Economic Survey-2021: Money Management and Financial Intermediation

January 30, 2021

- **Accommodative monetary policy** during 2020: repo rate cut by 115 bps since March 2020
- **Systemic liquidity** in FY 2020-21 has remained in surplus so far. RBI undertook various conventional and unconventional measures like:
  - Open Market Operations
  - Long Term Repo Operations
  - Targeted Long Term Repo Operations
- **Gross Non-Performing Assets** ratio of Scheduled Commercial Banks decreased from 8.21% at end-March, 2020 to 7.49% at end-September, 2020
- The monetary transmission of lower policy rates to deposit and lending rates improved during FY 2020-21
- NIFTY-50 and BSE SENSEX reached **record high closing** of 14,644.7 and 49,792.12 respectively on January 20, 2021
- The recovery rate for the Scheduled Commercial Banks through IBC (since its inception) has been over 45%

Regulatory Measures in Banking Sector

Commercial Banks

a. Merger of PSBs: Consolidation among another 10 PSBs, with Punjab National Bank, Canara Bank, Union Bank of India and Indian Bank as anchor banks came into effect from April 1, 2020.

b. Restucturing of MSME loans: A one-time restructuring of loans to MSMEs that were in default but ‘standard’ as on January 1, 2019, was permitted, without an asset classification downgrade, subject to certain conditions like aggregate exposure (including non-fund-based facilities) of banks and NBFCs to the borrower not exceeding `25 crore as on January 1, 2019.

The borrowing entity has to be GSTregistered. However, this condition will not apply to MSMEs that are exempt from GST-registration.

c. Large exposure framework:A bank's exposure under the Large Exposure Framework to a group of connected counterparties was increased from 25 per cent to 30 percent of the eligible capital base of the bank. The increased limit will be applicable up to June 30, 2021.

d. Export Credit: The maximum permissible period of pre-shipment and post-shipment export credit sanctioned by banks was increased from one year to 15 months for disbursements made up to July 31, 2020, in line with the relaxation granted in the period of realization and repatriation of the export proceeds to India.

e. Monetary policy transmission: external benchmarking of loans: RBI deregulated the interest rates on advances by SCBs (excluding RRBs).

With a view to strengthen the transmission of monetary policy, the banks were mandated to link all new floating rate personal or retail loans and floating rate loans extended to MSMEs to external benchmarks such as repo rate, Treasury Bill Rate and any external benchmark published by Financial Benchmarks India Pvt Ltd (FBIL).

Banks can offer such external benchmark linked loans to other types of borrowers as well. In order to ensure transparency, standardisation, and ease of understanding of loan products by borrowers, banks were also advised to adopt a uniform external benchmark within a loan category.

Under the external benchmark system, the interest reset period for loans was also reduced to three months with a view to pass on the benefit of reduction in policy repo rate to the borrowers more frequently.

Further, to make the benefit of external benchmark linked interest rate regime available to the existing borrowers (Base Rate/MCLR), banks were advised to provide a switchover option to such borrowers on mutually agreed terms.

Co-operative Bank

a. Revision in the target for priority sector lending: To promote financial inclusion, the overall priority sector lending target for Urban Co-operative Banks has been increased from the present level of 40 percent of adjusted net bank credit (ANBC) or credit equivalent amount of off-balance sheet exposure (CEOBSE), whichever is higher, to 75 per cent of ANBC or CEOBSE, whichever is higher by March 31, 2024.

b. Inclusion of co-operative banks as eligible member lending institutions under interest subvention scheme for MSMEs – issuance of guidelines: All co-operative banks have been advised of their inclusion as Eligible Lending Institutions under the "Interest Subvention Scheme (ISS) for MSMSEs 2018" of the Government. This scheme provides an interest relief of two per cent per annum to eligible MSMEs on their outstanding fresh/incremental term loan/working capital during the period of its validity.

c. Reporting of large exposures to Central Repository of Information on Large Credits (CRILC): Urban Cooperative Banks (UCBs) with assets of `500 crore and above were brought under the CRILC reporting framework. Accordingly, UCBs shall report credit information, including classification of an account as Special Mention Account (SMA), on all borrowers having aggregate exposures of `5 crore and above with them to CRILC.

d. Limits on exposure to single and group borrowers and large

exposures: The exposure norms for single borrower and a group of borrowers from 15 per cent and 40 percent of UCB's capital funds, to 15 per cent and 25 per cent, respectively, of UCB's Tier-I capital.

Further,UCBs shall have at least 50 per cent of their aggregate loans and advances comprising loans of not more than `25 lakh or 0.2 per cent of their tier I capital, whichever is higher, subject to a maximum of `1 crore, per borrower.

e. Submission of returns under Section 31 (read with section 56) of the Banking Regulation Act, 1949 – Extension of time: In view of the difficulties faced by UCBs in submission of the returns due to the ongoing COVID-19 pandemic, the timeline for the furnishing of the returns for the financial year ended on March 31, 2020, was first extended by three months, i.e., till September 30, 2020 and then further to December 31,2020.

f. Amendments to the Banking Regulation Act, 1949, Banking Regulation (Amendment) Act, 2020: The Banking Regulation Act has been amended by the Banking Regulation (Amendment) Act, 2020.

The key changes in the regulatory regime of UCBs pursuant to the Banking Regulation (Amendment) Act, 2020 are as under:

- The Reserve Bank has been given powers over the management of the UCBs, owing to which it can issue directions relating to the management of UCBs including approval for appointment of Chairman / MD / CEO, removal and remuneration of MD / CEO.
- Further, the Board of UCBs would be required to have not less than 51 percent members having special knowledge / practical experience in specified areas.
- The statutory restriction on grant of director-related loans/ advances has been widened and common directorship across banks shall be prohibited as per the provisions of the amended Act.

- The Reserve Bank has been vested with powers of approval of the appointment / removal of statutory auditors of UCBs.
- Provisions of the revised Act will enable UCBs to raise capital by issue of equity/ preference/special shares and debentures/bonds/like securities subject to such conditions as the Reserve Bank may specify on this behalf.
- TheReserve Bank has been empowered to supersede theBoard of Directors of a UCB; though in case of a UCB having operations confined to a single State, in consultation with the concerned State Government.
- TheReserve Bank has been empowered to sanction voluntary/compulsory amalgamation and to prepare a scheme for reconstruction of a UCB with the approval of the Central Government. The amended Act provides for winding up of a UCB by High Court at the instance of the Reserve Bank.

CHAMPIONS online platform for MSME

- In a major initiative, on 9th May, 2020, the GoI launched CHAMPIONS online platform to help and handhold the MSMEs. 'CHAMPIONS' stands for **C**reation and **H**armonious **A**pplication of **M**odern **P**rocesses for **I**ncreasing the **O**utput and **N**ational **S**trength.
- It is an ICT based technology system aimed at making the smaller units big by solving their grievances, encouraging, supporting, helping and hand holding them throughout the business lifecycle.
- The platform facilitates a single window solution for all the needs of the MSMEs.
- It is a technology backed control room-cum-management information system. In addition to ICT tools including telephone, internet and video conference, the system is enabled by Artificial Intelligence, Data Analytics and Machine Learning.

- It is also fully integrated on a real time basis with GoI's main grievances portal CPGRAMS and MSME Ministry's other web based mechanisms.
- As part of the system, a network of 70 control rooms have been created in a Hub & Spoke Model.
- The Hub is situated in New Delhi in Secretary MSME's office. The spokes are in the States in various offices and institutions of the Ministry.
- The GoI has also onboarded public sector banks to provide extended support for finance facilitation/ resolving through CHAMPIONS platform.

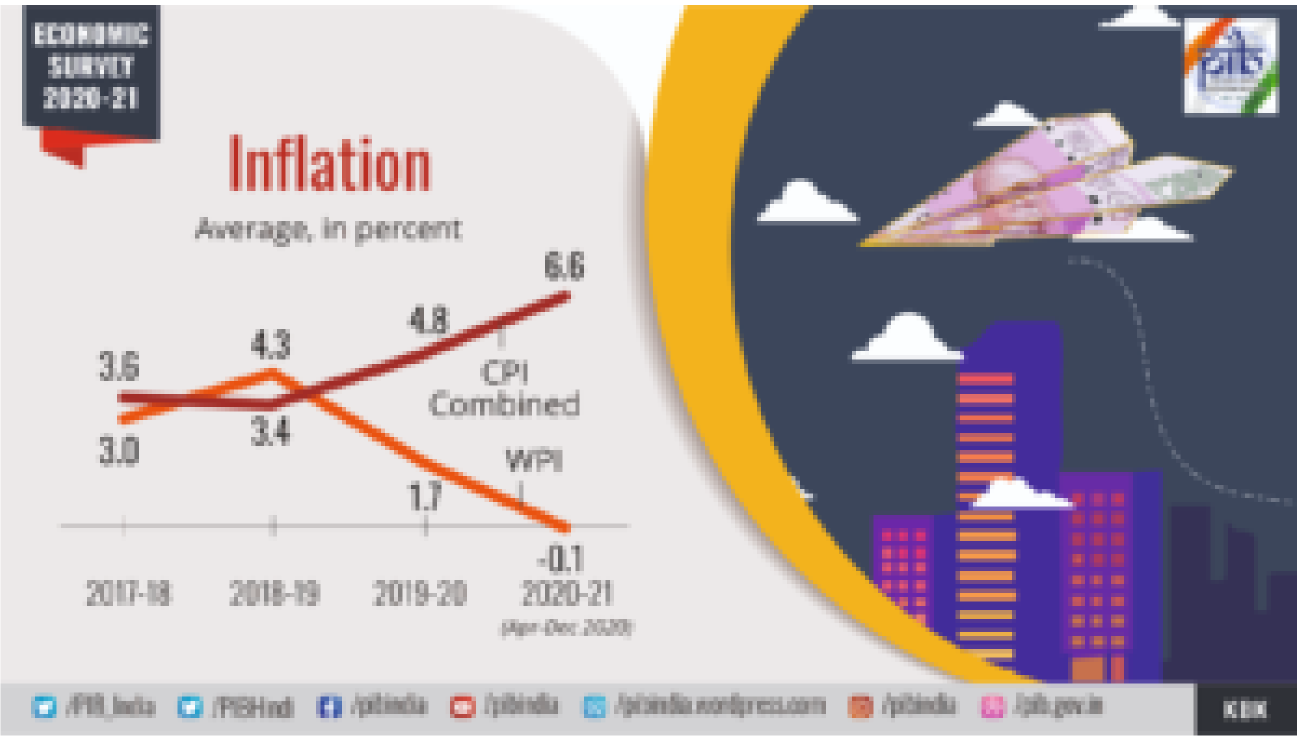
Regulatory Forbearance an emergency medicine, not staple diet!

- During the Global Financial Crisis, regulatory **forbearance** helped borrowers tide over temporary hardship
- Forbearance continued long after the economic recovery, resulting in unintended consequences for the economy
- Banks exploited the forbearance window for window-dressing their books and misallocated credit, thereby damaging the quality of investment in the economy
- Forbearance represents emergency medicine that should be discontinued at the first opportunity when the economy exhibits recovery, not a staple diet that gets continued for years
- To promote judgement amidst uncertainty, **ex-post inquests must recognize the role of hindsight bias** and not equate unfavourable outcomes to bad judgement or malafide intent
- An **Asset Quality Review** exercise must be conducted immediately after the forbearance is withdrawn
- The **legal infrastructure** for the recovery of loans needs to be strengthened de facto

Without Forbearance	With Forbearance

1. If the project is viable, the bank would restructure the asset and downgrade it to a Non-Performing Asset (NPA) and provision for the same.	1. If the project is viable, the bank would restructure the asset. As restructured assets do not require the same level of provisioning as NPAs, inadequate provisions are made.
2.If the project is unviable, the bank would not restructure the loan and declare the asset as non-performing. Crucially, banks do not gain by restructuring unviable projects in this case.	2. Capital-starved banks now have an incentive to restructure even unviable projects to reduce provisioning and avoid the consequent hit on capital.

Prices and Inflation



- **Headline CPI inflation:**
  - Averaged 6.6% during April-December, 2020 and stood at 4.6% in December, 2020, mainly driven by rise in food inflation (from 6.7% in 2019-20 to 9.1% during April-December,

2020, owing to build up in vegetable prices)
        - CPI headline and its sub groups witnessed inflation during April-October 2020, driven by substantial increase in price momentum – due to the **initial disruptions caused by COVID-19 lockdown**
        - Moderated price momentum by November 2020 for most sub groups, coupled with positive base effect helped ease inflation
    - **Rural-urban difference in CPI inflation** saw a decline in 2020:
        - Since November 2019, CPI-Urban inflation has closed the gap with CPI-Rural inflation
        - Food inflation has almost converged now
        - Divergence in rural-urban inflation observed in other components of CPI like fuel and light, clothing and footwear, miscellaneous etc.
    - During April-December, 2019 as well as April-December, 2020-21, the major driver of CPI-C inflation was the **food and beverages** group:
        - Contribution increased to 59% during April-December, 2020, compared to 53.7% during April-December, 2019
        - **Thali cost increased** between June 2020 and November 2020, however a sharp fall in the month of December reflecting the fall in the prices of many essential food commodities

- **State-wise trend:**
        - CPI-C inflation increased in most of the states in the current year
        - Regional variation persists
        - Inflation ranged from 3.2% to 11% across States/UTs during June-December 2020 compared to (-) 0.3% to 7.6% during the same

period last year.

- **Food inflation** driving overall CPI-C inflation due to the relatively more weight of food items in the index.
- Steps taken to stabilize prices of food items:
    - Banning of export of onions
    - Imposition of stock limit on onions
    - Easing of restriction on imports of pulses

- **Gold prices:**
    - Sharp spike as investors turned to **gold as a safe haven investment amid COVID-19** induced economic uncertainties
    - Compared to other assets, gold had considerably higher returns during FY 2020-21
- Consistency in import policy warrants attention:
    - Increased dependence on imports of edible oils poses risk of fluctuations in import prices
    - Imports impacting production and prices of domestic edible oil market, coupled with frequent changes in import policy of pulses and edible oils, add to confusion among farmers/producers and delay imports