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INDUSTRY OUTLOOK

ECONOMIC DIGEST (December 2020)

08 Decemer 2020

1. IMF says global economic recovery may be fading, risks still very high-Mint

The IMF warned the world economy's recovery may be fading as the resurgence of the coronavirus forces fresh restrictions to be imposed on households and companies… noted progress on a vaccine, but elevated asset prices point to disconnect from the real economy and a potential threat to financial stability. "While global economic activity has picked up since June, there are signs that the recovery may be losing momentum, and the crisis is likely to leave deep, unequal scars," officials said. "Uncertainty and risks are exceptionally high."

The UK, Germany and France as well as parts of the US and Australia are among those with new curbs on movement and businesses to contain the pandemic. They're not as stringent as the lockdowns imposed earlier in the year, but are still enough to damage growth. "Countries have started to climb back from the depths of the Covid-19 crisis," IMF MD Kristalina Georgieva said. "But the resurgence in infections in many economies shows just how difficult and uncertain this ascent will be."

2. India's GDP Contracts 7.5 % in July-September -Yahoo News

India's GDP contracted 7.5% in the July-September period in comparison to this period last year. With this, India has performed the poorest among major advanced and emerging economies and entering a technical recession for the first time since independence. The pandemic-induced lockdowns had led to a steep contraction of 23.9% in the GDP for the April-June quarter as compared to the same period a year ago. The two successive quarters of contraction mean that the country has now entered a "technical recession" for the first time since 1947.

The RBI has estimated that the economy will contract by 9.5% for the full fiscal year. The index is constructed from 27 monthly indicators using a dynamic factor model and suggests that the economy rebounded sharply from May/June 2020 with the reopening of the economy, with industry normalising faster than contact-intensive service sectors.

China's economy grew by 4.9% in July-September this year, faster than the 3.2% growth in April-June 2020. After virus-led lockdowns ravaged the globe, the growth recorded by major economies including the United States, Japan and Germany during the September quarter raised expectations that India would also enjoy a revival.

But while consumer businesses saw a boost due to increased spending in the run-up to the October-November festive season, hopes of a broader recovery were dashed, with the construction and hospitality sectors taking a hit...Meanwhile, the IMF has predicted that India's economy would contract by 10.3% this year, the biggest slump for any major emerging economy and the worst since independence. A report by Oxford Economics released earlier this month said that India would be the worst-affected economy even after the pandemic eases, stating that annual output would be 12% below pre-virus levels through 2025.

3. Festival demand underpins India's animal spirits in October-Mint

India's economy showed more signs of a recovery taking hold in October, increasing the likelihood it will exit a pandemic-induced recession in the final quarter of this year. Festival demand helped boost three of the eight high-frequency indicators last month, while three were unchanged and two deteriorated. That kept the needle on a dial measuring so-called 'Animal Spirits' steady at 5 -- a level arrived at by using the three-month weighted average to smooth out volatility in the single-month readings...Activity in India's dominant services sector expanded in October for the first time in eight months. The Markit India Services PMI climbed to 54.1 last month, the highest since February's 57.5, amid renewed increase in new work orders with business optimism also rising. It was also the sixth straight month of gains for the services gauge after hitting a record low of 5.4 in April.

Manufacturing activity continued to expand too, with the PMI rising to 58.9 -- the highest reading since May 2010. This helped the composite index climb to 58 from 54.6 in September. Both manufacturing and services sectors witnessed broad price pressures, which will likely keep the inflation-targeting RBI from resuming interest-rate cuts next month.

Exports lost some momentum last month as a second wave of Covid-19 infections started to hit the global economy. While shipments of drugs and pharmaceuticals along with farm and textiles helped, gems and jewelery, electronic and engineering goods were a drag. Imports remained weak on an annualized basis, but showed improvement from a month earlier as domestic economic activity continued to normalize.

Passenger vehicle sales rose 14.2% in October from a year ago ahead of Diwali. Retail sales too showed signs of picking up, even though they were nearly 60% below the year-ago level.

Demand for loans remained subdued. Credit grew just about 5% in the second half of October from a year earlier, slightly lower than 5.2% in the previous month, and well below the near 9% rates seen a year ago. Tighter liquidity conditions eased a tad in October, with RBI intervention in the foreign exchange market boosting some of the cash surpluses in the banking sector. Industrial production rose 0.2% in September from a year earlier. While production of capital goods declined 3.3% from a year earlier, consumer durables and non-durables rose 2.8% and 4.1% respectively. Although output at infrastructure industries shrank 0.8% in September from a year ago, it was well above the revised 7.4% decline seen in August. The sector, which makes up 40% of the industrial production index, had contracted by a record 37.9% in April.

4. Indian economy to struggle with coronavirus effects through 2025 - Mint

India will be worst-affected among the world's major economies even after the pandemic wanes, with output 12% below pre-virus levels through the middle of the decade. Balance sheet stress that had been building before the coronavirus outbreak will probably worsen. Priyanka Kishore, Oxford Economics projects potential growth for India at 4.5% over the next five years, lower than 6.5% before the virus. "It's likely that headwinds already hampering growth prior to 2020 -- such as stressed corporate balance sheets, elevated non-performing assets of banks, the fallout in non-bank financial companies, and labor market weakness -– will worsen," she said.

“The resulting long-term scars, probably among the worst globally, would push India’s trend growth substantially lower from pre-Covid levels." The IMF predicts GDP will shrink 10.3% in the year to March 2021 as sudden lockdown paralyzed activity. While a sharp rebound is forecast as economic activity resumes, there are lingering scars. HSBC Holdings Plc said India’s potential growth could drop to 5% in the post-pandemic world from 6% on the eve of the outbreak and more than 7% before the global financial crisis. A RBI paper predicted that the economy has entered a historic technical recession.

5. India losing $10.3 billion in taxes per year due to tax evasion by MNCs & individuals: Report - FE

India is losing over USD 10.3 billion (about ₹ 75,000 crore) in taxes every year owing to global tax abuse by MNCs and evasion by private individuals. The State of Tax Justice report said globally countries are losing over USD 427 billion in taxes each year to international corporate tax abuse and private tax evasion. This is costing countries altogether the equivalent of nearly 34 million nurses’ annual salaries every year. USD 10.3 billion, or 0.41 % of the USD 3 trillion GDP, is lost in taxes every year in India to global tax abuse. Of this, over USD 10 billion is lost to tax abuse by MNCs and USD 200 million to tax evasion committed by private individuals.

The social impact of the lost tax is equivalent to 44.70% of the health budget and 10.68 % of education spending. It also equals paying yearly salaries of over 42.30 lakh nurses. India is most vulnerable to illicit financial flows in the form of outward FDI and listed Mauritius, Singapore and the Netherlands as the trading partners which are most responsible for this vulnerability.

6. Special forum likely for foreign investors to ease contract woes - BS

The Centre is likely to roll out a special dispute resolution mechanism for enforcing commercial contracts between foreign investors and the government, particularly public infrastructure projects to establish a consultative panel and appoint mediators to address various domestic issues, both at the central government and state levels. The move follows concerns flagged by overseas investors about the cost and time involved in getting contracts honoured. Public infrastructure contracts are often stuck due to government interventions at various levels even in approved cases… global investors raised the issue of challenges in executing contracts.

While the government has been making incremental changes to the legal regime around enforcement of foreign contracts, several roadblocks remain. Now, the law ministry is in consultation with chief justices of high courts, to designate one or more civil courts as special courts, in order to streamline the process... a separate mechanism is essential as existing commercial courts are not fully operational yet. The impact of the pandemic on the functioning of commercial courts has affected the enforceability of contracts, considering that the frequency at which matters are being heard has been greatly reduced ever since courts in India suspended physical hearing to reduce the risk of spread of virus.

7. $271 bn consumer spending to shift from cash to cards, digital payments by 2023 in India: Accenture-ET

About 66.6 billion transactions worth USD 270.7 billion are expected to shift from cash to cards and digital payments by 2023 in India, and further increase to USD 856.6 billion by 2030. This rapid shift to digital payments due to the COVID-19 pandemic is urgently increasing the need for banks to modernise their payment systems, Accenture’s report, titled 'Playing the Long Game in Payments Modernisation', said.

The report is based on a survey of 120 payments executives at banks globally regarding the transformation of their payments business, as banks make multi-year investments to compete with non-bank digital-payments providers and comply with new regulations…forecasted that nearly 420 billion transactions worth USD 7 trillion, globally are expected to shift from cash to cards and digital payments by 2023 - and increase to USD 48 trillion by 2030. "In India, 66.6 billion transactions worth USD 270.7 billion are expected to shift from cash to cards and digital payments by 2023 - and increase to USD 856.6 billion by 2030," it said.

The rapid move to digital payments has put additional pressure on banks, with three-quarters (75 %) of surveyed bank executives saying that the pandemic has increased the urgency of their plans to modernise payment systems. "COVID-19 has accelerated the shift to digital payments at a pace banks could not have predicted. The pandemic will permanently change how consumers shop and pay for products as they prioritise convenience above all else," Sulabh Agarwal, Accenture's Payments said.

While banks' investments in new payments systems have focused primarily on meeting compliance deadlines, the way they will drive value moving forward is by embracing the changing consumer dynamic and improving the customer experience. "While India has been ahead of the curve in terms of real-time digital payments infrastructure driven by UPI and 24x7 NEFT, the pandemic has led to a further increase in digital, contactless payments as consumer behavior has undergone a shift," Sonali Kulkarni, said.

With newer players launching their payments offerings and increased uptake of 'Buy Now Pay Later' schemes, consumer experience and convenience is bound to improve significantly. "Banks in India have been making multi-year investments to modernise their payments systems, and going forward, we expect them to strengthen these investments to scale up and improve the resilience of their digital payment operations," she said.

8. Financial Support To Turn Around The Indian Economy-BW

Just before Diwali, the Centre came out with the third tranche of the economic packages it has announced since March to bolster up the Indian economy in the face of a slowdown made worse by a globe encompassing pandemic. The Union FM gave another nudge to a floundering economy to add to the festive cheer. Christening the new package Atmanirbhar Bharat 3.0, FM said the economy was 'seeing strong recovery', and Covid-19 active cases were on the decline. The fresh measures are expected to help sectors that have been the worst hit by the pandemic and the lockdown. Some such measures are directed at infrastructure and construction projects, which, the government hopes will be expedited, to help create jobs. The announcement came close on the heels of the Cabinet approval for the Production-Linked Incentive (PLI) scheme for ten sectors announced on 11 November, 2020.

9. India to spend $27 billion over 5 years to boost manufacturing-ET

India's cabinet approved a proposal to provide production-linked incentives of about 2 trillion rupees ($27 billion) over five years to create jobs and boost manufacturing...in 10 sectors including automobiles and auto parts, pharmaceuticals, textiles and food products to attract investment. The scheme has been designed to ensure that "critical sunrise sectors get necessary support from the government so we are able to build an India which is strong enough to serve the domestic market and link up with the global value chain," FM Sitharaman said… the government will give incentives worth $7.67 billion to auto and auto parts companies, $2 billion to the pharmaceutical sector and around $1.48 billion each to manufacturers of textile and food products.

The plan is the latest attempt to boost manufacturing -- one of the weaker links that has limited its economic growth and exports. A lack of incentives, issues in procuring land and archaic labour policies have discouraged investment. The government in Sept. cleared long-delayed labour reforms.

10. India likely to report current account surplus for current fiscal year: Adviser - CNBCTV18

India is likely to report a current account surplus at the end of the current financial year ending in March 2021, mainly led by a fall in imports. India's current account surplus rose to a record USD 19.8 billion in April-June as its trade deficit narrowed sharply. Demand for imports has fallen amid the COVID-19 pandemic, coupled with recent economic reforms initiated by the government to boost manufacturing.

11. Small firms seek big bailout plan - Mint

Thousands of small and medium-sized companies in India have missed loan payments and are staring at a prolonged period of distress owing to the pandemic while the larger ones have held their ground and, in some cases, thrived. MSME make up the overwhelming majority of companies that are seeking easier loan repayment terms from banks under the RBI's special restructuring window for those affected by the coronavirus pandemic. SBI has received recast requests from 35,000 MSME borrowers. That apart, 2,600 borrowers have applied for a restructuring of their personal loans and another 4,291 home loan customers have asked for recast. However, as banks have till 31 December to agree on resolution plans, SBI expects an additional restructuring of ₹13,000 crore worth of loans. Rival public sector banks are reporting similar trends. Most of the requests received are from small businesses.

12. Bank credit rises by 5.67%, deposits up 10.63%: RBI data - ET

Bank credit grew by 5.67 %to ₹104.04 lakh crore, while deposits increased by 10.63 %to ₹143.80 lakh crore in the fortnight ended November 6. In the fortnight ended November 8, 2019, bank credit stood at ₹98.46 lakh crore and deposits at ₹129.98 lakh crore. In the previous fortnight ended October 23, 2020, bank credit had risen by 5.06 % and deposits by 10.12 %. On a year-on-year basis, non-food bank credit growth decelerated to 5.8 % in September 2020 from 8.1 % in the same month of the previous year. Credit to industry recorded 'nil' growth in September 2020 as compared to 2.7 % rise in September 2019. Credit to agriculture and allied activities rose by 5.9 % during the reporting month, as against a growth of 7 % in this month last year. Loan growth to the services sector accelerated to 9.1 % in September 2020 from 7.3 % in September 2019.

13. RBI working group suggests permitting large NBFCs to convert into bank - Mint

The internal working group of RBI suggested that large NBFCs can convert into banks if they fulfil certain criteria. "Well run large NBFCs, with an asset size of ₹50,000 crore and above, including those which are owned by a corporate house, may be considered for conversion into banks subject to completion of 10 years of operations and meeting due diligence criteria and compliance with additional conditions specified in this regard," RBI recommended. RBI had constituted an internal working group on 12 June to review extant ownership guidelines and corporate structure for Indian private sector banks. India has 9,601 shadow banks, of which the top 50 account for 80% of market share by loans.

Between 31 March 2009 and 31 March 2019, the total assets of NBFCs grew at a compounded annual growth rate of 18.6%, while the balance sheets of scheduled commercial banks grew at a rate of 10.7%. The aggregate balance sheet size of NBFCs increased from 9.3% to 18.6% of the aggregate balance sheet size of scheduled commercial banks during the corresponding period. In absolute terms, the asset size of the NBFC sector (including housing finance companies), as on 31 March, 2020, is ₹51 lakh crore. RBI has increased its vigilance over the NBFC segment following last decade's high growth.

14. Big business houses may soon promote banks - FE

In a significant shift of stance, large corporates and conglomerates could own banks if the suggestions of an Internal Working Group (IWG) constituted by the RBI are accepted. The IWG recommends sweeping changes and easier rules that could altogether alter the Indian banking landscape with the presence of many more banks of all hues, e.g., large, well-run Non-Banking Finance Companies (NBFCs), with an asset size of ₹50,000 crore and above could become banks post 10 years of operations once they pass the due exercise. These could be owned by a corporate house so a Bajaj Finance, L&T Financial Holdings or an M&M Financial could make the cut. Many NBFCs have been keen to turn into banks as it would give them access to cheap CASA deposits even if meeting statutory ratios are initially expensive. RBI may prefer NBFCs become banks as they could then be better regulated and subject to more regulations. A final stake of 26%, as the IWG suggests, up from the current 15% could be a sweetener.

15. Government notifies guaranteed loan scheme for stressed sector - Business Line

The National Credit Guarantee Trustee Company Limited (NCGTC) formally informed banks and Non-Banking Financial Companies (NBFC) about expanded Emergency Credit Line Guarantee Scheme (ECLGS) 2.0. This is a follow-up to FM's announcement on November 12. While the first version of the scheme will remain, the new version will cover entities in 26 stressed sectors identified by KV Kamath Committee plus the health care sector, with credit outstanding of above ₹50 crore and up to ₹500 crore as on Feb 29. In both versions, 20 % of the credit dues will be given as working capital without any collateral. The rate of interest charged by banks will not exceed by 9.25%.

16. RBI commences first Test Phase of Regulatory Sandbox retail payments - HBL

RBI said two entities — Natural Support Consultancy Services Pvt Ltd, Jaipur and Nucleus Software Exports Ltd, New Delhi — started testing of their products under its 'Regulatory Sandbox (RS) - First cohort on Retail Payments - Test Phase' from November 16. RS usually refers to live testing of new products or services in a controlled and test-regulatory environment for which regulators may (or may not) permit certain regulatory relaxations for the limited purpose of the testing. Natural Support Consultancy Services' product 'eRupaya' is a set of Near-Field Communication (NFC) based Prepaid card and NFC-enabled Point of Sale (PoS) device to facilitate offline Person-toMerchant (P2M) transactions and offline digital payments in remote locations. The offline digital cash product, 'PaySe', of Nucleus Software Exports will help connect with rural areas for e-payments.

The product proposes to help in digitisation of payments in rural areas, starting with Self Help Groups (SHG), through an offline payment solution and a digitised SHG-centred ecosystem. The RBI received applications from 32 entities of which six where selected for the 'Test Phase'... commencement of testing was delayed because of Covid-19 situation. Two entities have started testing of their products from November 16, 2020. The remaining four are expected to start the test phase shortly.

17. Banks may prefer NPA route to recast for stressed debts-FE

Banks are likely to declare stressed accounts as NPAs in the second half of the current financial year rather than provide relief to borrowers under debt restructuring scheme. Many lenders including SBI have guided for a lower restructuring estimate till Dec'2020… banks may be dissuading corporate borrowers from restructuring their loans.

Current debt restructuring circular of the regulator has a problem in that it is delaying the reversal of the provisioning for the banks as compared to normal NPA restructuring. Even though banks have to provide only 10% for recasting a loan under debt restructuring scheme, the reversal of provisioning will take a lot of time. A borrower needs to make 30% debt repayment to bank for reversing the whole provisioning, as per August 6 circular of RBI. But if the bank declares an account as NPA, the borrower still has an option of availing debt restructuring under June 2019 circular of RBI and if you do restructuring of an NPA, though you need to make a 15% provisioning, but it will be upgraded, if the borrower just pays 10% of the amount.

In case, one-time restructurings are not actively invoked for resolution, there would be a large number of rating downgrades in Jan'21 and NPAs may rise from Q4 of the current FY… debt restructuring will be less than 1% of SBI's total advances of Rs.23.85 lakh crore. Similarly, PNB and Union Bank of India have halved their targets for restructuring to less than 3% of the loan book.

18. With LIBOR set to cease by 2021, RBI plans new Indian benchmark - Indian Express

RBI is going ahead with its plan to work out a new benchmark to replace Mumbai Interbank Forward Outright Rate (MIFOR) as the London Interbank Offered Rate (LIBOR) — the global benchmark for borrowings — is expected to cease after end-2021. "With the cessation of LIBOR, an alternate to MIFOR will also need to be developed," the RBI said. In 2012, the most widely used global financial benchmark, the LIBOR, was found to have been manipulated by individuals at various financial institutions, creating shock waves in the financial system. In India, MIFOR — which has LIBOR as one of its components — is a key benchmark used in the interest rate swap (IRS) markets.

19. FATF High risk and other monitored jurisdictions – RBI Press Release

The Financial Action Task Force (FATF), vide public document 'High-Risk Jurisdictions subject to a Call for Action' dated October 23, 2020, has called on its members and other jurisdictions to refer to the statement on these jurisdictions adopted in February 2020. FATF has further identified the following jurisdictions as having strategic deficiencies which have developed an action plan with the FATF to deal with them. These jurisdictions are: Albania, The Bahamas, Barbados, Botswana, Cambodia, Ghana, Jamaica, Mauritius, Myanmar, Nicaragua, Pakistan, Panama, Syria, Uganda, Yemen and Zimbabwe. Iceland and Mongolia are no longer subjected to increased monitoring based on the decision made at the October 2020 FATF plenary.

FATF plenary releases documents titled "High-Risk jurisdictions subject to a Call for Action" and "Jurisdictions under increased Monitoring" with respect to jurisdictions that have strategic AML/CFT deficiencies as a part of the ongoing efforts to identify and work with jurisdictions with strategic Anti-Money Laundering (AML)/Combating of Financing of Terrorism (CFT) deficiencies. Such advice does not preclude the regulated entities from legitimate trade and business transactions with the countries and jurisdictions mentioned there.

20. Raghuram Rajan's Message To India: Fix Structural Issues in Banking, Don't Take Shortcuts - Bloomberg

India will have to reform its banking sector the arduous way by addressing structural problems and not through "shortcuts" like opening up the sectors for corporates, former RBI Governor Raghuram has said… A RBI -constituted internal working group has proposed sweeping changes to the banking sector like allowing corporate houses to own banks and letting payments banks transition to a full-fledged lender. Rajan and former RBI DG Viral Acharya have both together questioned the timing and necessity of the proposed changes. Let me start by asking you where the worry stems from.

This is an idea that was on the table in 2013 but when the final licenses were given out, cooler heads prevailed and we didn't allow the entry of corporates into banking. Does it worry you that the idea is back on the table or does it bother you more contextually, given where we are in the financial system in India and the economic realities?

Raghuram Rajan: Both. At the end of that licensing process when we set out the terms for longer term on-tap licensing we had indicated from the RBI that, perhaps, it would be wise not to let full-fledged corporates that is, industrial houses whose primary business was industry or non-finance activities, into banking. We had left some room for houses that were primarily financial companies to enter banking. So, it's not as if all industrial houses are prohibited, it's just those that are primarily outside of the financial business.

We looked at the experience in other countries as well as our own. The temptation for industrial houses to lend to themselves, what is called self-lending, is significant and, of course, this happens more in bad times when the industrial house is in trouble. That's really a time when the bank should be exercising tremendous caution on who it's lending to and how much it's lending. If you're owned by a borrower, it's very hard to make that distinction. Previous episodes of allowing this—in the U.S. this is called banking and commerce, but across countries where there's been banking and commerce, there's been pretty severe crises. That does not mean that there are no good industrial houses that will stay independent but the conflicts of interest are significant.

So that's one reason why this has been prohibited in many countries and also in India. The second reason is that it creates an undue concentration of economic power. People put their money in banks, they think it's safe. If you own a bank and you need the money, well, it's very easy to get the money. As an industrial house you can grow significantly based on owning a bank and that makes you enormously powerful—economically and also to some extent politically. This is one other reason why banking and commerce has been frowned upon in other countries. Let's keep the financial side separate from the industrial side, that allows for more competition on either side and eliminates the conflicts of interest. So, for sound reasons the RBI historically has not permitted it.

There was a short episode when the first banking licenses were given out, when in fact the rules had been changed. Based on the experience during that time, we decided there were plenty of good possibilities outside the industrial house sector for new banking licenses and there was no need for the amendment so we changed the rule back to what it was before.

On principles, the report speaks of the fact that even in markets like the U.S. there is debate about the separation of banking and commerce. But from your vantage point, have you seen that debate evolve to any point where that line would be breached?

Well, typically, it hasn't been allowed in the United States. There are stray instances of small entities owning a bank, sometimes at arm's length, but in general you haven't had the mega conglomerates which combine industrial houses along with strong banks. In places like Japan, we had that we had the Zaibatsu, which were basically industrial combines around the house bank, and there was a belief that it was the strong Zaibatsus which led Japan into World War II.

The concentration of economic power also meant a concentration of political power and it led to dictatorial tendencies that drove Japan into war. In fact, post-World War, the U.S. administration focused on breaking up the Zaibatsus. Similarly, in Germany, the post-World War II, U.S. administration broke up the large combines and arguably that helped the German democracy post-World War II. So, this is an old debate, self-lending is part of the issue and it's important in India where the ability to regulate and supervise is still a work in progress.

Apart from the financial risks and stability issues, is the economic concentration issues. In India as we have some industrial houses gaining tremendous economic power, it's an issue which has to constantly be examined and it's one reason why we had this rule on the table. So, simply saying that we will amend the Banking Regulation Act, simply saying that we will work on consolidated supervision or we will perhaps bring stronger arm's length principles, or exposure norms, etc, those are not adequate to address the inherent challenges in such a model?

You've seen the difficulty in India in determining connectedness. Who is connected to whom? We know, in the past, of entities supposedly bringing in equity into a venture but, in fact that equity has been borrowed by somebody else within the group. So, when things are still quite murky, when we have only modest confidence in accounting, when we are working on making sure supervision is stronger and we have minute by minute evidence of where the money is flowing....When we don't have any of this really in place, simply laws will not make a difference.

You can exhort to all you want and criminalise some of these transactions but they still take place. The reality is that, until we have much greater confidence, and even then, what is the reason you need this, right? If you want more talent in banking from the private sector, you can always create more banks but they can be opened by professionals, they can be opened by financial houses, they can be opened by industrial houses that are largely in finance and there are a number of those.

There's plenty of opportunity you haven't exploited yet. So, the question is, why do you need to get the license now? Who is there knocking on the door at this point, who says, I want a license? Are you doing it only for a few or is it because this is in the larger interests of the country over the longer term?

So, you don't buy the argument that this is, at some level, frustration with the inability to expand banking capacity in the country?

We've had on-tap licensing for a while, there has been one application. So, there does seem to be a lack of interest in the existing stakeholders to come into banking? Yes, but I would argue that if you look at credit growth, it's fallen tremendously amongst the public sector banks. So, if you want to fix that why not look at your public sector banks and ask what's gone wrong? What is it that can be remedied here in order to increase credit growth? Why do you have to bring in a whole new set of banks to get that growth?

The problem sometimes lies in thinking that there are shortcuts to the longer run issues of how do I improve credit growth, how do I improve credit information, how do I improve credit recovery? We've had this reform of the IBC. Now the IBC is suspended and even while it was working it was slowly increasing the delays in recovering the money. So, I mean, think about the framework and start fixing the framework. That's tough. That requires more work. It's not a shortcut. Shortcuts could get you into even bigger problems than you are in today.

It is true, India's credit to GDP is very low but India's NPA to credit is very high. How with such low credit to GDP, do you have such high NPAs? Ask that question before you ask a conflicted set of bank owners to come in and possibly add to the load of NPAs.

Shortcuts are the bane of our system. Let's take the long path to figure out what's going wrong and fix it and that requires hard work and that work can be done. We've done it before. We need to do it now.

One theory to the 'why now' is that the government wants to privatise PSU banks. It's not clear who are these investors who would come in and buy even minority stakes.

The whole point of nationalisation was in some sense to expand the access to credit. We can debate till the cows come home whether that was successful or not, but we do have to ask was that a fantastic system beforehand. In the pre-independence days when you had the management houses and so on, we had fairly close networks within which credit circulated and that didn't do wonders for everybody else.

I am willing to believe there are some corporates who are going to be the next Ant Financials and create a tremendous amount of new lending etc. But that's when we also have to ask, are these the same corporates who are huge in the country already and can we afford the kind of concentration of economic and political power that means? I mean, I think that we need to ask all these questions before we say this is the one answer.

If we want to do a good job on privatising the public sector firms, you have to improve governance. There is no shortcut to that. You can't give it to somebody else and say I'll give you a full-fledged bank with all the access to funds and you fix it. Because it could be fixed in very bad ways, especially if you have a conflicted owner. Give it to somebody who already has huge debts and they will find a way to make those debts paid down or borrow from the banks to pay down those debts and even expand.

So, our controls on some of these large industrial houses and what they do is limited and, in that scenario, this is playing with fire.

The governance problems are ownership agnostic, which admittedly has been true. We've seen governance problems in PSU banks, we've seen governance problems in private banks, diversified private banks, promoter held private banks. But surely that's not enough reason to say that okay, there are governance problems everywhere so let's just open it up to segments where governance problems could be worse.

I think you have to be careful. Some old private banks, which are very narrowly focused in terms of the holdings and often are focused on specific communities, there's a long history of those governance problems. Some of them have made the transition into much more modern banks and have done very well. Banks like Federal Bank and so on. So, I think it is possible to transform them but they're really quite small and therefore not a huge issue. Over time, the ownership has changed and some of them have improved.

On the large private banks especially the widely held private banks, yes, there have been some very well publicised incidents of mis-governance in a couple of them but if you look at the size of the NPAs, the size of the problems in those banks, they are relatively limited compared to the size of the problems of the public sector banks. So, I think in terms of magnitude of the mis-lending or the poor lending, the public sector banks are much higher.

It's not just the infrastructure sector. If you look at this small and medium sector lending, that's where a lot of problems are starting to emerge and the size of the NPAs in that lending [needs to be watched]. Some of these loans are quite recent and when you make recent loans it takes time for them to go bad. Now the size of the NPAs in MSME lending is increasing significantly in public sector banks. So, I would say the number one governance problem is in the public sector banks. Clearly, we have to improve governance across the board but I think it would be wrong to characterise the size of the governance problems in the private banks as equivalent to the size of the problems in the public sector banks.

One issue, of course, is the direct licenses to industrial houses. The second is sort of a backdoor entry. One is via payment bank conversions and the second is via conversions of NBFCs which belong to large corporate houses. While the working group has given a list of to-dos before such conversion is permitted, they don't make it contingent upon the Banking Regulation Act for instance being amended. Do you think are risk to backdoor entry of corporates into banking?

When we thought of payments banks, these license were meant as a way to get payments and inclusion done by potentially industrial houses, including some telecom houses but with no access to credit. Everything that they collected had to be put either in deposits at the scheduled banks or in government securities. So that was a way of ensuring they would be safe and they would focus on payments. If they wanted to make loans they could tie up with a bank and actually some of them applied for alliances jointly with banks. I haven't kept track of how that is progressing. So that was the idea behind payments banks.

Now sometime later in 2018 or 2019 they said, okay payment banks, after five years we will consider you for a banking license. However, I think that meant only for payments banks that were run by financial companies. The idea was okay we've seen how you handled money. We have more confidence, now we think you can possibly start lending.

Both payments banks and small finance banks were thought of as 'proving grounds' for entities to learn the business of banking to show they were good and after they showed they were good, they could migrate to a banking license if they were thought fit and proper at that time.

So, all this was only for financial sector companies not industrial houses. The assumption that industrial houses are now eligible if they hold a payment bank license, I think is wrong. They would still be prohibited if they are industrial houses from migrating from a payment bank to a full-fledged universal bank or a small finance bank. However, with this amendment, if it is approved by the RBI, then there will be nothing standing in the way of getting a payment bank license, spending three years, then applying for a universal bank license. NBFC conversion has the same problem.

The whole advantage of banks comes from offering deposits because the public thinks deposits are safe no matter who offers them. Finance companies, NBFCs can't offer deposits, not the short-term deposits that banks can. So, they are distinguished from the banks. So, industrial houses can operate NBFCs but when it comes to deposit taking, we should put a barrier because otherwise it becomes too easy to raise the money and then you become too-big-to-fail in the eyes of the country. Very few large banks have been allowed to fail and that allows you essentially to own a money printing machine and entrusting industrial houses with that would be problematic for the most part.

It is also important to put this entire debate in the context of the existing supervisory and enforcement capacity of the Reserve Bank of India. Even if, hypothetically, if the debate moves in the direction of permitting corporates, would you say that it's absolutely important for the RBI to strengthen its supervisory and enforcement capability? Because we've just seen so many financial sector accidents.

That's precisely why Viral and I asked -- why now? You've just had two accidents, should we focus on learning the lessons from that. For IL&FS, what is it that we're missing on large NBFCs? How do we improve the whole process? To my mind, there's blame enough to spread on IL&FS including who the directors were, who the auditors were and, of course, what the regulators and supervisors were doing in monitoring the progress of IL&FS.

Yes Bank is another issue. I mean we have for some time been looking very closely at Yes Bank and trying to understand what it is that they were doing to show such profits while showing such low loan losses. Over time we understood what they were doing and started bringing them to book but, of course, it has come at some cost.

We need to understand this, we have some processes in place in trying to improve the flow of information, automating some of the data transfers from the banks to the RBI, but also trying to understand better what it implies. So, I would say, let's get all that straightened out. Let's make compliance much more effective for the existing banks and, maybe, at some point, we will be able to deal with conflicted banks, banks that start with a huge conflict of interest but because of very stringent regulation and supervision, don't succumb to them.

We're not there yet and so to do this now, it seems to me, would be really to invite trouble. Why not fix the problems in the system already, rather than invent new problems?

Broadly Dr. Rajan, would you advise that we just put this on the backburner? Some of the technical recommendations of the committee are very doable and make sense too.

The holding company if you're only a finance company you don't need that holding company structure. I mean, you don't need a holding company on top of one bank. There are some of those rationalisations that make absolute sense. I guess the promoter holding we've gone back and forth on should it be 15% or 26%. I know some people want it to be 26%. You could have a long debate about that and there have been long debates. So, I think the main issue is really this one and I would ask the question, precisely, why now?

21. RBI imposes monetary penalty on six entities-HBL

The RBI imposed monetary penalty on six entities, including Sodexo SVC India, Muthoot Vehicle and Asset Finance, QwikCilver Solutions, Phonepe, Delhi Metro Rail Corporation, and Punjab National Bank. In exercise of powers vested under Section 30 of the Payment and Settlement Systems Act 2007, the RBI has imposed monetary penalty on the entities for noncompliance of regulatory guidelines. It imposed a monetary penalty of ₹2 crore on Sodexo SVC, ₹1.39 crore on PhonePe, ₹1 crore on QwikCilver Solutions, ₹34.55 lakh on Muthoot Vehicle and Asset Finance and ₹5 lakh on DMRC. All of these are under the category of non-bank prepaid payment instrument issuers. It also imposed a penalty of ₹1 crore on PNB as an ATM network operator.

22. Lakshmi Vilas Bank…RBI proposes merger with DBS-BS

The RBI proposed to merge private sector lender Lakshmi Vilas Bank (LVB) with the India subsidiary of Singapore's DBS Bank, even as LVB was put under moratorium for at least a month by the government... DBS makes logical sense from the systemic point of view. . Employees and depositors of LVB will be protected, but "the entire amount of the paid-up share capital and reserves and surplus, including the balances in the share/ securities premium account of the transferor bank (LVB), shall stand written off." With a share price of ₹ 15.50 a piece, LVB's market cap on a fully float basis is ₹474.93 crore.

23. Centre to appoint advisor for stake sale in PSBs, insurance cos- BL

The Department of Investment and Public Asset Management (DIPAM), under the Finance Ministry, has floated a Request for Proposal (RFP) to appoint a consultant for advice on stake sale in banks and insurance companies. Disinvestment of Public Sector Banks and insurance companies is the next big move after three rounds of amalgamation of PSBs. As of now, the government owns 12 PSBs and seven insurance companies. DIPAM's move to appoint a consultant appears to set the blueprint to achieve this… in strategic sectors, at least one enterprise will remain in the public sector and private sector will also be allowed. The government has set a disinvestment target of ₹2.10-lakh crore for the current fiscal, out of which disinvestment of government stake in public sector banks and financial institutions (including LIC and IDBI Bank) is ₹90,000 crore while the remaining is to come from sale of stake in Central Public Sector Enterprises.

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