Economy This Week (13th Mar to 19th Mar 2021)

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1. Finmin sees red over SEBI move on AT-1 bonds tenor (BL 13/3/21)

- AT-1 (Additional Tier - 1) bonds are perpetual instruments issued by the banks, the capital raised will help these banks meet the capital requirements under the Basel guidelines.
- SEBI has issued a circular changing the guidelines regarding key valuation metrics of the AT-1 bonds. The regulator said that these bonds will be treated as having a maturity tenor of 100 years starting from 1st April.
- The Department of Financial Services (DFS) (part of the Finance Ministry) has raised concern over this and has asked the regulator to reconsider this.
- DFS has stated that this circular is disruptive and will lead to a huge swing in the net asset value (NAV) of debt mutual funds. As per DFS, the MFs are holding over ₹ 35000 Cr worth of AT-1 bonds, the value of which may fall to zero if the guideline is implemented.
- Logic is that if the nature of short term instruments that do not come with any specified maturity period is changed to 100 years then nobody would be willing to hold these in the short run and there would be a sudden rise in the redemption of these AT-1 bonds. In addition, this will shut down an avenue for the banks to raise capital, and increase reliance on govt capital. With the increased maturity tenure the banks will also have to provide higher interest.
- On the other hand, SEBI is concerned about the investors in AT-1 bonds whose investments were wiped out as in the case of YES Bank, Laxmi Vilas Bank; and the mutual fund industry has come out in support of these guidelines.
- These instruments though are perpetual in nature are generally recalled by the issuing bank after 5 years (call option), and this is considered as a tenure for these bonds. Now with tenure being increased to 100 years, the risk associated with these bonds will increase and the yields will also increase. This will result in notional losses incurred by the mutual funds which hold them. This notional loss will pull down the NAV of these debt MFs. If the investors in panic start redeeming these debt MFs, the fund will be forced to distress sell these bonds in the market.

2. India FX reserves become 4th largest in world (BS 15/3/21)

- India’s forex reserves have become the 4th largest in the world and have surpassed that of Russia.

- The central bank has started accumulating these to provide a cushion to the economy against any sudden outflows of dollars.
- India's foreign currency holdings fell by $4.3 bn to $580.3 bn as of March 5.
- China has the largest reserves followed by Japan and Switzerland.
- India's forex reserves are sufficient to cover imports for 18 months, have been bolstered by a rare current account surplus, rising inflows into the local stock market and foreign direct investment.
- Higher forex reserves will provide comfort to foreign investors and credit rating agencies as the govt will be able to meet debt obligations.

3. DFI to raise ₹ 3 lakh Cr (FE 17/3/21)

- The govt has decided to revive the DFI model as the banking sector-
    - Is not suited to fund long term infrastructure projects
    - Demand for such financing is too large to be met by the banking sector
    - Is burdened with large NPAs
    - Are tailored to provide working capital loans with shorter tenure
    - Lack the expertise to understand nuanced approach to infrastructure lending
- Cabinet has cleared a bill to set up Development Finance Institution (DFI) - National Bank for Financing Infrastructure and Development (NaBFID).
    - It will be managed by a professional and also will have a professional board
    - The board will have the powers to remove the whole-time directors and not the govt
    - The board will decide whether to subsume the state-run IIFCL
    - To draw the best talent the govt is offering market-driven emoluments to the top executives
    - The tenure of the managing director and deputy managing director could be increased along with relaxation in the age limit to attract top talented professional
- This will provide an enabling ecosystem for drawing capital and will fund long term infrastructure projects.
- DFIs will also play an important role in promoting infra projects under the ₹ 11 lakh Cr NIP.
- The DFI is expected to raise as much as ₹ 3 lakh Cr over the next few years, leveraging the initial capital of ₹ 20000 Cr.
- Initially, the govt will be holding the complete ownership of DFI but over a period of time with more investors coming in the govt's equity will be diluted to 26%.
- The bill is expected to be introduced in the present session of Parliament for clearance.
- The govt, to ensure that it will be lending at reasonable rates for the infrastructure projects which will ensure the long term viability of the DFI, will be granting tax benefits for a period of 10 years. The govt will also be amending the Indian Stamps Act to extend certain other benefits.
    - It is also important to ensure that the DFI will get access to cheaper funds as the banks will have access to CASA (Current Account and Savings Account) deposits.
- The DFI is also expected to have a positive impact on the bond market. The sovereign wealth funds and insurance funds that bring in-patient capital are expected to invest in this to get the benefits of tax exemptions. This will ultimately help deepen the bond market.
    - However, the bond market which stands at 15 to 16% of GDP needs many more structural reforms.
- Given that the demand for long term infrastructure financing is very large, a single DFI cannot satisfy the demand, hence the govt will be promoting such private-owned DFIs also.

4. RBI extends cheque truncation to all branches (FE 16/3/21)

- RBI will be extending Cheque Truncation System (CTS) across all bank branches by September 2021.
- This is expected to promote faster and smoother cheque clearances in the country.
- It will also make the customer experience uniform across all the branches in India.
- The banks can choose a suitable model for this like deploying a suitable infrastructure in every branch or following a hub and spoke model.
- CTS has been in use since 2010 and presently covers 1.5 lakh branches.
- However, some of the branches have not migrated to CTS which has created hardships for the customers of the banks.

5. No back door pact for defaulting promoters (IE 17/3/21)

- SC has ruled that promoters of insolvent companies, which are barred from bidding for their own companies under Section 29A of the IBC, will not be allowed to use any other scheme to regain control of the company even if it has gone into liquidation.
- Earlier the NCLAT had ruled that under Section 230 of the Companies Act (allows promoters/creditors to propose a restructuring scheme for the company in distress) cannot be used by anybody who is ineligible under Section 29A of IBC.
- The SC has upheld this decision of NCLAT and has stated that Section 230 would be applicable in the normal course of the working of the company and not the one that is facing liquidation under IBC.
- The SC has further noted that the company has to be protected from its management and corporate death.
- With this, the insolvency resolution process will be expedited. Under IBC the objective is to find a viable resolution plan for the company, if there are none then the liquidation process is conducted. It is important to speed up the liquidation process to maximise the value of the assets of the company.

6. Mechanised farming is the mantra for higher yield (BS 19/3/21)

- As per the census 2011, there are 263.1 mn workers (118.8 mn cultivators and 144.3 mn agriculture labourers).
- To boost farm mechanisation, Sub-Mission on Agriculture Mechanisation (SMAM) has been launched by the union govt, under which the purchase of many pieces of equipment will be provided with a subsidy to the extent of 40 to 50%.
- Tillage, sowing, planting, harvesting, reaping, threshing, plant protection, inter cultivation and residue management in all crops are getting mechanised across the states.
- This is coming after the union govt's promotion of the mechanisation of the agri sector.
- In FY18, FY19 and FY20 the central govt has released funds worth ₹ 1591 Cr, ₹ 2502 Cr and ₹ 2101 Cr respectively to the state governments to promote farm mechanisation.
- With mechanisation, the impact will be:
  - Save one-third of the time of operations
  - 30% reduction in labour requirements
  - Reduced requirements of other inputs such as fertiliser, diesel consumption, etc.
  - 17.9% increase in productivity
  - 14.1% increased seed germination

7. More banks may join RBIs systemically important banks (BS18/3/21)

- RBI's list of systemically important banks (SIB) may be altered with many of the PSBs being merged.
- As on date, SBI, ICICI and HDFC are part of D-SIB.
- With mergers of PSBs, the rankings of banks in terms of their asset sizes have changed.

8. Looking beyond privatisation (TH 18/3/21)

- Govt to increase the efficiency in the PSBs has announced privatisation. It is not yet clear whether privatisation would bring in efficiency or reduce associated risks.
- Around the world:
  - Many of the private banks have failed.
  - If private entities were so efficient then why do private companies account for a large chunk of NPAs?
- With the nationalisation of banks in 1969 and 1980, the banking sector was transformed. There were outcomes such as:
  - Increased access to credit for agri sector and also benefiting the poor
  - Employment generation activities were promoted
  - Poverty alleviation and rural development was supported
  - Women empowerment, small scale industries, etc. became a priority for the banks
  - This also promoted equitable regional growth. As per RBI data, there were 1833 bank branches in rural areas in 1969, which rose to 33004 by 1995 and continued to grow over the next decades.
  - This also reduced the dependence on money lenders in rural areas.
  - It also promoted the working conditions of the employees by ensuring higher wages, job security and other fringe benefits.
  - The PSBs have become vehicles of the Indian economy's growth and development and have become trustees of people's savings and confidence.
  - PSBs have also helped in making the country self-sufficient by promoting green, blue and dairy revolutions.
  - They also have contributed significantly to infrastructure development.
- PSBs have been making profits in FY19 and FY20, then why is govt privatising these instead of strengthening them? Such a move may -
  - Deny convenient and economical banking services to the common man
  - Risk monopoly and cartelisation
- Way forward
  - Rather than blaming the PSBs for higher NPAs, stringent measures must be taken to recover NPAs from the private corporate companies
  - There is an imperative to change the wilful defaults to criminal offence
  - A system should be put in place to examine the top executives of PSBs across the country

9. 50L got workers to be brought under social security net (FE 13/3/21)

- The Labour Ministry has set a target of bringing 50 lakh gig workers under the Employees' State Insurance Scheme (ESIC) after the implementation of the Code on Social Security is done. This number may go up in the future. The idea is to bring them under some sort of social security net.
- The code seeks to extend the social security benefits to gig workers and platform workers.
- The centre was to implement the four labour codes from 1st April 2021, but with many states yet to frame the rules, the implementation will be delayed.
- In the budget for FY22, govt has proposed to set up a database of informal sector employees including gig and platform workers.
- ESIC is applicable to establishments having more than 10 workers, option for those establishments with less than 10 workers has also been provided under ESIC.
    - ESIC is present in 570 districts and the govt wants to extend this to all 740 districts.

10. Rajya Sabha passes bill to raise FDI limit in insurance sector (BS 19/3/21)

- Rajya Sabha has passed Insurance Amendment Bill 2021 which increases the maximum Foreign Direct Investment (FDI) limit in the insurance sector to 74% (from 49%).
- Issues raised:
    - Govt selling the companies and leapfrogging to the privatisation of national assets.
    - When the insurance companies have not reached even 49% which is allowed now, why is the govt going for the increase?

11. Inflation quickens as Jan IIP contracts (TH 13/3/21)

- The retail inflation has increased to 5.03% on account of higher fuel prices and food prices.
- This is a three-month high.
- The Consumer Food Price Index (CFPI) has increased to 3.87% in February compared to 1.96% in January.
- Inflation in the transport and communications category was 11.4%, which is higher than 9.3% for January.
- The weakening base effect in February has contributed to higher food inflation.
- Vegetable prices remained in a deflationary mode for the third consecutive month.
- Health inflation which was at 6.3% (is a 17-month high) is turning structural.
- The industrial production contracted to 1.6% in January on account of a decline in output of capital goods, manufacturing and mining sectors. The index registered a positive growth of 1.04% in December.
- The manufacturing sector (weighing 77.6% in index) contracted by 2% in January against a growth of 1.8% in the same month of the previous fiscal.
- In the coming days, higher liquidity in the market, along with the rising fuel prices may add to inflationary trends.