the capital expenditure of the past few years indicates that the Government has exceeded its budgeted capex when it had leeway (by Rs 37500 crore in FY17) and has cut its expenditure below the budgeted as well when conditions were not favourable (Rs 46,600 in FY18). **So this year as well the Government can cut its capital expenditure in case it is needed to achieve its fiscal deficit target. However, we believe this might not happen.**

COMFORTABLE IN MEETING 3.3% OF FISCAL DEFICIT

- **We believe the Government will be comfortable in meeting the fiscal deficit target in current fiscal at 3.3%. This could be easily done through the RBI excess transfers at Rs 58,051 crores as against a revenue shortfall of Rs 90,000 crores, through pro rata expenditure adjustments.**
- For example, Union Government had already announced to extend the PM KISAN scheme to all 14.7 crore farmers in the country, irrespective of the size of their landholding, by approving an extra outgo of Rs 12,000 crore in addition to the Rs 75,000 crore allocated for the purpose. However, the data on "State wise/Installment wise list of beneficiaries counts summary report" published by PM-KISAN Portal shows the number of beneficiaries under the scheme is only 6.89 crore. The figure is coming close to the total number of operational KCC accounts in banking system as on March'2018.
- Slow farmer data validation process could have been the factor behind it. In many states, the uploaded relevant farmer data on the official portal so far is very small as compared to total estimated farmers and **West Bengal continues to shun PM-KISAN**.
- We believe, this may help the Government to save significant portion of the total allotted funding and the scheme's beneficiaries will only number around 9.7 crore in this fiscal unless the list of beneficiaries uploaded by the states expands faster. This will reportedly leave around 5 crore potentially eligible farmers out of the net, which translates into a saving of over Rs 30,000 crore for the Government in FY20.

Capital Expenditure (Rs Crore)

	Actual	Budgeted	Difference
2014-15	196681	226781	-30100
2015-16	253022	241430	11592
2016-17	284610	247023	37587
2017-18	263140	309801	-46661
2018-19	316623	300441	16182
2019-20		338569	

Cost Structure and Number of Beneficiaries under PM KISAN (In Crore)

As per Agricultural Census 2015-16	**Total**
Number of Operational Holdings	14.6
Income Support of Rs 6,000 per farmer per year	Rs 87600
Total Number of Beneficiaries Received 1st + 2nd Instalment as on 26.08.2019	6.9
Total Number of operating KCC accounts as on 31.03.2018	6.9
Source: SBI Research	

Arithmetic of RBI Surplus (Rs Crore)

1. Total Transfer (2+3)	1,76,051
2. Surplus for FY19	1,23,414
2.1 Interim Dividend in Feb'19	28,000
2.2 Remaining Dividend	95,414
3. Economic Capital (EC)	52,637
4. Budget FY20 Provision for RBI Surplus + Dividends of PSBs & FIs	1,06,041
4.1 Of which, RBI Surplus (Estimate)	90,000
5. RBI Surplus (over BE) + EC	**58,051**
6. Revenue Shortfall	**90,000**
7. Revenue Surplus from PM-KISAN & Others	**30,000**
8. Total Surplus (5+7)	**88,051**
9. Impact on Fiscal Deficit	**NIL**
Source: SBI Research	

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