Press Release

RBI’s surplus transfer to strengthen the fiscal flexibility of Government

Transparent policy framework for future transfers augur well for institutional credibility

Acuité Ratings believes that RBI’s decision to transfer a surplus of Rs. 1.76 Lakh Cr to the Central Government in the current year will help to strengthen the fiscal position of the Government in the background of the economic slowdown. A significantly higher net one-time inflow of Rs. 1.48 Lakh Cr from RBI (net of interim dividend already paid) will provide an opportunity to the Government to step up public investments without a material slippage in the fiscal deficit target, pegged at 3.3% for FY20. While the mechanics of the transfer are not yet clear, these funds are expected to find its way into the monetary system, improve system liquidity and have the potential to increase the currency in circulation from Rs. 21.6 Lakh Cr currently up to Rs. 23.0 Lakh Cr. Acuité further notes that a significant part of the reported transfer by RBI pertains to the realized profits of the previous fiscal and not out of revaluation reserves based on notional gains. Going forward, such transfers will be driven by a transparent and objective policy framework recommended by the Bimal Jalan Committee and implemented by RBI, which augurs well for institutional credibility.

Acuité expects that the net transfer of Rs. 1.48 Lakh Cr to the Government’s revenue accounts under the head “Interest Receipts, Dividends and Profits” will improve the fiscal position in the context of weaker tax revenues vis-à-vis the projected levels. As a result, the sub-entry of “Dividend and Profits” is likely to reach a level of Rs. 2.2 Lakh Cr as compared to the budget estimate of Rs. 1.63 Lakh Cr, a windfall of Rs. 60,000 Cr as per the estimates of Acuité. The additional flows over the budgeted figures will have a positive impact on the “Revenue Deficit” which may decline to Rs. 4.2 Lakh Cr from the budget estimate of Rs. 4.8 Lakh Cr – a decline of almost 12.5%. It is reasonable to expect that the incremental funds will be invested on capital expenditure, primarily in infrastructure and provide a booster shot to the ailing investment as well as the consumption cycle. In our opinion, the windfall revenues from RBI provides an opportunity to the Government to pursue a path of moderate fiscal intervention while not deviating from the long term goals with regards to fiscal discipline.

The surplus transfer closely follows the RBI’s decision to implement the recommendations of the Bimal Jalan Committee for a revised ‘Economic Capital’ framework. The committee has recommended that the RBI’s core contingency fund (CF) built through retained profits also called as the ‘Realized Equity’ should be within the range 6.5%-5.5% of RBI’s total balance sheet assets. This has been arrived at by the Committee via expected shortfall calculations under a stress scenario with increased risks to financial stability. RBI's current contingency risk buffer under this entry stands at 6.8%. The central board of RBI, however, has decided to peg the contingency risk buffer at the lower band of the recommended levels i.e. 5.5% of the balance sheet assets for now – thus facilitating the transfer of an amount of Rs. 52,637 Cr as excess risk provisions out of the aggregate Rs. 1.76 Lakh Cr surplus transfer to the Government i.e. only 30% of the total is from the CF reserves.

Acuité has further observed that the Bimal Jalan Committee has taken a conservative view of revaluation reserves, the other key component of economic capital. The committee has been of the view that such reserves primarily accrue due to unrealized valuation gains from RBI's currency, gold and investment holdings and therefore is a cushion against only market risks; any surpluses in this regard cannot be subjected to distribution or even used for meeting any shortfalls in other risk provisions.

Under the revised framework, the Committee at an aggregate level has recommended that gross economic capital including both contingency and revaluation reserves be maintained at a range of 20.0%-24.5% of RBI's balance sheet. Given the current economic capital levels of 23.3% and the resilience of the domestic economy, RBI's Central Board has decided to transfer its entire net income for the previous fiscal (July-June 2019) to the Government of India with the confidence that the lower band of 20.0% is adequate to address any systemic risks. This has translated to an additional amount of Rs. 1.23 Lakh Cr, which will be transferred to the Government over and above the transfer of Rs. 52,637 Cr from excess contingency reserves as outlined above. Since an interim dividend payment of Rs. 28,000 Cr has already been paid, the net quantum of transfer to the government budget will amount to Rs. 1.48 Lakh Cr.

Beyond the transfer arithmetic, Acuité is of the opinion that a transparent and objective framework put in place by RBI for transfer of surpluses to the central budget, on the recommendation of the Jalan Committee, is a significant step to address any concerns of subjectivity in this regard. It also notes that given the need to maintain the minimum contingency buffer of 5.5% and the minimum overall economic capital level of 20.0%, RBI's future transfers are likely to be relatively moderate and in line with the balance sheet growth as well as its realized profits for the year.

About Acuité Ratings & Research Limited:
Acuité Ratings & Research Limited *(Erstwhile SMERA Ratings Limited)* is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 6000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Mumbai.

Media Contact:

Suman Chowdhury President – Ratings Ph: + 91-9930831560 suman.chowdhury@acuite.in	Karan Mehrishi Lead Economist Ph: + 91-9910810569 karan.mehrishi@acuite.in

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