Indian Economy: Some Contemporary Perspectives

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Lecture No. 33

Indian Economy - Monetary Policy 5

Welcome back. So now, we have all already gone for 2021 analysis. And I think, the course title mentions about some contemporary perspectives, we have covered some recent one also. So, I thought, it is always good to introduce the audience with the recent changes when we are dealing with the historical perspective, because then it is easier to connect rather than having the complete recent outlook because then there will be disconnect and the audience may not be looking back again and going through those links that that are supposed to be at least established with regard to the understanding of this, this particular lecture.

So now, in the monetary policy, this is going to be the last lecture for monetary policy. After this, I will start the fiscal policy, because fiscal policy is interesting, because there are certain things that need to be discussed and I think it is easier that we should be focusing on. So, after fiscal policy one or two sessions will be moving to the WTO and Indian agriculture and the last session will be on the recent economic outlook that the syllabus outlet mentioned.

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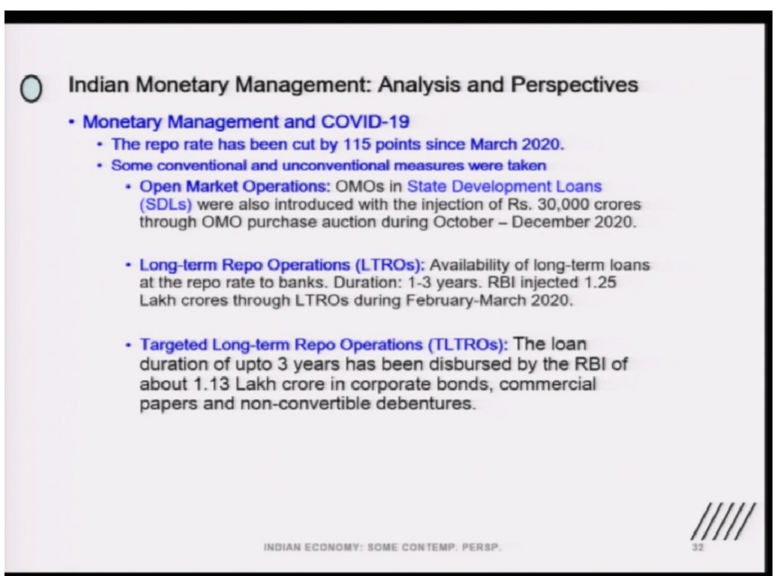

So here, in this particular section, I will be mostly focusing on the rest of the portion that I have not covered. So, the reference remains same not much change. From the monetary transmission point of view, so one angle that I always mentioned that there is always one target of the Central Bank is that if they are going to revise the interest rate then whatever the benefit that the general public should have because of the cut in the rate of interest, how much it has been passed by the banks to the commoners including industries businessmen, how much they have gained the benefit, because of this policy incidence that we had.

So, in the same way, so the repo rate as the economic survey 2020-21 mentions that the repo rate has been cut by 115 points that I mentioned in the beginning itself, that the table two was mentioning. So, 115 points since March 2020, some economy kind of conventional and unconventional majors have been undertaken and this is also one of the areas to look for.

So here, it is open market operations. So, OMO is in State Developments Loans were also introduced. So, State Developments Loans are in a similar way we have the Union Government and then, the state government. State governments also need money for their expenditure. And this state government also introduced the bond and this particular bond is eligible. So, most of the financial institutions and those insurance companies, pension funds are allowed to buy this particular SDL bond and this SDL bond is having some characteristics that it can become part of SLR requirements.

So, most of these banks they invest money and they and they buy these SDLs and then they simply keep it as a requirement for SLR, and that is why it becomes really important that these SDL bonds should be in sufficient supply, so that the states should also have the money to borrow from the banks and these SDLs are traded auction on the guilty security market and they will also have proper mechanism to go for borrowing from the market or mobilizing the money from the market.

But SDL bonds are normally, it depends upon the performance of the state. If the performance of the state is really good, which means that all the fiscal deficit parameters are intact, the growth is good, tax revenue generations are good, which means that if the state's financial health is really good, then the yield or the rate of interest on the SDL bonds will be lower, because states will now bargain that there is a less chance of any default. So, states can also default on the SDL, so if they have not generated sufficient funds for the interest payments.

So, SDLs are for example, if Karnataka is going to launch the SDLs or Tamil Nadu or we have the Kerala or for instance most of the South of Indian states, then you will find that their the economic activities are more aligned towards the services sector also and they have sufficient funds and with that promise they have been able to maintain the macroeconomic indicators better compared to the Jharkhand, Bihar where there is a lot of, there are concerns about the job creation and the services sector growth.

So, in that case, the states will offer higher yield, higher rate of return on the SDLs bond compared to the states which are performing better. So, the states which are inefficient will be offering, so BIMARU states earlier used to offer the higher rate of interest on the SDLs compared to the states which we are going route.

So, just to make sure that the states also have sufficient funds, because at that time, it was it had become a controversial topic that how states are given a less devolution of the tax, so the tax collections, whatever tax revenue or tax collection happened through GST it goes to the Central Bank and Central Bank gives some kind of devolutions. So, as per the 14-finance commission, it was around 40 percent, I will be discussing that once we go to the fiscal policy. So, this amount should be given to the states and the states should be using for their developmental plans.

So, open market operations for this first time in state developments were also introduced with the injection of rupees 30,000 core through OMO purchase auction during October December 2020. So, most of the infusions were entitled up to or they were allowed to have the exposure of up to 30,000 cores and through open market operation buy and sell of the SDLs. Then, Long-Term Repo Operations ability of long-term loans at the repo rate to the banks duration one to three years.

So, RBI injected around 1.25 lakh crores through LTROs, Long-Term Repo Operations rose long term repo operations during February-March 2020. So, this is also one of the policy instruments that has been mentioned in Economic Survey 2020-2021. Then, there is a requirement for Targeted Long-Term Repo Operations. So, the Targeted Long-Term Repo Operations basically include those operations which are up to 3 years of loans and this has been disbursed by the RBI about 1.13 lakh crore in corporate bonds, commercial papers and the non-convertible debentures.

So, the commercial papers are the short-term borrowing instruments and even corporate bonds are for the long-term because bonds are supposed to have the higher duration and then we have the non-convertible debentures this will also have the higher duration. And the best part is that about 1.13 lakh crores has been disbursed under this Targeted Long-Term Repo Operations and this has been done just to make sure that there is sufficient liquidity in terms of giving loans to the MSMEs and all other sectors.

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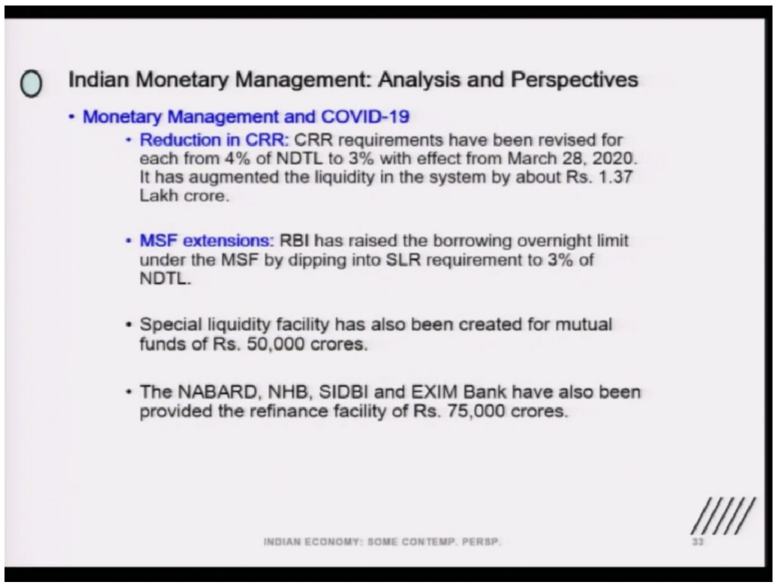

Then we had the reduction in CRR. CRR requirements have been revised for each from 4 percent of NDTL to 3 percent with effect from March 28, 2020. And through this also the liquidity augmentation system has worked and there is a liquidity augmentation of around 1.37 lakhs crore. So, that is also one a one contribution to this. Then we have the marginal standing facility extension. RBI has raised the borrowing overnight limit under the MSF by dipping into SLR requirement to 3 percent of NDTL. So, the SLR requirement of up to, so we have just gone through this concept MSF and we had mentioned that it is 1 percent of NDTL.

But now, given this a special situation that we were experiencing, the Central Bank has allowed the boring overnight limit of up to 3 percent of NDTL that means that this will also increase the liquidity into the system, Special liquidity facility has also been created for mutual funds up to 50,000 cores. So, mutual funds were also having the higher rate redemptions threat and that way to just make sure that they remain in business and they have at least to meet these obligations of higher redemptions, because of those uncertainties they were given 50,000 crores.

NABARD, National Housing Board, SIDBI, EXIM Bank have also been provided the refinance facility of rupees 75,000 crore. So, these are the incentives given to these entities. So, NABARD is for agriculture because this is the Central Bank of agriculture sector, so that is for agriculture. National Housing Board for real estate finance companies and all for developers, some relief must be given. SIDBI for small scale industries, Small Industry Development Bank of India.

And for EXIM Bank which is the Export Import Bank of India, it is all given in terms of facilitating the credit facility of the exporters on the current account so that they would be able to meet the requirement. So, this is also one of the important contributions. Then we have the monetary transmission, as I mentioned in the beginning. So, monetary transmission is one aspect that we always mentioned about and monetary transmission leads to what is called the important objectives to monitor that how much there is a pass on of the rate cut to the to the industry different stakeholders in the economy, including the common populace.

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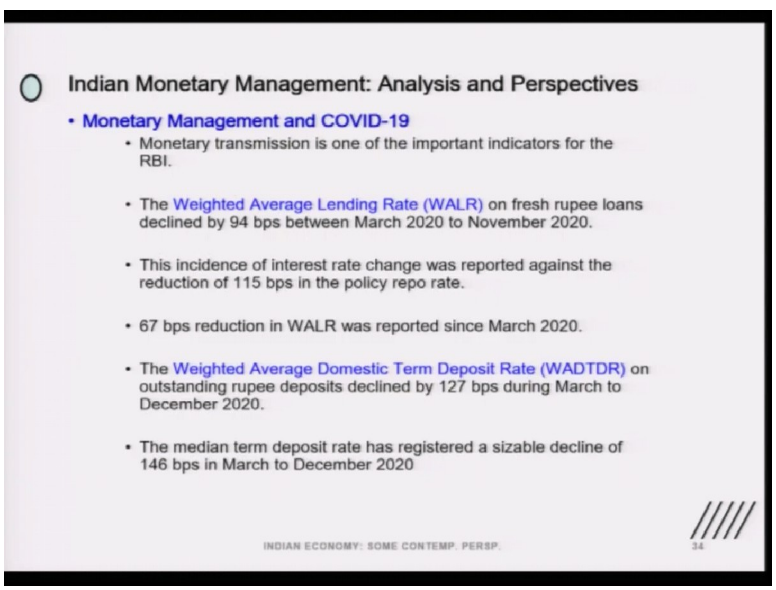

So, the Weighted Average Lending Rate because it depends upon the duration of the loan, so short-term, long-term, so there is some kind of index creation. So, this is the weighted average lending rate on fresh rupee loans decline by 95 basis points between March 2022 to November 2020. So, this is a situation, it is being mentioned. Since the lending rates are lower. So, this is the best time for the borrowers to borrow the money from the banks because banks are giving you the lower rate of interest on the loans.

So, when you have the rate of interest going towards expansion, which means that loans are going to be cheaper. So, if you are planning to buy a house or if you have any kind of capital asset plans, you should go for and you should have the lower rate of interest attached. This incidence of interest rate change was reported against the reduction of 115 basis points in the policy rates.

So, the Central Bank has reduced 115 basis points, banks have gone for reduction of 94 basis points. The weighted average 67 basis point reduction in WALR reported since March 2020. So, out of 94 basis point, if you just look at in detail, then you find that 67 basis points reduction in the lending rate is just after March return 2020. So, which means that this is also an indication that how quickly the banks and every entity linked with the interest rate cut have gone for revision of the interest rate and this benefit has been passed to the populace and the industry.

So, these are the monetary transmission conditions. The Weighted Average Domestic Term Deposit Rate on the outstanding rupee deposit declined by, but this is one of the negative sides. So, from the borrower side, there is good news that banks are going to reduce the interest rate and as a result you get to know about the lower borrowing cost. So, you will be borrowing at the lower rate. But if you are saver, which means that you are going to deposit money in the bank, then you are going to have the lower rate of interest on that. So, what has happened?

So, the Central Bank has gone for cutting down the revision in their policy rate by 115 basis points, the banks have gone for keeping the downward trend in the deposit rate by 127 basis points, which is much higher. So, for the lending they have gone for 94 basis points, but for the lending they have gone for 94 basis points, but for the deposits which they are supposed to pass on at a much higher rate, but they have gone for 127 basis points, which means that the savers are having limited incentive now. They do not have a much to gain if they are saving.

So especially, those populations which are vulnerable to the shock, basically the senior citizens as I mentioned in the in the last session that how when we have the rate of interest on deposits going down then the pensioners will have difficult time because they cannot keep their money in a stock market or else because it is not recommended as per their health conditions or anything.

So, that is why during March to December 2020 for savers it has been difficult time. So, this may lead to have the channelization of funds toward the mutual fund or they will be looking for alternative avenues.

So, one of the reasons that why gold price has gone up these days it has crossed the 50,000 limits, because people had limited avenues to invest money and even banks had gone for a heavy cut down in the deposit rates and this has resulted in channelization of extra money towards the precious metals. Because precious metals if you calculate the returns, it always gives better than, it is almost close to the stock market.

So, stock market in India it gives you the returns of 15 percent being the one of the biggest economies emerging market economies. But if you invest in gold, then gold, it sometime beats the market, but it hovers around 10 percent or so. But whenever we have a higher uncertainty you will find that people will look for the safer avenues and gold become one of the safest avenues because of these smaller ticket size. So, if you want to buy a house, you need a huge amount of money but you want to buy gold, you do not need that much. So, the ticket size really small. So, that is why it happens.

The medium term deposited has registered a sizable decline of 146 basis points in March to December 2020. And most of the banks if you ask them that why you have gone for lower cut on borrowing rate, but you have cut down the default rate much higher, they will say that, since they bear the expenses of maintaining the deposits and the branches and everything so that is why we cannot pay a higher rate of interest.

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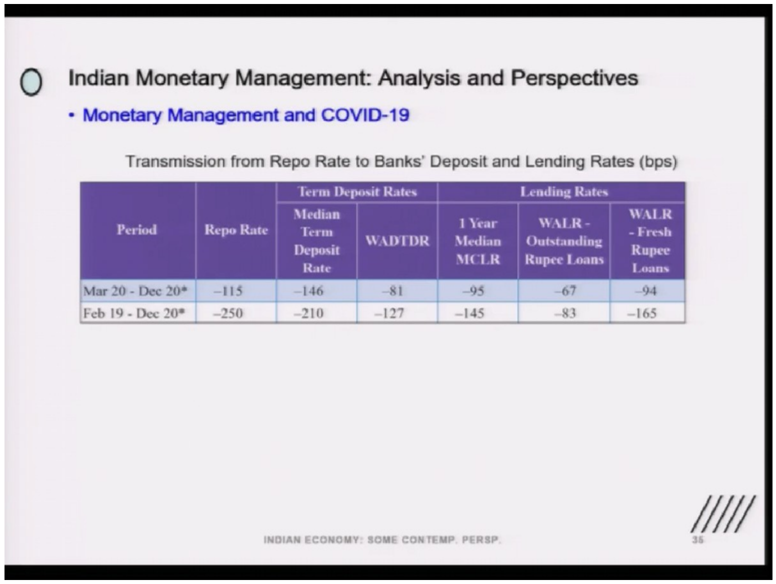

Period	Repo Rate	Term Deposit Rates		Lending Rates		
		Median Term Deposit Rate	WADTDR	1 Year Median MCLR	WALR - Outstanding Rupee Loans	WALR - Fresh Rupee Loans
Mar 20 - Dec 20*	–115	–146	–81	–95	–67	–94
Feb 19 - Dec 20*	–250	–210	–127	–145	–83	–165

So, this is a summary with the Economic Survey 2020-21 provides, the transmission from repo rate to the banker's deposit and the lending rate. So, it is the basis point. So, you can see that repo rate has gone by 115 and February 2019 to December 2020 to 50 basis point. The term deposit relates you can see it has gone down by minus 146,210. Then here, we have the weighted average of the deposit rate. So, it is minus 81 outstanding rupee loan, it is just 94, which means that the deposit rates are going to be the much more concern.

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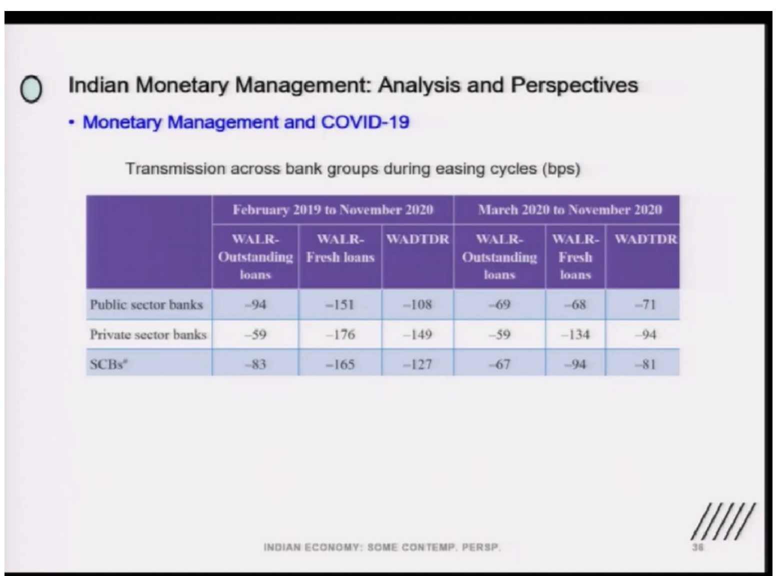

	February 2019 to November 2020			March 2020 to November 2020		
	WALR-Outstanding loans	WALR-Fresh loans	WADTDR	WALR-Outstanding loans	WALR-Fresh loans	WADTDR
Public sector banks	-94	–151	–108	-69	-68	–71
Private sector banks	-59	–176	–149	-59	–134	-94
SCBs*	-83	–165	–127	-67	-94	-81

Across banks also the Economic Survey gives the idea. So, public sector banks it has gone down by the 94 basis points, the fresh loans 151 and then the WS waited if you go then it is minus 108 and then, the on loan. So overall, what it looks like that the private sector banks have gone for giving higher benefit compared to the public sector banks and the schedule commercial banks. So, average appears to be minus 81. So, this is what it is looks like. So, the benefit has been passed to the public sector bank because of their bad health, they have not been able to pass on much, but the private sector banks have gone for a 94 basis points.

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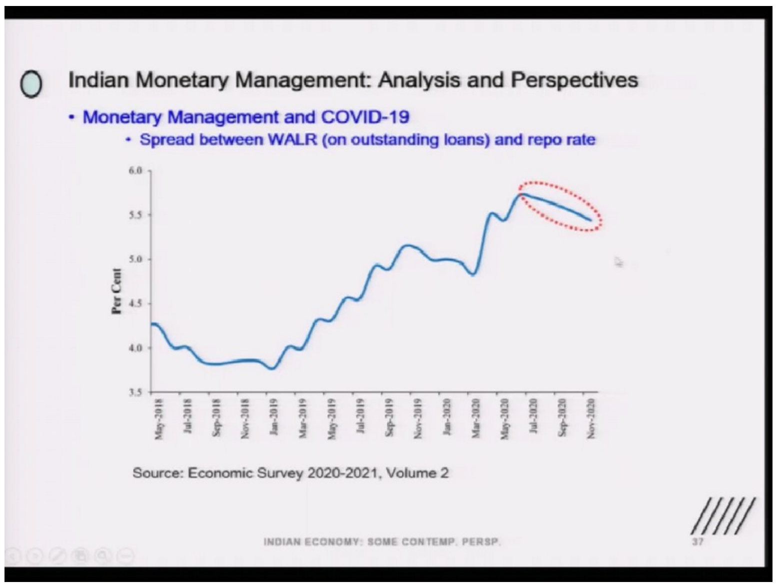

So here, is the estimated average lending rate that we have and the repo rate. So here, is the downward trend that we see that both have gone down. And this is what one of the concerns that the economic survey mentions.

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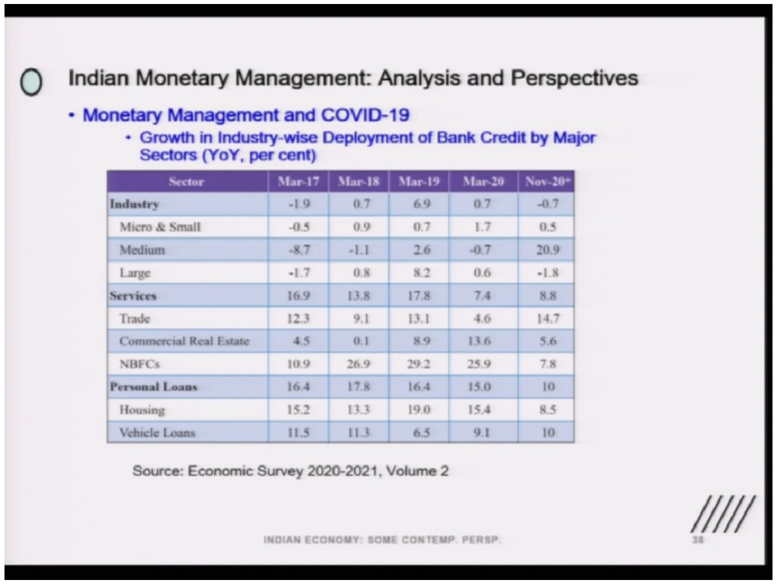

Sector	Mar-17	Mar-18	Mar-19	Mar-20	Nov-20*
Industry	-1.9	0.7	6.9	0.7	-0.7
Micro & Small	-0.5	0.9	0.7	1.7	0.5
Medium	-8.7	-1.1	2.6	-0.7	20.9
Large	-1.7	0.8	8.2	0.6	-1.8
Services	16.9	13.8	17.8	7.4	8.8
Trade	12.3	9.1	13.1	4.6	14.7
Commercial Real Estate	4.5	0.1	8.9	13.6	5.6
NBFCs	10.9	26.9	29.2	25.9	7.8
Personal Loans	16.4	17.8	16.4	15.0	10
Housing	15.2	13.3	19.0	15.4	8.5
Vehicle Loans	11.5	11.3	6.5	9.1	10

Then, the survey also highlights across sectors, that which all sectors are now important. So, in case of industry services, personal loans, so, in case of industry, it is March 17, March 18, March 19, March 20, you can see that industry it is in negative. The medium industry has a god the benefits are 20.9. Then here, we have the services 8.8, then trade. So basically, the major gainers are in November 2020 from March 20 it was minus 0.7 in March. But by November 20 because of those stimulus packages plan and the channeling of the credit to these medium enterprises, it has been high. But the large firms are not having that much gain.

In March they had the gain 0.6, but the medium, the focus has been on medium and the macro and small it is looking completely here. And then, the trade also 14.7 commercial Bank, commercial real estate 5.6, personal loans are on higher side, housing 8.5, vehicle loans are around 10. So, this is the overall outlook of the credit market that we are seeing.

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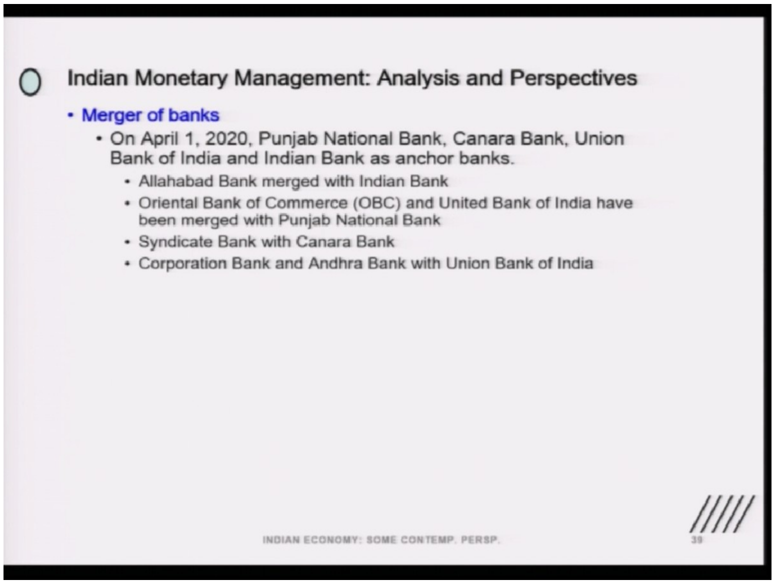

I also wanted to mention because since I did not cover this part, so maybe you will be asked in your exams or maybe from your understanding perspective, it is important that you should know about this. So, on April first 2020, Punjab National Bank, Canara Bank, Union Bank of India and Indian Bank became the major Bank. And there is merger of banks. So, Allahabad bank is now merged with the Indian Bank.

Oriental Bank of Commerce and Union Bank of India have been merged with the Punjab National Bank. So, Punjab National Bank is having now the Oriental bank Commercial Bank and the Union Bank of India. Syndicate Bank is merged with Canara Bank Corporation and Andhra bank with the Union Bank of India.

So, these are the recent developments happened and this happened because of the Twin Balance Sheet crisis because at that time, government felt that majority of these banks had the higher NPAs. So, just to make sure that it should not create extra burden on the Exchequer, they have gone for mergers and now, with the limited number of banks, though there are controversies for and against for say that it is good that you have the consultation of the banks fewer number.

But those who are against they say that it will give a limited option to the borrower or the lender to keep money in the bank because earlier it used to happen that they wish to get extra amount of or they use to have the options of going from one bank to another and they will have the variety of choices with regard to the product development and the extra benefit there will be attached with some riders.

So, those things are concerned but a government has gone for the merger of the bank. So, nowadays you will find that Indian bank will, so every Allahabad Bank branch will have the Indian Bank Allahabad logo or the name is written in a small letter. So, this is one.

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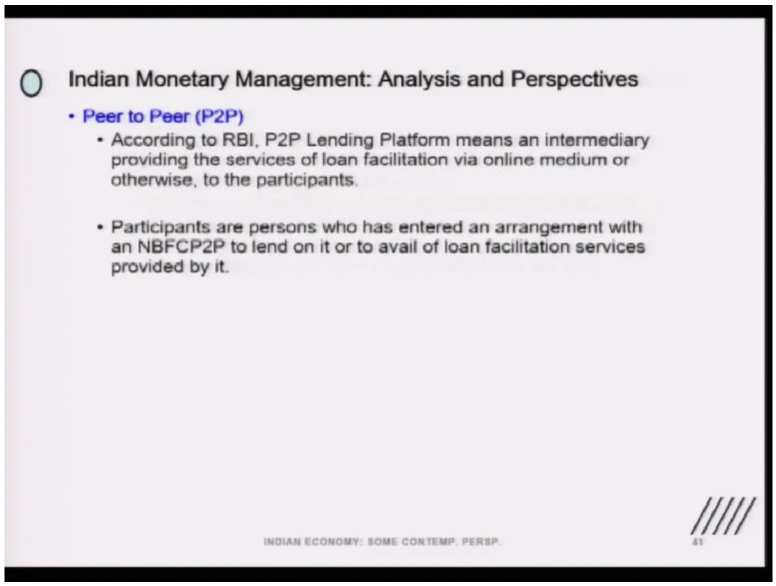

When Raghuram Rajan was the Governor at that time, so he had mentioned about the peer to peer lending platform. And peer to peer lending platforms are important to mention, because peer to peer lending platforms at that time because he was a more of a more of a digital person. So, he had mentioned that we should allow to have the peer to peer lending platforms operational and they should be also allowed to provide loan if they are. So, peer to peer lending platform means an intermediary providing the services of loan facilitation via online medium or otherwise to the participant.

So nowadays, there are a lot of controversies about this particular peer to peer lending platform where the recovery rate is low. So, peer to peer lending platform typically works is that those individuals who are not able to get the loan through the banks and other entities, because there is a higher requirement set by the RBI for sanctioning the loan, this peer to peer a form a will access or will provide the access of money through apps and all, so you can even borrow the money through apps you can register there, you have to submit the bills.

But certain documents for KYC, so KYC norms are a bit higher, but in some cases, it is being compromised and these individuals are given loan. But the rate of interest will be much higher than the rate of interest offered by bank. And as a result, it happens that there are higher default cases. Nowadays, it has been started coming into the print media and digital media also that pandemic when some people have faced the difficulties in making money, they have gone to these channels and they have borrowed money.

And because of the lack of opportunities, they have not been able to repay back and as a result, they have to face the adverse outcomes coming from the side of this P2P, there have been cases of suicides and death also. So, it was reported in case of in case of Telangana and other places. So, this is also one concern, but another concern is that this can be considered as one of the areas of expansion to look for where the peer-peer lending is playing a role. Participants are our persons who are entered an arrangement with the NBFC P2P to lend on it or avail the loan facilitation services provided by it.

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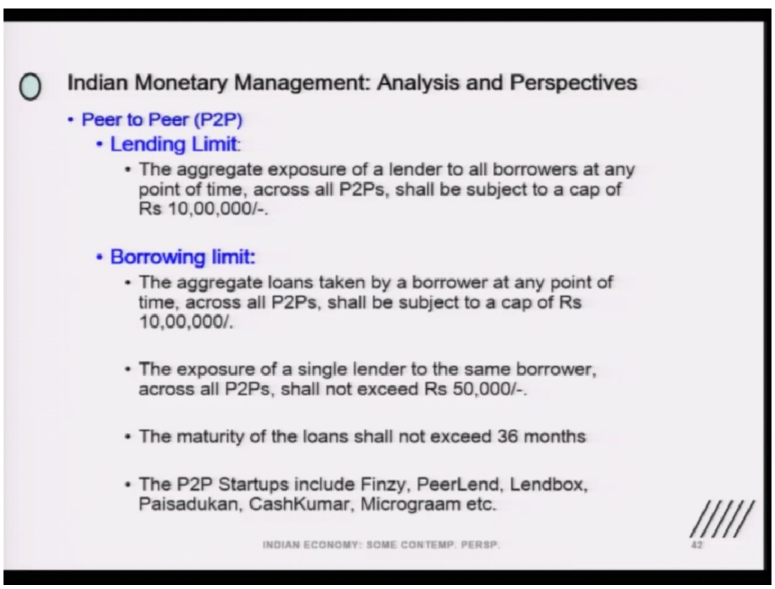

Then you have the lending limits. So, aggregate exposure of lender to all borrowers at any point of time, it should not be across all P2P subject to a cap of rupees 10 lakhs. Borrowing limit has been fixed so that there should not be any kind of extra risk generated from these P2P platforms. So, aggregate loans taken by per borrower at any point of time across all P2P shall be subject to a cap of rupees 10 lakhs.

The exposure of a single lender to the same borrower across all P2Ps are now being given the option that they should not exceed more than 50,000. The majority of the launch shall not exceed 36 months, which means that more than three years of loan should not be given. And P2P startup should also. So, these startups basically include Finzy, PeerLend, Lendbox, then you have PaisaDukan, Cashkumar, MicroGraam. So, these are the these are the P2P platforms that are important to mention.

So, I thought these are the recent developments and many times we do not cover such things. So, these things are important. Nowadays with the rise of the credit card and then you have the wallet system, where in online or wallet system wherein we can keep in money for some time and then we can use that for shopping or any other purpose those markets are also, those markets have also grown in recent years, the Central Bank is also coming up with some regulations.

In case a credit card, there is already some rules and regulations to check on the unnecessary the buy and sell of the credit card and there is a particular regulation of CIBIL score and also based on that, you will be given the cash limits and then, accordingly you can go for the settling of the contract of your credit card. And under FSLRC also we had seen that how microprudential regulations are going to help and how the consumer redressal units are going to be set up and how these units may help the consumer to address in any time kind of miss happening in this peer to peer or any kind of organization.

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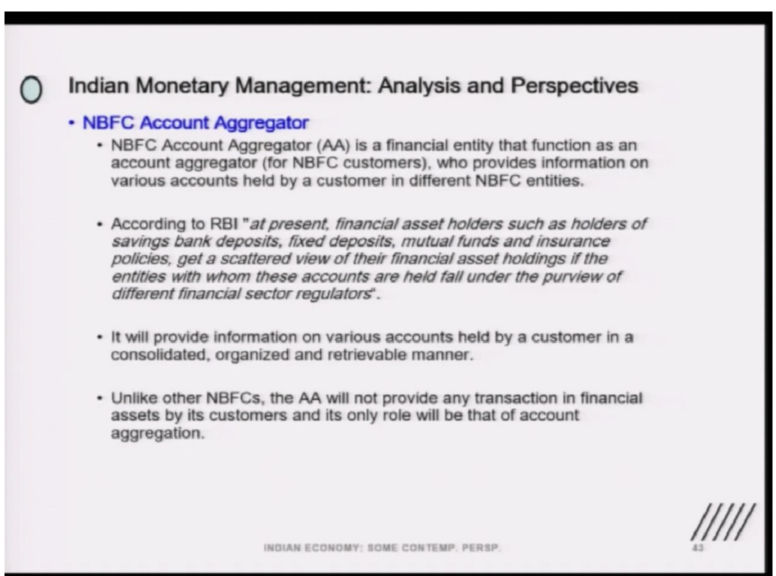

One more entity that has come up recently it is called NBFC Account Aggregator. NBFC Account Aggregator is an entity that functions as an account aggregator who provides information on various accounts held by customer in different NBFC entities. So, it will provide information on various accounts. So, nowadays, you will find that you have the different types of aggregators, you have the Paisabazaar, you have the PolicyBazaar, these website provide you the online services in terms of opening your D-Mat account, you can buy your policies, you can also go for some kind of saving options, if you want to explore some kind of saving options, then it will help you.

So, in intern what happens at once you open an account then they ask for certain details. So, there is a likelihood that since they have the crucial information, if they share this particular information with any other organization then it becomes some kind of the issue of what we call it the privacy concern. So, keeping that in mind these account aggregators are being now some rules are being devised by the Central Bank.

So, unlike NBFC, the account aggregators will not provide any transaction in financial assets by its customer and its only role will be that of account aggregation. So, this is one rule that the Central Bank is trying. And RBI also has mentioned this that at present financial asset holders, asset holders of saving bank deposits, fixed deposits, mutual funds, insurance policies, get a scattered view of their financial asset holdings, if the entirety is with whom these accounts are held or fall under the purview of different financial sector segments.

So, these are the recent development because of the online services now, it is easier for the customers to access or open the or utilize the financial services. But one risk that has happened that once you open the account, they ask for KYC norms and once, if you provide your all the details, so they can access the portfolio holdings, your financial position and if they share those details, then your financial security may also be compromised. So, keeping that in mind, it has been done in the same way.

So overall, I hope we have covered the landscape of the monetary policy, even the financial sector reforms. So, I hope it has given you the complete idea about the monetary system that we have in India, some policy instruments, I have also covered the recent changes in the monetary segment that we have.

Going ahead, we will have the fiscal policy and fiscal policies are important to be mentioned here, because fiscal policy requires a different kind of understanding. And we have gone through a lot of policy changes and keeping those changes in mind it is important that we should be knowing about it, we should be able to analyze it. So, I hope, in this in this particular at least 4 sessions that we had, you will have the complete idea about the monetary policy. Thank you. Thank you so much.