Mr. PM: it's time for bold economic thinking

The chief of the government would do well to take a leaf out of Narasimha Rao's book and show statesmanship

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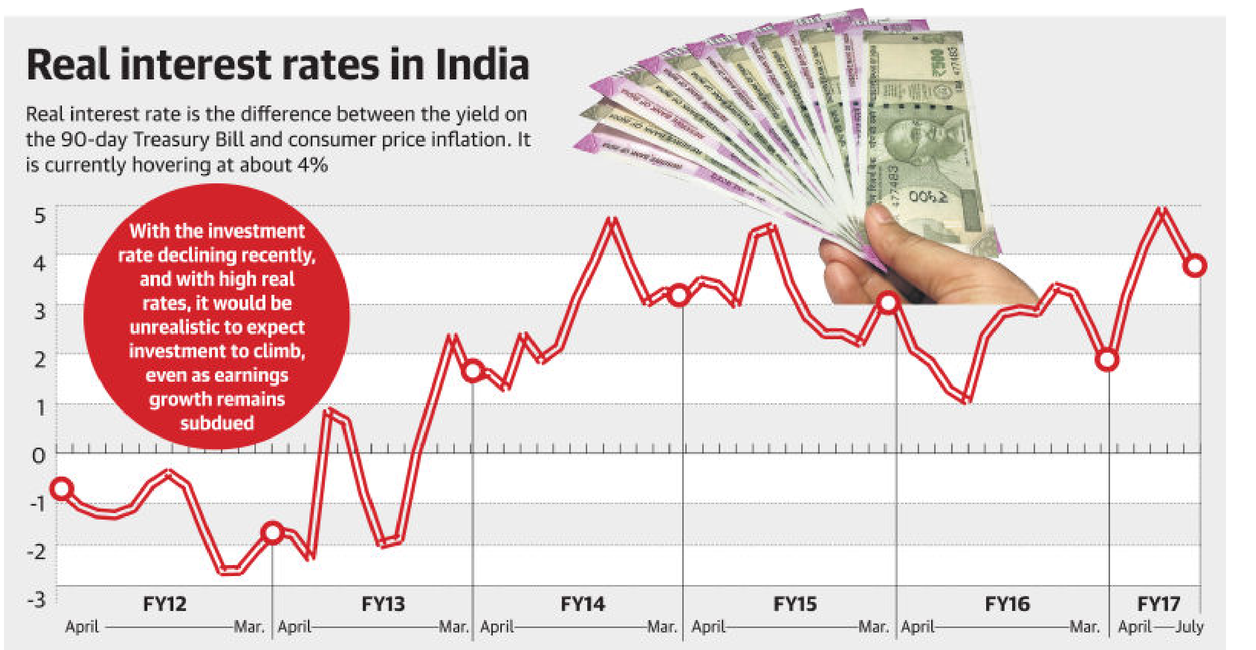
The Indian economy is currently in a paradoxical situation. The world has been praising India for its rapid economic growth, inflation is down, forex reserves are more than $400 billion, fiscal deficit is on target and current account deficit until recently has been less than 1% of GDP and comfortably financed by capital inflows.

India's oil imports in FY13 was $164 billion and by FY17 it was only $83 billion, thereby lowering the current account deficit as a percentage of GDP from 4.8% in FY13 to just 1.1% in FY17. The lucky government has also had two straight years of good monsoons. However, both the supporters and detractors of the present government have described the state of the economy as 'sinking' and as being 'in a tailspin', etc.

The stock market is at an all-time high in anticipation of a surge in earnings which is yet to materialise. The newly appointed head of the NITI Aayog, Rajiv Kumar, has been refreshingly honest in admitting that lack of investment and anaemic job creation are significant challenges for this government.

The RBI, in its latest monetary policy report, lowered the projected growth rate for FY18 from 7.3% to 6.7% and, more importantly, reserved its opinion as to whether the marked consecutive dip in growth rates for the last two quarters was a blip or not. So, what's going on? Politically, the government is on the defensive. But, it has so far refrained from taking hasty and populist spending decisions.



Source : Reserve Bank of India's 'Handbook of Statistics on Indian Economy'

'Production possibility'

Going by the hefty anecdotal evidence available, both the demonetisation episode of 2016 and the introduction of GST in July have imposed short-term costs in the form of lowering of growth rate in the current fiscal.

But it must be told in the same breath that the culture as well as the regime for direct and indirect tax compliance in India is undergoing a fundamental shift for the better in a way that has not happened before. This is certainly going to expand the 'production possibility frontier' of the economy. However, there is uncertainty on how fast this is going to happen. A lot will depend on follow-up policy actions on the part of the government. The equity market seems to bet the recent downward growth rate trend is just a blip.

'Eroded confidence'

Our diagnosis is, the lack of speedy resolution of the stress in PSU banks and corporate balance sheets has eroded business confidence leading to lower investment and poor job creation. The government announcement of a stimulus package may deal with the problem cosmetically rather than address it at its root. The current government has shown limited appetite for serious financial sector reform.

It has been long on rhetoric such as 'Indra Dhanush' and has evinced little resolve to deal with the massive non-performing loans problem.

The recent RBI move to refer large stressed accounts to the National Company Law Tribunal so that they could be dealt with under the Insolvency and Bankruptcy Code will likely lead to two consequences: One, the resolution will take a very long time, and two, recoveries will be much lower than what would have been possible by way of one-time payments that could have been negotiated with delinquent borrowers for full and final settlement of dues.

The aim to ring-fence boards and executive of PSU banks from probes by the three Cs, CBI, CVC and CAG, will impose a cost on the economy by delaying resolution of distressed loans and causing more losses to PSU banks. A decisive break from the shackles and shibboleths of the past is needed in respect of PSU bank policies.

The high savings in India are currently not directed to productive, long-term investments as corporates have still not been able to repair their balance sheets.

Further, that intangible thing called "confidence", be it consumer or business, has been faltering. In fact, the Dun and Bradstreet composite CFO Optimism Index which takes into account the overall financial and macroeconomic conditions has declined to a five-quarter low, slipping to 11% on an annual basis and by 5.7% on a sequential basis.

The AC Nielsen Consumer confidence index for India in Q2 2017 was 128, declining 7 percentage points compared with Q42016, while global consumer confidence rose 3 percentage points during this time interval. Despite the fall, Indian consumers are still the second most optimistic among the 63 countries surveyed by AC Nielsen.

The table captures the real interest in India (calculated as the difference between the yield on the 90-day Treasury Bill and consumer price inflation) which is currently hovering around 4%. Against the backdrop of a perceptible decline in the investment rate in the recent quarters and given such high real rates, it would be irrational to expect investment to pick up in an environment where earnings growth has also been elusive. What needs to be done now to get India back on the high growth track? We recommend a five-step plan:

Five-step plan

First, demonetisation was politically successful but an economic failure. We can use the current crisis to introduce an amnesty scheme, *a la* Indonesia, to allow tax payers to voluntarily disclose hitherto undisclosed income kept domestically and abroad. Indonesia – a nation of 250 million people, with 32 million registered tax payers but only 8.9 million actual tax payers – had close to 1 million people disclose $365 billion (40% of GDP) of undisclosed income this year, the bulk of which was held domestically and a portion abroad, notably $55.5 billion in Singapore.

The Indian government should announce a one-time programme valid till December 31, by when anyone can disclose previously undisclosed income held within the country and abroad, for which they will pay a small, one-time fine of 4%, while 50% of the domestic holdings (100% of foreign cash/near cash holdings) will need to be invested in two large government funds – one for infrastructure and the other for bank recapitalisation.

The amounts thus invested will be locked for seven years with a compound interest of 4% per annum. Post redemption, the amounts and the interest thereon can be used freely for any lawful purposes in India.

While scheme will be generous, come January 1, criminal prosecution should be instituted against Indian residents holding large sums of undisclosed income. This government has built some credibility to pursue cases of high-profile corruption. By highlighting the automatic exchange of financial account data with nations such as Singapore and Switzerland, it can ensure that the scheme is taken seriously.

The work done so far by the SIT on money stashed abroad and the information obtained through Panama leaks could be a good input to test and start the scheme. After all, this government had made the bringing back of black money kept abroad as one of its core election promises. Now it needs to walk the talk.

Second, ensure that the full extent of the NPA problem is recognised latest by December 31 and that banks make necessary provisions in this regard. The consequent shortfall in equity capital adequacy for PSU banks should be met through recapitalisation by March 31.

The boards of PSU banks should be recast by bringing in persons with demonstrated professional experience and achievement. The selection of CEOs of PSU banks and determination of their tenure and compensation package should henceforth be the main of their boards.

Boards should be fully empowered decide on loan resolution by way of real restructuring, with or without haircut, and one-time payment. All cases of suspected wrongdoing involving collusion between borrowers and banks in loan resolution should be screened and vetted first by a high-level committee of former bankers drawn from public and private sectors before being taken up by the 3 Cs. Clear guidelines should be established for such screening and vetting.

Third, accelerate infrastructure investments, especially in agricultural storage/support infrastructure, in post-harvest processing, water efficiency technologies, extension services etc. to make agriculture more productive.

Fourth, facilitate new export engines – 'Make in India' and 'Serve in India' – with emphasis on defense exports and medical tourism. An ambitious target of $100 billion over the next 10 years can be set for these two segments as the world is becoming an increasingly dangerous place and global population less healthy with chronic diseases for which India can offer holistic cures.

Lastly, the PM must take a leaf from the book of former Prime Minister, Narasimha Rao, who was heading a minority government. Despite its existence on the edge, he dared to bring in a technocrat at that time – Dr. Manmohan Singh – to launch economic reforms. That was statesmanship. Mr. Modi needs fresh and bold economic thinking to steer the future of 1.3 billion aspiring Indians and the next big battle for the ballot in 2019.

(Sivaprakasam Sivakumar is MD, Argonaut Global Capital and Himadri Bhattacharya is senior advisor, Riskontroller Global. Views are personal)

EVs: govt., private firms charging up

All set for cloud-based infrastructure

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India's push for electric vehicles is gaining traction with government as well as the private sector increasing investment in the back-end infrastructure required to achieve the Centre'sall electric vehicle target by 2030.

Activity under the Centre's Faster Adoption and Manufacturing of Hybrid and Electric Vehicles (FAME) scheme has picked up pace over the last year with the Centre providing direct support to more than 49,000 electric and hybrid vehicles between November 2016 and June 2017.

Previously, it had provided support for 99,000 vehicles between April 1, 2015 and November 2016.

Last month, the government-owned Energy Efficiency Services signed an agreement for the purchase of 10,000 electric vehicles from Tata Power with 500 of the vehicles to be delivered by November. The project attracted bids from domestic companies Tata Motors and Mahindra & Mahindra and from the Japanese multinational, Nissan.

"Environmental concerns are growing and people are realising they have to be responsible as far as fuel consumption is concerned," Alok Tripath, executive director at the Petroleum Conservation Research Association said in an interview.

Charging infrastructure

"In India, people are mistakenly thinking that providing charging infrastructure for electric vehicles is a the job of distribution companies, and the distribution companies feel this is just a plug point that needs to be given in which the car can be charged," Sanjay Aggarwal, managing director, Fortum India, told *The Hindu.*

"But this is far from the truth in the sense that it is more of a service provider function," Mr. Aggarwal added. "Electricity just happens to be a small part of the whole service offering. In Norway, we have a cloud service that is also connected to the payment gateway and every individual electric car owner gets an RFID tag. So while you are driving, you can look up on an app where the next charging station is and what the status of your battery is."

Fortum Oyj, the Finnish clean energy parent company of Fortum India, signed a memorandum of understanding with NBCC (India) Limited, a Government of India enterprise, to bring this cloud-based backend infrastructure for electric vehicles to India.

As a first step, Fortum inaugurated one 22 KW AC charger on a pilot basis in New Delhi. "We are looking to install 100-160 charging stations in the next 12 months in Delhi, Mumbai, and Bangalore," Mr. Aggarwal added.

The Centre also initiated its own pilot projects in the sector, having installed 25 charging stations in Bengaluru.

Competitive transport fuel bodies like the Indian Auto LPG Coalition have raised objections to electric vehicles saying that they were not suitable for commercial purposes since such vehicles do not remain idle at night, when most electric vehicle batteries are normally charged. This too can be addressed, Fortum said.

"India doesn't have cars in India that can be connected to the DC chargers," Mr. Aggarwal said. "Instead, they rely on AC charging which takes about 4-6 hours to charge. A DC charger typically takes 30 minutes for a full charge. Abroad, companies like Nissan and Tesla already have DC charging vehicles. As more car manufacturers come to India for electric, then DC charging will also be established."

EXPLAINER

Why do we need external benchmarks while pricing loans?

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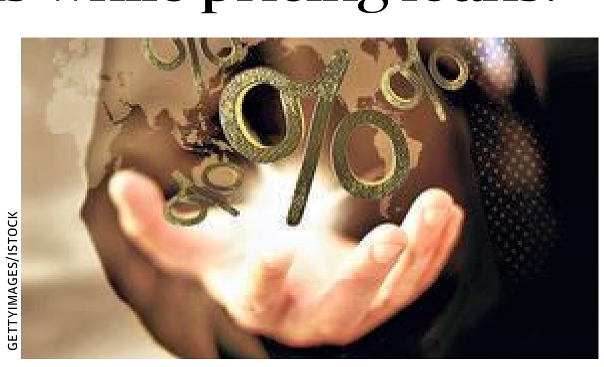

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An internal Study Group constituted by the Reserve Bank of India (RBI) has recommended that banks should set interest rates based on an external benchmark and not as per internal benchmarks as is the practice now. Here is what you need to know on the subject:

What is the need for external benchmarks?

■ The Study Group has found that the present loan pricing regime, that is, the marginal cost of fund based lending rate (MCLR) or the base rate under the previous regime were both calculated based on banks' internal factors such as cost of funds. They are insensitive to changes in the policy interest rate or repo rate. Analyses by the group suggested that banks deviated in an ad hoc manner from the specified methodologies for calculating the base rate and the MCLR to either inflate the base rate or prevent the base rate from falling in line with the cost of funds.

What external benchmarks are available?

■ The study group has cited 13 possible candidates as external benchmarks: the weighted average call rate (WACR), collateralised borrowing and lending obligation (CBLO) rate, market repo rate, 14-day term repo rate, G-sec yields, T-Bill rate, certificates of deposit (CD) rate, Mumbai interbank outright rate (MIBOR), Mumbai inter-bank forward offer rate (MIFOR), overnight index swap (OIS) rate, Financial Benchmark India Ltd. (FBIL) CD rates, FBIL T-Bill rates and the Reserve Bank's policy repo rate. The report also said that no instrument in India met all the requirements of an ideal benchmark.

However, the group shortlisted 3 candidates from these 13 – one of which could be selected by RBI as external benchmarks after receiving feedback from all stakeholders. The Study Group is of the view that the T-Bill rate, the CD rate and the RBI's policy repo rate are better suited than other interest rates to serve the role of an external benchmark.

From when will the external benchmark come into effect?

■ The Study Group has recommended that all floating rate loans extended beginning April 1, 2018 could be referenced to one of the three external benchmarks selected by RBI. The report said banks may be advised to migrate all existing loans to the new benchmark without any conversion fee or any other charges for switchover on mutually agreed terms within one year from the introduction of the external benchmark, i.e., by end-March 2019.

What will the spread be?

■ The Study Group was of the view that the decision on the spread over the external benchmark should be left to the commercial judgment of banks. However, the spread fixed at the time of sanction of loans to all borrowers, including corporates, should remain fixed all through the term of the loan, unless there is a clear credit event necessitating a change in the spread.

What is the reset clause?

■ The group suggested quarterly interest rate resets as opposed to a one-year reset as practised now for improvement in monetary transmission.

Will deposits also be linked to the external benchmark?

■ The report said banks may be encouraged to accept deposits, especially bulk deposits at floating rates linked directly to one of the three external benchmarks. The new State Bank of India chairman Rajnish Kumar has already expressed the need to move deposits rates to an external benchmark, in case loan prices are based on such benchmarks.

Mapping the not-so-normal monsoon

States where rainfall has been deficient make a difference to crop prospects

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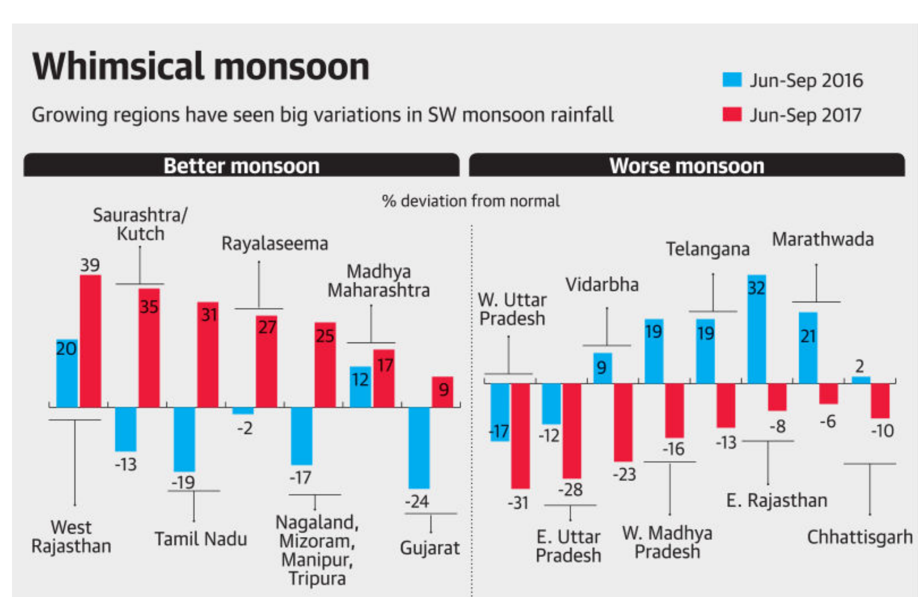
If you're statistically inclined, you may be celebrating the fact that the south-west monsoon for 2017, which is now bowing out, has turned out to be normal for the second consecutive year. But farmers know that there can be many shades of grey to an officially 'normal' monsoon.

Another bumper year?

India has received a total 841.3 millimetres (mm) of rain in the south-west monsoon season from June 1 to September 30 this year.

IMD deems the season 'normal' if the all-India quantum of rain falls within a 10% range of its long-period average of 887.5 mm. The 2017 monsoon fell short of the number only by 5%. In fact, the cumulative rainfall numbers this year aren't very different from 2016 when the country recorded 862 mm of rain. This may seem like good news. In 2016-17, India harvested a record crop of cereals (252.7 million tonnes) and managed a quantum jump in its output of both pulses (16.3 million tonnes in 2015 to 22.9 million tonnes in 2016) and oilseeds (25 to 32 million tonnes). This contributed to a significant bump-up in the agriculture leg of the GDP which grew 4.9% in FY17 compared with 0.7% in FY16.

But expecting an encore of that impressive performance just because this year's monsoon has turned out 'normal', would be unrealistic. More than the quantum of rainfall that is dumped on the sub-continent during the four critical months, it is the spatial and temporal distribution of rains that make or break crop prospects. On this score, the 2017 monsoon has been quite whimsical.



Source: IMD

Patchy distribution

For the purposes of measuring the spatial spread of rainfall, the IMD categorises India into 36 meteorological sub-divisions.

IMD's wrap-up of the recent monsoon season tells us that in the just-concluded monsoon season, 5 of India's 36 sub-divisions received excess rains, 25 received normal rains and 6 witnessed deficient rains. Last year, 4 sub-divisions were showered with excess rains, 23 were normal and 9 were deficient.

But the devil really lies in the details and the identity of the States that suffered deficient rains really matter to crop prospects. This year's monsoon has played truant in some key food-bowl States. For instance, West Bengal, Uttar Pradesh and Punjab account for a lion's share of kharif rice production. But this year's monsoon has been 29% below normal in Uttar Pradesh and 22% short of normal in Punjab. West Bengal alone has enjoyed a near-normal season, as has much of the southern peninsula. Madhya Pradesh, which is a critical growing region for the rabi wheat crop, has seen a deficiency of 20%.

Madhya Pradesh, Rajasthan and Maharashtra are similarly critical for pulses output. Of these, while Rajasthan has received excess rains (8% above normal) and Maharashtra has been just about normal, rains playing truant in Madhya Pradesh look set to impact pulses output.

While excess rains in Gujarat (19% above normal) could augur well for the groundnut and cotton crops, the patchy show in both Madhya Pradesh and Haryana (26% below normal) cloud the prospects for oilseeds such as soyabean, rapeseed, mustard and sunflower. There have also been wide variations between growing regions within each state, which can have a bearing on crop prospects.

Weak ending

Month-wise rainfall patterns during the south-west monsoon also play a big role in deciding cropping area and yield. In 2016, the monsoon got off to a snail-paced start, but picked up pace in the latter half of the season.

But this year's monsoon has behaved in exactly the opposite fashion. After excess rains of about 4% and 2% against normal seasonal patterns in June and July, the months of August and September have seen all-India rainfall fall 12-13% short of normal levels. Good rains in the months of June and July may have contributed to good sowing and coverage of the kharif crops. But deficit rains in August and September could impact the eventual output by pruning crop yields.

It is also important to note that rainfall in the last two months of the south-west monsoon dictate reservoir storage and soil moisture, both of which set the tone for the planting of the winter crops. Though there is much tracking and analysis of India's south-west monsoon and the kharif crop, the rabi season has been equally important to the country's agricultural prospects in recent years. Rabi output often matches or even exceeds the kharif output.

The rabi season accounts for the whole of India's wheat and gram harvest, a fourth of the output for coarse cereals and chips in with over a third of the yearly harvest of urad and moong. Oilseeds such as rapeseed and mustard, sunflower and safflower are also predominantly winter crops. Therefore, dry spells in the latter half of this monsoon, taken with deficient rains in key rabi growing regions, can make for less than rosy rabi prospects.

All this could explain why the agriculture ministry, in its First Advance Estimates, has painted a somewhat muted picture of crop prospects for FY18. The estimates are based mainly on cropping and sowing patterns and a lot can change on yields and output, as the year progresses. But so far, it appears as if India will have a hard time living up to the 4.9% expansion in agriculture GVA that it so comfortably managed last year.