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INDUSTRY OUTLOOK

ECONOMIC DIGEST (March 2021)

1. RBI Bulletin

I. State of the Economy

In India, economic activity is gaining steam as COVID-19 incidence recedes and the ongoing vaccine rollout releases pent-up optimism. All engines of aggregate demand are starting to fire; only private investment is missing in action and the time is apposite for it to come alive. Broader measures of liquidity reflect easing of monetary and financial conditions in the system.

II. Sectoral Deployment of Bank Credit in India: Recent Developments

The analysis of sectoral credit data provides insights into the flow of credit to various important sectors of the economy. Bank credit growth, which witnessed a slowdown in 2019-20, experienced a further setback in 2020-21 in the wake of COVID-19-induced lockdown but with the gradual resumption of economic activity, credit to agriculture and services sectors has registered accelerated growth in the recent period. Public Sector Banks (PSBs) have been primarily responsible for an accelerated growth in credit to agriculture and services sectors in the recent period. Even in the industrial sector, credit growth to medium industries has accelerated indicating positive impact of several measures taken by the Government and the RBI. Empirical estimates indicate that non-food credit is sensitive to interest rate changes with a lag, with industry and services sectors exhibiting greater sensitivity.

III. Assessing the Future Path of Monetary Policy from Overnight Indexed Swap (OIS) Rates

The use of the overnight indexed swap (OIS) rate as a measure of monetary policy expectation is gaining popularity in the literature. This article, by adopting the methodology of Lloyd (2018), empirically tests whether onshore OIS trades in India of different tenors (ranging from 1 month to 10 years) for the period from August 03, 1999 to May 31, 2019 are efficient measures of market participants' expectation of short-term interest rates. The article computes ex post "excess return" as the difference between the OIS fixed rate and the floating overnight reference rate. The excess returns of the OIS trades of tenors of up to one year were low ranging between 2 basis points (bps) and 20 bps indicating that these OIS rates were, on average, a fair indication of the direction of future course of monetary policy.

Specifically, the OIS rates of tenors 1, 9 and 12 months appear to more accurately measure the expectations of future short-term interest rates with the excess returns of these tenors, on average, being not significantly different from zero. Based on the findings of the study, the OIS rates in India are found to be credible predictors of the direction of monetary policy, if not the exact timing of policy changes.

IV. Do Markets Know More? India's Banking Sector through the Lens of Price-to-Book Ration (PBR)

What is an appropriate measure of bank value? This article argues that price-to-book ratio (PBR) of banks may be considered as an alternative measure of bank value to better understand their health and stability in the Indian context. While there are several indicators such as capital adequacy ratios, Z-scores, and profitability, none of them comprehensively capture the viability of the underlying business models of banks. Moreover, such standard indicators often change due to shifts in the regulatory environment without necessarily reflecting a fundamental change in the health of banks. Through credit intermediation, banks generate valuable intangible assets, such as private information on borrowers' worth and develop long-term banking relationships with them.

Since banking business is subject to stringent entry requirements and regulations, incumbent banks have greater access to market profits. These factors contribute to a bank's franchise value, which can be captured by its price-to-book ratio. The article finds that variations in PBR have linkages with financial and economic cycles. PBR also shares a close correlation with indicators relating to profitability and viability of banks. As it is available on a high-frequency basis, unlike the balance sheet data, PBR of banks promises to be a useful metric for policy purposes.

2. The challenge of financing the high-risk deficit is the daunting task ahead, says Ajit Ranade - FPJ

The third-quarter data on India's GDP shows that it has emerged from recession. There is a substantial increase in consumer spending by nearly 18 per cent, as compared to the previous quarter. This shows positive consumer sentiment. GDP growth has turned positive and there are signs of continued upward momentum during the fourth quarter also… there is understandable optimism about a sharp V-shaped recovery and growth of nearly 11 per cent. But much of the high growth next year would be a matter of the economy simply recovering ground lost during the pandemic year. As a result, after two years, the economic size of India would be barely 2 or 3 per cent above what it was in 2019. The Union Budget proposals have contributed greatly to reviving both consumer optimism and business confidence.

Record farm output

The high growth expected will depend quite a bit on the lead to be taken by the private sector, in strong consumer spending, as well in industrial investment. The ratio of investment to GDP has to rise from the current 28 per cent to nearly 36 per cent for the economy to show a sustained growth rate of 8 per cent. Fortunately, agriculture production is at a record level of 303 million tonnes this year. This is almost 10 per cent more than the average for the previous five years.

Some resolution to the impasse in the negotiations between the Central government and farmers agitating against the new farm laws for more than four months now, will go a long way in reviving growth optimism. It will also address the shortages that have arisen due to the blockade, and disruption in the delivery of crucial inputs like coal, fertiliser and even transportation fuel to Punjab and adjoining states… the growth optimism of next year comes from the fiscally expansionary stance. Even though the overall spending is budgeted to go up only by 1 per cent, the expenditure on infrastructure will go up by nearly 25 per cent. The expenditure on healthcare, including vaccinations and sanitation is up by nearly hundred per cent.

Two noteworthy features of the Union Budget were, firstly the transparency in disclosing all liabilities, and secondly, admitting a very large fiscal deficit. This large fiscal deficit of 6.8 per cent for next year, is not only far in excess of what was specified by India's own fiscal responsibility law, but also disregards international rating agencies.

Financing the deficit

But this high-risk deficit, while bold and ambitious, should not make us complacent about the challenge of financing it. The gross borrowing requirement by the Centre alone is more than Rs 12 trillion, which is Rs 1 trillion every month. That is just about equal to the monthly GST collection. The total borrowing requirement will eat up the entire incremental deposit in the banking system, assuming an eight per cent growth next year.

If the private sector capacity expansion and investment requires another 12 trillion rupees, it will put pressure on interest rates, since there is not enough funding available to accommodate this huge borrowing requirement. Actually, if the borrowing requirement of state governments is factored in, as well as those of public-sector enterprises, that number is above 23 trillion rupees. This huge borrowing simply cannot be met by the available pool of household savings in the country.

The RBI cannot simply print money, because that would be tantamount to monetization, which is explicitly prohibited by a 1997 agreement between the RBI and the Centre. Besides, direct monetisation could be inflationary. The RBI can do an indirect monetisation, by buying all the bonds issued by the Government of India in the secondary market. Indeed, it has been doing so for the last two years. When it buys the bonds against money that it has created, the RBI's balance sheet expands. That balance sheet has grown by 50 per cent in the past 2 years. And it will grow even further.

But a huge volume of borrowing through the market process, i.e. sale of bonds, can put upward pressure on interest rates, as well as crowd out private investments, which too are seeking to borrow from the same banking system and from capital markets.

Bilateral sweetheart deal

One way to ease this pressure is for the RBI to do a direct deal with the Centre, and give a fixed term five-year loan at a low interest rate against a pledged asset. That pledged asset could be all the shares that the Government of India owns in public sector enterprises. The combined value of all the shares owned by GoI today is more than ₹ 20 trillion, thanks to the exuberant stock market. Such a bilateral sweetheart deal is technically not monetisation, outlawed by the 1997 agreement, nor does it disrupt the credit markets, and hopefully takes off the pressure on interest rates too.

Another source of financing for the government of India is, of course, foreign funds. Thankfully, the inflow into the rupee-denominated government debt market has been quite strong and is expected to remain so next year. The government may also consider floating an international dollar denominated semi-sovereign bond through a proxy, such as the State Bank of India. This too can garner funds equivalent to ₹1 or 2 trillion.

Obviously none of the required financing can depend on increasing the level of taxation at a time when the economy is coming out of recession. Thus, next year is going to be a difficult balancing task to ensure adequate financing for the government without letting inflation or interest rates get out of hand, while also keeping the currency stable.

3. India's economy expands in December quarter, ending recession - Loop News Cayman

India's economy expanded by a weaker-than-expected 0.4 per cent in the October-December quarter, which still allowed it to escape recession following large contractions in the two previous quarters during the coronavirus pandemic. The National Statistical Office projected 8 per cent contraction for the 2020-21 financial year. In January, it had projected a contraction of 7.7 per cent for the fiscal year, following 4 per cent growth in 2019-20. Fertilizer production rose by 2.7 per cent in January, steel by 2.6 per cent and electricity generation by 5.1 per cent. Coal production declined by 1.8 per cent, crude oil by 4.8 per cent and natural gas by two per cent.

India's economy contracted by 7.5 per cent in the July-September quarter following a record plunge of 23.9 per cent in the previous quarter. The government had imposed a strict two-month lockdown across the country in March after the outbreak of the pandemic. A country enters a technical recession if its economy contracts in two successive quarters. India's recovery is expected to improve with a rise in consumer demand and investment.

The RBI is projecting GDP growth of 10.5 per cent in financial year 2021-22. The IMF has projected 11.5 per cent growth in calendar 2021. The IMF estimated that the Indian economy contracted eight per cent in 2020.

4. Reserve Bank favours retaining inflation target for next 5 years - Mint

Under India's flexible inflation targeting approach, the RBI is expected to work to maintain retail inflation at 4%, with an upper tolerance limit of 6% and a lower limit of 2%..."It is important to recognize that while setting a single target/tolerance band for the next five years, structural changes that may materialize or the type of shocks that may hit the economy are difficult to anticipate fully. Hence, flexibility must be built into the framework, without undermining the discipline of the inflation target, which has to be forward-looking to ensure that inflation expectations are firmly anchored over the medium term to facilitate decisions on investment, savings and consumption," the report said.

Changes suggested include inflation targeting framework for better transparency, accountability and operational efficiency. This includes modifying the definition of failure from the current three consecutive quarters norm of inflation remaining outside the tolerance band, to four consecutive quarters. The MPC may also consider providing a more explicit forward guidance on the interest rate path at a future date, as the projection process is strengthened further over time. Staggering on-boarding of external members on the MPC, having an official communication policy document, and releasing minutes within a week after the policy announcement were among other proposed changes. The report also floated the idea of RBI issuing its own bonds to help soak up foreign inflows into stocks that could threaten financial stability. “Activation of the standing deposit facility can address the security availability constraint of RBI for undertaking sterilization operations, but market-based sterilization instruments are required to avoid misalignment of the operating target relative to the policy repo rate. Adequate provisions for market stabilization scheme securities in the budget may be necessary to strengthen monetary operations of the RBI".

5. FM Nirmala Sitharaman attends G20 Central Bank Governors' meet - CNBCTV18

Union finance and corporate affairs minister Nirmala Sitharaman participated virtually in the First G20 Finance Ministers and Central Bank Governors (FMCBG) meeting under the Italian Presidency to discuss policy actions for transformative and equitable recovery. The other issues included global economic outlook, financial sector issues, financial inclusion and sustainable finance. FM spoke about India's policy response to the pandemic. India's domestic policies have been based broadly on supporting citizens through measures such as credit guarantees, direct transfers, food guarantees, economic stimulus packages and accelerating structural reform. She also spoke about India's vaccination programme, which is the world's largest and the most ambitious vaccination drive. India has extended vaccine support to several countries.

G20 finance ministers and central bank governors also discussed the implications of climate change on global growth and financial stability. Speaking on the Presidency's proposal to undertake systematic policy dialogue on climate risk and environment taxation, Sitharaman suggested that these conversations should remain within the ambit of Paris Agreement and should be based on the principles of common but differentiated responsibility, respective capability, and the voluntary nature of the commitments. The FM also stressed upon the importance of transfer of green technologies and scaling up of climate finance.

6. SBI: Ecowrap – GDP grows in Q3FY21 but postulated Q4FY21 GDP decline a statistical aberration reflecting expenditure clean up: GVA a better choice, Q4GVA at 2.7%

India's economy exited the recession and grew by 0.4% in Q3 FY21 after contracting 24.4% in Q2 and 7.3% in Q3. India is now one of the few major economies to post growth in the last quarter of calendar year 2020, with improvement in the economy's performance inversely tied to a drop in Covid-19 infections (even in most of the European economies the GDP contraction became more deep in Q4 2020 as compared to Q3 2020). But as India has seen an uptick in cases over the last few weeks, it has raised the risk of a new round of localised lockdowns. New curbs on movement of people or restrictions on businesses are a risk to the nascent recovery, given that gains in Q3 quarter probably came from the reopening of the economy. Q4 GDP growth is however estimated to decline in Q4 FY21 because of a statistical aberration with food subsidy clean up. GVA for Q4FY21 is at 2.7% and it is a better estimate to gauge economic recovery in the current background when tax numbers are notoriously fickle.

For the full fiscal GDP growth is expected to decline by 8.0% and GVA growth by 6.5%. For FY22, we still expect that real GDP growth would be around 11% and nominal GDP at 15%.Normally the gap between annual GDP and GVA is less than 70 bps. For the first time in FY21 the gap is whopping 148 bps primarily due to huge decline in net indirect taxes in Q1 (in Q1 the gap was 200 bps). The nominal loss of Rs 13.2 lakh crore in H1 has turned into gain of Rs 2.7 lakh crore in Q3 and is expected to be around Rs 2.8 lakh crore in Q4. For the entire fiscal, the nominal loss would be around Rs 7.6 lakh crore, though we believe that FY21 loss would be still less than the NSO estimate.

Agriculture & Allied activities grew by 3.9% in Q3 FY21 as compared to 3.4% growth in Q3 FY20. For FY21, agriculture is expected to increase by 3.0% as against 4.3% growth in FY20. Industry sector grew by 2.7% in Q3 primarily due to 7.3% growth in Electricity, Gas, Water Supply & other utility services and 6.2% in Construction. Mining & Quarrying is still in negative territory. For FY21, industry sector is expected to contract by 8.2% as against 1.2% decline in FY20. Electricity, Gas, Water Supply & other utility services is the only sector except Agriculture which is expected to grow in FY21. In Q3FY21, the services GDP growth, although negative, has recovered significantly to –1.0%, compared to a decline of –21.4% in Q1 and –11.3% in Q2, mainly due to rise in 'Financial, Real Estate and Professional Services', with growth at 6.6%. For FY21, services sector is expected to contract by 8.1% as against 7.2% growth in FY20. The GDP deflator growth for FY21 is estimated at 4.6%, showing a 100 bps increase from FY20. However, going forward the real GDP growth is expected to turn positive and deflator is expected to come down again. Overall, there is upward push in manufacturing, construction and trade, hotels, transport, communication & services related to broadcasting deflator and these are the sectors which have shown the highest GVA decline.

The real and nominal gross fixed capital formation growth have turned positive in Q3, which is a good sign and hopefully it will translate into better credit demand. Investment scenario, which can be better gauged by the actual tenders floated than announcements, reflects improved optimism in the last quarter (i.e., Q3FY21) with number of tenders published increasing by 23% by numbers and 16% by amount as compared to Q2FY21. Overall, 12240 tenders were published in Q3FY21 with an amount of Rs 2.14 lakh crore.

Corporate, in the listed space, reported better growth numbers across parameters in Q3FY21, as compared to Q3FY20, after improved EBIDTA in Q2FY21 post a dragged Q1FY21. While analysing more than 3000 listed entities, excluding BFSI and refineries, we observed around 5% growth in top line and around 40% growth in EBIDTA. Profit After Tax (PAT) too grew by more than 60% in Q3FY21 as compared to Q3FY20. Sectors such as Automobile, FMCG, Pharma, Cement, Steel, Consumer Durable etc. reported better growth number in all key parameters. With IIP manufacturing growth to remain in the positive territory in Q4 FY21 and bank credit showing a robust growth in January, growth will continue to show some traction. Private final consumption is also expected to grow in Q4 FY21 by 3.1% in constant terms. Most importantly, there is a 2x improvement in rating upgrades during Sept'20 to Jan'21 period as compared to April to Aug'20 period, indicating continued improved in corporate rating profile.

7. Quest for Restoring Financial Stability in India review: Former RBI DG Viral Acharya explains India's economy without jargon - FPJ

Financial Stability Report

Acharya's views are also earnest in insisting the need for India to move away from exerting pressure on the central bank and also a large section of public sector banks (PSBs) in which the government is a key stakeholder. In the last few years, the government spent billions of dollars recapitalizing state-owned banks. However, instead of rewarding the healthy banks, they supported weak banks, and the entire exercise did nothing to improve the credit books of banks. The same happened with demonetisation. The deposits of public sector banks went up substantially during the period, but the credit books of these undercapitalized banks did not improve. No growth was achieved by cash infusion either by depositors or by the government because of toxic loans, disallowing these banks to move fast. Even after the many shocks that the system received in terms of NPAs, the transparency that Acharya and the former RBI governor Raghuram Rajan wanted to bring to the system, is far off.

Most banks tend to evergreen loans, turning them into what they call 'zombie loans,' which have the same effect as the undead characters which keep coming back to cause trouble. However, most governments tend to maintain a 'status quo' on this burgeoning problem. Much to Acharya's chagrin, he quotes scientist Albert Einstein, who said that insanity is doing the same thing again and again and expecting different results. Acharya also believes that banks need to make decisive decisions, when it comes to taking haircuts on bad loans and moving them to a 'bad bank'. India's FM announced in the last budget that such a bank would be undertaken. However, public sector banks must choose their strategies right from raising private capital, and also consider selling good loans and assets to raise money and chase growth.

8. Interest income from PF to be taxed akin to interest from FDs- FE

The proposed taxation of interest income accruing from provident fund on annual contribution above ₹2.5 lakh would be treated in the same manner as the taxability of interest income on fixed deposits is governed. This means that the interest earned on the part of provident fund contribution that is above `2.5 lakh would be added to the total income of the taxpayer, which is usually taxed at the rate corresponding to the tax slab applicable for the income. "Instances have come to the notice where some employees are contributing huge amount to these (provident) funds and entire interest accrued/received on such contributions is exempt from tax under clause (11) and clause (12) of section 10 of the Act," the memorandum to the Budget proposal said. "The contribution to the provident fund that is in excess of ₹2.5 lakh would be in a separate basket and interest on that particular corpus would be taxable," Mr Kamlesh Varshney, JS, tax policy and legislation unit of CBDT, said.

9. Fix credit incentives: Economic Survey- Mint

The Economic Survey has urged the RBI not to delay the withdrawal of its COVID-19 forbearance measures as our economy recovers. It has also asked for an asset quality review to gauge the level of dud loans on banks' books. The survey warns against a repeat of errors made after the financial crisis of 2008-09. Back then, a slow reversal of RBI's liquidity support resulted in ill-weighed loans, worsened an outbreak of inflation set off largely by fiscal profligacy, and left Public Sector Banks (PSBs) in bad shape. The Centre will need to cough up big sums for PSB recapitalization.

10. Digital currency can transform payment transactions; poses disintermediation risk: RBI's Report on Currency and Finance (RCF) - NIE

Central Bank Digital Currency (CBDC) can bring about a sea change in payment transactions and quicken transmission. However, the virtual currency poses a risk of disintermediation of the banking system. "CBDC is, however, not an unmixed blessing - it poses a risk of disintermediation of the banking system, more so if the commercial banking system is perceived to be fragile". The public can convert their CASA deposits with banks into CBDC, thereby raising the cost of bank-based financial intermediation with implications for growth and financial stability. Further, in countries with significant credit markets, commercial banks may lose their primacy as the major conduit of monetary policy transmission. A proposed solution to limit disintermediation is to introduce a two-tier remuneration system for CBDCs, whereby transaction balances held by an individual remain interest free and are subject to a ceiling while CBDC balances of the individual over and above the ceiling are subject to a penal negative interest rate.

The RBI must monitor global developments, explore the possibility of the need for introduction of CBDC and remain in readiness to operationalise CBDC, as and when necessary. The attractiveness of CBDC stems from its digital feature as well as from being a sovereign liability. "CBDC can be designed to promote non-anonymity at the individual level, monitor transactions, promote financial inclusion by direct benefit fiscal transfer, pumping central bank 'helicopter money' and even direct public consumption to a select basket of goods and services to increase aggregate demand and social welfare," the report said. It can act as a direct instrument of monetary transmission. Besides, an interest-bearing CBDC can increase the economy's response to changes in the policy rate.

11. India Can't Afford to Stay Away From $1.5 Trillion Cryptocurrency Market: Founder of WazirX - Sputnik International

The Indian parliament is expected to consider a bill prohibiting all private cryptocurrencies and allowing an official digital currency to be issued by the RBI. In 2018, the RBI had curbed the use of and trade in virtual currencies, including Bitcoin, which was later revoked by the Supreme Court in March 2020. Sputnik spoken with Nishchal Shetty, founder and CEO of WazirX, an Indian crypto asset exchange and creator of WRX, the nation's very own digital asset.

Sputnik: The Indian government has announced that it will soon come up with a law for cryptocurrencies. The law will possibly put a ban on private cryptocurrencies. How do you view this?

Nischal Shetty: The proposed bill is not in the public domain so we don't know what will be allowed and what will be banned. Secondly, the government has not reached out to anyone in the Indian crypto sector at all to understand what sort of regulations are right in this system... this bill will get into a standing committee where there will be industry deliberation. So, it is going to be a long path towards this bill becoming a law. I think this will change towards regulation rather than a ban on private cryptocurrencies.

Sputnik: What would the implications of banning private cryptocurrencies be on the Indian economy and the sector per se?

Nischal Shetty: If the government completely bans cryptocurrencies, the impact it will have on India and India's economy will be massive. There are over 10 million Indians who hold cryptocurrencies and the value of these cryptos held by Indians is around $2 billion. So, if the government bans these cryptos what will happen to the wealth of these 10 million Indians because they hold this as an asset class today? The second part is that there are over 340 crypto-related startups in India . These startups will be directly or indirectly employing over 10,000 people. So, what happens to all these job losses that will occur as a result of a ban?

Third issue is of the country participating in it and innovation. When no country in the world is banning it, is it the right approach for India to ban cryptocurrencies and lose out on a new innovation and competition, while other countries are growing and building more knowledge and infrastructure about this whole crypto-ecosystem in their country?

So, India will not just lose what already exists, but it will also lose any chance of future economic growth from this sector.

And the crypto sector globally is valued at about $1.5 trillion. So, we are talking about letting go of an opportunity that is worth half the Indian economy. It is not a small sector to eliminate or to ignore, but we are talking about a large sector which is global in nature. And India, I believe, cannot afford to stay out of this massive sector.

If you look, the prime minister's vision was to make it a $5 trillion economy, you have an opportunity of $1.5 trillion in front of you. Countries like the US, UK, Sweden, Malaysia, and Singapore, etc. are regulating it because they know if they ban it other countries will get ahead of them. So, if others are regulating then India can also regulate it. Right now there is lots of confusion about what will happen, but hopefully that will clear up as we move ahead.

Sputnik: RBI Governor Shaktikanta Das said that cryptocurrencies may impact the financial stability of the Indian economy. How do you view this comment, as this is the basis upon which the government is planning to ban private cryptocurrencies?

Nischal Shetty: There are lots of studies around this and time and again global agencies have said that cryptocurrencies do not negatively impact the financial stability of the economy. Firstly, comparing it with currency is not correct. People have seen it as an asset class and they are trading in it. So, the whole premise of what Mr Das is saying is coming from a currency point of view.

But now if you look at crypto, it is classified under four major categories—currency and asset, utilities, or a security. As an issue with the currency aspect you can definitely try to prevent the use of crypto as a currency means, do not use it as a payment instrument, but you can still trade in it and use it as an asset class. If they have a fear, there is a way out and the way out is to regulate, not ban. If you ban, then you do not have any control over the ecosystem and you will be creating an underground economy because technically you cannot ban cryptocurrency. You can stop legitimate companies from participating but you cannot stop illegitimate, bad actors from accessing cryptocurrency.

So, by banning you will put good people into the underground economy and create more liquidity in the black market. No country in the world wants to create an underground crypto market because this is the most dangerous thing. There are direct correlations between countries suppressing legal usages of crypto versus the underground economy.

Sputnik: What should the government do to dispel the confusion around cryptocurrency as the news about banning crypto definitely discourages people from investing in this segment or investors may take their money from this?

Nishchal Shetty: Ideally, the Indian government should look at what the world is doing. It cannot formulate laws on our own; rather we should look at what the global economy is doing. What India should do is work with the industry to put rules and regulations in guidelines to operate the segment.

The first and most important guideline is to make sure that any crypto in the country is already KYC compliant. Second, any company that deals in the crypto sector must ensure that there are some safety guidelines which need to be followed strictly. Some investor protection policy must be there.

Sputnik: Can terrorists use this to launder their money as the government keeps telling every forum in support of banning it?

Nischal Shetty: In principle, you cannot stop someone from sending cryptocurrency to anyone else on the internet. Can a bad actor send crypto to another bad actor, yes they can but it's a completely open segment. So, you will always be able to trace what address the cryptocurrencies are being transferred to and if they want to use it they will have to convert it into cash somewhere in the country. At that point is where the government already has controls on KYC and other measures. So, at the point if any person tries to convert cryptocurrencies into cash they ultimately need INR in the country to purchase something.

12. Clear recovery underway but much better GVA & Q4 growth crucial for any sharp upturn: Rangarajan - FE

Positive growth in GDP after two successive quarters of negative GDP growth has ensured the Indian economy appears to emerge out of a recession, at least technically. But then, it may still be too early to celebrate as a lot still depends on the cross-sectoral performance and on the likely GDP growth in the fourth quarter. The recent estimates of the GDP for Q3 may have had a sobering effect on the way we view numbers but the "0.4 percent" growth has already produced confidence that India – the fourth-largest economy on the planet (after the US, China, Japan, and Germany) is clearly riding out of recession and exhibiting what they like to describe as a "V-shaped recovery".

Dr C Rangarajan prefers to still stay cautious. His concerns are broadly on two folds. One is to do with the expectations now for the fourth quarter GDP numbers. "As the numbers shared so far suggest, one may have to expect modest GDP growth number for the fourth quarter and not a spectacular increase given that the year as a whole is expected to conclude with a minus 8 percent growth. The growth in the next quarter is therefore likely to be similar to the third quarter". The other concern is around what appears a rather strange divergence between the GDP and the GVA (Gross Value Added) numbers.

GVA is a measure of output and is arrived at when the GDP number is adjusted for the impact of indirect taxes and subsidies. "I am still looking for a clear explanation on why the GDP is growing at a small positive and the GVA is at a negative 6.5 percent. The only explanation, at the moment, based on how these terms are defined, is that the indirect taxes and subsidies have had a crucial role in shaping such a divergence. We need to look at these numbers more closely," he says.

After all, if one were to look purely at the GVA number, crucial in any study of the sectoral performance, we still have some distance to cover before we can comfortably say that we have indeed come out of recession. A much better number, which is in positive territory and also a sharper growth in the fourth quarter is crucial if there is to be a sharp upturn in the economic growth. Putting together the modest recovery in the third quarter and a likely repeat in the fourth quarter, he feels, it is not seeming like a sharp "V-shaped recovery" because from a decline there is a move up the recovery path but still creeping ahead and not seeming to be sharply rising, at least at the moment.

13. Need for Infrastructure Financing in India - Daily Excelsior

Infrastructure financing is sine quo non for promoting and sustaining rapid economic growth. India's investments in infrastructure have been growing over the years, from Rs. 24 lakh crores between 2008 and 2012, to Rs. 56.2 lakh crore between 2013 and 2019. During this period, around 70 per cent of the infrastructure financing was sourced from the public sector and remaining was funded by the private sector – a sub-optimal mix for sustaining infrastructure financing in India. India aims to achieve the target of becoming a $5 trillion economy by 2025 and infrastructure development has an important role to play. As per the National Infrastructure Pipeline (NIP), the total capital expenditure in infrastructure sectors in India is projected at around Rs. 111 lakh crore ($1.5 trillion) between 2020 and 2025.

Critical Challenges

Challenges include (a) challenge of stressed assets faced by banks and infra-NBFCs, (b) limited private sector finance, (c) low adoption of sustainable and climate resilient development practices, (d) limited social infrastructure and (e) reduced external demand, industrial production, investment and employment, due to the COVID-19 pandemic.

Role of Institutional Financing

To overcome these challenges a combination of reforms, institutional finance and strong institutional technical assistance is needed. Infrastructure sector received adequate attention in the Union Budget 2021, with special focus on monetizing operating public infrastructure assets, foreign participation through InVITS and REITs route and proposed sharp increase in capital expenditure at Rs 5.54 lakh crores, which is 34.5 per cent higher than the budget estimate 2020-21. Together these will continue to create fresh investment opportunities.

The Union Budget 2021 announcement on setting up of a Development Financial Institution (DFI) to provide, enable and catalyze infrastructure financing is a positive move. However, considering the huge infrastructure financing need, a more diversified approach, that is, cooperation with Multilateral Development Banks (MDBs) is also an effective way forward. MDBs are well-positioned in transforming infrastructure needs into technically feasible and financially viable projects while creating financing platforms for institutional capital to enter at scale.

Capable of fulfilling common global financial needs, they generate impact at a large scale by (i) addressing sustainable development (ii) connecting borders and economies and (iii) bridging infrastructure investment gaps etc. Though, MDBs are only a small part of the overall infrastructure financing ecosystem, still they play a crucial role by providing innovative financing instruments, technical assistance and facilitate crowding in private sector investments in infrastructure.

Among the MDBs, the new generation banks such as the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB), focus mainly on infrastructure investments including traditional sovereign loans, non-sovereign operations and technical assistance. They have built up a sizeable infrastructure investment portfolio over last five years amounting to $22 billion for AIIB and around $25 billion for NDB. In India $5.4 billion worth of projects are being financed by the AIIB and $6.9 billion worth of projects by the NDB. In addition, there are huge bankable projects of India in pipeline. Due to the large and robust capital base, the potential lending capacity of these parallel institutions can be very substantial.

The modus operandi of these banks is "lean banking structure" with a small efficient management team and highly skilled staff. They are less bureaucratic, flexible and respond to client demands with agility. Progressing to expand their presence in the area of development financing and effective governance, these Banks have grown at a rapid pace, thereby creating a niche in the market.

India is the second largest shareholder in the AIIB and an equal shareholder along with other BRICS members, with 20 per cent stake in the NDB. By virtue of being the key shareholder, India is actively involved in formation of the Banks' key policies, governance structures, etc. This has contributed to the growth and business, Banks' engagements with other MDBs and market presence of these young banks. Considering the huge resource requirements for infrastructure development and long-term finance to support long gestation projects, India will benefit from further leveraging its partnerships with MDBs like the AIIB and NDB. This will help in promoting innovation and structural transformation and enhance financing of infrastructure. This opens avenue for a win-win situation for both India and these new MDBs. These MDBs can play a proactive role in fostering collaboration and cooperation, which, in turn, will fast-track infrastructure financing in member countries including India.

14. Official, private digital currencies can coexist, say IMF experts - BS

At a time when India is contemplating a ban on private cryptocurrencies, a blog— Public and Private Money Can Coexist in the Digital Age — by two IMF experts provides advice to the government. The blog by Tobias Adrian and Tommaso Mancini-Griffoli — both working at IMF's monetary and capital markets department — says today's world is characterised by a dual monetary system, involving privately-issued money by banks of all types, telecom companies, or specialised payment providers, built upon a foundation of publicly-issued money by central banks.

"While not perfect, this system offers significant advantages, including innovation and product diversity, mostly provided by the private sector, and stability and efficiency, ensured by the public sector". These objectives — innovation and diversity on the one hand, stability and efficiency on the other — are related. "More of one usually means less of the other. A trade-off exists, and countries — especially central banks — have to navigate it. How much of the private sector to rely upon, versus how much to innovate themselves? Much depends on preferences, available technology, and the efficiency of regulation".

Keeping pace with technology change, user needs, and private-sector competition will be challenging for central banks. However, they need not be alone in doing so. First, a central bank digital currency may be designed to encourage the private sector to innovate on top of it, much like application (app) designers bringing enticing functionality to phones and their operating systems. By accessing an open set of commands (app programming interfaces), a thriving developer community could expand the usability of central bank digital currencies beyond offering plain e-wallet services. For instance, they could make it easy to automate payments, so that a shipment of goods is paid once received. Or they could build a look-up function, so that money can be sent to a friend on the basis of phone number alone. The trick will be vetting these add-on services, so that they are perfectly safe, cautions the blog.

Some central banks may even allow other forms of digital money to coexist — much like parallel operating systems — while leveraging the settlement functionality and stability of central bank digital currencies. This will open the door to faster innovation and product choice. For instance, one digital currency might compromise on the settlement speed to allow users greater control over payment automation. This new form of digital money will be a stable store of value, if it was redeemable in central bank currency (digital or non-digital) at a fixed face value. This will be possible if it was fully backed by central bank currency. This form of digital money will be an efficient means of payment, as settlement will be immediate on any given digital money network — just as it is between accounts of the same bank.

"This form of digital money (which we have called synthetic currency in the past) could well coexist with a central bank digital currency. It will require a licensing arrangement and a set of regulations to fulfil public policy objectives, including operational resilience, consumer protection, market conduct and contestability, data privacy, and even prudential stability". At the same time, financial integrity could be ensured via digital identities and complementary data policies. Partnering central banks requires a high degree of regulatory compliance, say the authors.

An inter-ministerial committee, headed by former finance secretary Subhash Chandra Garg, had first suggested a draft Bill to ban cryptocurrencies. It defined virtual currency as a "cryptocurrency, by whatever name called, means any information or code or number or token not being part of any official digital currency, generated through cryptographic means or otherwise, providing a digital representation of value which is exchanged with or without consideration, with the promise or representation of having inherent value in any business activity which may involve risk of loss or an expectation of profits or income, or functions as a store of value or a unit of account and includes its use in any financial transaction or investment, but not limited to, investment schemes". A committee of secretaries, chaired by the Cabinet secretary, has also given its report on cryptocurrencies. The Supreme Court, in March 2020, had struck down the RBI's restrictions on banks to stop providing services to crypto trading platforms.

15. Punjab & Sind Bank, BoM & BoI are likely privatisation candidates

The market is betting on Punjab & Sind Bank, Bank of Maharashtra and Bank of India as the likely candidates for the finance minister's ambitious bank privatisation plan. In her Budget speech, FM Ms. Nirmala Sitharaman said the government planned to privatise two sate-run banks, other than IDBI Bank… The government had earlier allowed merger of 13 banks into five banks… Of the six banks kept out of merger, Indian Overseas Bank, Central Bank and UCO Bank are under PCA (prompt-corrective action). The RBI had kept the three banks in the PCA framework after massive asset quality deterioration, losses in the books and lower capital levels. PCA banks were unlikely to be offered for privatisation due to poor investor demand. Leaving SBI and five merged banks, there are six public sector banks, viz., Bank of India, Punjab and Sind Bank, Bank of Maharashtra, Indian Overseas Bank (IoB), Central Bank of India and Uco Bank.

16. India's tryst with deep tech & the art of spawning disruptors - FE

What is holding back India from spawning global tech disruptors like Tesla, the iconic American electric car and cleantech company, or BioNtech, a German company that came up with the new mRNA-based vaccine to combat COVID-19? If companies from India are to transition from a volume play to a value play and look beyond low cost, greater efficiency cycle and seek an orbital shift in capital and wealth creation then investing in ownership of intellectual property is the path to pursue and deep tech, the vehicle to ride on.

Why Deep Tech

Deep tech implies a space where companies work on technologies like Artificial Intelligence (AI), Machine Learning, Blockchain, genomics and use engineering innovation and build it into their core across sectors…Thus far, the India story – be it in IT or pharma and health care – has been largely that of as a volume play and in IT, a services play, which also throws up wealth creation but the spin-offs are disproportionately higher when riding on the strengths of product and IP-ownership, e.g., Tesla's market cap, which is nearly double than that of some of the other iconic and long-standing car makers of America. There is a growing interest in this space in India and greater clarity and focus among the various stakeholders to look towards creating an ecosystem that can spawn deep tech-driven disruptors.

A Growing Interest

According to Nasscom's study, today 19 percent of all the startups in India are leveraging deep tech to build more complex and smart solutions with Bangalore, Delhi NCR, Mumbai, Pune, Chennai, and Hyderabad as important hubs. The bulk of these deep tech startups are into enterprise technology (29 percent in all) followed by 8 percent in fintech and nearly the same amount in healthcare. 87 percent of total deep tech investments in 2020 were in AI start-ups with AI, IoT (Internet of Things), and big data analytics emerging as the most preferred technologies.

Where India Has An Edge

Kris Gopalakrishnan, Infosys co-founder feels, "we need to pick and choose areas or strategic sectors where we will be globally competitive and then invest in research capability, supply chain and seek suitable regulatory support." Others also see the need to nurture talent with academic institutions willing to support students with suitably designed courses and provide industry linkages. Indian companies could leverage the strengths and capabilities in biotech, a space where we already have a good R&D infrastructure and talent. Or even in automotive, particularly two-wheelers, where we lead in volumes and could now look at the value-play. Then there could be other areas like medical instrumentation and medical devices.

Incubator and More

To address some of these issues and perhaps provide a platform of sorts, an idea was set in motion about six months back to create a deep tech incubator and this led to the setting up of 'India Deeptech', an alliance between deep tech startups, incubators and venture capital funds to promote deep tech startups in India. It describes itself as one that tries to "bring together all the elements of the ecosystem in India under one roof with the objective to enable creation and scaling of more startups focused on scientific research and engineering innovation.".. But then Gopalakrishnan sees it as an enabler.

If in the US, incubators within academic institutions in Boston or Pittsburg or say at the Cambridge Science Park in the UK, play a crucial role, India needs to build on its research clusters, invest in translational capabilities to take products from a laboratory to market, create scope for accelerators and incubators, design special funds, offer more research grants aided by suitable government policies that can drive deep tech start-ups to follow the lead from their global role models and disrupt the market with their own products and solutions. "There are also now funds focussed on IP creation and deep tech," says Gopalakrishnan. These areas are also high-risk and high-reward spaces. For instance, the industry is experimenting with hydrogen-powered vehicles but which one will win in the long-term and which technology will be better is difficult to predict.

Time for India

Estimates vary between 500 to 700 Indian companies looking seriously at deep tech… "But then, for those seeking to wait for enablers to fall into place, may do well to study the story of BioNTech and its scientist couple founders and their arduous journey into the limelight. It is arguably a stellar example of how persistence pays.

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