Guest Column

Central Bank's Demon Stance Vindicated

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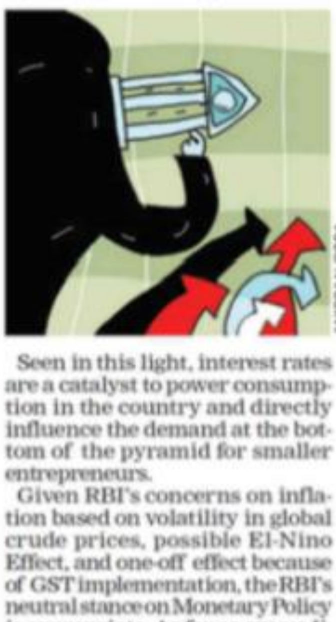
Non-food credit growth in India YOY is quite low at 3.29% as of February 2017, largely led by de-growth in the industry segment, mainly large corporates, which de-grew by 4.89% during the period. But a closer look at a sectoral level shows that credit growth at MSME (including industry and services) and consumer credit have grown 8.61%. But how is it possible that credit is stalled at the large corporate level (which we colloquially refer to as investments), but growing at the grassroots? After all small entrepreneurs derive orders from the large corporates. But this logic tends to see credit growth through the prism of manufacturing sector alone, which represents only 25% of GDP. The explanation is that apart from of a top-down trickle economy, there is a bottom-up consumption economy too.

Out of 609 micro industries financed and tracked by Capital First, only 38% are in the manufacturing sector. The larger entrepreneurship ecosystem is driven today by consumption. Services such as salons, *kirana* shops, trading, chemists, eateries, architects, designers, fuel stations, garages, doctors, travel agents are doing quite well and powering overall credit growth. Decades of loan book built by large corporate loans are getting rebalanced to financing consumption and trading, which is a welcome development.

The other factor is whether demand is affected by demonetisation. Here the data shows that economic activity is back to pre-November levels. Enquiries for loans are a lightning rod for economic activity. CIBIL reports show that retail loan enquiries fell 12% in November '16 over Sep '16, but are now higher over September '16 by 9%. Similarly, CIBIL commercial bureau records show a dip in enquiries of 4% in November '16 but up 29% in February 17.

The sensitivity to lower interest rate is higher at the bottom of the pyramid. A corporate does not choose to put up a plant because interest rates are low, they would bother about larger issues like project clearances at State and Central level. On the other hand, low rate directly affects the monthly repayment capability and hence, a consumer buying a home, or a trader using finance as working capital is likely to avail credit if the interest rate is low enough to afford the EMI. The latent need for goods and services are huge in India owing to an aspiring class, and is hugely elastic to interest rates and corresponding affordability.



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Seen in this light, interest rates are a catalyst to power consumption in the country and directly influence the demand at the bottom of the pyramid for smaller entrepreneurs.

Given RBI's concerns on inflation based on volatility in global crude prices, possible El-Nino Effect, and one-off effect because of GST implementation, the RBI's neutral stance on Monetary Policy is appropriate. As far as excess liquidity due to demonetisation is concerned, the RBI may use any of liquidity tools excepting CRR in the days to come. But sooner than later growth at the grassroots, which is humming along now, can be accelerated and will become a distinct priority.

(The author is chairman at Capital First)