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Monetary policy is losing its sting

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In FY15, every incremental rupee of money supply generated less product

Krishna Kant | Mumbai
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Monetary policy is losing its sting with every incremental rise in money supply generating less growth each passing year. In FY15, every incremental rupee of money supply generated just Rs 1.2 of incremental gross domestic product (GDP). The ratio was 1.6x in early 2000s and 2.2x on the eve of economic reforms in 1991 according to data from the Reserve Bank of India (RBI).

Broad money supply is currency in circulation, deposits, demand deposits plus all kind of fixed deposits.

In all, India's broad money supply including currency in circulation and bank deposits has grown 4.7 times in the last ten years but GDP grew only 2.1x at constant prices and 3.9x at current prices during the period. The culprit is the growing inefficiency of debt. According to RBI data of schedule commercial bank every rupee of bank credit (food+ non-food) yielded Rs 1.9 worth of GDP at current prices in FY15 down from 2.9x in FY05 and 5x in FY91.

This shows in corporate India's finances. For example in the last ten years, the combined debt of the BSE 500, BSE Mid-cap and BSE Small index companies excluding

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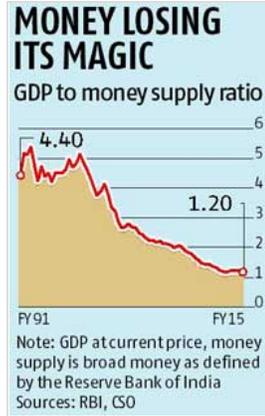
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banks & financials is up 9.2x but their net sales are up only 5.2x during the period. Between financial year 2004-05 and 2014-15, the net sales of the 806 companies in the sample grew at a compounded annual growth rate 18 per cent much slower than 25 per cent CAGR growth in their combined borrowings during the period.



Economists blame it on diversion of bank credit to unproductive uses such as funding non-Plan expenditure in case of the government borrowings plus over leveraging by the corporates. "Credit growth or money supply raises GDP only if it is used to finance productive and economically viable

projects. But for several years now, the government — the biggest borrower — is using debt to finance non-Plan expenditure rather than capital expenditure. On the other hand the corporate sector over-leveraged itself in the boom years and many of the projects are now not yielding desired revenues and profitability," says Madan Sabnavis chief economist ICRA Ratings.

Others blame it on diversion of credit to less productive uses such as real estate, personal loans and highly capital intensive and long-gestation industries such as infrastructure, power and telecom among others. "If you look at the break-up of the credit growth, a majority of the loans in the last decade or so went to these sectors rather than to traditional manufacturing companies that are quick to convert incremental borrowings into operational projects and revenues," says Dhananjay Sinha head institutional equity Emkay Global Financial Services.

For example, in the construction & infrastructure sector, every rupee of debt yielded revenues of Rs 0.64 in FY15. In power, the debt to revenue ratio is 0.5, in real estate it is 0.62 and in telecom it is 1.09. The ratio would fall further if all corporate liabilities including equity are taken into account.

In contrast, the ratio is 3.7 for automobile & auto-ancillaries companies, 2.8 for pharma companies in the sample and 3.0 for cement makers. This has created a wedge between the monetary policy and the real economy. "You see the western countries now have almost unlimited supply of money at almost zero cost but it has neither led to higher demand from consumers nor greater investment by the corporate sector," says Sabnavis.

Instead, this is fuelling assets inflation and speculative investments. "There has been a strong global rally in equities ever since the world's top central banks started their easy money policy. The rally has defied poor economic growth and corporate profitability," says Dhananjay.

The question worth asking is what happens when the GDP to money supply ratio falls below one as is likely to happen soon.

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