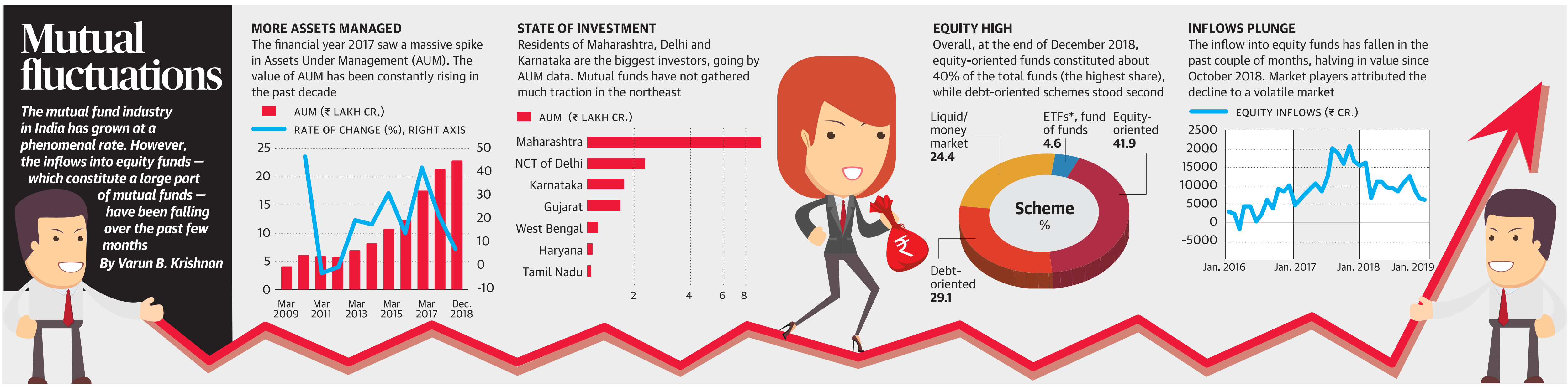


Mutual fluctuations

The mutual fund industry in India has grown at a phenomenal rate. However, the inflows into equity funds — which constitute a large part of mutual funds — have been falling over the past few months

By Varun B. Krishnan

MORE ASSETS MANAGED
The financial year 2017 saw a massive spike in Assets Under Management (AUM). The value of AUM has been constantly rising in the past decade

STATE OF INVESTMENT
Residents of Maharashtra, Delhi and Karnataka are the biggest investors, going by AUM data. Mutual funds have not gathered much traction in the northeast

EQUITY HIGH
Overall, at the end of December 2018, equity-oriented funds constituted about 40% of the total funds (the highest share), while debt-oriented schemes stood second

INFLOWS PLUNGE
The inflow into equity funds has fallen in the past couple of months, halving in value since October 2018. Market players attributed the decline to a volatile market

*ETFs: Exchange traded fund | Source: Association of Mutual Funds in India, CMIE | Graphic: L. Balamurugan

Inflation is tamed, but households don't think so

Identifying the reasons for the gap between perception and reality is crucial to indicate inflation is well under control

AARATI KRISHNAN

While many macro indicators relating to India are all over the place, one indicator that is behaving itself is the inflation rate.

After averaging 10.4% in the five years from 2009 to 2013, CPI inflation for industrial workers (the old measure of consumer price inflation) collapsed to 4.91% in the last five years. The new CPI series flagged off in 2012 shows even more heartening trends. It shows that consumer-level inflation has stayed below 4% for 12 consecutive months now, nosediving to 2% in January 2019.

So, is this record-low inflation getting noticed by ordinary Indians?

Fears moderate

Since 2005, the RBI has been conducting a statistical survey of inflation expectations of Indian households four or five times every year. It quizzes 5,800 selected respondents from 18 cities on their perception of current and future inflation rates.

This survey shows that the proportion of households expecting prices to rise has been falling steadily in the last five years. In fact, just last week, the Monetary Policy Committee cited the sharp decline in household inflation expectations while cutting interest rates.

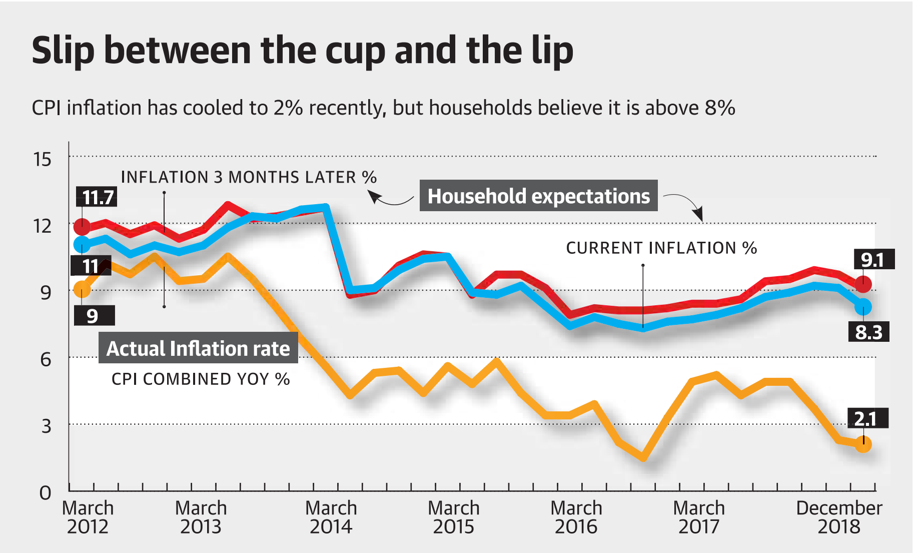
In June 2013, there was near unanimity among RBI's survey participants that prices would rise in the coming months, with 99.1% of the survey respondents bracing for it. But after consistently topping 95% from end-2009 to June 2013, the proportion of people expecting prices to rise began to moderate from the second half of 2013. Hovering at 70 to 80% for the last five years, the proportion stood at 72.9% in the latest December 2018 survey.

The fear that inflation will spiral out of control has receded in the last five years too. In June 2013, 66% of the survey participants believed that prices would rise at a faster rate in future. The latest survey though, showed only 46% expecting higher inflation, with nearly a fifth of respondents even saying that they expected no price rise in the coming months.

But while households seem to be aware of a receding inflation threat, their perception of current inflation rates are at wide variance with the official data.

In December 2018, India's CPI inflation rate stood at just 2.1%. But when asked where the current inflation rate is, RBI's survey participants gave out numbers that averaged to 8.3%. They also expected the inflation rate to be at 9.1% in three months' time and at 8.6% in one year's time.

Comparing the data from RBI's inflation expectation surveys against actual CPI inflation over a decade, it is clear that the gap between perception and reality has been widening. One of the worst spells of inflation experienced by Indian consumers in the past decade occurred in 2013, when official CPI inflation stayed above 10% for four consecutive months from August to November 2013. At that time, households asked by RBI to estimate current inflation rates pegged the number at 12%-plus.



Slip between the cup and the lip

CPI inflation has cooled to 2% recently, but households believe it is above 8%

Source: RBI surveys on household inflation expectations, MOSPI

But after flaring up in late 2013, the CPI inflation rate moderated to 7% by August 2014 and been heading further south in the four and half years that followed. But household estimates of inflation remained stuck at 7-8% in this period.

So, when inflation was sky-high at 10%, Indian households believed it to be 12%-plus. Now, when it is at 2%, they still believe it to be at 8.3%. In effect the gap between actual inflation data and the layman's perception of it has sharply widened.

Why the gap?

So why do Indian households believe that prices are rising at over 8% a year when CPI data shows nothing of the sort? Researchers within and outside the RBI, who have studied the survey over the years, have offered several explanations.

Some suggest that Indian household expectations of inflation tend to be 'adaptive.' That is, when asked about inflation rates or expectations, households base their responses on past data, instead of sticking their neck out on how prices would move in future.

But even if households base their inflation 'predictions' on past data, it isn't clear why they have remained anchored to inflation rates that prevailed a good four years ago.

Others critique the survey questions as being too complicated for laymen to grasp.

Some flag the possibility that 5,800 respondents for this survey don't really represent a broad cross-section of the population. This can certainly be true, as RBI's survey is confined to urban respondents from 18 chosen cities while the CPI Combined captures the inflation experience in rural areas as well.

Rural consumers are estimated to spend far more on food items than their urban counterparts.

Food items, which have been deflating on collapsing crop prices, carry a weight of 54% in the CPI Rural index, but only 36% in the CPI Urban index.

Spending patterns vary

A third and very likely possibility is that the actual spending patterns of Indian households now bear very little resemblance to the weights assumed in the CPI index.

Given that the current CPI series has 2012 as its base year, the weights that it assigns to different items of the household budget are based on spending patterns captured a good seven years ago. Recently, MPC member Ravindra Dholakia argued to replace this outdated method of fixed-base inflation indexing with a contemporary chain-weighted index.

But if it turns out that Indian households are increasingly cutting back on their food budgets to splurge on housing, health, entertainment and education, an index rejig could actually bump up the official inflation rate.

Overall, figuring out the reasons for the widening gap between perception and reality on consumer price inflation, is important for a government keen to convince the electorate that it has succeeded in taming the inflation monster.

RBI needs to crack this puzzle too, to reassure the common man that its hawkish interest rate policies have done him some good

Incubating agro forestry models — an idea blooms

Forum to foster 'emerging industry'

M. SOUNDARIYA PREETHA

The Aadhimalai Pazhangudiyinar Producer Company at Kotagiri is a farmer-producer firm with 1,609 tribal people from the Nilgiris region as its shareholders.

Started in 2013 and incubated by Keystone Foundation, this company currently has four production centres and runs four retail outlets. It sells non-timber forest produce such as honey, amla and coconut, and value-added products, including coffee and pickles, candies, and textiles, all grown or produced by the tribal people. These are sold in bulk to traders and in the retail market.

Expansion plans

"We are looking at business development. We want to expand to cities, probably to Bengaluru first, and increase production. But, all the six directors of the company are tribal people and cannot bring in much investment. Financial institutions will not support us as we do not have assets. All the machinery that we have are given by government agencies or organisations. We are heavily dependent on government support," says A. Sudhir, CEO.

Hence, when the company learnt about the Agroforestry Business Incubation Forum project, which is to be inaugurated at Mettupalayam on February 19, it joined the forum as a member. The incubation facility would have the machinery that the company needs. "We can use the machinery for a fee and need not invest in equipment. The logistics cost will not be high as the facility is at Mettupalayam. We can increase production and in turn, our procurement of produce from the tribals will go up," he adds.

GREEN SHOOTS

The company is one of the 20-plus members enrolled so far with the project. The facility has been set up by the Forest College and Research Institute of Tamil Nadu Agricultural University on its premises at Mettupalayam with ₹2.4 crore financial support from the Entrepreneurship Development and Innovation Institute. The agro forestry business incubation centre is said to be the first-of-its-kind in India. "Agro forestry is an emerging industry with big time opportunities," says Anandan Ramasami, CEO of the Forum.

The centre's aim is to develop entrepreneurship in agro forestry and create business opportunities. It will have a lab and machinery to produce value-added items, equipment to develop products on a pilot scale and a training centre. It will accommodate 20-50 incubatees at a time with an incubation period of about two years.

NBFCs will retain place under the sun

Expect reset in liquidity strategies; non-retail asset quality, a key monitorable

KRISHNAN SITARAMAN

After a steady growth over the past few fiscals, the trajectory of NBFCs (non-banking financial companies) and housing finance companies (HFCs) is set to change again after the latest round of liquidity challenges.

This fiscal, interest rates and borrowing costs started swinging north. This, coupled with liquidity issues faced by NBFCs in the last five months or so, have resulted in funding access challenges.

Measures by the Government of India, the Reserve Bank of India, the State Bank of India, and the National Housing Bank have for sure mitigated the stress to an extent, but it's not business as usual yet.

Cutting disbursements

In the third quarter of this fiscal, non-banks have curtailed disbursements by 20-40%, even more in the non-retail segments. Consequently, growth in assets under management (AUM) is expected to halve in the second half, and lower the entire fiscal's AUM growth to about 15%.

That said, annualised growth of NBFCS in the first half of this fiscal was a healthy 20%, similar to the 18% compound annual growth seen between fiscals 2014 and 2018. This was because of their inherent strengths such as excellent customer relationships, adaptability, local knowledge and innovativeness.

GETTYIMAGES/ISTOCK

Sound liquidity policies will help build resilience to short-term liquidity shocks.

Their share of overall financial system credit, which rose 500 basis points (bps) since March 2014 to 18% in March 2018, is unlikely to change this fiscal, despite the expected moderation in growth. Over the medium term, as access to funding improves, retail asset classes should exhibit a relatively steady growth.

Intense competition

Nevertheless, competition will remain intense, especially from private sector banks and potentially from some large public sector banks, as they find their mojo back after asset quality challenges recede.

Further, wholesale lending, which has been one of the growth engines in the recent times for NBFCs, will decelerate.

This could have second-order effects on the asset quality for this book. Delinquencies could increase, given the fact that credit flow to the sector is slowing down. We also remain watchful of the asset quality in small and medium enterprises financing, especially the loans against property (LAP) segment. That is because of the sensitivity of borrowers to prolonged funding crunch.

Since 2015, stress in LAP has been coming to the fore. With seasoning of the portfolios and reduction in balance transfer cases, non-performing assets (NPAs) in LAP are expected to rise further and cross 3% in the medium term.

However, quality in the traditional retail asset classes such as vehicle finance and home loans is unlikely to be impacted much, given the granularity of loan books.

So where are the major shifts due to occur?

One, there will be a structural shift in the liquidity and liability management of NBFCs. The quantum and quality of liquidity cushion would become a key differentiator, going ahead.

Low interest rates between fiscals 2015 and 2018 led to higher capital market borrowings, especially short-term, by NBFCs.

This led to a mismatch in asset-liability maturity profiles for entities with longer-term assets. While most NBFCs had maintained adequate bank lines for these, access in a timely manner became challenging, putting the spotlight on cash and equivalents in balance sheets. Diversification in bank lines and ensuring steady access to sanctioned bank lines will also be a focus area.

Two, NBFCs are expected to re-orient their resource profile by reducing reliance on short-term borrowings.

Three, while their funding requirement will remain high, commercial banks, saddled with their own issues (both in terms of capital and Prompt Corrective Action framework stipulations), are unlikely to immediately fill the void.

In such a scenario, retail bonds offer an attractive option, but are costlier.

Securitisation

Securitisation has clearly emerged a preferred source of funding of late, with volumes in the first nine months of the current fiscal well exceeding that for the entire last fiscal.

Overall, sound liquidity policies will help build resilience to short-term liquidity shocks, and structurally strengthen the sector.

Amid all this, it's important to note that NBFCs have navigated a few cycles of stress over the past two decades.

While these have caused short-term pain, they have also spawned structural changes after periods of adjustment which have made the sector stronger.

That cycle should repeat yet again, and NBFCs, after a period of adjustment, are expected to continue their key role in the Indian financial system.

(The writer is Senior Director - Financial Sector and Structured Finance Ratings, CRISIL)

INTERVIEW | ARIJIT BASU

'Idea is to strengthen bank's balance sheet'

Govt. spending spurs loan demand, but private investment yet to revive: SBI MD

MANOJIT SAHA

From changes in functions and risk assessment processes to accelerated provisioning, **Arijit Basu,** *MD, State Bank of India, explains the steps the country's largest lender has taken to strengthen the balance sheet: Excerpts from an interview:*

SBI has recorded corporate credit growth of about 20% y-o-y till December. Where is the demand coming from?

■ One is due to low base. Two, we are extending loans to very well-rated and less-risky firms. Growth has come from government's infrastructure spending. We have extended loans to firms like NHAI, SIDBI, Nabard, PFC, REC etc. Other than that, the firms we have given loans to are very good names like HDFC or Bajaj Finance.

Is the momentum continuing this quarter also?

■ We have a pipeline, like highway projects, where we have virtually government guarantee and we have sanctioned a few loans, some of them may get disbursed.

But may be we will not end up with 20% growth. Our guidance is somewhere in the region of 12-15%. Retail has grown very well, and also home loans. For retail, we will end the year with 18-20% growth. The aim is to ensure that the quality of the assets improves.

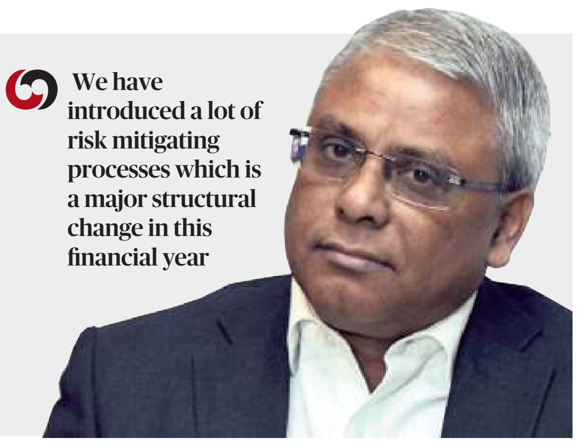
What steps is the bank taking to ensure this?

■ We have introduced a lot of risk mitigating processes which is a major structural change this financial year.

There is now a credit risk review committee for loans above ₹10 crore, before it goes to the sanctioning committee. They do a risk heat map, whether it is high risk, low risk, etc. They can even give a no-go. This is an addition to the credit risk assessment. The idea is to prepare a balance sheet so that it can absorb any shock.

How will you do that?

■ You can achieve that by making upfront provision. In the third quarter, we have utilised ₹5,800 crore of earnings to make accelerated provisioning which we were not required to do. IL&FS for example, we had limited exposure, but whatever exposure we have at the holding company level, we felt that the haircut will be 50%. So, instead of 15% which is all that we were required to do, we have provided 50%. Similarly, we were required to make 40% provision for the power sector projects, but we have made 50% provisioning as we estimate the haircut could be 50%. We will continue to do this process till the balance sheet becomes so strong that whatever happens it will not impact our [profit and loss account].



We have introduced a lot of risk mitigating processes which is a major structural change in this financial year

Slippages have been lower than last year. What is the guidance for this year and the next?

■ This year, slippages are significantly lower. Corporate slippages will be drastically lower compared to last year. Up to December, corporate slippages were less than ₹8,000 crore and total slippages were around ₹30,000 crore. In FY18, corporate slippage was about ₹80,000 crore. This year, total slippages should be significantly lower given the position achieved till Q3. Next year, slippages should come down even more. Even if there are unexpected events, slippages will be within the guidance.

What organisational changes has SBI undertaken to address asset quality issue?

■ We had expanded the corporate accounts group (CAG) to 8 branches in different cities, handling about 500 accounts. Many of these large corporate slippages happened from CAG.

The main purpose for starting the CAG was for better service and solutions to the best-rated and the most-valuable firms. But because CAG was expanded to a level where there were a number of stressed assets, this could not be performed effectively. Now, we have retained only blue chip firms – AA or AAA – in CAG. There are now just four branches. The number of accounts has come down from 500 to 200.

What happened to the other companies in the CAG?

■ We have formed a new group called commercial clients group – CCG. There are 2,500 corporate accounts in the bank, out of which 200 are in CAG and the remaining are in CCG.

Is private investment rising?

■ We have not seen that much of a revival in private investment till now. Whatever is happening in the private side is linked to the government.