Economy This Week (20th Apr to 3rd May 2020)

Economy is an important part of the UPSC prelims and mains exams; this series titled ‘Economy This Week’ has been initiated to address the need to read and analyse economic articles in various business-related newspapers. The round-up of the Economy/Business section news for 20th Apr to 3rd May 2020 is given below. Business news is essential for IAS exam preparation.

1. Repo auctions get poor response (TH 24/4/20)

- The first auction of the second tranche of RBI's Targeted Long Term Repo Operations (TLTRO) has received poor response.
- This has been done in order to provide liquidity support for the NBFCs. The amount availed under this would be deployed in investment grade bonds, commercial papers and non-convertible debentures of NBFCs (at least 50% of these funds availed by the banks was mandated to be deployed in small and mid-sized NBFCs).
- The bid value was almost 50% of the notified value (i.e., they received bids for ₹ 12580 Cr. against the notified amount of ₹ 25000 Cr; bid to cover ratio was 0.5).
- This limited participation clearly highlights the reluctance of the banks to lend to small and mid-sized NBFCs.

2. RBI to impose cap on reverse repo (BS 20/4/20)

- The RBI is opposed to the practice of banks in parking the funds under its reverse repo window. Hence, it may not hesitate in imposing a cap on the reverse repo usage to ensure there is liquidity in the system.
- The RBI has slashed the reverse repo twice recently, the most recent by 25 bps to take the reverse repo to 3.75%.

3. White label ATMs struggle for survival (BL 25/4/20)

- The lockdown has increased the pain for White Label ATMs (WLAs) which were already under stress. These ATMs are facing viability issues.
- In the last three weeks, the transactions at these ATMs have fallen by 50% (even before this, the transactions in these were 25% to 35% lower compared to those in the regular banks).
- These were already under stress as these were unable to break even at the current rate of interchange fees. If the situation continues then some of these WLAs will have to shut shop.
- The other issues plaguing them are low volume of transactions (as these are mainly set up in rural areas - 80% of the total), high fixed costs.
- About 75% of the cost of running these WLAs are fixed in nature (rent, power, connectivity, etc.).
- The interchange fees has been fixed at Rs 15 per transaction and on a regular day, this has 70 to 75 transactions per machine compared to 110 to 120 transactions in a bank ATM.
- In June 2019, RBI had announced a committee to look into interchange fee structure. The recommendations of the committee are yet to be made public.
- Apart from this, another issue that has affected these is the fall in the uptime (ATM available and running to complete the transaction). It has come down from 85.8% to 73.5% (spare part transportation, logistics, engineer movement to correct connectivity issues, cash movement because of the lockdown, etc).

4. Costly to bypass MPC framework (IE 28/4/20)

- Post the 2008 Global Financial Crisis, like many other countries, India embarked on a path to pump liquidity into the market and like in many other countries, it did not end too well for India.
    - By 2013, the inflation was inching towards a double digit number and fiscal deficit was too high.
    - The market got caught in the taper tantrum and experienced external sector fragility.
    - These remain issues even today but India has improved vastly on the front of inflation (which has stabilized the external sector too).
- The RBI Act was amended to put in place the flexible inflation target framework (monetary policy framework agreement - MPFA), under which a Monetary Policy Committee (MPC) was set up and was given the duty of maintaining the inflation rate at 4% (plus or minus 200 bps).
- Until now the MPC has worked well lending transparency and democratic accountability to the rate setting process.
    - Inflation is very much within the range.
    - Food inflation has been managed.
    - Borrowing costs have been kept at reasonable levels.
- However, some of the recent decisions of the RBI have made the MPC decision on rates partly redundant.
    - RBI in recent times have taken various measures to increase the liquidity in the market but it has not led to satisfactory change in the interest rates.
        - It has contradicted the decision of the MPC to hold the interest rates.
        - Liquidity is no silver bullet for addressing the issues in financial sector.
    - The reverse repo rate is used by the banks to park the excess liquidity with RBI; the central banker has reduced this outside the MPC recently. Usually, the practice is that such tools are changed as a part of MPC resolution.
- The net effect is that RBI is controlling the interest rates in the market and not the MPC. The legal mandate of the MPC to set the interest rate is contracted by the liquidity management practices or decisions of the RBI.
- Other issues are:
    - The supply disruptions caused could lead to cost push inflation.
    - On the other hand, the increased supply of money could lead to rise in the economy-wide borrowing rates and imperil financial stability.