Economy This Week (30th Nov to 6th Dec 2020)

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1. Capital account convertibility (BL 1/12/20)

- The balance of payments is made up of two accounts - current and capital.
  - Current account consists of imports and exports of goods and services.
  - Capital account consists of cross border movement of capital by way of investments and loans.
- Current account convertibility means converting rupees into other currencies and vice versa without any restrictions whenever payments are made.
- In the case of capital account convertibility, there should not be any restrictions on Indians converting currencies to invest abroad and vice versa for foreign investors in case they are investing in India. India currently has partial account convertibility. Recently some of the reforms that have been taken to move towards capital account convertibility are:
  - Increased foreign portfolio investment limits in Indian debt markets (through Fully Accessible Route - FAR)
  - Easing of external commercial borrowing framework by relaxing end-user restrictions
  - Inward FDI is allowed in most of the sectors
- Despite many advantages associated with capital account convertibility, there are concerns of volatility in forex that is attached to this, hence developing countries are wary about this. Tarapore Committee in 2006 pointed this out.

Read more on Balance of Payments in the linked article.

2. India lagging on targets set in 1st RE-Invest (BL 1/12/20)

- The third edition of RE-Invest concluded on 28th November.
- India is still far away from meeting the targets set under first RE-Invest held in 2015.
- In the first edition, green energy commitments of deploying 271 GW were made. Current installed capacity is around 90 GW (36 GW solar and 38 GW wind energy).
- In solar energy, there has been a significant increase in capacity addition, but the same cannot be said about wind energy. This has been attributed to the withdrawal of benefits that were earlier given to wind energy project developers.
- Concerns:
  - Land availability problem. Some of the developers have started working around this problem by acquiring chunks of land rather than a single piece of land.

- The practice of the state governments to terminate Power Purchasing Agreements (PPAs) has been a concern for the project developers.

3. States need more legroom to raise development finance (LM 1/12/20)

- The central government has increased taxes on fuels and collected additional revenues; states do not have this option as the prices of these fuels are already high.
- In addition to this, the states have given up most of their indirect taxes under the ambit of GST and have a limited scope of boosting tax revenues (except in the case when the economy grows).
- This comes in the background of [Comptroller and Auditor General (CAG)] coming out with a report questioning the borrowings done by Kerala Infrastructure Investment Fund Board (KIIFB).
    - Has questioned rupee-denominated borrowings done by it.
    - Some of the KIIFB's borrowings are not just contingent liabilities but direct liabilities and should be included in the state's sovereign borrowing and Kerala not reporting this is unconstitutional.
- The state government has held that -
    - It has issued these rupee-denominated bonds after getting approvals from the central banker.
    - Off budget borrowings done by the centre is also not reported in its finances. Sovereign borrowing is distinct from borrowing done by state entities.
- If every state takes such a route then the total investments in the market can be increased to 40% of GDP.

4. Big decline in govt capex is pulling down the economy (LM 1/12/20)

- Despite the government's expenditure being cut, the growth for the second quarter is at a negative 7.5%.
- The final consumption expenditure of the government contracted by 22% in Q2, which in rupee terms comes to a ₹ 1.6 tn drop (centre+states) compared to the first quarter. What's more concerning is the fact the capex of the government has declined, which is considered as a growth stimulant for the economy.
- This means during the period wherein the government was unlocking the economy and was announcing a raft of stimulus measures to reverse the growth cycle, it was actually cutting down its budgeted expenditure. If the government had stuck to its budgeted expenditures, then the economic recovery could have been much stronger.
- The tax revenue receipts of the government have come under pressure because of the pandemic, this cannot be the reason for this decline in expenditure as the government in the month of May had extended its borrowings by ₹ 4.2 tn to ₹ 12 tn for FY21.
- The recent data has shown that the controlled expenditure has continued in the month of October also which may reflect in the growth rates for Q3.

5. Municipal Bonds (BS 3/12/20)

- The bonds issued by Lucknow Municipal Corporation (LMC) have been listed on the Bombay Stock Exchange (BSE).
- Bonds worth ₹ 200 Cr have been issued.
- Lucknow has become the 9th Indian city to have raised municipal bonds and the first city from North India to do so.

- It is also the first city from north India to get listed on the Bombay Stock Exchange (BSE).
- The funds raised through the issuance of these bonds will be used for developing infrastructure in water supply projects, housing projects, etc.
- Following this, Prayagraj, Varanasi, Agra and Kanpur would be issuing the muni bonds.
- The LMC bonds have offered a coupon rate of 8.5% and have a tenure of 10 years.
- The real cost of borrowing for LMC will come at around 7.25% after accounting for the ₹ 26 Cr incentive given by the centre for raising these bonds.
- These bonds have been rated at AA.
- So far, ₹ 3600 Cr has been raised by issuing the muni bonds. Funds raised through such issues are typically used to finance infra projects in housing, water, roads, etc.
- As per SEBI framework (2015), the local body -
    - Should not have a negative net worth in any of the three preceding financial years.
    - Shouldn't have defaulted on payments in the last one year.

6. Policymakers in a quandary as inflation looks far from ebbing (LM 1/12/20)

- The high inflation rate has reduced disposable income for the people as they would be paying more for the same quantity of goods/services.
- The higher prices of vegetables and proteins have kept the inflation rate elevated.
- Retail inflation measured at headline CPI (Consumer Price Index) has hit a six and a half year high of 7.6% for the month of October.
- The supply-side disruptions, prolonged monsoons, crop damage in the Deccan area will continue to push up the prices of food articles.
- The consumption accounts for over 55% in GDP and with the pandemic, the incomes of the households have been affected. At this time, higher inflation will further add to the household problems.
- The Private Final Consumption Expenditure (PFCE) for FY2020 stood at ₹ 123 tn and 1% rise in inflation will mean that the consumption expenditure will have to rise up by ₹ 1.23 tn to consume the same goods and services. With pressures on their incomes, the households tend to contain their expenditures of non-essentials when the food prices rise fast.