Keeping the Economy Funded

What is the issue?

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- RBI has raised the repo rate by 25 bps in order to rein inflation.
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- While controlling inflation is important, it is also vital to ensure sufficient funds to aid businesses to capitalise on projected economic uptick in FY2019.

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What is RBI's inflation outlook?

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- **Projections -** RBI looks confident of the growth prospects and has estimated the FY18-19 growth to be 7.4% (FY 2017-18 level was only 6.6%)
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- Notably, it has sighted improved "Foreign Direct Investment" (FDI) flow and pick-up in services and manufacturing growth as reasons for optimism.
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- Hence, in line with the projection in its June review, RBI in its recent review again revised its 2H FY19 inflation forecast upwards by 10 bps to 4.8%.
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- **Actions -** RBI's "Monetary Policy Committee" (MPC) has also raised the repo rate by 25 basis points (bps) for the second time in a row.
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- This has reiterated RBI's position as an inflation warrior by sticking to the path of maintaining the $4\pm 2\%$ inflation target.
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- Clearly, it is watchful of inflationary pressures like firming household expectations, monsoon spread, increase in crop MSP and fiscal risks.
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What are the challenges to reap the projected economic potential?

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- The latest FICCI survey shows that capacity utilisation levels are in the 75-80% range for sectors such as auto, chemicals, electronics, leather and footwear, machine tools, metals, paper products and textiles.
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- Considering this, the funding pattern calls for change – funds has to now move away from working capital loans and cater to capacity enhancement.
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- Hence, while increase in the cost of funds (due to 25 bps raise by RBI) is being debated, the real issues will be fund availability for capacity enhancement.
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- This can be ushered in only through a conscious policy push as the Indian banking sector is in a deep mess.
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What is the scenario in India's banking sector?

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- Public sector banks (PSBs) that comprise 70% of the total banking system, hamstrung by poor balance-sheets, are yielding space to private players.
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- The government and the RBI have leaned heavily in favour of the insolvency bankruptcy code (IBC) to resolve the NPA problem.
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- Also, the RBI has put 11 PSBs in the prompt corrective action (PCA) framework list and reportedly six more are likely to be added to this list.
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- RBI's recent "Financial Stability Report" (FSR) estimates that the gross NPA ratio (bad loans as a percentage of total loans) will reach 12.2% by March 2019.
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- While would be the highest since 2000, a further warning bell is that FSR states that this could worsen further if macro-economic conditions deteriorate.
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- More significantly, for PSBs the gross NPA ratio may increase from 15.6% in March 2018 to 17.3% by March 2019 - indicating severe stress.
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- In this context, private banks will have to do the heavy lifting in meeting the

credit needs of an economy which is beginning to recover.
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What is the way ahead?

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- India's investment cycle is poised for a cyclical upswing from FY19, after years of sub-par performance.
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- In this context, it is important to incentivising and nurturing sectors in need of funds before the cost of funds begins to bite.
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- Notably, this is all the more significant considering the global headwinds, which looks risky due to rising political and trade tensions, and currency wars.
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Quick Facts:

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What is "Prompt Corrective Action"?

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- To ensure that banks don't go bust, RBI has put in place some trigger points to assess, monitor, control and take corrective actions on banks which are weak.
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- The process or mechanism under which such actions are taken is known as Prompt Corrective Action (PCA).
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What is "Financial Stability Report"?

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- "Financial Stability Report" (FSR) is released by the RBI.
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- It reflects the overall assessment of the stability of India's financial system

and its resilience to risks emanating from global and domestic factors.
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- The Report also discusses issues relating to developments and regulation of the financial sector.
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Source: Business Line

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