Economy This Week (23rd Jan to 29th Jan 2021)

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1. RBI moots scale based tighter regulatory framework for NBFCs (TH 23/1/21)

- RBI has suggested tougher regulatory framework for the Non-Banking Finance Companies (NBFCs) sector to prevent recurrence of any systemic risk to the financial system.
- The framework is based on a scale-based approach and will have a four-layered structure.
    - Base layer (NBFC-BL)
    - Middle layer (NBFC-ML)
    - Upper layer (NBFC-UL)
    - Top Layer
- If the framework is visualised in a pyramid form then:
    - The NBFCs where least regulatory intervention is required or those non-systemically important NBFCs will be at the bottom (NBFCP2P lending platforms, Type 1 NBFCs, etc).
    - Next layer will consist of NBFCs which are classified as Systemically important NBFCs (NBFC-ND-SI), deposit-taking NBFCs (NBFC-D), HFCs, etc. The regulations for this layer shall be stricter compared to the lower layer.
    - Next layer will consist of systemically important NBFCs which have a large potential for systemic spillover of risks and impact financial stability.
- The current threshold for being classified as systemic is proposed to be revised to ₹ 1000 Cr.
- There is also a proposal to reduce the extant NPA classification norm of 180 days to 90 days.

2. RBI proposes NBFC regulation (BL 23/1/21)

- When we move up the layers in the pyramid, the regulations will increase and become strict.

- The proposal is to regulate the top 25 to 30 NBFCs in line with the banking sector.
- Over 9200 will be in the NBFC-BL (P2P, Account Aggregators, non-operative financial holding companies), NBFCs with asset size up to ₹ 1000 Cr. This will cover more than 95% of the non-deposit taking shadow lenders.
- For NBFC-BL, the central banker has proposed to harmonise the extant NPA classification norm of 180 days to 90 days.
- ML would cover NBFC non-deposit taking, systemically important deposit-taking NBFCs, housing finance companies, infrastructure finance companies, etc.
    - Linkage for their exposure limits is proposed to be changed from owned funds to Tier I capital (as is applicable for banks currently).
    - These NBFCs should not give loans to companies for buyback of shares/securities.
- UL - consists of NBFCs identified as systemically significant (25 to 30 players).
    - The regulatory framework will be bank-like but with some modifications.
    - CET-1 capital could be introduced for these at 9%.
    - It is suggested that these players be prescribed differential standard asset provisioning on the lines of banks.

3. RBI proposes NBFC regulation (BL 23/1/21)

- On the basis of their nature of activities, these will be classified under the Base Layer (BL) and Middle Layer (ML).
- Base Layer:
    - Non-systemically important NBFCs (NBFC-ND), besides Type 1 NBFCs (that do not have either access to public funds or customer interface), NBFC P2P (Peer to Peer), Non-Operative Financial Holding Company (NOFHC) and NBFC - AA (account Aggregators).
    - The time period of classifying NPAs has been reduced from 180 to 90 days.
    - The asset size threshold has been raised from ₹ 500 Cr to ₹ 1000 Cr (which will bring more number of NBFCs under this category - from 9133 to 9209).
    - The entry norms have been tightened by increasing the minimum net owned funds from ₹ 2 Cr to ₹ 20 Cr.
- Middle Layer:
    - Consists of non-deposit taking NBFCs (292 as of July 2020) and deposit-taking NBFCs (64).
    - NBFC-HFC (housing Finance Company), IFC (9 Infrastructure Finance Companies), IDFs (four Infrastructure Debt Funds), SPDs (Stand-alone Primary Dealers) and CICs (64 Core Investment Companies) irrespective of their asset size will fall under this bucket.
    - Concentration Norms for NBFCs are laid down separately for lending and investment exposures (15% each for a single borrower and 25% for a group of borrowers), now RBI has proposed to merge the two limits into single exposure of 25% and group exposure of 40% computed as per Tier-1 capital (banks currently have single and group exposure limit of 20% and 25% respectively).
- Upper Layer:
    - For the top 50 NBFCs, which will be determined based on a range of parameters -
        - Size - 35%
        - Interconnectedness - 25%
        - Complexity - 10%
        - Supervisory inputs - 30% (it includes the type of liabilities, group structure, segment penetration)
    - As per RBI, the top 10 NBFCs in terms of asset size will automatically fall under this.

- These will have to maintain CET-1 at 9% (banks will have to maintain CET-1 at 7.375%) and also comply with leverage requirements (banks under Basel 3 will have to maintain a leverage ratio of 3.5% and in case of D-SIBs it is 4%; leverage ratio is the ratio of tier 1 capital and bank's exposures).
  - Top NBFCs will also move to differentiated standard provisioning norms, hence NBFCs with higher exposures to say commercial real estate may have to carry higher provisioning than earlier.
- Top Layer:
  - For now, this will remain empty.
  - If there is a systemic perceived from specific NBFCs in the upper layer then RBI can push some of these NBFCs into the top layer.

4. RBI proposals for NBFCs don't address key issues (TH 26/1/21)

- If the proposals are implemented then it will help these become more resilient to credit shocks.
- However, these will not address the funding and liquidity issues of the NBFCs.

5. Legally guaranteed MSP will not hit exports (BL 23/1/21)

- India's agri exports were estimated at $38.7 bn in 2019, accounting for 7% of total agri production. Exports of India also account for 2.5% of the total global agri exports.
- There is a discussion that if MSP is guaranteed then the export competitiveness of agri products will be lost.
  - Firstly, increased agri exports do not necessarily mean that the prices for the farmers have increased as they are connected with markets.
  - The farmers' livelihoods are not dependent on the global markets primarily nor does the agriculture sector itself dependent on the exports in any major way. India's agri exports' value is less than 10% of agri GDP (though the value of agri exports has been increasing).
    - 9 to 10% of the paddy is exported, but a large number of farmers are involved in the cultivation of this. In the case of cotton, it comes to 11 to 14%. In other crops, it is much lesser.
    - In the case of rice, the govt procured a record 44% of production at MSP in 2019-20, but the exports to global markets were not affected and non-basmati rice export doubled from the earlier year.
  - Another issue discussed is the impact of guaranteed MSP on cropping patterns. It is said that guaranteed MSP will shift cropping patterns and lead to greater production of pulses and oilseeds and it will lead to a change in the current agri import-export.
  - This could also reduce the dependence on import of vegetable oils and see an import substitution and save forex reserves.
  - It is important to note that the global markets and prices that prevail for various commodities are not a result of free or fair markets but of rigged rules in international trade.
  - Whether to provide legally guaranteed MSP or not and our agriculture policies should be decided prioritising the farmers' interests and not export markets.

6. Cost of guaranteed MSP (IE 23/1/21)

- Farmer unions protesting have demanded the repeal of the three farm laws and to provide legal guarantee for MSP. Currently, there is no statutory backing for the MSP.
- This can be done-
  - If the govt buys the entire crop from the farmers at MSP.
  - Govt mandating that the MSP will be the floor price for bidding in mandi auctions and forcing the private players to buy at a price at least at this floor price. This would not be feasible on many fronts.
    - Though govt mandates that sugarcane be sold at FRP - order issued under provisions of Sugarcane (control) order 1966 issued under the Essential Commodities Act - the mills have delayed payments to the farmers.
    - Market dynamics will determine the demand from the buyers' side.
    - If they are forced to purchase at a specific price and they run out of business then it will not benefit the farmers also.
  - Govt procurement
    - The MSP value of total production of 23 crops worked out around ₹ 10.78 lakh Cr in 2019-20.
    - All of this is not marketed and some are retained for self-consumption, the seed for next season and for animal consumption.
    - After all of this, the marketable surplus comes to an average 75% yield, MSP for this would come at around ₹ 8 lakh Cr.
    - Out of this, the govt need not spend on the sugarcane as the FRP is paid by the mill owners and the govt has already been paying MSP of ₹ 2.7 lakh Cr on wheat, pulse, paddy, oilseeds in 2019-20. Thirdly, the government need not have to purchase everything in the market, only if they can purchase even a third of this then it will lift up the market prices. In addition to this, the govt would be issuing food grains under NFSA which will offset some of the expenditures incurred by govt.
  - Issues with guaranteed MSP
    - Procurement does not cover livestock products, fruits, vegetables which comprise 45% of the overall agriculture, forestry and fishing output. The value of milk and milk products combined is more than that of cereals and pulses combined.
    - Guaranteeing the MSP will also have fiscal implications, rather than this, guaranteeing minus incomes linked to per acre or hectare landholdings would be a better way.

7. MSP guarantee won't solve the problems of Indian farmers (LM 9/10/20)

- With the govt passing the Farmers Produce Trade and Commerce (Promotion and Facilitation) Act 2020, there are concerns about MSP. The fear is that govt may stop providing MSP.
- The law has not made any such mention and the govt so far has not made any changes to its position on the procurement of food grains by FCI.
- The farmers are concerned that the FCI may procure from traders who have purchased these food grains at a cheaper cost from open markets (as there are no commissions and taxes).
- In this context, many of the opposition parties are demanding the government to guarantee MSP procurements. This demand has gained traction as it remains to be the only visible and accessible form of state support to agriculture.
  - Though MSP is announced for 23 crops, the procurement is centred around rice and wheat.

- The govt has procured more than what is mandated under buffer stocks. Such a huge procurement puts a financial burden on the centre and creates inflationary pressures by withdrawing the essential food grains from the market.
- The procurement of rice is mainly done in the top seven states and that of wheat from the top five states. Such skewed procurement practices might also cause environmental imbalances (farmers continue to grow rice despite the consequences of water and soil depletion).

- With the demand in the market becoming lower in the coming days (weaker economy and higher import costs), the MSP is unlikely to provide a solution for the low price realisation of most agricultural produce.

8. Govt mulls 5% inflation target to give RBI room (LM 28/1/21)

- Govt is considering increasing the CPI-based inflation target to 5% with a tolerance level of 200 bps so that the central banker will have more leeway to reduce the interest rates to boost economic growth.
- It is expected to be announced along with many other measures that the govt will be taking to boost growth.
- As per the first estimates of NSO, the economy is expected to shrink by 7.7% this fiscal.
- Govt in 2016 had notified CPI inflation target of 4% to be applicable from 5th August 2016 to 31st March 2021, with a tolerance level of 200 bps.
- As per the RBI Act of 1934, the govt in consultation with the central banker is supposed to fix inflation target for the next five years, starting from 1st April 2021.
- The need to increase the threshold was evident when recently the central banker had to pause the interest rate cuts with retail inflation hitting a 77 month high in October 2020 (at 7.61%), this was when the economy was struggling and required more stimulus, in addition to this, the economy had shrunk by 23.9% and 7.5% in first and second quarters of current fiscal respectively.
- Though retail inflation fell to 4.6% for the month of December, it averaged 6.6% for the nine months of the fiscal.

9. Our chance to champion solar energy as a cause (LM 26/1/21)

- The current govt has made it a priority to push the renewable energy sector and within this, it has focused on solar energy.
- India has been eager to become a lead member of the World Solar Bank (WSB), a multilateral lender proposed by the International Solar Alliance (ISA), by making an equity commitment of $600 mn for 30% stake in it.
- The proposal to set this up could be cleared soon by the steering committee of ISA.
- It could also be located within India itself, a study conducted has mentioned Bengaluru, New Delhi or GIFT City as the places best suited for this. If this happens then WSB would be the first multilateral development bank with its HQ in India.
- As the challenges associated with climate changes keep increasing, India should position itself as a champion of solar energy and India has been working towards this-
  - By 2014 there was only 3 GW of installed capacity of solar energy, this now stands at 37 GW (India has a target of having 100 GW by 2022).
  - Though this increase is significant, it accounts for just 10% of the total electricity capacity.
  - Hence it is clear that India has a long way to go before it can reduce its dependence on fossil fuels.

- Though covid has disrupted the installation, govt is confident of achieving the target (NITI Aayog Chief has stated that India would be crossing the target of 175 GW by 45 GW by 2022).
- Issues:
    - Solar cells are made up of wafer-thin slices of crystalline silicon; China and Taiwan account for over two-thirds of its output (issue with these cells are that they have less efficiency - can convert only a fifth of sun's light into electricity).
- Hence, India must develop the technology to take lead in this sector.

10. PSBs prefer AT1 bonds to raise equity capital (BS 29/1/21)

- Public Sector Banks (PSBs) are preferring the Additional Tier 1 (AT1) bonds for recapitalisation. The PSBs are the only ones issuing these bonds whereas the private sector banks are raising equity capital.
- The higher issuance of these bonds has been promoted by RBI, which wants these banks to be adequately capitalised to lend higher in the coming days and also take care of the bad debts arising because of the pandemic.
- So far in this fiscal, the PSBs have raised ₹ 17608 Cr through this and many are to issue these in the coming days.
- One change that has happened is that SEBI has shielded retail investors from buying these bonds and these are being placed on private placement basis, with only Qualified Institutional Buyers (QIBs) allowed to invest.

11. Govt may continue export promotion scheme (BL 27/1/21)

- Govt is considering continuing with the Export Promotion Capital Goods (EPCG) scheme, which allows exporters to import certain capital goods used in manufacturing without paying any duties.
- This is despite WTO panel ruling that the scheme is not consistent with the multilateral rules (India has already rolled back the MEIS scheme). India has appealed against this at the Appellate Body.
- The Foreign Trade Policy (FTP) 2015-20 was extended for one more year because of the impact of covid and most of the schemes including EPCG were extended.
- Under the scheme, imports of capital goods for pre-production, production and post-production are allowed at zero customs duty provided there are exports worth six times of the exempted duties, taxes and cesses, in six years.
- The capital goods attract on an average customs duty of 7.5%, exemption of this would provide an advantage to the exporters.

12. Cabinet clears policy on PSU privatisation (BS 28/1/21)

- The union cabinet has cleared the policy on privatisation and the details are expected to be announced in the upcoming budget.
- The policy will lay out a plan for the presence of the govt in strategic and non-strategic sectors.
- The policy was part of Atmanirbhar policy which was announced last year, govt has stated that it would be opening up all the sectors for private sector participation.

- Govt has stated that it will limit its presence to one to four companies in strategic sectors and to privatise, merge or bring the remaining companies under a holding company.
- As per the policy floated by the Department of Investment and Public Asset Management (DIPAM):
    - Around 18 sectors are classified as strategic such as power, telecom, defence, banking, insurance, etc.

13. To cool core inflation, budget may lower import duties (BL 27/1/21)

- Govt is looking into reducing the import duties to reduce the core inflation (a measure of price rises in non-food and non-fuel commodities and represents a long term trend).
- In December, headline inflation has come down to a 14-month low of 4.6% but however the core inflation has remained elevated at 5.5% (was 5.7% in November), this was the consecutive 8th month where the core inflation has remained above 5% level.
- When the companies incur higher input costs, it would simply inflate the prices of goods and this, in turn, would affect the common man.
- This will limit the options for the govt in terms of boosting economic growth rate, creating employment opportunities, investments in infrastructure, etc.
- The pandemic has led to a simultaneous demand and supply shock. In order to reduce the impact, govt is looking into reducing the import duty on metals and components. The govt has also identified many other products for the reduction of import duties.
- However, there is no clarity if the taxes on fuel will be cut as it adds to input costs.

14. Biden could revive WTO (BS 25/1/21)

- On the first day of the new administration, USA re-joined WHO and Paris Climate Accord, reaffirming its commitment to multilateralism.
- In the coming days, it may allow the appointment of new chief and judges in the appellate forum of its dispute resolution body (DSB).
- However over a period of time, the effectiveness and the role of WTO have come into question with inequitable distribution of benefits of globalisation and allegation that China is gaining by circumventing the rules of WTO, hence many years before, there were calls for reforms in the WTO.
- India has benefited from this, as one of the complaints regarding the export incentive schemes was ruled against India, which was then appealed but as the Appellate body is dysfunctional, hearings have not taken place so far.

15. At WTO India supports 'per farmer subsidy' rule (BL 26/1/21)

- Indian govt is working on a paper for WTO consideration which would be focusing on the adopting per farmer subsidy methodology so that subsidies for sustaining the livelihood of poor farmers could be treated differently from those used by some developed members to support large scale farm exports.
- India has been asking WTO to redefine the methodology of calculating farm subsidies to take into account the level of sops that each farmer is getting in every country.

- It now wants the WTO to adopt 'per farmer subsidy' methodology and redefine the 'principle of proportionality' so that subsidies for sustaining the livelihood for poor farmers could be treated differently from those used by developed countries to promote farm exports.
- India and China have pointed out that developed economies account for more than 90% of the global entitlements of $160 bn and this is beyond their de minimis. On the contrary, developing members have access only to de minimis, which has resulted in a major asymmetry.

16. Grain purchases may see a rejig (FE 25/1/21)

- Govt is planning to tweak the way state-run Food Corporation of India (FCI) procures and stores food grains.
- The proposals include:
  - Conducting third-party audits, which will bring in transparency and reliability in procurement operations in addition to bringing in a different view of the system.
  - Govt wants to revise archaic grain standards, which were set 20 to 30 years ago, keeping with the advances in harvesting and handling technologies and also include chemical and nutritional parameters.
  - The grains to be procured should not be lower than the grade used for human consumption.
  - Gunny bags should be tagged and traders, farmers should map and tag their produce before they sell at mandi to FCI or any state agencies (idea is to ensure end-to-end traceability, right from farmers to beneficiaries).
  - It wants to benchmark procurement quality and cost of acquisition with regard to private procurement.
  - To strengthen PDS, it intends to assess fair price shops on various parameters - infrastructure, inventory control, number of customers, etc.
  - Seeking feedback from ration shop beneficiaries to address their grievances.
- The overall expenditure of the govt (on procurement and food security) has ballooned over the years (was ₹ 1.73 lakh Cr in FY20), there are still complaints over the quality of the stocks.
- In addition to this, the food security obligations have strengthened open-ended procurement which has led to a costly pile-up of stocks.
- The debt burden on FCI has also increased. It had a debt of ₹ 3.3 lakh Cr at the end of FY20 (by FY21 it could have risen to ₹ 3.5 lakh Cr) and its interest outgo was ₹ 19167 Cr.

17. Big Bang end for Libor could overload markets (IE 27/1/21)

- At the end of this year, the interest rate benchmark Libor will be scrapped.
- This could leave banks and customers struggling to switch trillions of dollars worth of transactions to an alternative.
- In its place, rates set by central banks will replace Libor.
- One of the new benchmarks - Sonia - is set by the Bank of England, but switching outstanding contracts from Libor to Sonia in the last minute will be tricky.

18. Banks ready to move on from LIBOR (BS 27/1/21)

- The LIBOR will be scrapped at the end of 2021.
- Indian banks are ready to delink their foreign exchange loans from London Interbank Offered Rate (LIBOR) to an alternative reference rate.
- The two popular alternative rates are - Secured Overnight Financing Rate (SOFR) and Sterling Overnight Interbank Average Rate (SONIA), the issue with these rates is that globally only a few swap deals are linked to them.
- Three types of lending referenced to such international benchmarks are:
    - Line of credit
    - Raising dollar loans for working capital
    - Long term external commercial borrowings (ECBs)
    - Of these short-term borrowings are not an issue but the long-term loans are the problem area for both lenders (banks) and borrowers

19. India inks pact with IEA to bolster its energy security (LM 28/1/21)

- India has signed the Strategic Partnership Framework (SPF) with International Energy Agency (IEA).
- This will lead to an extensive exchange of knowledge and would be a stepping stone towards India becoming a full member of IEA.
- IEA is a Paris-based agency having 30 member countries.
- It is keen on India becoming a member as it will boost the global energy security apparatus and add more weight to its dealing with OPEC.
    - Recently Saudi Arabia (world's largest oil producer) cut its production and this led to volatility in oil prices (it accounts for around 40% of the global production and 83% of India's oil imports).
- Requirements for a country to become an IEA member:
    - Maintaining emergency oil reserves equivalent to 90 days of net imports (India currently stores 10 days of oil requirements with domestic refiners storing cold starve for 65 days' requirements; govt is also building the strategic reserves to support another 12 days' crude oil needs).