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Views, Reflection and Erudition

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Central Banking in India: Changing Contours

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Preface

It gives me immense pleasure as we embark on yet another fiscal year for our flagship research digest on the BFSI sector. At the inception of its third fiscal year, the digest has established itself as one of the most sought after and revered platforms available in the country for noteworthy representation of stakeholders' interests in the financial sector.

After two very successful and enriching years of publishing this bi-monthly digest, we are pleased to launch our newly rebranded Banking & Finance Digest to cater to the vast expanse and requirements of the financial sector in India. The digest, now rechristened as the FICCI's Financial Foresights will be a quarterly publication on the views, reflection and erudition of the domain experts as well as FICCI's in house research and analysis on the BFSI sector.

In an effort to increase our Industry and Government engagement, we will distribute the copies of our Financial Foresights to our extensive network of CEO's and experts of leading financial institutions, merchant bankers, stock exchanges, insurance companies, economists, policy makers and regulators. Through our extensive distribution of the Foresights and pan industry wide reach, we assure you that we will leave no stone unturned in living up to our motto of becoming the "Industry's voice for Policy Change"

Through this new initiative, we at FICCI aim to become a knowledge repository of facts and figures on latest ensuing topics pertaining to the economy in general and the BFSI sector in specific. I request your earnest support in making this new initiative of ours a great success. As always, we do look forward to your views and suggestions to help us improvise the content of the Financial Foresights and make it more relevant and informative.

Rajiv Kumar
Secretary General

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Central Banking in India: Changing Contours

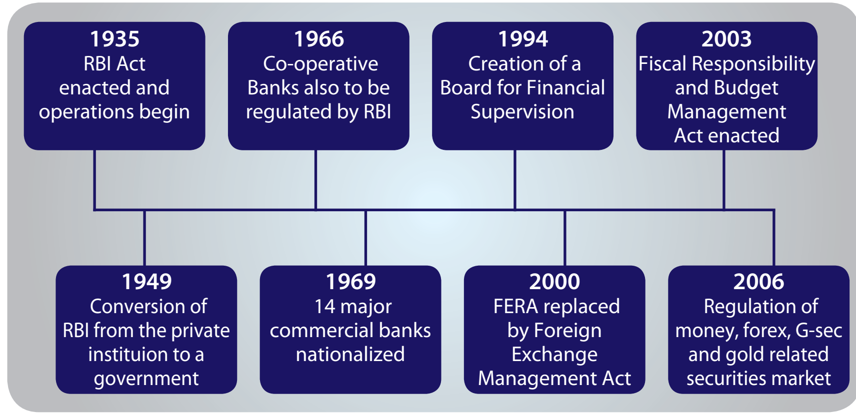
Mr. Shachindra Nath, *Group CEO, Religare Enterprises Limited*

History of central banks

The formation of central banks was slow as there was no paper currency, but commodity money in the form of gold and silver. First central bank in the World was founded in Sweden in 1668 – Riksbank, which was followed by the Bank of England in 1694. Till the beginning of the nineteenth century only few more central banks were established around the world; however, during the nineteenth century several European countries formed central banks with Japan following in 1882. The sudden spurt of central banks in Europe was primarily driven due to exigency of war financing. Other reasons for the established of central banks included - to issue currency; to regulate and supervise the banks and financial entities: and to serve as a lender-of-last-resort. Central banks initially functioned as private entities, but war financing and payment under war reparations led to nationalization of many central

"Reduction in interest rate can play the role of a nudge for the government to carry out other policy reforms"

banks. Once the need for war finance reduced, the role of central banking increasingly focused on the larger economy of a country, which required the central banks to mobilize resources for planned development and at the same time tackle high inflation.



Evolution of the central bank in India

In India, the first banking institution which was in the nature of a central bank was set up 1773 – General Bank of Bengal and Bihar (close to 80 years after establishment of Bank of England). However, 1921 is considered the true beginning of a central bank in India, when the Presidency Banks of Bengal, Bombay and Madras amalgamated to form the Imperial Bank of India, which performed the role of a central bank till the formation of Reserve Bank of India (RBI). In addition, till 1959, Indian rupee was the currency for Kuwait, Bahrain, Qatar and United Arab Emirates, which was issued by Reserve Bank of India; however, to avoid excess strain on the India rupee, a separate currency was created relieving RBI of the responsibility of issuing currency for the countries.

Mandate of RBI

The Preamble to the RBI Act laid out the objectives as "to regulate the issue of bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage"

The main functions of the RBI, as laid down in the statutes are –

a. Formulate, implement, and monitor the monetary policy
b. Regulator and supervisor of the financial system
c. Manager of foreign currency
d. Issuer of currency
e. Development role and
f. Banker to Government, including the function of debt management and banker to other banks

From the preamble it is clear that the focus of central bank is to ensure monetary stability by using the tools available. Additional functions that RBI performs in India are to regulate the financial system as well as play a development role by encouraging financial intermediation in the country. In developed economies a separate authority for regulation of the financial system is set up; however, in India the RBI has performed this role since the beginning of its formation. Since independence, the Indian economy has grown by a staggering 100 times and the linkage with the global factors has increased significantly making it essential for RBI to consider changes in the global environment while framing policy.

Tools available to RBI

RBI has the following tools available to meet its objectives:

- Cash reserve ration
- Marginal standing facility
- Statutory liquid ratio
- Bank rate
- Refinance facilities
- Lender of last resort
- Liquid adjustment facility
- Loans and advances to banks
- Open market operations
- Directed credit for lending to priority sector
- Repo/ Reverse repo rate

Balance between inflation and growth

RBI has been committed to maintaining a balance between growth and inflation in the near term, while fostering faster growth with lower inflation over a longer

period of time. An important point to remember is that RBI is not an inflation targeting central bank unlike the European Central Bank, Bank of England, Bank of Canada and Reserve Bank of Australia, but RBI does provide accountability for its performance on inflation.

While wholesale price inflation remains high at close to 8%, the core inflation (non-food manufactured goods) has reduced from 8.5% in March 2011 to 4.95% in March 2012. Nevertheless, GDP was below 5.5% during the first quarter of calendar year 2012 (for the full financial year 2012 it was 6.5%) and the market expects it to be below 6% for financial year 2013. It is imperative that RBI reduces the key interest rate and cash reserve ratio to provide a needed push to the growth of the economy as high interest rates are resulting in high cost of borrowing for the private sector. Though additional stimulus to the growth of the country will be the result of structural reforms by the government, reduction in interest rate can play the role of a nudge for the government to carry out other policy reforms.

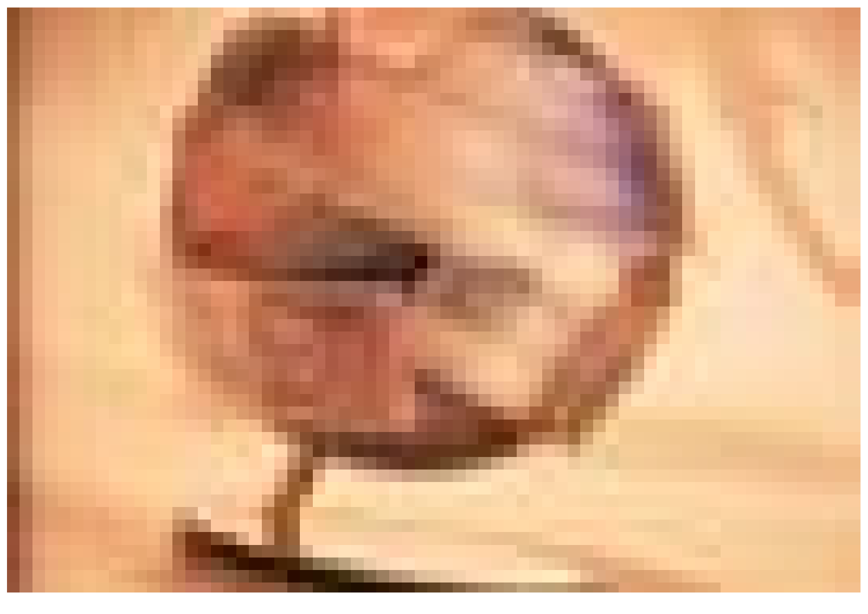
Supervision and regulation

After the global crisis central banks around the world have increased focus on regulation of banks; however, RBI has maintained a focus on regulation and supervision of banks as well as non-banking finance companies in India for a long time now. Consequently, the financial institutions in India weathered the storm better when compared to the developed countries. In line with the agreed norms by the Basel Committee on Banking Supervision, RBI released guidelines in May 2012 for India banks to transition to Basel III beginning from January 2013 in a phased manner till March 2018. Due to change in requirements for capital adequacy so as to strengthen the capitalization, banks in India will require additional capital of close to INR 3 trillion by 2018. The implication of such a requirement will be a likely increase in the cost of funds for banks which can have detrimental effect on the economy.

With the objective of increasing inter-regulatory co-ordination in India, the government formed the Financial Stability and Development Council (FSDC) in December 2010. The FSDC includes the Finance Minister as the Chairperson, Chief Economic Advisor, Secretary of the Department of Economic Affairs, Secretary of the Department of Financial Services, Governor of RBI, Chairman of IRDA, SEBI and PFRDA. As a result of the formation of the FSDC, the objective of maintaining financial stability is now being carried out in co-ordination with the other regulators of the country. By working with the other regulators, the availability of information on a timely basis improves which aides in effective policy making.

Foreign exchange management

The current Euro zone crisis has affected the currency markets around the world. India's foreign exchange market is also affected with the rupee having depreciated by close to 23% in the last one year due to global as well as domestic



factors. As a manager of foreign currency, RBI intervenes in the market regularly to ensure that the market does not experience significant volatility. Though the rupee is fully convertible on a current account basis, it remains partially convertible on a capital account basis.

RBI has is following a gradual process for conversion to capital account, but a structured roadmap for conversion should be established on lines of the recommendations of the Committee on Fuller Capital Account Convertibility chaired by Mr. S.S. Tarapore.

Encouraging growth of financial intermediation

RBI also plays a development role in India which is also different from the central banks of the developed countries. By encouraging financial intermediation, RBI intends to increase the savings ratio which can be utilized for investment for economic growth. RBI has adopted two approaches to the development role. First, by establishing focused institutions such as Industrial Finance Corporation of India (IFCI), State Financial Corporations (SFCs), Industrial Development Bank of India (IDBI), Industrial Credit and Investment Corporation of India (ICICI), National Bank for Agriculture and Rural Development (NABARD), National Housing Bank (NHB), Infrastructure Development Finance Company (IDFC) and second, by encouraging expansion of banking in the non-urban areas.

In August 2011, RBI issued the draft guidelines on licensing of new banks in the private sector to further expand the availability of banking services and credit in the country. These much awaited final guidelines will boost the central banks financial inclusion agenda and extend the reach of banking within the economy.

> **"The much awaited final guidelines on licensing of new banks in the private sector, will boost the central banks financial inclusion agenda and extend the reach of banking within the economy"**

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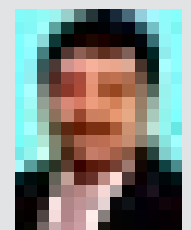


Mr. Shachindra Nath
Group CEO
Religare Enterprises Limited

Mr. Shachindra Nath (Group Chief Executive Officer) Religare Enterprises Ltd. carries the overall responsibility for leading all pivotal operations and businesses of the group. He has been associated with Religare since the year 2000 and has been instrumental in building various businesses under the Religare umbrella from scratch.

His strategic agility coupled with hands on approach has been a key to Religare's growth and success over the years. With a career span of more than 20 years, Shachindra is a highly accomplished professional backed by an exemplary academic record. He is a University rank holder for his Bachelor's degree in Law from the Banaras Hindu University, Varanasi. He also went on to pursue a Post Graduate diploma in Intellectual Property Rights from the Amity Law College, Delhi.

Prior to joining Religare; Shachindra has worked in the manufacturing and Financial services sector in various capacities. A great motivator and leader, when not at work he loves to read, contribute to columns, travel and spend time with his family.

Central Banking In India: Changing Contours

Dr. Manoranjan Sharma, *DGM, Canara Bank, Bangalore*

There has been a heightened consciousness of the role of central banks because in an integrated global financial system, the vulnerabilities of any player are quickly transmitted to other economies. Banks have to develop a near foolproof system, with adequate supervisory and regulatory safeguards. But financial liberalisation tends to increase financial fragility. Increased 'moral hazard' is attributed to low bank franchise value in explaining why financial liberalisation tends to make bank crises more likely. Increased market exposure of the financial system and its vulnerability to macroeconomic shocks make it difficult to check speculative pressures of global financial markets.

Given the inherently risky nature of banking and the double whammy affecting banks (banks' assets under constant threat of depreciation, liabilities, i.e., deposits vulnerable because of the possibility of sudden withdrawal), banks must plough back profits through reserves for expansion and provide for losses and current and contingent expenses, while meeting the needs of its customers. The need

"This has been a central-banking century…. The number of central banks has risen from 18 in 1900 to 172 in 1998. The world now has almost half a million central bankers".

The Economist, 28 November 1998

for maintaining capital is often based on capital performance and financial flexibility in decision-making process.

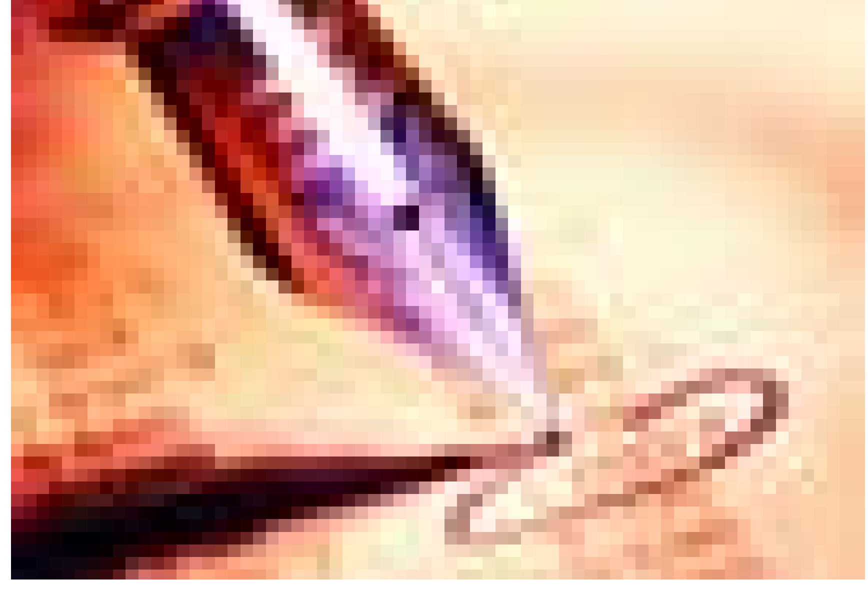
The supervisory approach covers supervision of financial institutions (banks, securities' firms and insurance companies); financial infrastructure (accounting, auditing, corporate governance standards, payment and settlement systems); and transparency (data dissemination, fiscal and monetary policy transparency).

Basel III Methodological and Policy Frame

Post-global crisis, the Basel Committee on Banking Supervision (BCBS) issued far-reaching proposals (December 2010) to effectively modify the policy frame over the long haul by strengthening global capital and liquidity regulations, limiting leverage and enhancing capital buffers in good times to promote resilient banking. Basel Committee's March 2012 Review stressed "Full, timely and consistent implementation of Basel III will be fundamental to raising the resilience of the global banking system, in maintaining market confidence in regulatory ratios and in providing a level playing field".

Key elements of this revised framework require strengthened capital requirements for counterparty credit risk exposures arising from derivatives, repos, and securities financing activities; increased capital transparency; leverage ratio to contain excessive risk-taking in the banking system; countercyclical capital framework; and a global minimum liquidity standard.

Unlike Basel II, which focused solely on capital requirements, Basel III examines bank regulation more holistically since banks suffered liquidity and leverage induced stresses well beyond the sustainability of their weak capital buffers in 2007-09. Basel III necessitates a consistent increase in capital in both qualitative and quantitative terms. Banks must have adequate capital to support risks beyond the core minimum requirement, take prompt and decisive action to reduce risks and restore capital in case of identification of deficiencies for addressing increased risk. Some major changes, however, relate to emphasis on core equity capital (minimum of 7% of RWAs v/s 2% currently); introduction of liquidity requirement in the form of Liquidity Coverage Ratio & Net Stable Funding Ratio (NSFR); constraints on leverage in form of Leverage ratio; and introduction of Counter cyclical capital buffer.



Some basic issues in India relate to infusion of capital and a sharp increase in the equity component from 2% to 4.5% while the minimum CRAR remains 8%. Further, there is a capital conservation buffer of 2.5% composed of equity, thereby raising the equity component in capital from 2% to 7%. The RBI has consistently adopted prudent and effective policy in respect of exposure of banks to risky segments, viz., the real estate sector, capital market and NBFCs to increase the resilience of the system. More fundamentally, the thrust on countercyclical capital and countercyclical provisions moderates the credit and asset price boom. There are also issues of leverage ratio (ratio of Tier 1 capital to book value of assets including off-balance sheet items), high pool of liquidity, information asymmetry, stress testing, migration to IFRS, asset quality and infrastructure financing.

With capital charge for various forms of risk now becoming mandatory, risk also stems from volatility in business cycles,

susceptibility to contagions and diversification. Size necessitates greater capital. But bigger size banks leverage this position more effectively than small-sized banks. Size of the banks also guards effectively against any normal risks emanating from business, such as, credit, market and operational risks.

ICRA estimates that the new capital requirement would necessitate Indian banks (except foreign banks) raising Rs. 6,00,000 crore in external capital over next nine years, besides lowering their leveraging capacity.

Additional capital is required to meet growth of off-balance sheet activities, sensitivity of banks balance sheet to changes in interest rates, increasing globalization and Basel III compliance. Banking capital could be shored up by public equity offers, venture capital, selling stakes to large foreign banks to meet fluctuations in capital requirements stemming from fluctuating quality of risk exposures and fully meet all elements of expected losses by provisioning and availability of exclusive capital to support unexpected losses. Future estimation of risk-reward matrix must not only consider the amount of available capital, but also incorporate leverage adjustment costs and the duration mismatches of assets and liabilities.

Given the preponderance of the public sector banks (PSBs) in India, PSBs require most of this capital. While higher core capital could dilute the return on equity for banks, Indian banks may still find

it easier to make the transition to a stricter capital requirement regime than some of their international counterparts since the regulatory norms on capital adequacy are already more stringent, and most Indian banks have historically maintained their core and overall capital way above the BCBS's regulatory minimum on bank capital adequacy, liquidity and leverage. RBI's Basel III guidelines stipulate a more stringent minimum common equity Tier 1 capital of 5.5% (versus BIS's 4.5%); and March 2017 deadline (BIS' deadline-January 2019) for implementation of 2.5% capital conservation buffer.

The Government provided Rs. 16,500 crore and Rs 15,888 crore for capitalization of PSU banks in 2010-11 and 2012-13 budgets, respectively. Private banks are well capitalized, though some may need equity to fund their growth plans.

At an aggregate level, Indian banks fare well against the Basel III requirement for capital. Considering a growth rate in excess of internal capital generation rate, stricter deductions from Tier I and some of the existing perpetual debt (around Rs. 25,000 crores) would become ineligible for inclusion under Tier I, some banks may need to infuse superior or core capital.

The Basel III framework, which are based on the computation of risk-weighted assets (RWAs) up to 2019, monitor and enforce compliance relating to quality, consistency, and transparency of the capital base; the risk coverage of the capital framework (particularly, the capital requirements for trading-book and securitization exposures); formal leverage ratios; and promotion of countercyclical capital buffers.

Monetary Policy

The meltdown highlighted the inherent fallacy of trying to achieve the twin goals of price and financial stability with the single instrument of short-term interest rates in terms of the "Jackson Hole consensus", i.e., central bankers' must keep inflation low and stable.

Ben Bernanke and Gartler have, however, demonstrated that using interest rate policy in this way may not be strong enough to arrest the upswing of asset prices and leverage. Moreover, asset bubbles are difficult to detect and their impact on the economy difficult to assess. Further, interest rate policy which "leans against the wind is costly as compared with the cost of dealing with the fall-out".

Central banks are now reviewing the role of monetary policy in countering financial imbalances by finding means of bringing in changes in credit, leverage and asset prices. The Federal Reserve and Bank of England have justifiably stressed the need for a closer investigation of macro-prudential tools focused on financial sector and interest rate to respond to the challenges of financial cycles and to address the three-fold challenge of price stability, financial stability, and output stabilization.

The Financial Stability Forum (FSF) and the Basel Committee are ascertaining the appropriateness of capital buffers above Basel minima to the loan growth at each individual firm, introduction of a dynamic provisioning framework, and building up of maximum leverage rates. Such countercyclical measures require balancing countering financial excesses and developing a dynamic financial sector capable of supporting the growth of the economy. Since such policy rules may reduce supervisory discretion and introduce pre-commitment, these rules must be updated periodically so that they are not arbitraged, and they are able to keep pace with the new developments in financial sector.

Central Bank's Role in Financial Regulation

The conventional models failed because of their complete inability in aggregating concentrations of subprime mortgage risk across different business areas, insufficiently long data histories of VaR models and use of a point-in-time rather than through-the-cycle methodology necessitating an expanded role of central banks in financial regulation. Covering economic risk creates incentives for central banks to reduce the frequency of systemic crises, and develop tools to reduce macro-systemic risk, and micro-prudential tools to reduce the frequency and impact of crises on individual systemic institutions. A central bank's expertise in financial infrastructure is useful in management of crises and development of micro-prudential tools to reduce the systemic impact of failure by encouraging the use of systems posing far less systemic risk. Central banks' expertise in macro-financial analysis helps in designing macro-prudential tools and facilitating the use of monetary policies and macro-prudential policies in complementary ways.

However, the regulatory role of the central bank brings potential costs, e.g., sustenance of an insolvent institution under the central bank's supervision, even when unnecessary or undesirable.

The conflict between supervision and becoming LOLR ignores several aspects that give rise to synergies between supervision and resolution. Supervisory information helps gauge the systemic impact of failure of an institution and the effect of being LOLR on central bank's balance sheet. A role in resolution also induces the central bank to adopt a tough supervisory stance from the beginning because of the impact on its own balance sheet and the reputational costs of mishandling of the

crisis. Such a stance by the central bank also attempts to "sharpen their eyes in the supervision of individual systemic institutions".

Micro-prudential objectives may conflict with the macroeconomic objectives of the central bank forcing them to compromise the conduct of monetary policy, particularly when the banking system is under stress. While a central bank is responsible for prudential supervision of individual institutions and monetary policy, highly visible failure in the former may undermine people's confidence in the latter.

Financial Stability Frameworks

Pre-crisis attempts to introduce a new financial regulatory structure include the US Treasury's March 2008 blueprint. This blueprint stressed complex and ineffective regulation of deposit taking institutions, with five coordinating federal agencies in regulation and resolution of national banks and state authorities, particularly in oversight of mortgage markets.

The Reserve Bank of India assessment of the health of India's financial sector in its Financial Stability Report (FSR) is based on a holistic assessment of the disparate elements of the financial sector eco-structure – the macroeconomic setting, policies, markets, institutions. However, the instruments of assessment of the stability of the financial sector, the build up of systemic risks and the movements of various vulnerabilities have been considerably upgraded. Despite global macro-financial fragilities, the Indian financial system remains stable.

Conclusion

While Dodd-Frank in the US and hedge-fund rules in Europe are quite intrusive, considerable international regulatory change, e.g., new capital and liquidity requirements, resolution and recovery planning, tighter constraints on business lines and leverage, changes in market infrastructure and consumer protection has occurred together with a convergence of regulatory, government and economic forces in Washington, Brussels and London. The Economist stressed "The power of central banks has steadily increased over the past couple of decades. .... Never before in history have central banks wielded so much power" (25 September 1999). Since this two-decade old observation, the role of central banks in maintaining financial stability has been reinforced because of 'the new normal'.

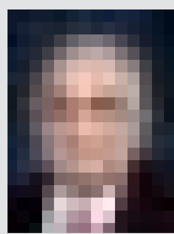
Weak and ineffective regulations, inter-alia, caused global financial meltdown necessitating more comprehensive and robust regulations and supervision. A strong regulatory and supervisory framework is a necessary and not a sufficient condition. Ultimately, strong, comprehensive rules and regulations must be effectively enforced.

The Basel Committee's Standards Implementation Group closely monitors and coordinates the implementation of rules and recommendations. The Committee's sequential implementation assessment process is based on

> **"A strong regulatory and supervisory framework is a necessary and not a sufficient condition. Ultimately, strong, comprehensive rules and regulations must be effectively enforced"**

countries' progress in adopting the Basel regulatory framework; the consistency of national and regional legislations with the agreed Basel III rules; and to determine whether the rules are practically delivering the anticipated outcomes across different countries and result in comparable outcomes at the bank level.

There are, however, practical difficulties in implementation and diverse approaches to well-designed global rules and regulations, e.g., differences in terms of insolvency regimes, permissible banking business, imposition of taxes on financial transactions, arbitrage by the industry and potentially damaging unilateral changes by national regulators to making the global financial system safe and stable. Since such differences can stymie reforms, attempts must be made to achieve a consensus because of distinctive peculiarities across regions and institutions.



Dr. Manoranjan Sharma
Chief Economist of Canara Bank,

Dr. Manoranjan Sharma, the Chief Economist of Canara Bank, has First Class Bachelors degree, First Class First Masters degree in Economics, First Class Postgraduate Diploma in Business Management and PhD.

He has over 300 publications including in The Business Review (Cambridge), Occasional Papers (RBI-Mumbai), Bank Quest, CAB Calling, Professional Banker, Analyst, Yojana, The Indian Banker, The Economic Times, Business Line. He has presented papers at several national and international Conferences and delivered Keynote Addresses at various Universities.

Widely traveled both in India and abroad, Dr. Sharma has made presentations and Chaired Sessions at Conferences organised by Marcus evans (Malaysia), Terrapinn Pte Ltd. (Singapore), Naseba (Paris), Max Planck (West Germany)- Indian Institute of Science (IISc), Bangalore and World Association for Sustainable Development (London).

His five edited books, viz., Leading Issues in Indian Economy, Studies in Money, Finance and Banking, India's Transforming Financial Sector, Dynamics of Indian Banking and Indian Economic Policies and Data have been globally acclaimed.

His views have been cited in the Parliament, The Associated Press (New York), Dow Jones (New York), International Herald Tribune (New York), Wall Street Journal (New York), The Economic Times

Central Banking In India: Changing Contours

D.R. Dogra, MD & CEO, CARE Ratings

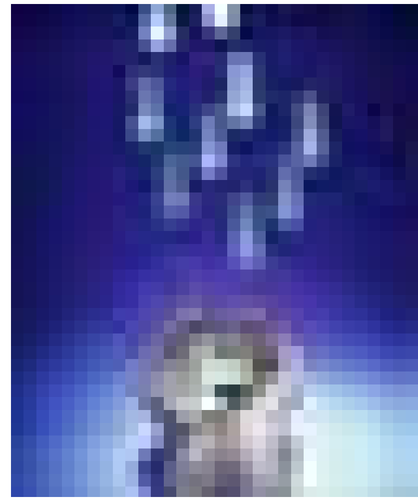
Introduction

Central banking in India has traditionally followed the basic principles as given in the textbook with the focus being mainly on conduct of monetary policy and management of public debt. However, over the years, and in the aftermath of the financial crisis and sovereign debt crisis, several issues have arisen relating to the role of a central bank. The question is whether there is need to change the role of this institution?

Besides, the changing global economic structure makes central bank intervention in other markets a key tool for orderly development. The conventional principle of inflation targeting and the commitment to a medium-term inflation objective with the flexibility to address deviations from full employment, and a move towards transparency is still the order of central banking. But now the role has gotten expanded to focus also on regulation as the crisis has reminded us that the responsibility of central banks to protect financial stability is as important as the use of monetary policy effectively in the pursuit of macroeconomic objectives.

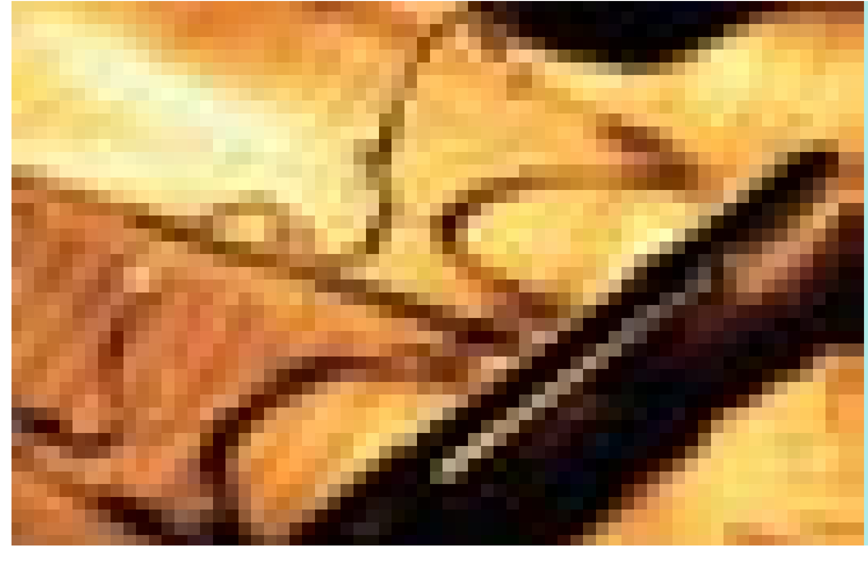
It is felt now that central banks can dedicate separate toolkits

"Understanding and applying the lessons of the crisis will take some time"



to achieve financial stability and macroeconomic objectives separately. Monetary policy tools can be brought to include management of the central bank's balance sheet and communication of future policies. Financial stability policy encompasses, as the first line of defense, a range of micro-prudential and macro-prudential tools enhanced by monitoring and analysis of potential risks to systemic stability. Clearly, understanding and applying the lessons of the crisis will take some time.

Additionally, the central bank in the Indian context has to blend these two roles into meeting two other responsibilities that are paramount today: government debt and forex management. This is a major challenge given that these two objectives are really outside its purview as decisions are being taken elsewhere in the government or being determined externally in forex markets. Governments have their own motivation for running deficits which has to be facilitated by the RBI and at times also be financed either directly or indirectly. Also the management of forex reserves also raises issues relating the right value of the 'rupee' which has to be addressed by the central banks. But given that they have a bearing on conduct of monetary policy it is essential to harmonize these links.



Regulation first

The focus on regulation is probably the foremost role that central banks will have to be called upon to play. While it is true that the Indian system has been unaffected by the financial crises, the level of complexity in the financial sector has grown with the major banking players being present indirectly in all streams such as banking, capital markets, investment banking, insurance and probably even pensions going ahead. Given the existence of regulatory overlap there is need to ensure that risk from one segment does not spill over to the other; and since banks are in all areas through the subsidiary route or alliances, the role of the central bank is even more important here.

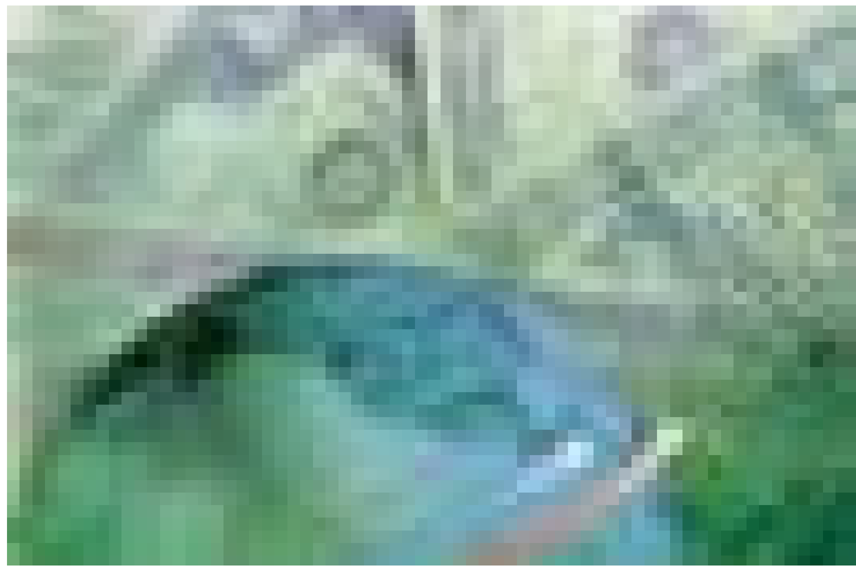
This is where financial stability and its maintenance come into play. Financial instability has critical consequences for economic activity, price stability and the monetary policy transmission process. Central banks are the ultimate source of liquidity for the economy, and appropriate liquidity provision is crucial to financial stability. The performance of their monetary policy functions provide central banks with a macroeconomic focus and an understanding of financial markets, institutions and infrastructures is required for the exercise of a macro prudential function. It should be an explicit mandate of central banks to maintain financial stability through appropriate micro-and macro-prudential policies. And monetary policy should be regarded as a legitimate part of the macro-prudential supervisors' toolkit.

Macro prudential supervision and regulation involves examining systemic risks that arise from the interaction between individual banks or the risk that the default of a single bank. One way by which we can significantly reduce such problems would be to bring in progressive capital adequacy requirements. In other words, the greater a bank's systemic importance, the more equity it would be required to hold. Capital reserves for systemically important banks in excess of a minimum level could also act as a kind of "automatic stabilizer". Reserves built up in "good times" allow banks to absorb losses in "bad times" without interfering with normal business operations. Another way of achieving the

required countercyclical effect is imposing direct restrictions on loan-to-value ratios if there are signs that a bubble could be forming in certain markets, such as the one for home loans. When rapid growth in credit or other indi¬cators of financial excesses accompany as¬set price increases, the central bank should employ stress tests to measure the effects of changes in credit conditions on asset prices, economic activity, and financial stability. Instead of seeking to identify bubbles, the authorities should simply ask whether current financing conditions are raising the likelihood of sharp rever¬sals in asset prices that are disruptive to economic activity. If so, preventive actions need to be taken. More importantly, this has to be an ongoing process. It has been noticed that in the aftermath of the financial crisis in the west, stress tests were carried out on European banks, but the important thing is to make this a habit as given the present global environment one is never sure where the risk lies and it is mandatory to ensure that these risks are under control.

Making monetary policy effective

Conduct of monetary policy will remain the most important aspect of central banking as it is a traditional function. Their role as anchors of price stability is important at all times for developing economies. A credible, medium-term orientation on price stability is the best contribution that central banks can make toward sustainable, stable growth. A credible commitment to price stability anchors inflation



expectations, depresses inflation risk premia and contributes to keeping longer-term interest rates low, thus helping to contain the costs of servicing public and private debts. Such a commitment to price stability must be symmetric, ruling out both inflation and deflation. Maintaining inflation expectations anchored at levels consistent with price stability remains the essence.

However, in India we have seen that monetary policy has also to be anchored to growth expectations and hence, the objective becomes dualistic. While interest rates and liquidity is one input going into the growth process, it is still crucial for borrowers. The central bank hence has to have its objectives stated clearly so that there is greater clarity on future policy action. Announcing pre-decided goals of growth and inflation with a preference for either of the two should be transparent to minimize distortions in the market.

What is important is that central banks should act in a predictable manner, within a framework that is understood by price setters as consistent with the maintenance of price stability in the medium term. At the same time, the framework needs to strike a balance between fostering predictability through steady-handedness and the need for flexibility when facing unforeseen circumstances. An issue that has to be sorted out here is the management of public debt. This is increasingly becoming important because there is an implicit funding support that is provided by the central bank for a brrowing programme of the government.

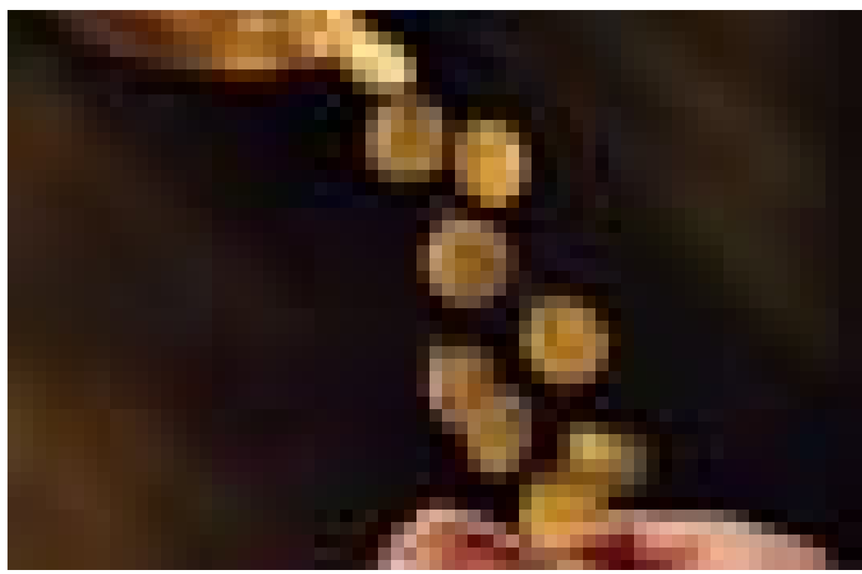
Managing contradictions: monetary policy and public debt

In India, the RBI handles the functions of both monetary policy as well as government debt. As the banker to the government and the manager of internal debt, it has to see to it that the borrowing programme goes through. But this can mean that it affects liquidity in the system which in turn can prompt specific measures in the domain of monetary policy which in turn affects the entire structure of interest rates. Enabling

government borrowing for instance puts pressure on liquidity which in turn pressurizes interest rates which prompts central bank intervention through open market operations, for example, which in turn could change the contours of monetary policy action.

The goals and conduct of debt management and monetary policy can actually complement each other. The traditional view is that the cost of debt service is secondary to the need of funding debt. Structurally, skilful debt management aids monetary policy in producing a deep, liquid and resilient market for operations. However, debt management aimed only to minimize costs might create tensions with monetary policy by relying on short-term debt (given the normal upward slope of the yield curve). Over the business cycle, debt management can get in the way of monetary policy, for instance, if GSecs are issued heavily when the central bank is easing. Historically there is some mapping between institutional arrangements and the interactions of the two policies.

Not so long time ago, the Bank of England served its governments as debt managers, consistent with a concept of monetary policy as embracing debt management. Subsequently, as the Bank of England focused on inflation targeting through short-term rate setting, debt management was moved to a separate dedicated office. Many governments in the euro area have also set up debt management offices given Euro system monetary operations that advance against broad collateral



rather than buying government debt outright. In the United States, where the central bank's mission remained broader, the Treasury and the Federal Reserve have continued to cooperate in debt management as principal and agent.

Separating the two functions in the Indian context could be a case so that the same entity does not handle both debt management and monetary policy. While there is no direct conflict there are still instances where the RBI facilitates government borrowing even while raising interest rates in inflationary times. This conflict will be eschewed in case the two functions are separated.

Managing forex reserves

Forex transactions in the country are based on market conditions and the role of RBI has traditionally been to introduce measures which enhance the flow of funds into this market. Therefore, policies favouring external commercial borrowings or FII investment have been driven by the central bank. However, progressively it has been seen that in this uncertain world the volatility in currency can be destabilizing and calls for direct intervention. This causes the RBI to take action in terms of supplying or mopping up dollars which could go against its own monetary policy framework.

In fact, central banks of a number of developing countries have found it helpful to intervene in the foreign exchange market as a way of encouraging exports and labor-intensive manufacturing. However, this practice can create problems for the global system when the country or countries concerned are large, either individu¬ally or collectively. More importantly the same has the potential to create distortions in liquidity thus leading to issues with monetary policy. Progressively, this will be a challenge for the RBI which will have to find ways for minimizing the shock element in this market.

Grow the financial markets

While the role of the central bank is mainly on the regulatory and policy front, in the context of India there is also the important role of

growing the financial market. This growth goes hand in hand with appropriate policy framework that has to be created so that there is harmonious development. Bringing in financial products is the forte of the central bank because every new product, like say the IRF (interest rate futures) or CDS (credit default swaps), needs to have appropriate regulation in place so that there is the orderly development of the market. Here the responsibility of the central bank is high because while being the originator as well as regulator, it walks the tightrope of making the products market friendly while keeping the oversight in place. Further, in areas such as micro finance, the RBI has to keep working to ensure that these new areas develop so as fulfill the objective of say, inclusion.

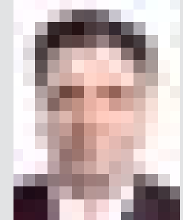
Independence of the central bank, an enabler

Thus, the role of central banking is getting more focused on virtually all segments of the economy. But, the important thing to make it effective is to resolve the debate over the independence of the central bank. Can a central bank be independent when all these functions have to be carried out simultaneously?

The view which is now prevalent globally is that central banks are more likely to safeguard their independence and credibility by acknowledging and explicitly addressing the tensions between inflation target¬ing and competing objectives than by denying such linkages and proceeding with business as usual. Central banks should make clear that mon¬etary policy is only one part of the policy response and cannot be effective unless other policies—fis¬cal and structural policies, financial sector regula¬tion—work in tandem.

Central banks already require substan¬tial operational independence in order to pursue their mandates. They will require even greater independence when finan¬cial stability becomes an overriding mandate especially in India where there is multiplicity of regulators in the financial sector. There is already talk of the creation of a super-regulator in this segment, and one view is that it should be the central bank. They will, in turn, have to es¬tablish the legitimacy of their actions in circumstances where the nature of threats to financial stability is poorly understood. The market may not be happy if there are curbs in credit growth in the inter¬est of financial stability that may in turn cause asset pric¬es to fall. This makes it important for the central bank to clearly communicate its assessment of the risks and the rationale for its policy actions. But more independence also comes with equivalent accountability as independence is po¬litically viable only with accountability, and the best way to enhance accountabil¬ity is for central banks to become more transparent and forthright about its objectives and approach.

"The central bank has to have its objectives stated clearly so that there is greater clarity on future policy action. Announcing pre-decided goals of growth and inflation with a preference for either of the two should be transparent to minimize distortions in the market"



D.R. Dogra
MD & CEO
CARE Ratings Ltd.

Mr. D R Dogra has over 34 years of rich experience in credit rating, commercial banking and extensive knowledge about functioning of the corporate sector. Being one of CARE's first employees and an integral part of the top management since 1993, he has overseen the strategic growth and development of the company over the years. His passion and dedication is greatly responsible for the successful growth and development of CARE from a small spin off to a leading credit rating agency in the country.

Mr. Dogra holds a post-graduate degree in Management from FMS, University of Delhi. He is a gold medalist in his Post-Graduate Degree in Agriculture from Himachal Pradesh University. He is also a Certified Associate of the Indian Institute of Bankers. Prior to joining CARE, Mr. Dogra held several positions in a leading Bank for over 15 years.

Migration to Basel III

Ms. Roopa Kudva, *MD & CEO, CRISIL*

The Basel Committee on Banking Supervision has come out with the third of the Basel accords, Basel III, in 2010-11, as a response to the deficiencies in financial regulation exposed by the global financial crisis of the late 2000s. Basel III sets standards for bank capital adequacy, stress testing, and market liquidity risk.

In India, the guidelines, prescribed by the Reserve Bank of India (RBI) for implementation between 2013 and 2018, are more stringent than the one proposed by the Basel Committee on Banking Supervision. The requirement of common equity capital is higher, the leverage ratios are stricter, and the period for implementation shorter, in RBI's guidelines.

India's banks have maintained their equity and overall capital adequacy ratios well in excess of the minimum levels prescribed by the regulator. The leverage ratios are currently adequate, and are expected to be in line with the prescribed regulatory requirements. CRISIL, therefore, believes that India's banks will be ready to migrate to the new guidelines by January 2013. However, the banks may face challenges in raising additional capital to maintain growth on an ongoing basis through the implementation period.

"CRISIL believes that India's banks will be ready to migrate to the new guidelines by January 2013"

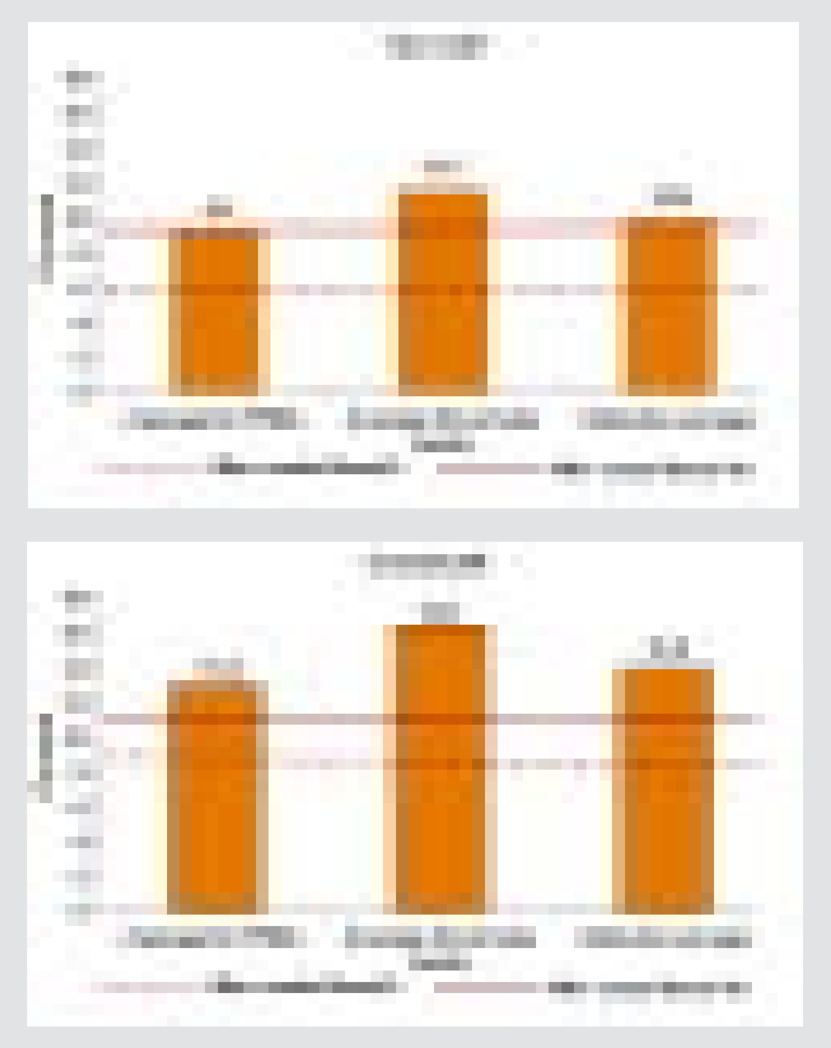
The following sections of this article highlight the five key measures of the Basel III guidelines prescribed by RBI and the impact in terms of compliance requirement.

Meaure 1: Quality of capital to enhance significantly

The capital adequacy ratio (CAR) has been increased to 11.5 per cent of risk-weighted assets from 9 per cent. Table 1 indicates the minimum requirements for each component of capital, and the timelines for transition to the new standards.

Implementation of Basel III guidelines will enhance the proportion of equity capital—which has the highest loss absorption capacity—to 8.0 per cent from 3.6 per cent required earlier. The capital conservation buffer of 2.5 per cent in excess of the minimum equity capital will help absorb potential losses in financial exigencies. If a bank's equity capital ratio dips below 8.0 per cent, or below the stipulated minimum during the implementation phase, the bank may face regulatory constraints in distributing earnings (as in paying dividend, for instance).

Chart 1: Comparison of Basel II, Basel III and estimated position as on March 31, 2012



RBI can also prescribe an additional capital requirement of up to 2.5 per cent as a counter-cyclical buffer, which may increase the total capital requirement to 13 per cent. The objective of this buffer, set aside during times of excessive credit growth, is to create a cushion for periods of stress. The buffer will be created in the form

Table 1: Minimum requirements in capital

[In per cent]	Basel II	Basel III	Basel II India	Basel III India	Timeline for Basel III India
Equity capital					
A) Minimum equity capital	2.0	4.5	3.6	5.5	January 1, 2013 to March 31, 2015
B) Capital conservation buffer	-	2.5	-	2.5	March 31, 2015 to March 31, 2018
C) Total Equity Capital (A + B)	2.0	7.0	3.6	8.0	January 1, 2013 to March 31, 2018
D) Non-equity Tier-I capital	2.0	1.5	2.4	1.5	
E) Tier- I capital (C+D)	4.0	8.5	6.0	9.5	January 1, 2013 to March 31, 2018
F) Tier-II Capital	4.0	2.0	3.0	2.0	
G) Total Capital (E + F)	8.0	10.5	9.0	11.5	January 1, 2013 to March 31, 2018

of either equity capital or non-equity Tier-I capital instruments with loss-absorption capacity.

Impact: Indian banks comfortably placed to migrate to Basel III; capital requirement for growth to remain high

- India's banks have largely maintained a higher equity capital ratio than the guidelines stipulate. The industry's Tier-I capital ratio and overall CAR are comfortable—estimated at around 10.0 per cent and 14.0 per cent, respectively, as on March 31, 2012.
- CRISIL believes that Indian banks are well placed to migrate to the Basel III requirement by January 2013, and to comply with the minimum equity capital requirement of 5.5 per cent, as all banks currently have a common equity capital ratio which is above this requirement. However, the minimum common equity requirement will increase significantly—to 8.0 per cent by March 2018—resulting in banks having to raise substantial capital to meet this requirement.
- CRISIL reckons that banks will need to raise equity capital of Rs.1.4 trillion till March 2018 to meet growth requirements, while they comply with equity capital requirements. The requirement may increase by another Rs.1.3 trillion if investor appetite for non-equity Tier-I capital instruments is low. Public sector banks, given their relatively lower capital ratios and moderate internal accruals, will account for the bulk of this requirement and will, therefore, need regular infusions from the GoI to meet the equity capital requirement.

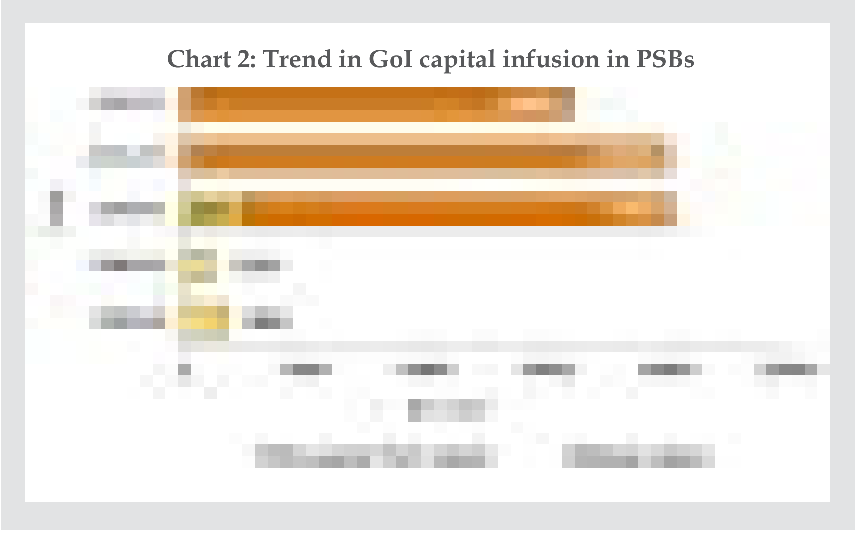
Meaure 2: Non-equity Tier-I capital instruments to carry higher loss absorption capability

- RBI's Basel III guidelines prescribe that fresh non-equity Tier-I capital instruments carry a write-off clause to qualify as capital. This clause will enhance the instruments' loss absorption capacity. The clause will be triggered by events such as infusion of public funds, or the banks' inability to remain viable unless the instrument is written-off, upon which such instruments will either be written-off or converted into equity capital. The existing non-equity Tier-I capital instruments in the banks' balance sheet without the 'write-off' clause will need to be phased out over the decade beginning January 1, 2013.

Impact: Lower investor appetite may lead to higher need for equity capital

- The banks' non-equity Tier-I capital instruments, such as perpetual non-cumulative preference shares (PNCPS) and innovative perpetual debt instruments (IPDI) currently do not have write-off clauses. These instruments will, therefore, not qualify as capital under the new guidelines. The banks will need to phase out these securities over the decade beginning January 1, 2013, and replace them with eligible securities. Introduction of this clause may also lead to reduced investor appetite, and increased costs of raising new forms of non-equity Tier-I capital instruments.
- The requirement for an increased proportion of equity capital, and the introduction of the write-off clause for non-equity Tier-I capital instruments, is driving incremental capital infusions in PSBs, mainly as equity capital by GoI. Alternatively,

Chart 2: Trend in GoI capital infusion in PSBs



the terms and conditions of instruments such as PNCPS and IPDI must be modified to introduce the write-off clause, or they must be converted to equity. Accordingly, the capital infusions by GoI in PSBs since 2009-10 have been primarily in the form of equity, unlike in previous years, when capital infused was as non-equity Tier-I capital.

Meaure 3: Tighter deduction norms to reflect true capital

RBI's Basel III guidelines recommend that deductions from capital be made from equity capital, so that the availability of true capital may be determined in calculating risk-based measures. This is unlike the previous guidelines that permitted deduction of 50 per cent each from Tier-I and -II capital for most deductibles (except intangibles and deferred tax assets, which are deducted from Tier-I capital).

The guidelines prescribe that any shortfall in the defined benefit pension fund be fully deducted from equity capital. Furthermore, under Basel III, all unamortised pension liabilities (including the second pension option and enhanced gratuity liabilities) are to be recognised on the balance sheet. Accordingly, from January 1, 2013, banks must deduct the entire amount of unamortised expenditure from equity capital.

The guidelines limit banks' investments, in the equity share capital of unconsolidated financial subsidiaries/associates, to 10 per cent of the paid-up capital and reserves. Investments in excess of 10 per cent will be deducted from the equity capital of the investing bank.

Impact: Could result in decline in banks' equity capital ratios

While deduction of unamortised second pension option and enhanced gratuity libialities from capital will result in a 40-to-50-basis-point reduction in equity capital ratio, the limit on investment in unconsolidated subsidiaries is unlikely to have a significant impact.

Measure 4: Introduction of leverage ratio to contain build-up of excess leverage

$$\frac{\text{Tier-I capital}}{\text{Bank's on-balance sheet and off-balance sheet exposures}}$$

The highly leveraged balance sheets of international banks were the main causes of the global economic crisis of 2008. The leverage ratio, therefore, seeks to contain the banks' off-balance sheet and on-balance sheet leverage, and to complement their risk-based capital measures.

The simple, non-risk-based measure for leverage is aimed at containing build-up of excessive leverage. Banks will need to maintain minimum levels of leverage ratio (likely to be 4.5 per cent), after the supervisory monitoring period which commenced on January 1, 2011. Off-balance sheet items shall be included with appropriate credit conversion factors. After a supervisory monitoring period, a parallel run will be conducted between January 1, 2013 and January 1, 2017. The leverage ratio will be finalised based on the results of the parallel run, and shall be effective January 1, 2018.

> **"Stringent funding and liquidity requirements, and increased costs of raising capital may constrain banks' profitability"**

Impact: Indian banks unlikely to face problems in adhering to leverage ratio

Given the Indian banks' limited range of derivative products and international exposure, their current off-balance sheet exposures are generally small. A few Indian private sector and foreign banks, however, do have sizeable off-balance sheet exposures (including derivatives and securitisation). CRISIL believes that these banks will, nevertheless, meet the minimum leverage ratio requirements given their current large capital bases and the long implementation period.

Measure 5: Introduction of liquidity and funding ratios to ensure banks maintain adequate liquidity

The RBI guidelines on liquidity risk management prescribing the liquidity and funding ratios are currently in the draft stage and based on the Basel III recommendations.

Liquidity coverage ratio (LCR):

$$\frac{\text{Stock of high quality liquid assets}}{\text{Total net cash outflows over the next 30 calendar days}} \geq 100\%$$

Maintenance of a minimum LCR will ensure that banks maintain sufficient high-quality liquid resources to survive stress scenarios lasting a month. Banks must maintain adequate unencumbered, high-quality, assets that can be used to meet liquidity needs over a 30-day horizon, under an acute stressed-liquidity scenario. The liquid assets include cash, including reserves in excess of CRR requirements, government securities in excess of SLR requirements, SLR securities as allowed by RBI, marketable securities of foreign sovereigns, and corporate bonds and certain securities issued by public sector entities or multilateral development banks with some 'haircut'. While the LCR is currently subject to an observation period, banks will have to submit an LCR statement to RBI from June 2012, though the guidelines will be effective from January 1, 2015.

Net stable funding ratio (NSFR):

$$\frac{\text{Available amount of stable funding (ASF)}}{\text{Required amount of stable funding (RSF)}} \geq 100\%$$

This measure complements LCR, and establishes a minimum acceptable amount of stable funding over a one-year horizon. The ASF for banks includes capital, liabilities with effective maturity of more than a year, and the portion of stable term deposits (with maturities of less than a year) and demand deposits that is expected to remain with the bank during periods of financial stress. The ASF should be adequate to cover the RSF, which include the bank's assets and off-balance sheet activities that are less liquid, over a one-year time horizon. An RSF factor is applied to each asset to arrive at the RSF; assets that are more liquid and readily available to act as sources of liquidity in an extended stress environment receive a lower RSF factor than assets that are less liquid. The NSFR is currently subject to an observation period, banks will need to submit an NSFR statement to RBI from June 2012, while the guidelines will be effective January 1, 2018.

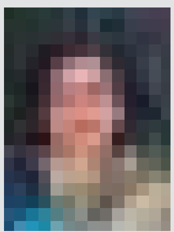
Impact: Banks well placed to comply with the new liquidity and funding ratio requirements, if the same are implemented in the current form

- The current RBI provisions allow cumulative mismatches of up to 5 per cent, 10 per cent, 15 per cent, and 20 per cent of the cumulative outflows in the first four maturity buckets—next day, 2 to 7 days, 8 to 14 days, and 15 to 28 days, respectively. The LCR provision effectively means that banks cannot have negative mismatches in short-term maturity buckets, and must maintain higher liquidity. Analyses of maturities of select assets and liabilities of banks in the past three years indicate that cumulative mismatches up to 28 days have been well within the current RBI guidelines. CRISIL, therefore, believes that India's banks are comfortably placed to comply with the new LCR requirements.
- LCR, together with NSFR, will, however, force banks to focus on long-term stable funding sources such as retail deposits, stable savings accounts, as opposed to short-term bulk deposits and certificates of deposits (CDs). On an overall basis, these provisions will strengthen the banks' liquidity. However, they may reduce interest spreads to some extent.

In conclusion, migration to Basel III will strengthen banks as the guidelines aim to significantly enhance the quality of banks' capital by augmenting the equity capital (equity and reserves) requirement, and increase the loss-absorption capacity of non-equity Tier-I instruments. Introduction of the 'write-off' clause in non-equity Tier-I instruments may increase their pricing, and adversely impact investor preference for such instruments over the long term. Fresh capital infusion by the Government of India (GoI) in public sector banks (PSBs) is, therefore, expected to be primarily in the form of equity capital, rather than non-equity Tier-I instruments.

The guidelines for liquidity risk management[1] will require banks to maintain greater liquidity, and improve their ability to withstand liquidity stress. CRISIL believes that Indian banks will adapt to the new liquidity requirements fairly well, given that the banks maintain an aggregate cash reserve ratio (CRR) and statutory liquidity ratio (SLR) level of around 30 per cent of their deposit base. The banks have also maintained limited funding mismatches in shorter-term maturity buckets. CRISIL believes that India's banks are better placed than their counterparts in the West, to meet guidelines stipulating a stable funding mix; this is because India's banks have higher current and savings account and retail term deposits. Nevertheless, stringent funding and liquidity requirements, and increased costs of raising capital may constrain banks' profitability.

[1]While the draft guidelines on liquidity risk management have been issued, the final guidelines are still awaited.



Roopa Kudva
MD & CEO
CRISIL

Ms. Roopa Kudva is Managing Director and Chief Executive Officer of CRISIL, a global analytical company providing ratings, research, and risk and policy advisory services, and a subsidiary of Standard & Poor's.

Ms. Kudva was appointed Managing Director and Chief Executive Officer of CRISIL in 2007. CRISIL has evolved under her leadership into a diversified analytical platform with a global client base and delivery footprint, while remaining the undisputed thought leader in all its segments. During her tenure as CEO, CRISIL's profits have more than doubled, its customer-base has grown from 1,000 to 30,000, and its reach has expanded from 9 Indian cities to 150, while its international operations now cover more than 30 countries across the globe. CRISIL has pioneered the rating of mid-sized and small Indian companies, and the publication of independent equity research in India, and has ramped up rapidly in these segments.

Earlier, Ms. Kudva led CRISIL's ratings business, and set up CRISIL's Global Analytical Centre, which carries out high-end analytical work for Standard & Poor's and McGraw-Hill Financial. Ms. Kudva joined CRISIL in 1992, and has more than two decades of credit-related experience across sectors, including a secondment to Standard & Poor's, Paris, as Director, Financial Institutions Ratings.

Ms. Kudva regularly features in lists of the most powerful women in Indian business compiled by prominent Indian publications, including Fortune India and Business Today. She is a member of several policy-level committees relating to the Indian financial system, including committees of the Securities and Exchange Board of India and the Reserve Bank of India. She is also a member of the Executive Council of NASSCOM, which is the premier trade body and the chamber of commerce for the Indian software industry. Ms. Kudva has received the Distinguished Alumnus Award from the Indian Institute of Management, Ahmedabad.

Ms. Kudva holds a degree in statistics, and a postgraduate diploma in management from the Indian Institute of Management, Ahmedabad

Central Banking In India: Changing Contours

Mr. Atul Joshi, *Managing Director & Ceo, India*

A. Problem of fast rising NPLs

Fitch in its Report titled 'Indian Banks'- A Health Check' published in August 2011, projected rise in gross NPLs level for the Indian banking system to 3% as at March 2012. RBI's latest financial Stability Report pegs this number at 2.90% coming virtually close to our own estimate. In the latest Banking Sector outlook published in February 2012, Fitch estimates Gross NPLS to rise to 3.50 – 3.75% for the sector by March 2013. Unseasoned restructured assets which are currently estimated at 6-6.5% of system assets do however add some concern as potential slippages could be higher this time compared to that in 2008. State owned utilities and aviation could comprise about 3.5% of the restructured assets and while their restructuring is viewed imminent, eventual loss given default would be limited.

In broad terms, the problem of fast rising NPLs while being quite characteristic of any economic downturn, in India's context needs to be seen in the light of three major dimensions (i) asset concentrations (ii) expected rise in stressed assets as the economy faces slower acceleration in growth and (iii) banks' provision cover.

"For the longer term, larger threat to the banking system comes from "Standard Restructured Loans"

Regulatory challenges in terms of high inflation stickiness – partly both cost-push and demand-pull – have metamorphosed itself into high interest rates and thereby incremental cost of existing and new investment. This has exerted significant pressures on corporates across the board (small, mid and large) as they bear the higher costs against both slowing investment and consumer confidence.

When combined with a fragile global economy and the sovereign's limited or no fiscal power, the above challenges will prove pivotal in deciding the future of banking system's asset quality. That being said, better underwriting skills, improved provision cover, adequate capital cushion and an involved regulatory oversight does add some comfort factor. However, to appreciate and understand the issue in its entirety, it is important to take a closer look at some of the following aspects in detail:-

i) Sharply risen concentration levels: Exposure to weak sectors of aviation and state electricity boards have increased at a significant pace since 2007 which currently stand at 3.5% of total system assets. Most of these will be restructured in the next few quarters given their poor financial health. Of concern, is also the sharp build-up in infrastructure loans as government's thrust on infrastructure lending opened scope for credit intermediation during periods of slower growth in the post-2008 crisis years. Infrastructure loans, at 15% of the total loans, is the largest component of Indian banks' portfolio and stands the risk of being restructured in double-digits if inaction on the current state of policy paralysis gets coupled with incrementally slower growth. At a sub-7% growth level, the risk of delinquencies remains high which may warrant a reassessment of the expected 3.5%-3.75% gross NPL level in the system. While eventual losses are expected to be low in state-owned exposures, a sustained period of economic slowdown (though not a base case scenario) could have a detrimental impact on infrastructure projects.

However, of immediate concern is the continuing rise in stressed assets as cyclical sectors incrementally find it hard to negotiate high interest rates and a slowing economy. Small and medium companies have, thus far, proved to be most vulnerable. These SMEs stand at risk of further deterioration if the economy continues laggard performance. In addition, weak monsoons can further compound delinquencies in agriculture lending books. This sector is witnessing sharply declining propensity to pay following the previous agri debt waiver by the government.

For the longer term, larger threat to the banking system comes from "Standard Restructured Loans", bulk of which is expected to be contributed by state-owned utilities, aviation and infrastructure sector.

ii) Higher Stressed Assets: On account of the above pressures, NPLs have continued to rise through most of 2011-12 and stood at close to 3% as at FY12. The agency estimates that gross NPL levels for the system could touch close to 3.75% as pressure on the cyclicals get prolonged. Further deterioration cannot be ruled out if corporate margins continue to face pressures from various corners such as power, fuel, wages, interest cost and volatile exchange rates.

At the same time, sharp growth seen in restructured loans over the last two years (currently estimated at around 3% of system assets) is expected to bunch up on existing NPLs on account of higher mortality this time around. However, state utilities and aviation which would continue to account for a signification portion of restructured loans are expected

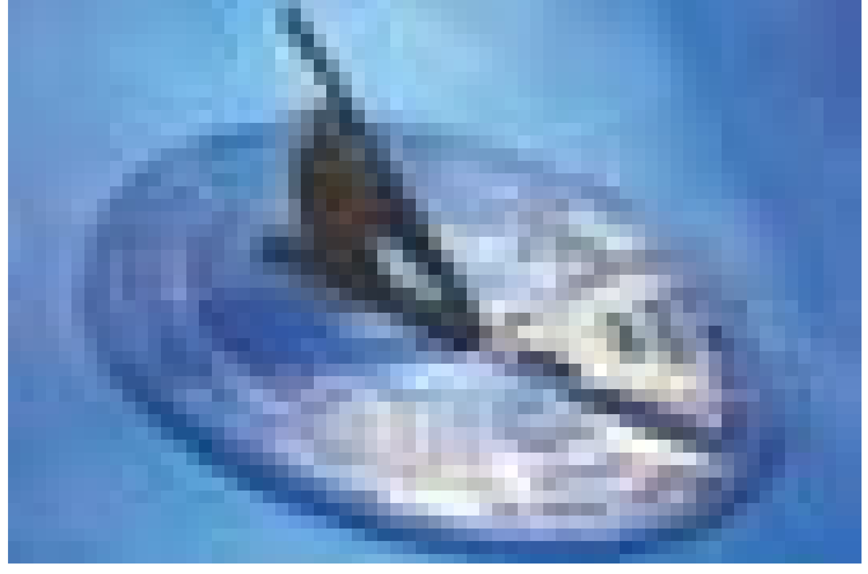
to remain 'standard' given state's involvement in the resolution process.

iii) Better provisioned: Higher regulatory involvement– particularly after the credit crisis – coupled with growing appreciation towards improved risk management has led to higher provision across banks. The specific coverage level of the banking system is estimated at around 55%-60%, which though has come down from 70% levels of September 2011, is relatively appreciable compared to the past. Besides, the provisions are at different levels for different category of banks e.g. most large state owned banks have average provision in low 60s, the large private sector banks in high 70s but mid sized state owned banks between 40 and 50 percent. Given this, the mid and smaller banks are expected to continue to face pressure as their relatively weaker quality of credit is pitched against existing lower provisioning. Again, at a granular level, provisioning could actually be much weaker for some banks which have higher concentration to weak state assets (utilities and aviation). Restructuring of such assets under the current framework attracts a 2% provision which is viewed to be inadequate given their high risk profile.

B. Implementation of Basel III

A recent document published by the Basel Committee on Banking Supervision which listed progress on the implementation of Basel III in G20 nations shows that India is only one of three countries to have published final regulations regarding the same, the other two being Japan and Saudi Arabia. The aforesaid guidelines issued by the RBI regarding the Basel III capital rules are stricter than those required by the Basel committee, but, the near term impact on Indian banks may be relatively benign, with common equity tier 1 ratios of many already close to 8% or above.

According to Fitch estimate, over the full implementation period, banks may need to raise up to USD 50bn of additional capital to meet the minimum common equity tier 1 capital requirements, after accounting for a 50bps buffer. More than 3/4th of the total capital requirement accrues between FY16-FY18. Additional challenges in maintaining healthy capital ratios may emerge from (i) the phase-out of Basel III non-compliant hybrid instruments (ii) if the RBI decides to implement additional requirements in the form of a countercyclical buffer and (iii) if RBI requires higher capital buffers for systemically important banks.



This requirement needs to be planned well by the government on the fiscal side, considering its stated intention to maintain majority shareholding in public sector banks, which constitute over 70% of the banking system. Government banks, if unable to successfully raise capital from the markets, may also add to the government's fiscal challenges.

Finally, implementation of the Basel III liquidity and funding standards may be more challenging. The funding of long-tenor infrastructure loans with shorter term deposits in recent years has lead to rising funding gaps on government bank balance sheets. This is reflecting in increased refinancing and liquidity pressures in the banking system.

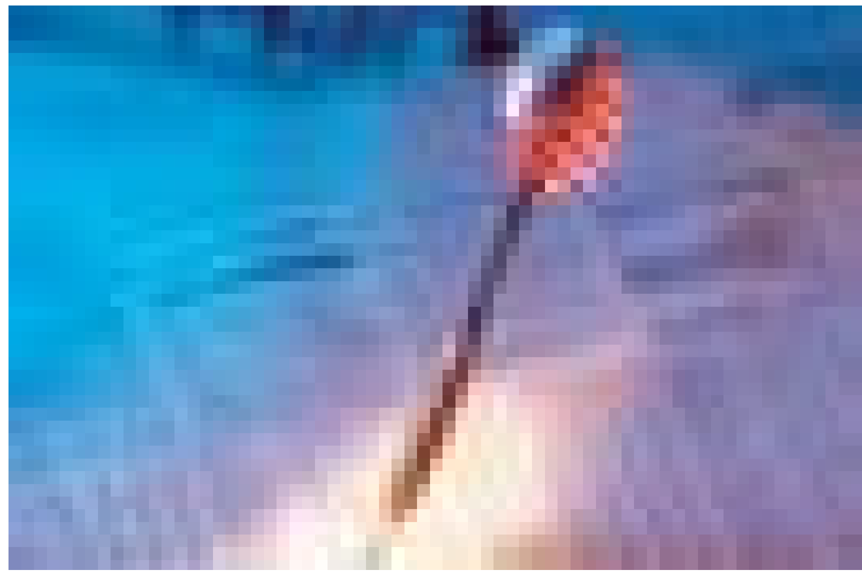
C. Scope for Interest Rate Reduction and Inflation

India in the last one decade has seen three cycles of growth. FY 2004 to FY 2008 was period of low inflation and high growth. Second phase following the global crisis was FY 09- and FY 10 where the economy was pacing ahead but

on the back of a humongous fiscal stimulation. The third phase, FY 10 to date is the waning period of the stimulation and the slowdown to more realistic sustainable over longer period level of GDP growth. India today is seeing lower GDP growth and high inflation – almost getting into a stagflation like situation. To stem up the GDP, presently the government does not have any fiscal space available to it and fiscal policy action to revive growth is totally ruled out. In the absence of possibility of a fiscal stimulation, the market is looking at monetary stimulation in the form of interest rate reduction.

Let's examine interest rate from the point of view of maintaining the delicate balance between GDP growth and inflation on one hand and the headroom available to RBI for reducing interest rates.

Interest rate is a necessary but not a sufficient condition for investment growth. Anecdotic evidence to this hypothesis is from the fourth quarter i.e. January-March 2012 (Q4FY12) investment growth, which increased by 3.6% y-o-y from a contraction of 0.3% in third quarter i.e. October-December 2011 (Q3FY12). Policy interest rate during Q4FY12 remained nearly same as in Q3FY12. Repo rate was increased by 25 basis points (bps) to 8.5% on 25 October 2011 and remained at same level till 17 April 2012, when



it was reduced by 50 bps. Other monetary policy change during this period was liquidity easing by reducing cash reserve ratio by 125 bps (50bps on 24 January 2012 and 75 bps on 9 March 2012).

After the Lehman crisis, in a short span of 7 months between Oct 08 and April 09, repo rate was cut by 475 bps and cash reserve ratio was reduced by 150 bps. This while supported the growth the resultant inflation was headline WPI inflation (10.4%) and CPI inflation (14.9%) in March 2012 were beyond RBI tolerance levels and higher than sustainable level of inflation for growth. RBI tightened monetary policy by increasing repo rate by 375 bps between 19 March 2010 and 25 October 2012.

Critics of RBIs monetary policy argue that the RBI is choking economic growth. But wasn't this inevitable? In order to control inflation, some growth sacrifices have to be made. RBIs monetary tightening has also resulted in growth slowing down to 5.3% in Q4FY12 from 8.6% in Q4FY10. Tight monetary policy controls demand through increased borrowing cost and this leads to growth slowdown. While through its monetary policy actions, the RBI was able to reduce demand and thereby the growth significantly, the resultant impact on inflation was not as pronounced as growth slowdown. This is evident from data - wholesale inflation declined to 7.55% (provisional) in May 2012 from 10.4% in March 2010.

Impact of monetary policy actions should not viewed on the basis of headline inflation, it should be viewed on the basis of core inflation. Core inflation followed a

(%)	FY06	FY07	FY08	FY09	FY10	FY11	FY12	Coefficient of Correlation Between GDP growth and Inflation
Real GDP growth	9.5	9.6	9.3	6.8	8.3	8.4	6.5	–
Inflation (GDP Deflator)	4.2	6.4	6.0	8.0	6.5	8.4	8.0	-0.74
Inflation (WPI)	4.5	6.6	4.7	8.1	3.8	9.6	8.9	-0.60

downward trajectory from November 2011. While headline inflation declined by 0.19 percentage points (pp) during December 2011 and May 2012, core inflation declined by 3 pp (from 7.9% in December 2011 to 4.9% in May 2012). Even the proportion of core inflation to headline inflation declined to 37.24% in May 2012 from more than half until January 2012.

A simple correlation analysis between real GDP growth and inflation rate (measured by GDP deflator and wholesale price index) suggests a strong negative correlation between GDP growth and inflation. Relationship between GDP growth and inflation is more pronounced for inflation measured by GDP deflator. GDP deflator is a better proxy for inflation as it also includes services prices in it. Whereas, WPI based inflation does not include services in its weighting diagram.

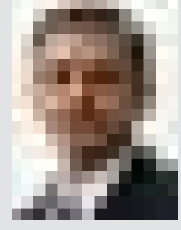
Supply side inflation could be tackled by increasing supply, changes/modification of Agricultural Produce Market Committee (APMC) Acts to make free movement of agricultural produced within country, strengthening of food storage and supply chain. Higher investment in food supply chain through private sector participation or public private partnership or foreign direct investment can address problems related to high and sticky food inflation.

The RBI in April 2012 reduced repo rate by 50bps, is there is further scope for reduction in interest rate? While the declining core inflation suggests RBI has achieved its target of inflation control, other factors are pointing towards maintaining current interest rate regime. Based on (i) present trend of growth (ii) deficit and (iii) inflation including suppressed inflation, it is not feasible to reduce interest rate immediately without creating further inflationary pressures. The best policy would be to maintain status quo on policy rates. A prolonged period of high inflation has the potential to destabilise long term capital allocation and labour market dynamics, this would slowdown economy further.

"Impact of monetary policy actions should not viewed on the basis of headline inflation, it should be viewed on the basis of core inflation"

Other major factors for maintaining status quo on interest rates are: i) increase in indirect taxes in FY13 budget that may push up inflation ii) depreciating INR iii) structural bottlenecks in supplies esp. agricultural produce iv) rural wages increasing at faster pace than rural retail inflation - as measured by consumer price index for rural labour.

Disclaimer: The opinions and views expressed in this article are personal to the author



Atul Joshi
MD & CEO
Fitch Ratings, India

Atul Joshi is Managing Director and Chief Executive Officer at Fitch Ratings, India.

Previously, Atul was Managing Director and Head of the Business & Relationship Management (BRM) Group for India at Fitch. He has more than two decades of experience in the financial services industry. Prior to Fitch, Mr. Joshi was in charge of the Financial Institutions Group at ING Vysya Bank India. He was also the Parent Account Manager for India at ING Bank NV. Mr. Joshi started his career at ICICI Bank, where he worked for close to 13 years in both global and domestic treasury functions as well as in project finance.

Atul is a double graduate in Economics and Commerce from Mumbai University, and an all-India 12th rank holder in Chartered Accountancy.

Changing contours of RBI's roles and responsibilities

Agenda for RBI's action in the 21st century

***Mr. Nirmal Jain,** Chairman, IIFL*

The Reserve Bank has played a key role in the development of banking and financial sector in India. Set up in 1934 by RBI Act 1934, it was entrusted with all the important functions and responsibilities of central banking in India. These functions have evolved over the decades. Besides traditional functions that a central bank performs, the RBI has also handled enormous non-monetary responsibilities particularly for development of agriculture, backward areas and promotion of banking habits.

Its exemplary performance in maintaining financial stability and managing risks in the system has enabled it to gain its independence and autonomous status. Although in terms of extant legal framework, the RBI may not be very independent, as the 1934 Act governing its operation says, 'The Central Government may from time to time give such directions to the Bank as it may, after consultation with the Governor of the Bank, consider necessary in the public interest.' In practice, however, RBI enjoys considerable freedom from government intervention and influence in public perception as well. In the recent past, RBI has taken positions contrarian to the same of

"What we forget is the huge cost paid by the nation in terms of masses perpetuating in poverty being excluded from the formal financial system"

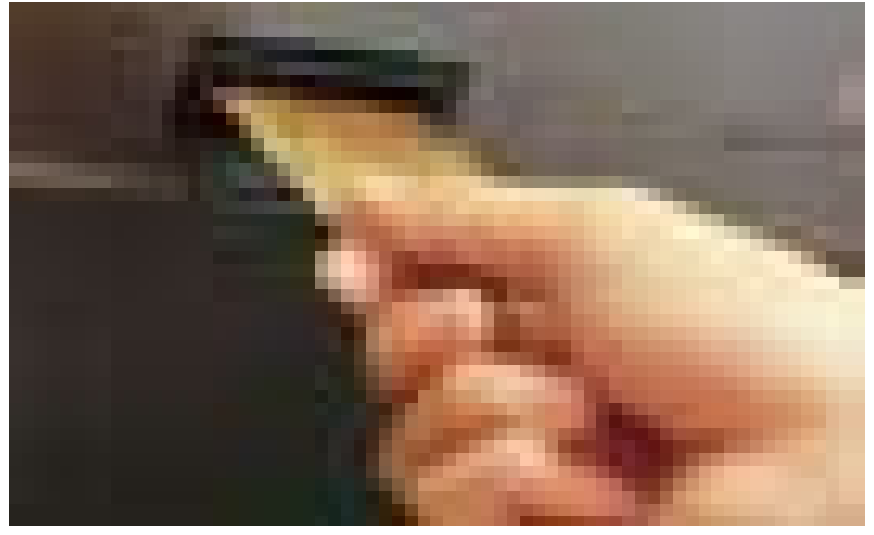
government, on principles.

Like most other central banks, RBI has been performing functions of issue of currency, control of volume and end use of bank credit, maintaining official rate of exchange and controlling foreign exchange operations, being a banker to the government and lender of last resort to commercial banks etc. RBI controls banking system through the system of licensing for new banks, branches of existing banks, mergers, reconstruction and liquidations. It also has power to revoke licenses, carry out inspections, demand information, monitor liquidity of their assets, and regulate their method of working besides other functions. These controls have been very effective and India's commercial banking system is fairly robust and sound.

After independence, the government has empowered RBI through legislation in 1949 and again in 1969 at the time of privatization of banks, to undertake developmental responsibilities. RBI has pursued this and taken several measures to provide financial and credit support for industrial and agricultural development in India. Towards this objective, RBI has promoted many leading financial institutions such as– IDBI, NABARD, UTI, EXIM Bank, DFHI and DICGC. RBI has also been bestowed with powers to promote sound banking habits, take banking to remote rural areas and help in overcoming India's economic backwardness. India has made substantial progress in reaching credit to farmers and saving farmer's from exploitation at the hands of moneylenders.

Yet, when we do a critical evaluation of what we have achieved, it looks like a situation of one of the slowest runners in the race, who looks back the distance covered and pats himself on the back. Yes, we have covered substantial distance. But looking at all the co-runners in the race, be it China or Singapore or developed countries like USA or Germany, several questions come to our mind.

- Why even after 65 years of independence, almost 65% of our population has hardly any access to banking services?
- Similarly, since independence, our farmer's per capita income has less than halved in relation to his non-farming urban counterpart. Why are farmers poorer despite doling out incessantly tax payers' money and deposit holders' subsidy?
- Why do our SMEs find it difficult to raise either equity or debt capital, despite clear focus of public policy on the same? Why do they still not have a functioning corporate bond market?
- Why do our savers hardly earn 4% and even good quality borrowers pay over 14%?



We need to answer these difficult questions even as we boast ourselves about India's relative stability in the midst of global financial turbulence. What we forget is the huge cost paid by the nation in terms of masses perpetuating in poverty being excluded from the formal financial system.

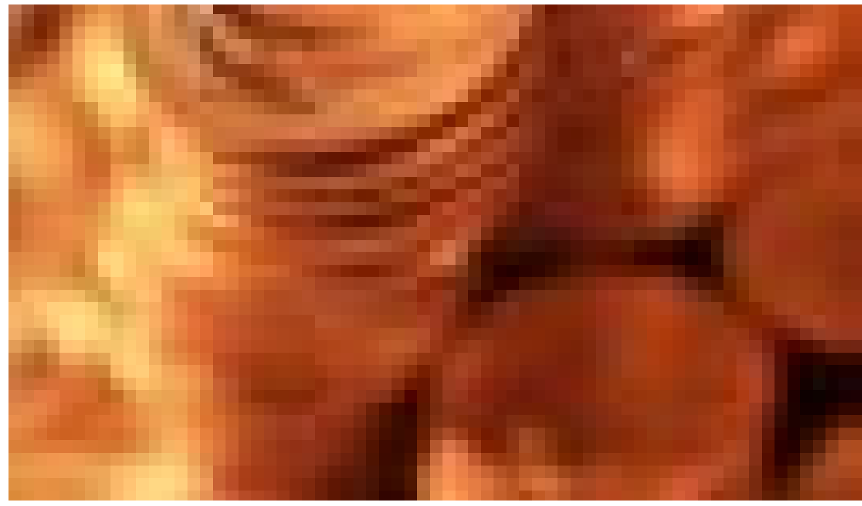
In the last 50 years, many emerging economies and developing nations have marched significantly ahead of India from an agrarian system to a post-industrial modern society. Not surprisingly, one of the primary drivers has been the spread of banking and financial services or in other words financial inclusion. Imagine if the developed countries were to go back 40-50 years in time and adopt such ultra conservative approach to avoid this financial crisis, would they do it? The answer is an obvious 'No' as they have experienced how letting the growth engine run smoothly with the lubricant of finance drives

growth, raises output, increases employment and in the process takes millions of people out of poverty.

The RBI governor recently urged banks to look upon financial inclusion not as an obligation but as an opportunity to build fortune at the bottom of the pyramid. To quote the Governor Dr. Duvvuri Subbarao 'Unless banks are convinced that reaching out to the common man is not just a forced regulatory imperative but a potential business opportunity, the numbers will remain without life.'

The Governor is absolutely right. The numbers have remained and will remain lifeless till banks see opportunity and not obligation to reach out to unbanked areas. At present, the banking services are not saturated even in urban areas. This is evident from the fact that the youngest and even small private sector banks are able to set up branches in urban areas and pluck the low hanging fruits. They remain in a kind of comfort zone with no real need or compulsion to go out to remote villages and difficult terrain. In the past whenever there were no compulsions on public sector banks, they would not really set up many branches in rural areas.

On the other hand, if entry is freed as in the case of securities broking, innovative technology and process initiatives by brokers has resulted in brokers reaching out to small places and handling funds and securities settlement for the customers. Brokerage rates have come down to rock bottom levels of 0.02% and still all large players



are profitable. Brokers are looking at small places as an opportunity and not obligation as the business is intensely competitive and urban markets are already saturated. No regulator has urged them to do so but ruthless forces of free market leave them with no choice.

Banks take public deposits and pose a systemic risk and therefore a robust regulatory framework is a must. At the same time, we need many more new banks to drive financial inclusion and foster competition so that consumer gets the best product at best price. The duties of ensuring transparency, disclosure and fair practices must very well remain but not by artificially restricting new entrants, new branches, new products or even pricing.

Perhaps India needs 500 new banks today. It may sound as ridiculous as it would have in 1991, that we need 500 new cement plants or 50,000 broking terminals. If only 5 licenses are available, then 2G kind of 'political influence', 'fixing' and opportunistic scramble are inevitable. The current draft guidelines indicate a cautious 'open and shut' approach to bank licensing. Like in most other countries, new bank licences need to be on tap, available to all 'fit and proper' cases willing to abide by the regulatory requirements. RBI has to guard against malpractices by a sound system of inspection, monitoring and reporting.

When there is discretion to give licenses in a scarcity situation, wrongdoings cannot be prevented. Witness the fact that even death sentence in countries like China, has not prevented corruption.

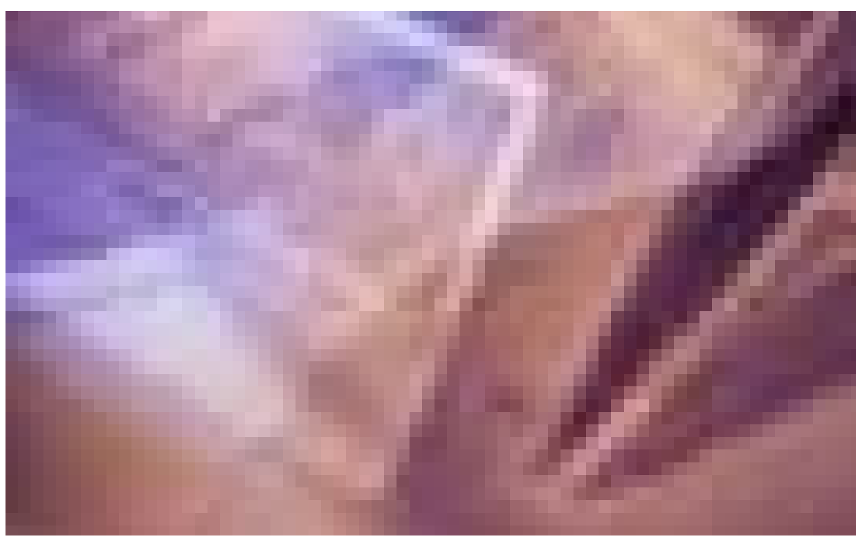
The current situation in banking industry reminds us of the License raj era in manufacturing sector till 1991. The government controlled through licensing, new capacity and pricing for products like cement, steel, automobiles etc. Our policy makers believed with conviction that without controls, customers will be fleeced and become victims of scams, profiteering and poor quality products. What they achieved was exactly the reverse. We then had acute shortage, high prices and poor quality of products. Adjusted for inflation, cement and steel are now not only much cheaper but come with superior quality and easy availability. The

consumers get much better value and companies too are growing. New capacities have a cascading effect of driving employment and economic growth.

The low penetration of banking services deprives masses of formal financial system to transfer funds, access to credit or best instruments to invest. It also causes a parallel economy of black money. The easy availability of money, finance and banking has allowed enterprises to blossom, raise output, income and employment with cascading impact on other sectors and the entire economy as well. The aggregate capital and managerial bandwidth of existing banks is hardly adequate to meet the current requirement, leave apart the expected three fold growth in the monetary economy in a decade.

The apprehensions that RBI has about new entrants in banks are similar to what our policy makers had about new entrants in cement and steel industries. It has become all the more imperative now because many sectors of the economy have opened up in India and more importantly most other economies, world over opened up and participated in the globalization and have benefited. The banking sector, once open for new entrants, will see a huge flow of capital, innovation, ideas and ensure that existing players are also a lot more efficient.

The RBI needs to assume a much pragmatic role for sustaining and accelerating the economic growth of the country. The financial inclusion will be a derivative of economic growth. We have seen that direct



controls have very little efficacy as compared to forces of market when freed. The experiences of developed countries show that as economies develop and mature, the central bank steps back by freeing access to financial intermediation and micro regulations, thereby paving the way for market forces to work efficiently. Even a socialist country like China has integrated with the rest of the world. In the nascent stage of growth, hand-holding was much required. In the present environment, there should be growth and fair competition, the failure to do so will lead to denial of fruits of growth and inclusion to masses.

RBI has been extremely risk-averse and overcautious. For instance, there is huge enthusiasm to take lessons from the perils of shadow banking and apply them to NBFCs in Indian conditions. Comparing the sophistication and complexity or the size and enormity of banking and financial services industries in developed countries versus India is akin to drawing similarities between transport systems of motor cars and bullock

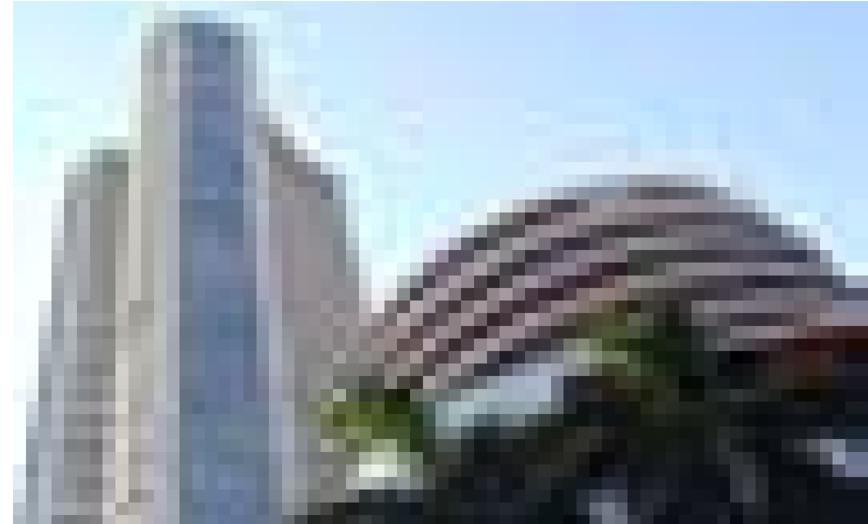
> **"Financial inclusion will be a derivative of economic growth"**

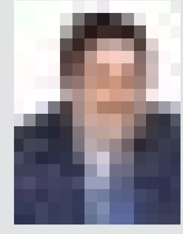
carts. When there is accident of motor cars, applying the same road safety rules to bullock carts, will further decelerate the slow moving system. We should be vigilant of not drawing any wrong lessons from the global financial crisis witnessed in the last 3-4 years. NBFCs in India have always had much higher capital adequacy and never dealt in exotic derivatives or complex products such as Credit Default Swaps (CDS). At the other extreme, these NBFCs have been contributing towards filling the gap created by inadequate banking. They have innovated, evolved a low cost system and specialised origination and risk assessment skills in certain credit verticals. They endeavour to reach out to segments and geographies where banks do not find it viable to enter. How else would they have survived, without access to low cost deposits or refinance from RBI.

NBFCs have complemented banks and evolved a system pertinent and appropriate for Indian economy and populace with low per capita income and relative poverty.

While nobody will argue against utmost controls to prevent frauds, risks or scams, there is always a cost of conservatism and risk aversion. We all agree that human lives are far more important than financial losses. Imagine we have strict motor vehicle safety regulations ensuring no accident ever, even if 60% of population has no access to motorized vehicles! Or think of a two-year-old toddler trying to walk; he stumbles and is injured. The overcautious mother then prevents the child from walking without supportive crutches till the age of 20. She then brags to the neighbours that her child, however weak, has never been hurt.

The RBI needs to pursue rigorously its twin responsibilities of development and regulation. In the twenty-first century, it is uniquely placed in the Indian context. It has the autonomy, credibility, experience and talent pool to execute the agenda for growth and development. The RBI has no doubt done a commendable job of managing risks and ensuring credibility. Going forward, that will not be adequate discharge of its duties to the people of India who are yearning for a superior standard of living, like the rest of the world.





Nirmal Jain
Founder & Chairman
India Infoline Group

Mr. Nirmal Jain, Founder and Chairman of India Infoline Group (IIFL) is a first generation entrepreneur, who is credited with building one of the largest financial services companies in India in just about a decade. A PGDM (Post Graduate Diploma in Management) from IIM, Ahmedabad, a rank holder Chartered Accountant and a Cost Accountant, Mr. Jain began his career in 1989 with Hindustan Lever Limited (HUL), the Indian arm of Unilever.

In 1995, he founded his own independent research company, Probity Research and Services Pvt Ltd, which is today known as India Infoline and recently branded as IIFL. Over the years, Nirmal steered the company to ever greater heights, through financial turmoil, regulatory upheaval and survived brutal competition from deep-pocketed institutional and MNC players. He has won several awards and has been ranked as the '2nd most valuable CEO in India' by Business World in 2009.

Under his aegis the IIFL group has also expanded globally and has subsidiaries and offices in Colombo, Dubai, New York and Singapore. He is a voracious reader who also loves travelling. He is also passionate about contributing to society, especially in the fields of education and healthcare for the under privileged, for which he has setup the IIFL foundation.

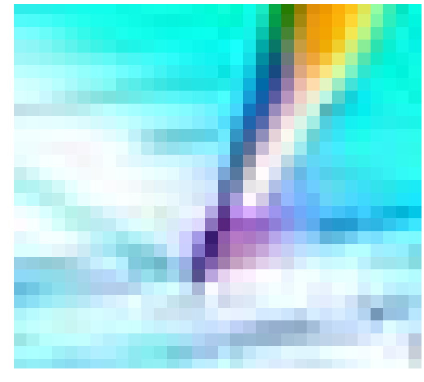
Central Banking in India: Changing contours

Dr. Bansi Lal Patheja, *GM, Punjab National Bank*

Reserve Bank of India's has always focused on monetary stability and operations on currency and credit system in India. During the **first phase of changing contour** i.e., 1930's, which may be called infancy and uncertainty, the RBI was virtually subservient to the dictates of the Government and measures were taken to curb its capacity for independent actions. However shortly after India's Independence in 1947, the RBI was nationalised in 1948 which led to the beginning of the **second phase of changing contours.**

Theearlyyearswerecharacterised by a good degree of fiscal rectitude and harmony in monetary and fiscal policy with areas of potential conflict being minimal. The fact that the rate of inflation was modest compared to other developing countries during this period is indicative of the success of macro-policy management and facilitated the task of the RBI in pursuing other developmental activities. During this period, the RBI was vigorously involved in promoting the institutionalisation of credit to agriculture and industry in pursuant to the overall objectives of the respective Five-Year Plans. Apart from helping to

"The Indian Banking industry had witnessed a complete transformation following reform and liberalization process initiated by RBI"



channelise credit to agriculture and industry, an important objective of the RBI was the promotion and mobilisation of savings by reinforcing the foundations of the banking system. During the period of the Second World War, India witnessed indiscriminate growth of branch banking. To restrict branch expansion, RBI introduced a restrictive branch licensing policy which was followed initially during the years 1947 to 1954. Thereafter, till 1962, a liberal Branch Licensing Policy was pursued by RBI.

Further **the third phase,** from nationalisation of the RBI in 1948 till nationalisation of major commercial banks in 1969, may be considered as maturing of the RBI into a full-fledged professionally managed central bank, perhaps one of the foremost in developing countries. During that era the interest rates were administered for easy access of market borrowing and the Statutory Liquidity Ratio (SLR) requirements of the banking sector were periodically hiked. In this regard, the nationalisation of banks and transfer of ownership to Government provided a captive market for the government. Simultaneously, recourse to the RBI credit was also high, leading to high levels of monetisation. To neutralise the effect of monetisation on the price level, the RBI, in turn, had to intermittently increase the Cash Reserve Ratio (CRR) requirements of the banking sector. After nationalization, a lot of branch expansion was targeted at making the banking available to Rural & semi urban populace. This led to huge expansion of banking in India & a lot of financial inclusion.

The fourth phase in the changing contour approximately starts from 1990-91. Major changes in the monetary policy framework took place in many countries around this time. While people in many developed countries were tired of persistent and high inflation during the earlier years, the journey of the centrally planned economies towards a market determined system also began around this time. While radical changes were taking place worldwide, the Indian economy during 1990-91 experienced a severe balance of payments crisis. The crisis was clearly a fallout of the fiscal profligacy during the Eighties. At the same time, with gradual opening up of the economy and development of domestic financial markets, the operational framework of the RBI also changed considerably with clearer articulation of policy goals and more and more public dissemination of vast amount of data relating to its operations. However in the year 2001, four areas - interest rate policy, deficit financing, cooperative credit policies and management of substandard banks were on the top of RBI's concerns.

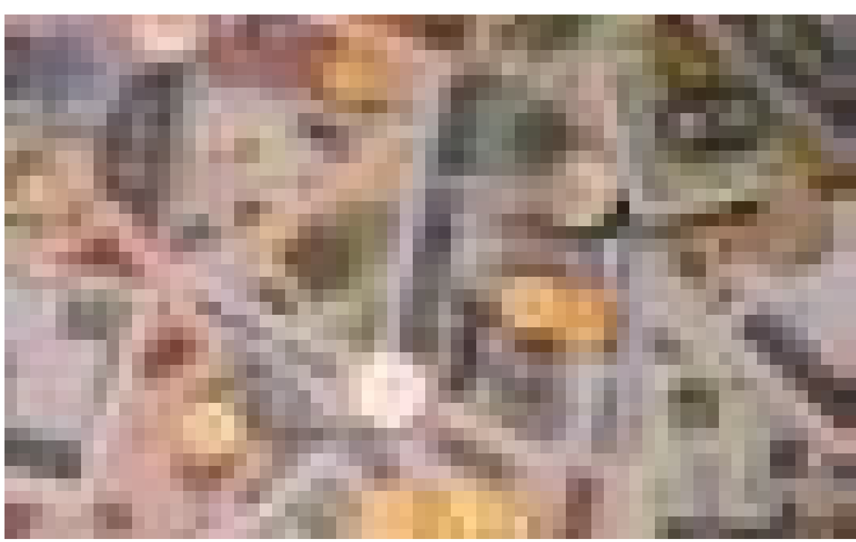
In November 1994, a high powered Board for Financial Supervision (BFS), comprising the Governor of RBI as Chairman, one Deputy Governor as Vice Chairman, other Deputy Governors and four Directors of the Central Board of RBI as Members was constituted with the mandate to exercise the powers of supervision and inspection in relation to the banking companies, financial institutions and non-banking financial companies. RBI has formulated and put in place a supervisory strategy which highlighted the importance of on-site Annual Financial Inspections- the main plank of banking supervision. As a result of this rigorous supervision, Indian Banks were able to absorb the external and internal shocks.

The Reserve Bank, as the custodian of the country's foreign exchange reserves, is vested with the responsibility of managing their investment. The legal

provisions governing management of foreign exchange reserves are laid down in the Reserve Bank of India Act, 1934. The RBI's reserves management function has grown in length & breadth in terms of importance and sophistication for two main reasons. First, the share of foreign currency assets in the balance sheet of the Reserve Bank has substantially increased. Second, with the increased volatility in exchange and interest rates in the global market, the task of preserving the value of reserves and obtaining a reasonable return on them has become challenging.

With the introduction of the Foreign Exchange Management Act 1999, (FEMA) with effect from June 1, 2000, the objective of RBI shifted from conservation of foreign exchange to "facilitating external trade and payment and promoting the orderly development and maintenance of foreign exchange market in India". For capital account transactions, the Reserve Bank regulations provide for general permissions/automatic routes for investments in India by non-residents, investments overseas by residents and borrowings abroad, etc. RBI ensures timely realisation of export proceeds and reviews, on a continuous basis, the existing rules in the light of suggestions received from various trade bodies and exporters' fora. It lays down policy guidelines for risk management relating to forex transactions in banks and is also entrusted with the responsibility of licensing banks/money changers to deal in foreign exchange and inspecting them.

Impact of Changing Contours: Partly as a result of such institutional changes in recent years, inflation in India has been moderate relative to other developing countries despite high fiscal deficit. RBI, though not formally independent, has enjoyed a high degree of operational autonomy during the post-reform period. In fact, during the recent period, the RBI enjoys considerable instrument independence for attaining monetary policy objectives. Significant achievements in financial reforms including strengthening of the banking supervision capabilities of the RBI have enhanced its credibility and instrument independence. Due to all these initiatives-from secure environment to liberal policy to robust risk management provided by the central bank, no major Indian Bank failed in the banking history contrary to the developed counties.



Transition of Monetary policy Framework

Monetary policy framework, has been a continuously evolving process contingent upon the level of development of financial markets and institutions as also the degree of global integration. In India, monetary policy framework has undergone significant transformation over time. India followed a monetary targeting framework with feedback during the mid-1980s to 1997-98 under which broad money was used as an intermediate target for monetary policy. This framework was, however, rendered increasingly inadequate by the mid-1990s due to several developments that took place with economic and financial sector reforms.

- First, on account of measures undertaken during the 1990s to develop the various segments of the financial market, there was discernible deepening of the financial sector. This significantly improved the effectiveness in the transmission of policy signals through indirect instruments such as interest rates.
- Second, with the opening up of Indian economy, increase in liquidity emanating from capital inflows raised the ratio of net foreign assets to reserve money. This rendered the control of monetary aggregates more difficult.

- Third, there was also increasing evidence of changes in the underlying transmission mechanism of monetary policy with interest rate and the exchange rate gaining importance vis-à-vis quantity variables.

Due to these financial innovations in the economy during the 1990s, the stability of the demand function for money came under question. Recognising the challenges posed by financial liberalisation and the growing complexities of monetary management, the Reserve Bank switched to a **multiple indicator approach in 1998-99.**

Operating Methodology: Under the multiple indicator approach, while broad money continued to remain an information variable, greater emphasis was placed on rate channels for monetary policy formulation. A host of macroeconomic indicators including interest rates or rates of return in different segments of financial markets, along with other indicators on currency, credit by banks and financial institutions, fiscal position, trade, capital flows, inflation rate, exchange rate, refinancing and transactions in foreign exchange available on high frequency basis are juxtaposed with output data for drawing implications for monetary policy formulation. As a result, monetary policy operation became **more broad-based** on a diverse set of information and provided flexibility in the conduct of monetary management.

- The multiple indicator approach itself, however, continued to evolve and was further augmented by forward-looking indicators and a panel of parsimonious time series models. The forward-looking indicators are drawn from the Reserve Bank's industrial outlook survey, capacity utilisation survey, professional forecasters' survey and inflation expectations survey. The assessment from these indicators and models feed into the projection of growth and inflation. Simultaneously, the Reserve Bank also gives the projection for broad money (M3), which serves as an important information variable, so as to make the resource balance in the economy consistent with the credit needs of the government and the private sector.
- Application of CRR on banks' liabilities and open market operations (OMO) have traditionally been the liquidity management instruments of monetary policy. But, with the introduction of liquidity adjustment facility (LAF) in 2004, overnight management of systemic liquidity at desired interest rate emerged as the most active instrument of monetary policy. The LAF was operated through overnight fixed rate repo (central bank liquidity injection rate) and reverse repo (central bank liquidity absorption rate) to provide necessary guidance to market interest rate. However, a new operating procedure was put in place in May 2011.

The new operating procedure retained the essential features of the earlier LAF framework with the following key modifications.

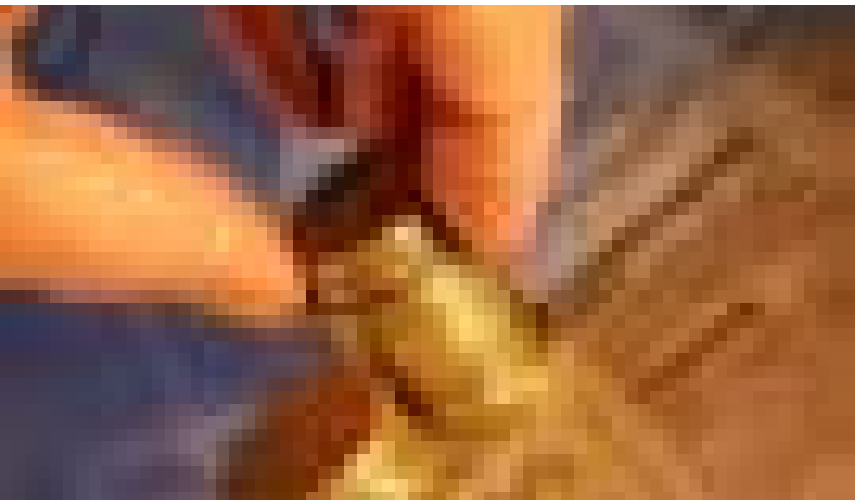
- First, the weighted average overnight call money rate was explicitly recognised as the operating target of monetary policy.
- Second, the repo rate was made the only one independently varying policy rate.
- Third, a new Marginal Standing Facility (MSF) was instituted under which scheduled commercial banks (SCBs) could borrow overnight at their discretion up to one

per cent of their respective net demand and time liabilities (NDTL) at 100 basis points above the repo rate.

- Fourth, the revised corridor was defined with a fixed width of 200 basis points. The repo rate was placed in the middle of the corridor, with the reverse repo rate 100 basis points below it and the MSF rate 100 basis points above it. Earlier repo and reverse repo rates did not move in tandem-the difference varied from time to time.

The new operating procedure, by removing some of the major drawbacks in the earlier LAF framework, has improved the implementation and transmission of monetary policy.

- Bank rate known as reference rate was an important tool for the RBI from May 1957 to October 1991 to control the economic disruptions. However in 2011-12, RBI decided to align the Bank Rate with the Marginal Standing Facility (MSF) rate, which in turn is linked to the policy repo rate under the Liquidity Adjustment Facility (LAF). Henceforth, whenever there is an adjustment of the MSF rate, the RBI will consider and align the Bank Rate with the revised MSF rate. All penal interest rates on shortfall in reserve requirements, which are specifically linked to the Bank Rate, also stand revised. Thus RBI had replaced Bank rate with repo rate as the main monetary tool to manage liquidity and interest rates. Section 49 of the Reserve Bank of India Act, 1934 requires the RBI to make public (from time-to-time) the standard rate at which it is prepared to buy or re-discount bills of exchange or other commercial paper eligible for purchase under that Act. Since discounting/rediscounting by the Reserve Bank has remained in disuse, the Bank Rate has not been active.



Other Major Changes:

1. **From Class Banking to Mass Banking:**

- Earlier without the prior approval of the RBI, the Banks could not open a new place of business in India or abroad or change. The opening of the new branches was restricted to the urban and metro areas. As such the banking facilities were enjoyed by the elite class while the poor masses were under the clutches of money lenders who exploited them brutally. To overcome this, a framework for a branch authorisation policy was put in place since September 2005.
- With the passage of time, RBI felt that branch expansion in Tier 2 centres (population between 50,000 and 99,999 as per Census 2001) has not taken place at the desired pace. Therefore, to provide enhanced banking services in Tier 2 centres, the RBI proposed to permit banks (other than RRBs) to open branches in Tier 2 centres without taking prior permission. RBI issued the branch authorisation policy to make sure whether at least 25 per cent of the total numbers of branches to be opened during a year are proposed to be opened in unbanked rural centres.
- Thus with the introduction of branch authorisation policy, RBI, while considering applications for opening branches, will give weightage to the nature and scope of banking facilities provided by banks to common persons, particularly in underbanked areas, actual credit flow to the priority sector, pricing of products and overall efforts for promoting financial inclusion, including introduction of appropriate new products and

the enhanced use of technology for delivery of banking services to the bottom of pyramid.

2. **From Micro to Macro Management:**

- The Indian Banking industry had witnessed a complete transformation following reform and liberalization process initiated by RBI. The RBI gave more operational autonomy and freedom to banks to evolve their own policies and procedures for effectively functioning based on their business needs. Banks have been given more freedom in decision making in the areas like interest rates, assessment of working capital limits, monitoring and follow up of loans, treasury operations, forex business, etc. In nutshell, RBI has shifted from the micro management to macro management.

3. **From regulated to deregulation of interest rates:**

- Earlier RBI had regulated environment in terms of interest rates, service charges etc. which gradually shifted to deregulation of interest rates. After financial sector reforms, administered interest rate on deposits and lending of the banks proved to be inefficient. Hence, Reserve Bank of India gradually deregulated interest rate on both liabilities and assets side of the commercial banks. Till June 2010, a few categories of interest rates that continued to be regulated on the lending side were small loans up to Rs 2 lakh and rupee export credit, and on the deposit side, the savings bank deposit interest rate. The rates on small loans up to Rs 2 lakh and rupee export credit were deregulated in July 2010, when the Reserve Bank replaced the Benchmark Prime Lending Rate (BPLR) system with the Base Rate system. With this, all rupee lending rates were deregulated. RBI deregulated interest rate on savings fund deposits effective 25.10.2011, with a stipulation to pay same rate on deposits upto Rs one lakh. Depositors of higher amount are to be paid same rate for same amount of deposit.

4. **Risk Management:**

- The Reserve Bank of India in April 1992 on recommendation of Narsimham committee introduced a risk asset ratio system for banks in India as a capital adequacy measure in line with the Capital Adequacy Norms prescribed by Basel Committee. Later on, the Basel Committee on Banking Supervision released a comprehensive version of the revised framework i.e., Basel II in June 2006.

> **"Change is the law of life and those who look only to the past or the present are certain to miss the future."**
> ***John F Kennedy***

- Basel II was designed because its predecessor i.e. Basel I was considered risk insensitive and too preliminary to cope up with the rapid developments in the financial sector resulting in substantial regulatory arbitrage. The basic purpose of Basel II was to leverage on the risk management systems of internationally active banks and use that for enhanced risk management architecture and, in the process, have better measurement of capital requirements.
- All the Indian banks have adopted the standardised approaches under the Basel II framework in 2009, however, the pace of migration to the advanced approaches has naturally been very slow.

Though the Reserve Bank has set an indicative time schedule for implementation of the Advanced Approaches, banks' response has been less than encouraging so far. Thus the banking industry adopted more sophisticated risk management systems. The Reserve Bank, the supervisors is making a rapid strides to be able to appreciate the nuances associated with the quantitative techniques and modeling.

5. **Journey to Basel III Regime:**

- At present the movement is towards Basel III. The Basel Committee has prescribed a detailed roadmap for smooth transition to Basel III standards between January 1, 2013 and January 1, 2019. In this regard, the assessment shows that Indian Banks are well positioned to adjust to the Basel III norms well within the phase-in period. However, there exist many challenges, such as upgrading risk management systems and meeting the credit needs of a rapidly growing economy even while adjusting to a more demanding regulatory regime.

With the change in central banking contours as detailed above, RBI handled the post crisis environment lucratively. This is evident from the fact that during the crisis period, India has admirably fought the downward spiral of recession. During 2008-09, India's GDP stood at 6.7% while the GDP of developed countries entered the negative zone. However, dependence of Government on RBI to control inflation, manage Rate of Interest, Growth and other Macroeconomic parameters has increased. The expectation from RBI is mounting day by day. Nevertheless, RBI has proved its worth by managing the economy successfully in testing times.

Lessons from the Global Financial Crisis

Monetary policy evolution is influenced not only by the changing paradigm in monetary economics but also by the developments in the financial market and macroeconomic outcomes. In the event of adverse developments, adequacy of extant economic policies is put to test as was during the recent global financial crisis. Crisis is not desirable but they seem unavoidable. They do, however, provide us the opportunity to assess various tenets of extant policy framework. Against this backdrop, a few important monetary policy lessons that emerged from the recent crisis.

- The recent crisis has demonstrated that a monetary policy solely aimed at fine-tuning of short-term objectives can pose risks. Before the crisis, monetary policy focused more on short-term demand management while inflation was firmly under control, particularly in the advanced economies. It was felt that fine-tuning of monetary policy on the basis of indicators, such as output gaps and measures of core inflation, led central banks towards excessive 'short-termism'. This in turn contributed to build up of risks. Thus, policies focused on short-term objectives may not deliver desired economic outcomes in medium to long term.
- The experience of recent crisis has changed the perception as to how central banks should go about achieving their macroeconomic stabilisation objectives. It has become clear that mandate of monetary policy should encompass macro-financial stability and not just price stability.
- Inadequacy of monetary policy instruments in central banks' operational frameworks was also evident during the cri-sis. As was seen during initial

phase of the crisis, monetary policy framed and implemented via instrument of policy interest rate remained ineffective. Consequently, central banks had to resort to a number other unconventional quantity-based measures to ease financial conditions. Thus, there is a need to broaden the toolkit of monetary instruments.

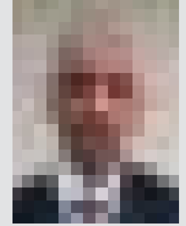
- Though financial frictions play an important role in business cycles, they were not explicit part of the models used for policy analysis by central banks. In most crises, including the recent one, it has been seen that shocks to financial system accentuate information asymmetry and affect policy transmission. Therefore, not only must financial frictions be properly understood, but they should also be built into macro-econometric models that central banks use for forecasting and policy formulation.
- After the crisis, it has been increasingly felt that central banks could better discharge lender of last resort function if they are also vested with micro-prudential regulation and supervision of banks. It could reinforce macroprudential action by eliciting regulatory and supervisory instruments to dampen pro-cyclicality.
- The operating procedures of monetary policy in future would have to take into account the implications of build-up of sovereign debt during the crisis. In this context, cautions that central bank operating procedures in the future are likely to be more complicated with more tools and more options. Monetary and fiscal coordination, therefore, assumes further importance in the implementation of monetary policy.

Conclusion:

Recent global financial crisis has, however, shown that low levels of inflation and high levels of growth do not guarantee financial stability. Accordingly, there is an increasing emphasis that financial stability should also be an explicit objective of central banks besides price stability and growth. In India, however, financial stability was recognised as another important objective of monetary policy much before the crisis.

"There is an increasing emphasis that financial stability should also be an explicit objective of central banks besides price stability and growth"

Thus, monetary policy in India has evolved to have multiple objectives of price stability, growth and financial stability. These objectives are not inherently contradictory, but rather they are mutually reinforcing. Sometimes, it becomes very difficult to maintain fine balance between growth and inflation. Both price and financial stability are important for sustaining a high level of growth, which is the ultimate objective of public policy.



Dr. Bansi Lal Patheja
General Manager
Punjab National Bank

Dr. Bansi Lal Patheja, General Manager,Punjab National Bank

Dr. Bansi Lal Patheja, a doctorate from a premier institute, IIT Delhi, started his career as directly recruited Management Trainee in Punjab National Bank in 1977. A versatile banker, Dr B L Patheja carries with him over 34 years of rich Banking experience. He is heading Management Advisory and Services Division (MASD) as the General Manager . He worked in different capacities in various branches and Administrative Office of Bank during his banking career spanning over three decades. He has also worked in all areas of banking including branch operations, credit and foreign exchange at branches in Delhi, Kanpur, Bahadurgarh, etc He has a vast experience in banking both at operational level and administrative level.

His papers have been published in various prestigious magazine and compendium of Bankers' conference.

Growth Vs Inflation: It's Different This Time

Mr. Sujit Kumar, *Manager, Union Bank of India*

It is compelling to quote the master at the very start of this article. It is neither paying homage, as an act of faith, nor taking cover for the arguments. Developments of last one year in India's economy and polity has been uncomfortable, if not worrying, even if set in their global context. The prevailing state of economy warrants a better scrutiny of facts and if it has changed then it follows that we have to be extra vigilant while administering policy prescriptions from the conservative wisdom.

Of the multifarious roles assumed by the Reserve Bank of India (RBI) - maintaining stability of both prices and the financial system and supporting economic growth- the common thread underlying any policy is that it should promote growth (Padmanabhan, 2012).It is understandable given India's long quest for freedom from that unenviable 'Hindu Rate of Growth'. Indian economy has recorded impressive growth post balance of payments (BoP) crisis of 1991 and it underwent structural changes in the period following. The share of services sector (including construction) in the economy has increased from 41 per cent in 1991 to 67 percent in 2012.This brings some resilience in trend rate of growth as level of

"India's economic growth is estimated at 5.3 percent for final quarter of fiscal 2011-12, a marked contrast to 9.2 per cent growth in Q4 FY11"

activity in services sector is less volatile compared to agriculture which still rely on good monsoon or industry that has become increasingly co-integrated with global cycle. However, given the inter-sectoral linkages, the overall growth depends on rate of investments and importantly capital goods production in industry.

India's economic growth is estimated at 5.3 percent for final quarter of fiscal 2011-12, a marked contrast to 9.2 per cent growth in Q4 FY11. There are several explanations offered for gradual decline in rate of growth including unfavorable external scenario, domestic policy inertia discouraging investors, elevated inflation and therefore, the conservative policy response of monetary tightening raising interest costs, etc. Importantly, the reasoning behind the policy response is that growth-inflation relation, better known as Phillips Curve, breaks off after certain level of inflation, and thereafter reverses its nature, i.e., further inflation becomes detrimental to growth. Moreover, if policymakers continue pushing through growth friendly policies, inflation may become structural by feeding through elevated expectations. This is, arguably, why RBI raised its guard again in its mid-quarter review of monetary policy in June 2012. This line of argument has its root in Milton Friedman's celebrated paper titled 'the role of monetary policy' (1968). However, since then central banks have played with different variants of policy prescriptions including targeting monetary aggregates, inflation level, and more recently the overarching stability of financial system.

Inflation has been persistently high in India in recent years. Inflation, as measured through wholesale price index, averaged 9.6 percent and 8.9 percent respectively in FY11 and FY12. RBI has been deft in assessing the underlying momentum and changing drivers of inflation and has calibrated its policy response so as not to hurt growth aggressively while taming inflation (Gokarn, 2012). The modus operandi of monetary tightening is through curtailing demand side pressure on prices and therefore, some growth will be sacrificed while taming inflation. The sacrifice, however, becomes too serious if it impairs the medium to long run drivers of growth. This is exactly where the prescriptions of textbook wisdom need to be examined.

> **"When the facts change, I change my mind. What do you do, sir?"**
>
> *J M Keynes*[i]

Of Investments: RBI sympathetic not sorry

India's remarkable growth story of last two decades is rightly attributed to rising rate of investments in economy. Investment rate has risen from near 20 per cent in 1980s to about 36 per cent. The increasing and sustained growth of recent years, hence, is no surprise. With a capital- output ratio of 4.1, as estimated by Planning Commission, a growth of 8.5 percent and above is easily explained. Reforms undertaken by successive governments post BoP crisis encouraged private enterprise which reflects in India's increasingly assertive firms in the global market place.

Cumulative aggregation of newly rising expectations, in a benign external scenario, encourages a favourable 'state of long run expectations' which is critical in determining level and direction of investments in economy. Investment decisions, after all, depend on estimate

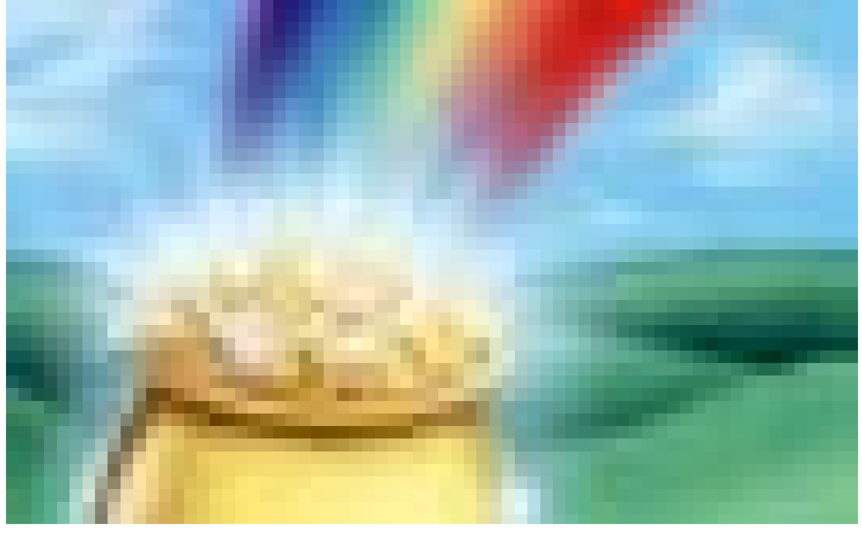


Table 1: Macro Foundations of Investor's Belief in India Story

	FY93-96	FY97-00	FY01-04	FY05-08	FY09-12
Real GDP % y/y	6.2	6.6	5.5	8.8	7.5
IIP % y/y	7.6	5.9	5.1	12.2	4.7
WPI % y/y	8.3	4.6	4.9	5.5	7.6
Center's F. D. % to GDP	4.9	5.3	5.4	3.4	5.8
CAD % to GDP	1.2	1.1	-0.9	1.0	2.9
USD/INR	31.7	39.5	46.9	43.7	46.7

Note: The four year averaging smoothens out eventful years and so captures the momentum in macro indicators from medium term perspective. To illustrate, FY98 was hit with Asian Financial Crisis, FY01 saw collapse of dotcom bubble, and FY03 was a draught year whereas FY09 witnessed the Lehman event. In such years the macros came under severe strain but underlying optimism in economy about the medium to long run prospects helped to it recover back.

of present value of all ensuing streams of income from the investment intended. If the expected benefits exceed the expected costs accounting for foreseeable risks in realizing the proceeds, the investment decision is actuated. It is important to recognize the important role of 'state of long-term expectations' in the investment decisions taken and their adjustments in due course of realization of expected proceeds. It can be argued that a benign monetary policy helps even such investments to be undertaken which otherwise hung on borders of net expected benefits. However, such investments are likely to undergo corrections in case future does not pan out as expected. More worrying is a general correction/ impairment in expectations about long run for it derails the very growth momentum in economy and the effects may have medium-to-long term consequences.

Central banks assume important role and responsibility in shaping and nurturing such state of long run expectations through control over various monetary and banking aggregates and importantly, through effective communication to stakeholders about its acts and intentions. RBI is hailed for its prudent governance of financial markets with precautionary and gradual approach. A similar prestige is yet to be earned for its prime mandate- of ensuring price stability while supporting economic growth. This is not to take away the credit that RBI deserves for its evolutionary approach in monetary policy[ii] .

Let us scrutinize some of the facts on Indian economy and some policy stands taken recently, in the light of arguments discussed above. India's annual economic growth for FY12 is estimated at 6.5 percent; lowest in last nine years. The slowdown is set in context of uncertainty surrounding Euro zone and a weak overall external demand conditions impacting India's trade. The external woes have been compounding further with current account deficit widening up to 4 per cent in FY12. Rupee has been under extreme pressure in last one year and has fallen to historical lows of 57.32 per US $ on June 22, 2012; year on year depreciation of over 27 percent. Outlook remains grim in near term at least. The industrial output growth has been flat and is expected to remain week even in first half of fiscal 2012-13. Industrial sector output (mining, manufacturing, and electricity

sectors) has grown by 2.6 percent in FY12. Of which, the second half (Oct-Mar) growth in industrial output was even miserable; 0.8 percent over corresponding period of previous fiscal.

Industry captains have blamed the high interest cost scenario in economy as villainous in a milieu characterized with prevailing uncertainties. RBI, however, dismisses the charge that high interest costs have impeded investments arguing that the real interest rates today are below the real rates in boom years of 2004-08 (Subbarao, 2012). RBI adds that its current stance is intended to dampen inflationary pressures re-emerging in primary articles, even if non-food manufacturing or Core inflation is stabilizing below 5 per cent lately. The stance is based on risk of inflationary pressures getting generalized, if not checked in incipient stage.

RBI's stand of persisting with rates has confused many economists as the texture of mid-term review statement is surprisingly hawkish, a sharp contrast to the Annual Policy Statement of April-12. In April, RBI said that "reduction in the repo rate is based on an assessment of growth having slowed below its post-crisis trend rate which, in turn, is contributing to a moderation in core inflation. However, it must be emphasised that the deviation of growth from its trend is modest." Well if Q3 FY12 growth at 6.1 percent y/y, the input for April policy assessment, was modest deviation from trend rate of growth, how about 5.3 percent growth noted for Q4 FY12!!

Lately, there is a growing chorus that 'India's potential rate has scaled down post crisis 2008-09' and is anywhere around 7.5 percent at best. Sadly, RBI's is also joining this chorus. This chorus, if believed, implies policy makers should not push growth further as demand side pressures will get manifested in inflation without improving growth. This presumes that India is at its supply frontiers at present, a term technically known as full employment level, given the structures of economy, and therefore 'further reduction in the policy interest rate at this juncture, rather than supporting growth, could exacerbate inflationary pressures'.

Potential growth rate of an economy like India remains a cloudy idea as there remains so much potential waiting to be unleashed, e.g. low rate of women participation in labour, disguised labour in agriculture, NextGen (aged between 10 to 20 years) to be developed as human capital, etc. What remain constraining are, indeed, capital investments. It is through capital investments that supply frontiers could be shifted outwards, which in turn diffuse the inflationary tendencies emerging due to inter- and/ intra -sectoral differences in growth.

Monetary policy transmission mechanism, through interest rate channel, in India is found to be weak (Shah, 2011) and, even if partially effective, expresses at a lag of three or more quarters (Mohanty, 2012). Lately, the savings growth, as proxied through growth in time deposits of banks, has been weak

'further reduction in the policy interest rate at this juncture, rather than supporting growth, could exacerbate inflationary pressures'

while investments have just fallen flat. Monetary transmission, it appears, has taken different route this time. High nominal interest rates have encouraged very few to park their extra cash in time deposits of banks. Investments, however, have suffered more bruises than intended.

While RBI may be right in asserting that investments downfall is more due to other reasons as real interest rates are lower compared to that of boom years, the policy prescription based thereon is far from convincing. The reason investments were high despite relatively high real rates in boom years could be that investors harbored a strong 'state of long-term expectations' about the prospective yields on capital and it justified investing even if real cost of employing capital were higher. Elevated nominal interest rates, in any case, do more harm than good. In a milieu donned with uncertainties of various kinds, high nominal interest not only dampens investments but fail to stimulate savings either. For savings being a function of income reduces in aggregate as the total income falls.

India story has lived on high and rising rate of investments

and savings in economy. The difference in investments and domestic savings could be tapped, in better times, from rest of world. However, expecting deficit financing from rest of world may open vulnerabilities further as outlook remains subdued in medium term. India's current woes are multifold; declining growth, sticky inflation, widening deficits-fiscal and current account, sharply depreciating currency, flat industrial output, weak external demand, snail pace clearances etc. It is important to guard against a general impairment in 'state of medium to long-term expectations' in economy marred with uncertainties-external as well internal. Encouraging investments, through a benign monetary policy, could be better way to douse inflationary fires in medium term rather persisting with conservative policy chasing short term spikes in prices.

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[i]Keynes in reply to a criticism during the Great Depression of having changed his position on monetary policy, as quoted in Lost Prophets: An Insider's History of the Modern Economists (1994) by Alfred L. Malabre, p. 220

[ii]For a detailed survey and analysis refer Ashima Goyal's paper 'History of Monetary Policy in India since Independence' IGIDR WP-2011-018.

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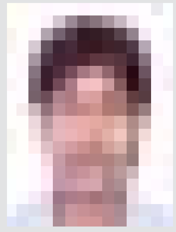


Sujit Kumar
Manager
Union Bank of India

Sujit Kumar is Manager (Economics) at Union Bank of India. His responsibilities include research on macroeconomics and its ever-growing interface with banking & finance. He is a postgraduate in economics from University of Hyderabad, India with specialisation in Macroeconomics, Econometrics, and Behavioural Economics.

The Policy Pulse

Banking Sector

April 2012

1. **Macroeconomic and Monetary development Report for 2011-12:**
   The RBI in April, released the Macroeconomic and Monetary Developments document for 2011-12. The document serves as a backdrop to the Monetary Policy Statement 2012-13. Growth is likely to improve moderately in 2012-13. While inflation has moderated, risks to inflation are still on the upside. Accordingly, monetary policy needs to support growth without inflation and external imbalances by excessively fuelling demand. Fiscal policy has a key role to play in speeding up public investment to crowd in private investment while ensuring fiscal consolidation.
2. **Annual Policy Statement for 2012-13:**
   RBI Governor announced the Annual Policy Statement for the year 2012-13. As per the statement inflation has moderated in recent months, however it remains sticky and above the tolerance level, even as growth has slowed. These trends are occurring in a situation in which concerns over the fiscal deficit, the current account deficit and deteriorating asset quality loom large
3. **RBI surprises with 50 bps repo rate cut:**
   The RBI cut interest rates for the first time in three years by an unexpectedly sharp 50 basis points to give a boost to flagging economic growth but warned that there is limited scope for further rate cuts.
4. **RBI tightens norms for bank lending to gold finance cos:**
   Concerned over spurt in gold imports, RBI asked banks to reduce exposure to NBFCs giving loan against the precious metal and has set up a working group to suggest ways to deal with the issue.
5. **Higher Administered Prices of Petroleum Products**
   Making a case for raising prices of diesel, kerosene and LPG, the RBI said that from the perspective of vulnerabilities emerging from the fiscal and current account deficits, it is imperative for macroeconomic stability that administered prices of petroleum products are increased to reflect their true costs of production.

May 2012

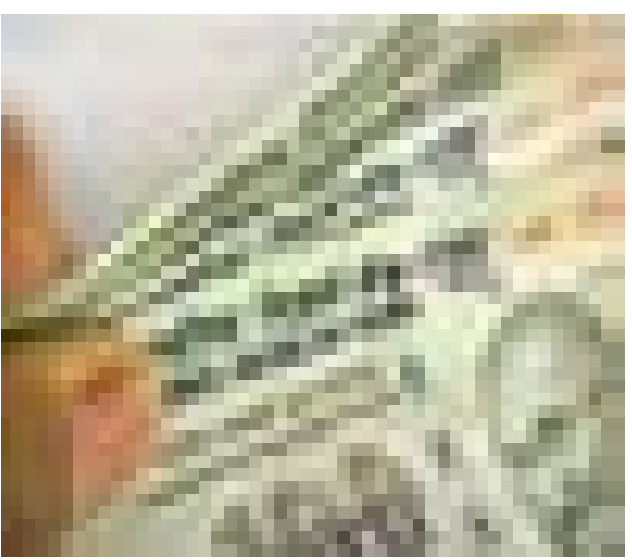
6. **RBI: Banks must maintain 7% core capital:**
   The RBI directed Indian banks to maintain a minimum tier I capital or core capital which is equity and reserve under the final guidelines on Basel-III capital regulations. Moreover, the regulator, for the first time, asked lenders to keep a capital conservation buffer of 2.50%.
7. **RBI to look into fixed rates loan products**:
   RBI planned to set up a committee to look into the issue of facilitating the development of fixed rate loan products in the banking system.
8. **RBI does not rule out selling dollars to oil cos:**
   RBI said that it had the option open to sell dollars directly to state oil companies, to help ease pressure on the rupee that hit another record low. RBI also said that central bank was not considering a sovereign bond offering right now.
9. **RBI eases norms to encourage foreign currency flows:**
   In a bid to stem rupee's free falling against the US dollar, the RBI announced two-pronged measures to ease norms for foreign currency flows. The regulator hiked the rate of foreign

currency deposits for non-resident Indians by 75-175 basis points to 200 bps for maturity period of one year to less than 3 years and to 300 bps for maturity period of 3-5 years.

10. **RBI asks exporters to sell 50% of forex earnings:** In order to arrest the declining value of the rupee, the Reserve Bank asked exporters to sell 50% of their retained foreign exchange earning. The central bank has also fixed limit for intra-day trading of foreign currency by banks.
11. **RBI steps in to curb volatility, not support price**: As the rupee dipped to its all time-low of 54.46 to a dollar in early trade , leading to increasing calls for arresting its fall at any cost, RBI Deputy Governor KC Chakrabarty said the Reserve Bank intervenes in the forex market only to curb volatility and not the slide.
12. **RBI intervening in INR forwards:**
    RBI has been seen intervening in the rupee forward markets, alongside its defence of the spot rupee, possibly to replenish its FX reserves and to replace domestic rupee liquidity, traders said. That intervention in forwards, coupled with the heavy demand for short-term hedging by importers and foreign investors, has led to a steep inversion of the dollar/rupee forward curves, both offshore and onshore.
13. **High government borrowing may crowd out private sector: RBI**
    RBI Governor said that the government's large borrowing could crowd out credit to the private sector, the situation could become more critical if there is fiscal slippage.

June 2012

14. **RBI says liquidity is in comfort zone:**
    Citing a recent drop in banks' daily borrowings from the RBI and steady overnight cash rate, RBI Deputy Governor, Subir Gokarn said that Liquidity in India's banking system is in "comfort zone". He also said the RBI has the option of buying bonds through open market operations if stress emerged on liquidity.
15. **RBI announces steps to liberalise capital account transactions**
    RBI has announced a series of measures to liberalise capital account transactions,



including raising the overall limit for FII investment in G-Secs from $15 billion to $20 billion and allowing Indian companies in the manufacturing and infrastructure sector (and earning foreign exchange) to avail of ECB for repayment of outstanding rupee loans towards capital expenditure and/or fresh Rupee capital expenditure under the approval route. The government also reduced the minimum period investors need to hold some bonds to three years from five years, making them more attractive to foreign funds that typically prefer short-term instruments.
    In order to broad base the non-resident investor base for G-Secs, it has been decided to allow long term investors like Sovereign Wealth Funds (SWFs), multilateral agencies, endowment funds, insurance funds, pension funds and foreign central banks to be registered with SEBI, to also invest in G-Secs for the entire limit of $20 billion.
16. **RBI ups limit on number of remittances:**
    The RBI increased the number of remittances by non-resident Indians to individuals to 30 from 12 per year, it said in a news release. The measure is another step to help boost dollar inflows and protect a weakening rupee.
17. **RBI rules out 1991 type crisis in 2012:**
    Ruling out a repeat of 1991 crisis situation in 2012, RBI Governor D Subbarao said the current economic situation is different from what it was two decades ago as rupee is market-determined,

forex reserves are good and financial markets are "resilient". Unlike 1991, the rupee's exchange rate is market determined "which is our great strength". India now has a USD 280 billion foreign exchange reserves and financial markets are resilient and robust, he added.

18. **RBI does the unexpected, leaves repo, CRR unchanged:**
In a bid to tame the inflation demon, the RBI dissapointed the market by keeping the policy repo rate unchanged at 8% in its mid-quarter monetary policy.The cash reserve ratio (CRR) too remains unchanged at 4.75%.

19. **RBI chief says government must cut spending:**
The Indian government must reduce spending and not just raise taxes for fiscal consolidation, the RBI's Governor Subbarao said a day after the central bank kept interest rates steady.

20. **RBI relaxes norms on short-selling Govt. debt:**
The RBI has allowed lenders to hold long and short positions in government bonds in their trading portfolios, and said they can short sell the securities only if they cover their positions through purchases in the market.

21. **RBI dose for rupee: ECB limit, FIIholdings in G-SECs hiked:**
In a bid to check rupee's free falling against the US dollar, the RBI hiked the limit of external commercial borrowing (ECB) to USD 10 billion. Moreover, the regulator also increased the limit of overseas investment in government bonds by USD 5 billion to USD 20 billion.

22. **Rating downgrade could hit the banks' overseas funding – RBI**
The ability of Indian banks and corporates to borrow overseas could be hit if the country's sovereign rating is downgraded, the RBI said, after recent cuts to the country's outlook by Fitch and Standard & Poor's. "A change in the current external rating of the country could have 'cliff effects', impacting both, the availability and the cost of foreign currency borrowing for Indian banks and firms," the RBI said in a report on financial stability.

Capital Markets Sector

April 2012

1. **FII norms for commodity exchanges relaxed**
The government has released the revised consolidated FDI policy and as per the new policy, FIIs will no longer require government approval to invest in commodity exchanges. The cap on FII investment, however, remains at 23 per cent. Government approval would continue to be required for the FDI component of investment up to 26 per cent in commodity exchanges.

2. **Disaster recovery guidelines for exchanges and depositories**
SEBI has issued guidelines on business continuity and disaster recovery for exchanges and depositories. This is to ensure their preparedness in the event of a natural calamity.

3. **SEBI: Companies must get SCORES authentication before listing**
SEBI has issued a mandate to exchanges that

companies can now list on the bourses only after they authenticate themselves on SEBI's web-based grievance redressal system, SCORES.

4. **New reporting format for disclosing financial results**

   SEBI has unveiled a new reporting format for disclosing financial results for companies other than banks. The notification incorporates changes in listing agreement regarding disclosure of interim financial results by listed companies.

May 2012

5. **Common KYC norms for financial sector**

   SEBI said it was in talks with other regulators, including RBI and IRDA, for common know-your-customer (KYC) norms for the financial sector. KYC with any one of the KYC Registration Authority (KRA) will suffice for all the transactions across spectrum of the financial sector. At present, there are three KRAs.

6. **Panel moots SEBI-RBI mechanism to track foreign fund flows**

   The Parliamentary Standing Committee on Finance' report on the Prevention of Money Laundering (Amendment) Bill, 2011 was tabled in the Parliament.It pointed out the scrutiny of fund flows into the markets could not be left to individual banks, as tainted money flowing into the markets remained a distinct possibility. Suitable amendments may therefore be made in the Bill to monitor and curb possible money laundering through stock/securities markets. The panel further said that all the regulatory and intelligence agencies, including RBI, SEBI, FIU(IND), the Enforcement Directorate, the Directorate of Revenue Intelligence and Investigation Wing of the Income Tax Department, should set up a monitoring/co-ordination mechanism for this purpose, while remaining alert to such financial flows.

7. **Government makes norms stringent for incorporation of companies**

   The government has formed a Coordination and Monitoring Committee (CMC) co-chaired by secretary Ministry of Corporate Affairs and Chairman SEBI to identify and monitor the state of affairs of vanishing companies with public shareholding. It has also made the norms stringent for incorporation of companies.

8. **SEBI asks government to route Rajiv Gandhi Scheme through MFs**

   To minimize risk associated with direct stock investment for new investors, SEBI has submitted a proposal to the Finance Ministry to route tax-saving Rajiv Gandhi Equity Savings Scheme through Mutual Funds.

9. **SEBI notifies Alternative Funds Regulations**

   SEBI has notified Alternative Investment Funds (AIF) regulations to monitor unregulated funds, encourage formation of new capital and consumer protection. The regulator has classified private pool of capital into three broad categories - venture capital, private equity and hedge funds. These funds should not have more than 1000 investors and the minimum investment amount should not be less than Rs 1 crore. SEBI has also mandated that sponsors should contribute at least 2.5% of the initial corpus.

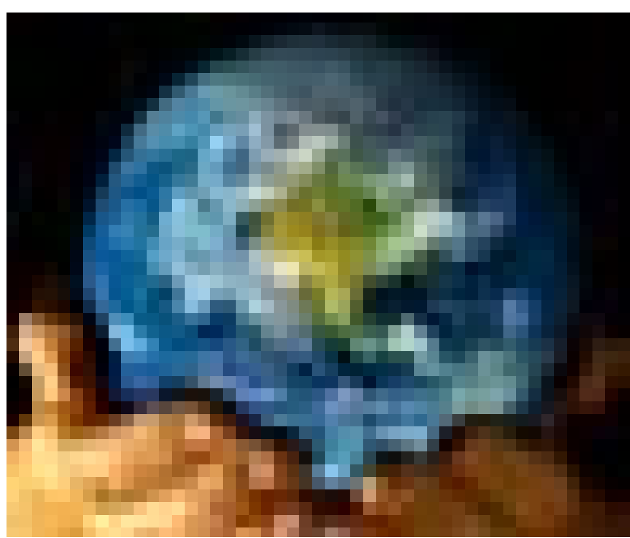
10. **New Consent Norms**

    SEBI has issued amendments to Consent Circular dated April 20, 2007 to streamline the consent order process to deal with various offences. It now prohibits use of monetary settlement for dealing with a list of serious offences, including various fraudulent trade practices, as also insider trading and front running, other serious offences which cause substantial losses to investors or affect their rights, failing to make an open offer and manipulation of net asset values of mutual funds.

11. **Foreign investor norms eased to accelerate capital inflows**
    The government has allowed qualified foreign investors (QFIs) from six member-countries of the Gulf Cooperation Council (GCC) and 27 countries of the European Commission (EC) to invest in the Indian capital market to enhance foreign capital inflows. Originally, it was limited to the 34 countries that are members of the FATF. Also, a $1-billion window over and above the current $20-billion FII limit has been created for QFI investment in corporate bonds and mutual fund debt schemes.

June 2012

12. **Exit norms for defunct regional stock exchanges (RSEs)**
    SEBI has specified exit norms for defunct regional stock exchanges (RSEs). Under these norms, SEBI has allowed companies on these platforms to be listed on other operating stock exchanges. However, exclusively listed companies on RSEs, which fail to obtain listing on any other stock exchange, will cease to be a listed company.
13. **SEBI wants Mutual Funds to launch pension products**
    SEBI said mutual funds could come out with pension schemes to attract retirement money into the capital market and that it was in touch with Finance Ministry to sort out the taxation issues. It is understood that SEBI would have to modify regulations to enable the mutual fund houses to launch of pension schemes.



14. **SEBI notifies norms for ownership, listing of stock exchanges**
    SEBI has notified new rules for ownership and governance of stock exchanges, which is expected to encourage the setting up of new bourses and enable exchanges to get listed. The new rules cap the ownership of a single investor at 5% with an exemption for stock exchanges, depositories, insurance and banking companies and public financial institutions, which can hold up to 15%. The net worth of a stock exchange has been pegged at Rs. 100 crore, while 51% of the equity has to be mandatorily held by public shareholders. The new rules also allow stock exchanges to list on any recognised stock exchange other than itself and its associated stock exchanges, within three years of commencing operations, subject to certain criteria.
15. **SEBI makes e-voting mandatory for top 500 listed companies**
    SEBI made it mandatory for top 500 listed companies to provide electronic voting facility for shareholders to participate in key business resolutions.
16. **SEBI relaxes share sale regulations**
    SEBI has relaxed rules to help companies raise capital and to comply with public shareholding norms, offering them a degree of relief against sliding markets and an economic downturn that have made tapping investors difficult. Listed firms have been allowed to auction shares on the stock exchanges more frequently even within the cooling-off period of 12 weeks they were required to observe from their previous share sale through offer routes. Also, investors in such offerings will no longer be required to pay the entire bidding amount upfront.

Insurance Sector

April 2012

1. **IRDA hikes third-party motor premium rates by 5-20%**
   IRDA raised premium rates for third-party motor insurance policies by up to 20 per cent for 2012-13. The third-party premium for personal cars and two-wheelers was raised by five per cent. For commercial vehicles, the premium was raised by 15-20 per cent.
2. **IRDA for govt-backed health insurance scheme**
   The IRDA strongly came out in support of a government-backed health insurance policy, which is in the works with an aim to provide health cover to a large population. Stating that it could be on the lines of the existing Rashtriya Swasthya Bima Yojana, Mr. J Hari Narayan said they had to see the contours of the scheme once it was ready. But there were risks involved with a government-backed health scheme and one such could be that the pricing may go up, he added.

May 2012

3. **IRDA bans products with highest NAV guaranteed**
   IRDA has asked life insurers to stop selling highest net asset value (NAV)-guaranteed products. In a recent communication to all life insurers, the regulator has said, "The marketing of products labeled as highest NAV product shall not be allowed". These products contribute almost 20 per cent to the total premium collection of life insurers.
4. **IRDA suggests an 'everything product' for villagers**
   In a bid to make insurance a significant part of the ongoing financial inclusion initiatives in rural areas, IRDA came up with the concept of an 'everything product' to address several risks of a typical household, with a single premium. Disclosing this, IRDA Chairman J Harinarayan said the regulator was awaiting a response from the Life Insurance Council to its suggestion on such a product that would be available only under the rural social responsibility obligation mandated to insurance companies by law.
5. **IRDA to cap risk passed on to reinsurance firms**
   Soon, insurance companies in India will not be able to pass on a majority of their risk to reinsurers. IRDA is set to specify the retention limit in this regard for insurance companies. In a communication to the CEOs of insurers, IRDA said companies operational for more than 10 years would not be able to cede more than 30 per cent of their premiums to reinsurance companies. Those operating for less than 10 years would have to retain half the risk in their books. There were no such caps till now.
6. **Another step to curb mis-selling of insurance, albeit with lacunae**
   The IRDA asked life insurers to follow a standard format for application forms, also known as proposal form. The intent is to curb mis-selling of products and make buyers aware of what they are buying. Once these changes are rolled out, buyers will be required to give more information about their lifestyle and needs. The regulator has asked insurers to include two categories — customer needs and recommendations. The guidelines, once notified, will be effective from September 1.
7. **IRDA caps commission on limited tenure policies**
   IRDA said commission paid by insurers to agents selling policies with limited paying

tenure should be 10-25 per cent of the first-year premium. The regulator specified the rate of renewal commission for such plans, where the premium paying tenure is lower than the policy term. The move is to discourage policies with limited tenure. This is the first time the insurance regulator has capped the commission on traditional plans, which include endowment, money-back and term assurance plans.

8. **IRDA likely to strengthen insurance ombudsmen**
   Insurance ombudsmen may soon be allowed to deal with the grievances of individual consumers involving claims higher than the Rs 20 lakh permitted at present. The scope may also be increased to cover all kinds of complaints, including mis-selling, from the issue of a policy to its maturity. IRDA is looking into a proposal in this regard.

June 2012

9. **IRDA to allow combo products**
   IRDA said the product would be a combination of a pure term product covering life risk and a health insurance cover. However, a life insurer will be allowed to tie up with only one non-life insurer and vice-versa. Life insurance companies will provide the term product covering life, whereas non-life insurers will underwrite the health insurance policy.

10. **New health insurance norms may raise premiums**
    Soon, you may be able to buy a health insurance policy that will provide you cover till 65 years and may get a 15-day free look-in period, during which you can return your health policy, with no questions asked, according to the draft guidelines for health insurance issued by the IRDA. At present, there is no free look-in period for health insurance products.

11. **IRDA worried over growth of single premium group policies**
    IRDA is concerned about the growth of group single-premium policies. Even as the life insurance business in general has slowed down, the group single-premium policies segment is witnessing growth. The same trend has been continuing in April 2012, the first month of the new fiscal. Industry experts say that the increase in group policies might not actually lead to higher profitability. It might simply shore-up the top-line, but the lower rates would not make any positive impact on profits.

12. **Annuity, a must in all pension plans: IRDA**
    Life insurers will have to provide an immediate or deferred annuity, even in cases where pension products are surrendered before vesting date. "At the time of surrender or vesting, the policyholder shall have to buy a single-premium, deferred annuity or an immediate annuity product from the same insurer who sold the original pension policy", Mr. J. Hari Narayan, Chairman, IRDA said.

13. **IRDA issues norms on 'orphan' policies**
    The insurance companies are allowed to allot any of the lapsed 'orphan' life insurance policies to other individual insurance agents with valid license for rendering effective service to the policyholders. In the guidelines on servicing of orphan policies, IRDA said the life insurers should notify the particulars of the newly-allotted agent to the policyholders concerned.

14. **First year premium of life insurance companies up 1.4 per cent in April-May: IRDA**
    First year premium of the life insurance

companies rose by a marginal 1.4 per cent year during the first two months of the current financial year, according to data released by IRDA. The combined first year premium of the public and private sector insurers during April-May, 2012,stood at Rs 12,428.83 crore, up from Rs 12,253.44 crore during the same period a year ago, IRDA said.

15. **New life insurance policies might be worth the wait**

    In its draft guidelines, IRDA asked the country's life insurance companies to re-file their existing products and withdraw the same by September 30. IRDA takes around five to six months to clear a product, say industry players. There is good chance of the guidelines being finalized. From the customers' point of view, it may not be a bad idea to wait as the changes suggested will be more beneficial to customers, say experts. These guidelines are designed to help promote the concept of insurance for protection rather than using it as an investment tool

Financial Reforms Tracker

DIPP Update

- DIPP announced that the consolidated FDI circular will be announced every year instead of six-monthly basis. The next policy would be on March 29, 2013. According to the latest notification issued by the Department of Industrial Policy and Promotion's (DIPPs) on consolidated FDI policy
- The Government has decided to liberalise the policy and to mandate the requirement of Government approval only for FDI component of the investment by the FIPB. FIIs investment in commodity exchanges of up to 23 per cent will no longer require Government approval. At present, foreign investment, within a composite (FDI and FII) cap of 49 per cent, under the government approval route is permitted in commodity exchanges. This change aligns the policy for foreign investment in commodity exchanges, with that of other infrastructure companies in the securities markets, such as stock exchanges, depositories and clearing corporations.
- The policy also clarified that subject to the sectoral foreign holding cap, companies will now need prior permission from Reserve Bank of India (RBI) for an overall FII holding of beyond 24 per cent. After RBI permission, the companies can allow FIIs to hold more than 24 per cent after the approval for the same by their boards and shareholders.
- The Government also issued a clarification on Non-Banking Finance Companies (NBFC) stating that the activity of 'leasing and finance,' which is one among the 18 NBFC activities, where induction of FDI is permitted, covers only financial leases and not operating leases. This provision intends to clarify the coverage of the term 'leasing and finance', in so far as the NBFC sector is concerned.

Evolving Dynamics in India's M&A Landscape

Co-organised by FICCI & Cavendish Group

20th September 2012

Taj Lands End, Bandstand, Mumbai

Key Speakers*

M. Veerappa Moily , Minister for Corporate Affairs

Ashok Chawla, Chairman, Competition Commission of India

Anjali Prasad, Joint Secretary, Department of Industry Policy and Promotion

Sidharth Birla, Vice-President, FICCI and Chairman, Xpro India Ltd.

Dinesh Kanabar, Deputy CEO & Chairman Tax, KPMG

Mukesh Butani, Partner, BMR Associates

Shardul Shroff, Partner, Amarchand Magaldas

Somasekhar Sundaresan, Partner, J Sagar and Associates

Vijaya Sampath, Advisor to Chairman, Bharti Group

Who Should Attend

Legal Firms

Investment Bankers

Tax Experts

Corporate Sector

Regulators & Policymakers

Consultants & Analysts

Private Equity & Venture Capitalists

European companies looking to enter India

For further details, please contact:
Mr. Apoorv Srivastava,
Research Associate-Financial Sector, FICCI
Tel: 011-2348 7424, Email: apoorv.srivastava@ficci.com

FICCI's Data Centre

Indian Economy-An Update

Key Economic Indicators

GDP	5.30% - Q4, 2011-12 6.10% - Q3, 2011-12
IIP	2.4% (May, 2012) -0.9% (April, 2012) Revised
WPI Inflation (%)	All Commodity: 7.25 %*(Jun, 2012) All Commodity: 7.55 %*(May, 2012)
CPI Inflation (%)	10.36% (May, 2012)
Interest Rates	CRR: 4.75% p.a (wef 09 March, 2012) Bank Rate: 9.00% p.a. (wef 17 April, 2012) Reverse Repo Rate: 7.00% (wef 17 April, 2012) Repo Rate: 8.00% (wef 17 April, 2012)
Exchange Rate	55.60 (Dollar), 68.12 (Euro) 86.20 (Pound), 70.06 (Yen) [July 09, 2012 to July 13, 2012, weekly average]

Key Facts Q1 FY12-13: A snapshot

- GDP has now contracted by 0.3 per cent for two consecutive quarters at the end of 2011 and the start of 2012.
- The Industry Ministry now permits FIIs to invest up to 23 per cent in commodity exchanges without prior approval.
- Headline inflation was 7.55 per cent in May.
- The IIP data for the month of May 2011 has grown 2.4% higher as compared to the level in the month of May 2011. The cumulative growth for the period April-May 2012-13 stands at 0.8% over the corresponding period of the previous year
- Fiscal deficit during April and May was Rs 1.42 trillion ($25 .3 billion)
- India's current account deficit at 20-year high

Economic Scenario

- GDP has contracted by 0.3 per cent for two consecutive quarters at the end of 2011 and the start of 2012. The level of GDP can be depicted as broadly unchanged over the past year, during which time it has fallen by 0.1 per cent, primarily due to weakness in the production and construction sectors. The GDP growth rate was 5.30%, Q4 2011-12
- The services output has continued to grow, albeit at a slower rate in each of the last two quarters. Within the production sector, weakness has been concentrated in oil and gas output. Output in the mining and quarrying sector as a whole has contracted by nearly 14 per cent over the past year.
- The small downward revision to the first quarter's growth rate was due to a lower figure for construction output than previously estimated, which now shows a fall of 4.8 per cent.
- In terms of expenditure, growth over the past eighteen months has depended primarily on net trade, with some expansion in exports while im-

ports have held fairly steady. The euro-area's financial difficulties have held back exports to the EU, the UK's main export market, but exports to the rest of the world have shown some strength.

- Household final consumption expenditure has fallen a little in real terms over the same period, and there has been a sharp running down of inventory levels while investment has been broadly flat.
- In the income measure of GDP, compensation of employees - the biggest component - was unchanged between the last two quarters reflecting weak earnings growth. However it increased compared with last year due to the impact of rising numbers of jobs (as measured by the workforce jobs figures) at the end of 2011.

Inflation

The Reserve Bank of India earlier this year cut interest rates but warned that inflationary concerns continue to be high on its watch-list. In the past, the central bank has said that India's sustainable rate of growth without pushing up inflation is about 7 per cent.

India's headline inflation in May rose to 7.55 per cent. WPI inflation rose 7.23 per cent in April. The government also revised upwards the inflation rate for March from 6.89 to 7.69 per cent, the highest in 2012. Food inflation is still high at double-digit levels and rose to 10.74 per cent and any hike in fuel (petrol and diesel) prices in the near future will spur inflation.

The inflation numbers come as a critical moment as industrial production has fallen sharply and the rupee continues to struggle at alarmingly low levels against the dollar.

WPI in 2012

Month	Per Cent
May	7.55
April	7.23
March	7.69 (revised up from 6.89)
February	7. 36
January	6.55

Fiscal Deficit

Fiscal deficit during April and May was Rs 1.42 trillion ($25 .3 billion), or 27.6% of the full fiscal year 2012-13 target of Rs 5.14 trillion or 5.1% of GDP. Low growth rates, lower-than-estimated government revenues, and higher-than-expected expenditures, especially on welfare schemes for rural employment and the right to food, may force the deficit to go up in 2012-13, as happened in the previous financial year.

India's current account deficit at 20-year high

India's current account deficit the difference between imports and exports deteriorated to a record high of 4.5% of the GDP or $21.7 billion - a level seen for the first time in 20 years - for the quarter ending March 2012. CAD more than tripled when compared to the 1.3% for the same period in the previous year and is worse than that recorded in 1991 BoP crisis in the recent history.

Trade Deficit

Although exports grew by 20% in 2011-12, imports rose at a faster pace, and the trade deficit went up to $185 billion, the highest ever in the country's history.

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India's New Stock Exchange

FICCI's Reaction to IIP data for May 2012

The IIP data for the month of May 2011 has grown 2.4% higher as compared to the level in the month of May 2011. The cumulative growth for the period April-May 2012-13 stands at 0.8% over the corresponding period of the previous year. FICCI voiced the concerns of the Industry and stated that Industry wants the government to take some bold decisions on reforms in areas like decontrolling diesel price, reducing fiscal deficit and encouraging foreign investments to uplift business sentiments.

Commenting on the Index of Industrial Production (IIP), Mr R V Kanoria, President, FICCI on 12th July, 2012 said

"The May IIP figure of 2.5% perhaps indicates that the growth had bottomed out by April when there was a negative growth as per the revised figures. Industry is eagerly awaiting the implementation of some of the announcements being made in the last few weeks by the Government to scale-up this modest growth achieved in May. The growth in manufacturing is not broad based as only twelve out of twenty two sectors have shown positive growth and major sectors like capital goods, chemicals, apparels continue to register negative growth month after month. We also hope that RBI cuts down interest rates further at least by another 50 basis points immediately so as to encourage investments and prevent this modest growth from slipping into negative territory."

FICCI's twelve point action agenda for stimulating Economic Growth

Emphasizing the need for a unified approach for tackling economic crisis, FICCI has recently unveiled a twelve point agenda for stimulating economic growth.

In principle, FICCI believes that the current economic problems are largely a result of domestic factors like delays and uncertainty over key economic legislations, lack of fiscal consolidation, monetary tightening, project delays on account of factors including stalled environmental clearances, problems in land acquisition coupled with a prolonged pause in reforms and an atmosphere of unwillingness in decision making in bureaucracy.

It may be noted that FICCI's twelve point action program to address the crisis situation are the following:

1. Government should eschew the temptations of a premature welfare state and announce an immediate moratorium on any additional expenses on doles
2. Expedite the implementation of the Goods and Services Tax (GST).
3. Ease the monetary policy
4. Do not pass the Land Acquisition Bill in its current form
5. Provide fiscal stimulus for investments across sectors
6. Push through with FDI policy reforms in areas where action is possible outside the ambit of Parliament – multi-brand retail, civil aviation etc.
7. Extend the price decontrol mechanism to diesel and other oil products.
8. Take steps to energize the coal sector by fostering competition.
9. Strengthen frameworks for raising funds for infrastructure financing in the economy through instruments like Municipal Bonds etc
10. Pursue the objective of food security through productivity increase and agriculture marketing reforms
11. Fast-track implementation of critical policies and projects like National Manufacturing Policy, National Electronics Policy, PCPIR etc.
12. Address the issue of repatriation of black money to immediately mitigate the BOP situation by entering into global revenue sharing agreements

In this context, it is essential to elaborate on some of the above points briefly so as to have a better understanding of the immediate steps that needs to be taken to prevent the economy from slipping into recession and stimulating growth at the same point of time

Investment Banking Updates

In association with

Mergers & Acquisitions

- **India** ranked as the fourth most targeted nation in **Asia Pacific region** in 1H 2012 with $26.2bn, down 26% on 1H 2011 ($35.2bn)
  - India targeted M&A volume reached only $4.5bn in 2Q 2012, down drastically from 1Q 2012 ($21.8bn)
- India outbound **M&A** volume reached $2.8bn in 1H 2012, the lowest half level since 2H 2009 ($1.1bn) and down 87% from the record volume achieved in 1H 2010 ($21.1bn)
  - India **Outbound M&A** volume stood at $2.0bn in 1H 2012, more than double the $774m announced in 1Q 2012, and marks the highest quarterly level since 3Q 2011($3.5bn)
- Conversely, India **Domestic M&A** volume totaled $22.7bn in 1H 2011, up significantly on the $9.8bn announced in the same 2011 period and marks the second highest first half level on record after 1H 2010 ($29.9bn)
  - Pushed by the $9.5bn merger by **Sesa Goa** with Sterlite **Industries/Cairn India/Madras Aluminium/Vedanta Resources** announced in 1Q 2012 in what was the largest India M&A transaction so far this year and the largest India Domestic deal on record

India Announced M&A Advisory Ranking 1H 2012

Pos	Advisor	Value $m	No.	%Share
1	Morgan Stanley	11,383	10	38.2
2	JPMorgan	10,643	7	35.7
3	Citi	10,202	7	34.2
4	Bank of America Merrill Lynch	6,553	1	22.0
5	Barclays	1,977	4	6.6
6	Ernst & Young	1,531	10	5.1
7	Enam Financial Consultants	1,251	5	4.2
8	Goldman Sachs	1,066	2	3.6
9	Deutsche Bank	858	3	2.9
10	Oppenheimer & Co Inc	635	1	2.1

Equity Capital Markets

- Indian ECM volume stood at $7.1bn in 1H 2012, down 14% on the $8.3bn raised in the same 2011 period but still up on the $1.5bn raised in 2H 2011
  - 2Q 2012 totaled $1.0bn, down significantly on the $5.4bn raised in 2Q 2011 and also down from the $6.1bn recorded in the previous quarter
- IPO volume reached $260m in 1H 2012, down from the $802m raised in the comparable 2011 period and marks the lowest half year level since 1H 2009 ($62m)
- On March 2, Oil & Natural Gas Corp-ONGC completed a $2.6bn follow on via bookrunners Citi, Bank of America Merrill Lynch, HSBC, JM Financial Group, Morgan Stanley and Nomura in what was the largest ECM transaction for India in 2012 YTD and the fifth largest Indian ECM transaction on record

DBTop 10 India ECM Deals in 1H 2012

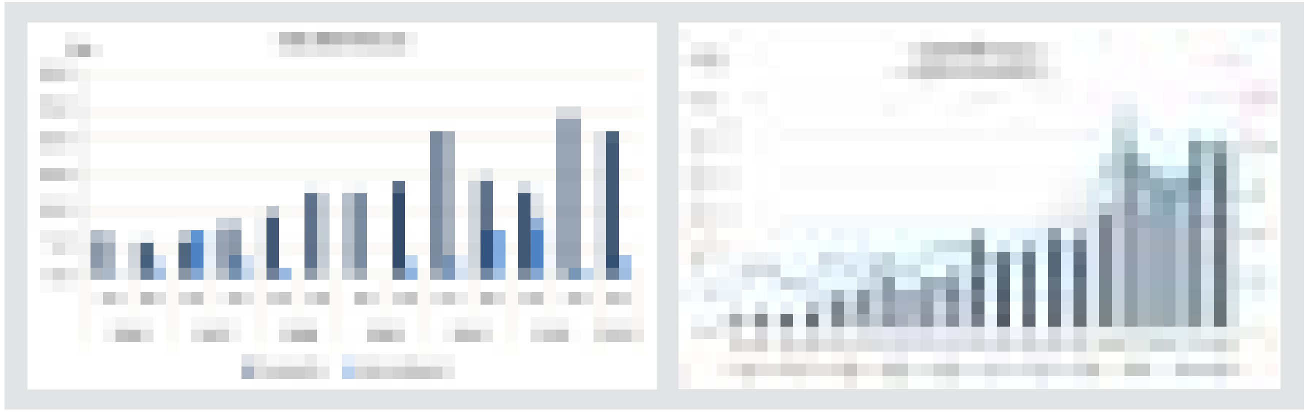
Date	Name	Sector	Deal Type	Deal Value $m	Bookrunners
2-Mar	Oil & Natural Gas Corp - ONGC	Oil & Gas	FO	2,584	Citi, BAML, HSBC, JM Financial Group, MS, NOM
23-Feb	Housing Development Finance Corp - HDFC	Finance	FO	1,927	Citi
29-Jun	Cairn India	Oil & Gas	FO	362	Citi
27-Jun	Axis bank	Finance	FO	328	HSBC, GS
8-Feb	ICICI Bank	Finance	FO	298	GS
1-Feb	Housing Development Finance Corp - HDFC	Finance	FO	270	DB
14-Mar	Wipro	Computers	FO	149	Citi, CS, MS, UBS
27-Feb	Multi Commodity Exchange of India	Finance	IPO	137	Citi, Edelweiss Financial Services , MS
19-Mar	Amtek India	Auto/Truck	CONV	130	SCB
9-Feb	WNS Holdings	Professional Services	FO	113	BAML, DB

Debt Capital Markets

- **India DCM** volume totaled $24.0bn via 246 deals in 1H 2012, up 17% on the $20.5bn raised during 1H 2011
- **Agency and Corporate IG** bonds account for 39 % and 17% of total DCM volume, respectively with $9.4bn and $4.0bn in 1H 2012. Both deal types have reached record 1H levels
  - On Jan 27th, **Indian Railway Finance** completed a $3.6bn rupee-denominated bond via bookrunners **State Bank of India, AK Capital Services and ICICI Bank** in what was the second largest bond by an Indian issuer on record
- **India Domestic DCM** volume reached $21.3bn in 1H 2012, up 67% from comparable period last year ($12.7bn). Average deal size decreased 8% to $108m in 1H 2012 from $118m in 1H 2011
- **International** issuance fell 67% to $2.6bn in 1H 2012 from the $7.8bn raised in the same 2011 period, whilst deal activity dropped to 11 transactions in 1H 2012 compared with 1H 2011 (19 deals)

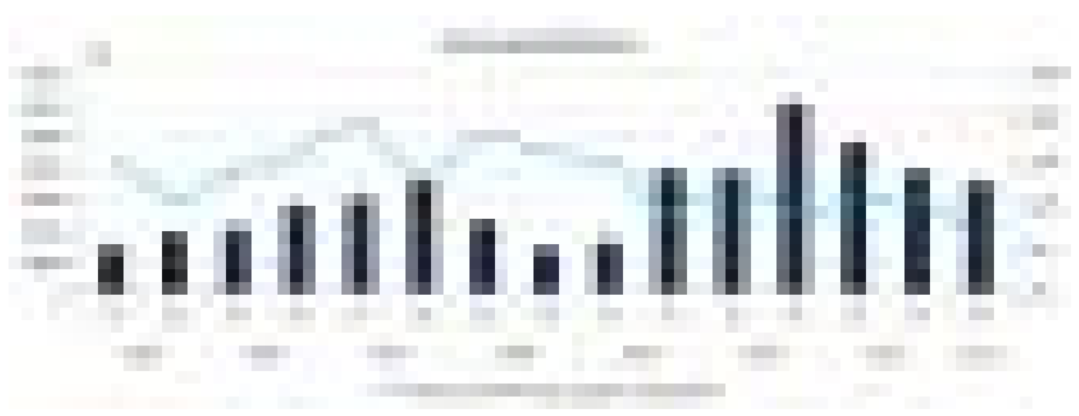
India DCM Bookrunner Ranking 1H 2012

Pos	Bookrunner	Value $m	No.	%Share
1	ICICI Bank	3,680	53	15.4
2	Axis bank	2,855	64	11.9
3	AK Capital Services Ltd	2,058	39	8.6
4	State Bank of India	1,982	17	8.3
5	Trust Investment Advisor	1,447	68	6.0
6	HSBC	1,387	29	5.8
7	Barclays	1,159	28	4.8
8	Standard Chartered Bank	1,106	24	4.6
9	Kotak Mahindra bank Ltd	1,075	41	4.5
10	Darashaw & Co Ltd	968	42	4.0

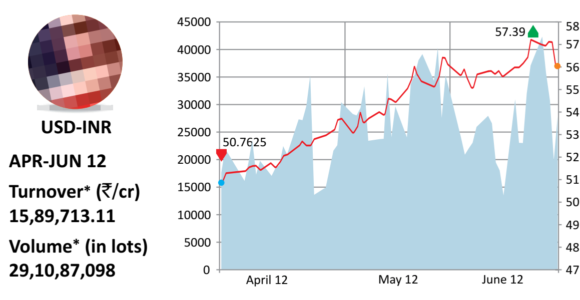


IB Revenue

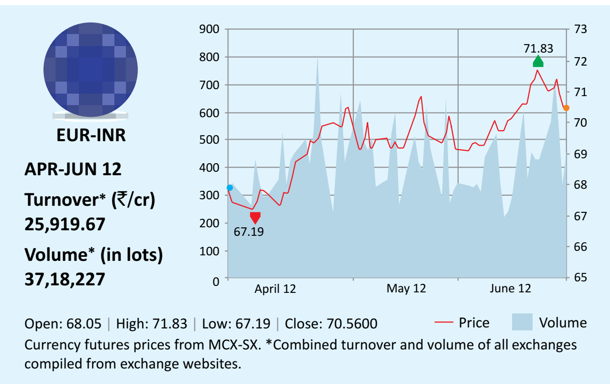
- **India IB Revenue** has reached $242m in 1H 2012, less than half the $503m earned in 1H 2011 and marks the lowest half year level since 2H 2008 ($232m)
- **DCM** fees account for 31% of total India IB revenue in 1H 2012 with $76m, the highest half year share on record
    - Despite the record share, revenue at $76m in 1H 2012, is down from the $135m earned in 1H 2011 and marks the lowest 1H level since 2010 ($65m)
- **M&A revenue** saw the biggest fall in revenue with $48m in 1H 2012, a 67% drop from 1H 2011, and represents the lowest half year level since 2H 2009 ($34m)
    - ECM fees saw the second biggest drop (60%) during the same period to $24m in 1H 2012



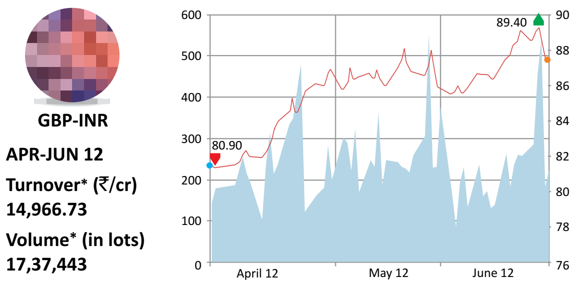
Markets Watch



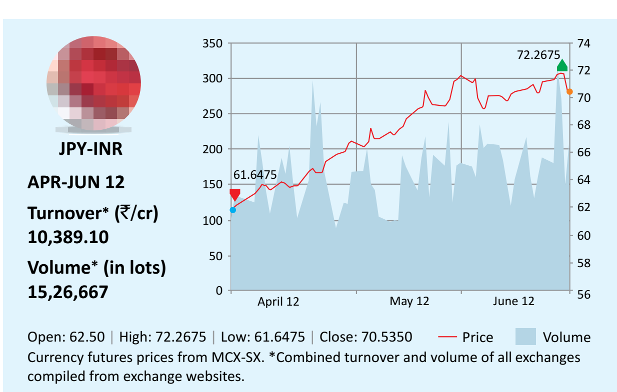
Open: 50.97 | High: 57.39 | Low: 50.7625 | Close: 56.1100 — Price Volume
Currency futures prices from MCX-SX. *Combined turnover and volume of all exchanges compiled from exchange websites.



Open: 68.05 | High: 71.83 | Low: 67.19 | Close: 70.5600 — Price Volume
Currency futures prices from MCX-SX. *Combined turnover and volume of all exchanges compiled from exchange websites.



Open: 81.86 | High: 89.40 | Low: 80.90 | Close: 87.5425 — Price Volume
Currency futures prices from MCX-SX. *Combined turnover and volume of all exchanges compiled from exchange websites.



Open: 62.50 | High: 72.2675 | Low: 61.6475 | Close: 70.5350 — Price Volume
Currency futures prices from MCX-SX. *Combined turnover and volume of all exchanges compiled from exchange websites.

Market Commentary

MCX-SX USDINR futures jumped more than 11.72% in last three months, owing to strong demand for the US Currency from oil importers, increased capital outflows from the Indian stock market and concerns over a slowdown in global economic growth. Joining the Standard & Poor's move, Fitch Ratings cut India's credit rating outlook to negative, signalling that the Indian currency is at a risk of losing its investment-grade status.

At the global front, Moody's downgrade of world's 15 biggest banks and mounting worries over Euro-zone debt crisis, including the size of the bailout needed to save Spain's banks and lowering of the growth forecast from April projections by the US Federal Reserve, were few key events that added fuel to the fire and helped US Dollar to hit an all-time high against the Indian Rupee in the month of June. Steps taken by the Reserve Bank of India proved insufficient to stop the Dollar's flight against the Indian Rupee.

Outlook

MCX-SX US Dollar hit a record high of 57.39 against the Indian Rupee on June 22 and on June 28. After that US Dollar slipped sharply against the Indian Rupee and hit a low of 54.52 on July 4. Overall uptrend is still intact in the MCX-SX USDINR and it may continue its upward rally again if it breaks 57.40 level on the upside.

On the downside, immediate support is at 54.10 and if the pair breaks the given level, then it may test 52.00 levels, while inability to break the given level may pull the pair again towards the levels of 55.85, 56.95 and 57.39. Now, for hitting a new high against the Indian Rupee, Dollar must give daily close above 57.40 as this time daily close above the given level of 57.40 will push Dollar towards 58.50 and then 60.00 a Rupee.

- Rekha Mishra, Sr. Research Analyst
Bonanza Commodity Brokers Pvt. Ltd.

Financial Sector

Events Calendar 2012

FICCI – Sa-Dhan Annual Conference on Micro Finance
7th – 8th August 2012 | Hotel Ashok, New Delhi

FIBAC 2012 Conference
4th -6th September 2012 | Hotel Trident, Nariman Point, Mumbai

FICCI-ICC Conference on "Evolving Dynamics in India's M&A Landscape"
19th -20th September 2012 | Hotel Taj Lands End, Mumbai

FICCI's Capital Markets Conference- CAPAM 2012
12th October 2012 | Mumbai

FICCI – BFA's Asian Financial Cooperation Conference
26th -27th November 2012 | Hotel Trident, Nariman Point, Mumbai

For any further details about events,
please write to us at bfsi.events@ficci.com

Synopsis of past events

Interactive Meeting with Mr. U. K. Sinha, Chairman, SEBI

April 10, 2012- Mumbai

FICCI organized an interactive meeting with Mr. U. K. Sinha, Chairman, Securities and Exchange Board of India on April 10, 2012 in Mumbai. The meeting was chaired by Ms. Naina Lal Kidwai, Senior Vice President, FICCI. Other participants included members of FICCI's Capital Markets Committee.

L to R: Mr. Anup Bagchi, Co-chair, FICCI's Capital Markets Committee and M.D. and CEO, ICICI Securities Ltd.; Mr. Sunil Sanghai, Chair, FICCI's Capital Markets Committee and M.D., Head of Global Banking-India, HSBC Ltd.; Mr. U. K. Sinha, Chairman, SEBI; Ms. Naina Lal Kidwai, Senior Vice President, FICCI and Country Head-HSBC India and Director-HSBC Asia Pacific, HSBC Ltd. and Ms. Nirupama Soundararajan, Additional Director and Team Lead-Financial Sector, FICCI

The participants deliberated on the policy issues having a bearing on the performance of the capital markets sector including reasons for low QFI investments despite several recent measures announced by the government, regulatory requirement for publicly listed companies either to increase public shareholding to 25% or to de-list by June 14, 2013, implications of GAAR and need to strengthen corporate bond market. Members also requested the SEBI Chairman to consider the extension of the Rajiv Gandhi Equity Savings (announced in the Union Budget 2012-13) Scheme to Mutual Funds. The SEBI Chairman invited detailed inputs on these issues from the Committee.

- Role of the MFI Board in customer protection
- Board composition in MFIs
- Independent Directors in MFIs
- Role of Banks in MFI governance
- CEO performance management and compensation

FICCI, through this forum, brought out some of the best industry experiences for MFIs which will help them strengthen their governance practices and also help in scaling up their operations to achieve the goal of Financial Inclusion.

Workshop on "Strengthening Microfinance Institutions (MFIs): Good Governance and Strategic People Practices"

April 23, 2012

Participants at the Rountable on "Insurance Fraud and Prevention"

FICCI Workshop on "Strengthening Microfinance Institutions (MFIs): Good Governance and Strategic People Practices" examined some of the contemporary debates in MFIs governance while focusing on effective deliverance of good governance through appropriate systems and structures.

Mr Anand Sinha, Deputy Governor, Reserve Bank of India

delivered the Keynote Address in the Inaugural Theme Session. In his address, he emphasized on the need for MFIs to address concerns on governance practices by creating a mechanism to monitor management activities and operations.

Mr Sinha also stressed that Microlenders need to realign their business model and ensure responsible lending; even though there is a clear dilemma of profit versus social objective. According to him, excessive compensation packages in the MFI industry is another key issue which needs to be addressed.

The Workshop participants included Senior Executives from MFIs, Banks, Investors, Rating Agencies and other financial institutions that are involved in management and organizational strategy. In Group Discussions, the participants deliberated on the following themes:

Roundtable on "Insurance Fraud and Prevention"

May 31, 2012-FICCI, New Delhi

Insure against fluctuating currency prices

Hedge on

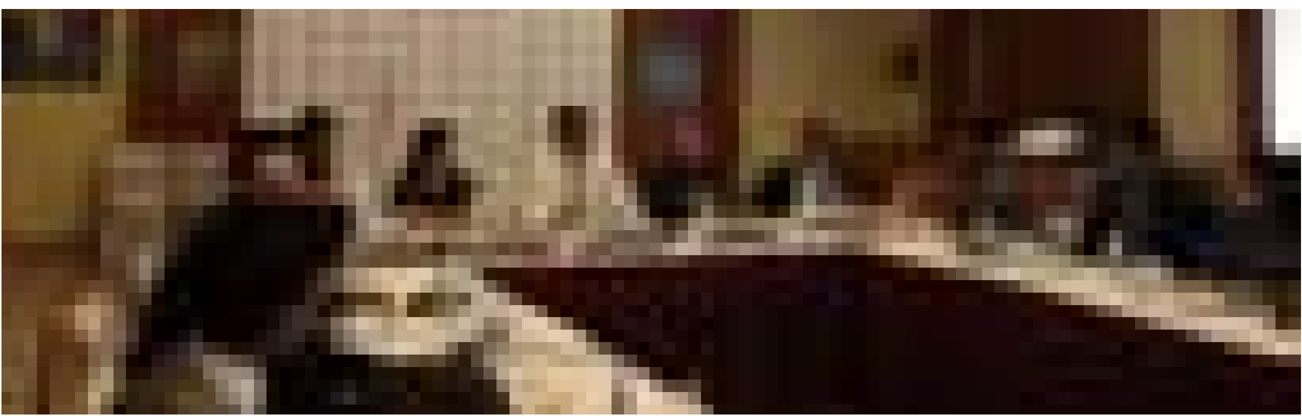
www.mcx-sx.com

An industry roundtable was organised on "Insurance Fraud and Prevention" on May 31, 2012 at Federation House, New Delhi.

Mr Dennis Jay, Executive Director, Coalition against Insurance Fraud (of USA) was the keynote speaker at the roundtable. The Coalition against Insurance Fraud is a US based national alliance of consumers, government agencies and insurers dedicated to combating all forms of insurance fraud through public advocacy and consumer education. Other speakers at the roundtable were Mr Antony Jacob, Co-Chair, FICCI Health Insurance Advisory Board and CEO, Apollo Munich Insurance Co Ltd, Mr U Jawaharlal, Editor, IRDA Journal and Dr Somil Nagpal, Health Specialist, World Bank.

The objective of the roundtable was to create awareness around insurance fraud and to stimulate discussion on how it can be prevented. The discussions focused on how fraud increases premiums for consumers and is a major challenge for insurers.

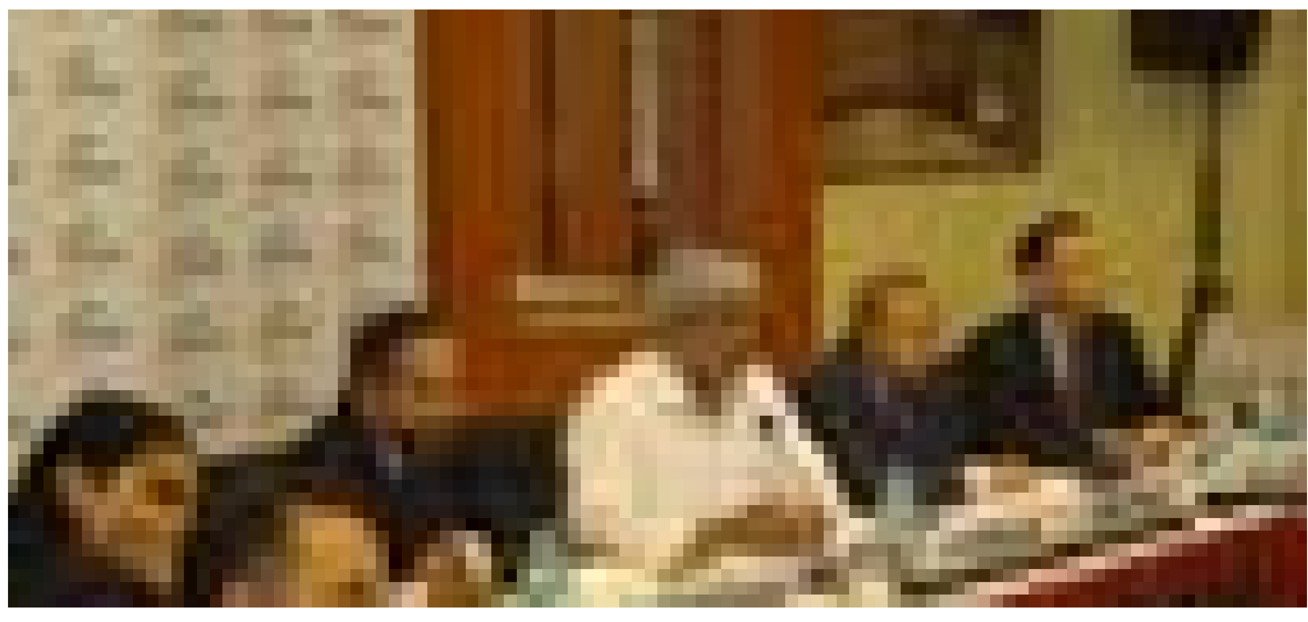
As an outcome, it was agreed that Insurance fraud can be tackled by collaborative efforts of all stakeholders, increased public awareness, sharing of knowledge amongst the stakeholders and use of technology for fraud detection. It is extremely important as an industry to collaborate and develop an India specific solution for us to minimize or get rid of fraud.



Participants at the Rountable on "Insurance Fraud and Prevention"

Interactive Meeting with Mr. R. Gopalan

June 6, 2012- New Delhi



Participants at the Interactive Meeting with Mr. R. Gopalan Secretary-Economic Affairs, Ministry of Finance

FICCI organized an interactive meeting with Mr. R. Gopalan, Secretary-Economic Affairs, Ministry of Finance on June 6, 2012 in New Delhi. The meeting was chaired by Dr. Arbind Prasad, Director General, FICCI.

The participants at the meeting included members of FICCI's Capital Markets Committee, Ms. Vijaya Sampath, Co-chair, FICCI's Corporate Laws Committee and select members of the financial services sector.

The participants deliberated on the policy issues having a bearing on the performance of the capital markets sector including sectoral FDI caps, regulatory requirement for publicly listed companies either to increase public shareholding to 25% or to de-list by June 14, 2013, tax matter related to pass through certificates, need for corporate bond market to fund infrastructure, CDS as a credit enhancement tool and need for relaxing the requirement of unlisted companies to list in India before raising capital abroad. The Committee would be submitting detailed inputs on these issues to the Ministry of Finance.

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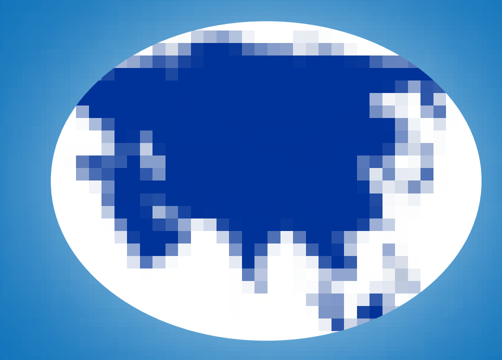
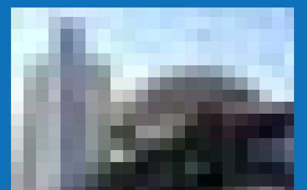
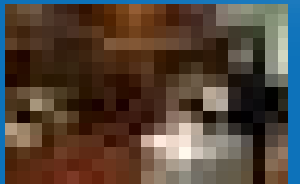
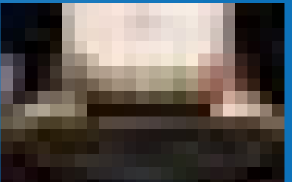
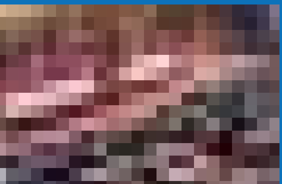
Asian Financial Cooperation Conference



'Open Asia, Open Finance'

Co-organised by FICCI & BOAO Forum for Asia (BFA)

November 26-27, 2012
Hotel Trident, Nariman Point, Mumbai, India

Key Speakers

C. Rangarajan Chairman, Prime Minister's Economic Advisory Council, India*

Kaushik Basu, Chief Economic Adviser, Ministry of Finance*

Anand Sharma, Minister of Commerce & Industry, India*

Syed Abul Hossain, Minister of Communication, Bangladesh

Zhou Wenzhong, Secretary General, Boao Forum for Asia

Dinesh Kumar Mittal, Secretary, Ministry of Finance*

Y. M. Deosthalee, Chairman & Managing Director, L&T Finance*

Who Should Attend

The Asian Financial Cooperation Conference is a must attend event for anyone with an interest in doing business with Asian economies

- Presidents, CEOs, CFOs, COOs and senior corporate executives
- Investment bankers
- M & A advisors
- Executives of the Banking and Financial Services Sector
- Corporate finance professionals
- Corporate finance lawyer
- Life & Non- Life Insurance Companies
- Consultancies

For further details, please contact Mr. Apoorv Srivastava, Research Associate-Financial Sector, FICCI at Tel: 011-2348 7424 or email: apoorv.srivastava@ficci.com

Forthcoming Events

Financial Inclusion Conference 2012
"The First Mile Walk into the Financial System"

7 - 8 August 2012

Sa-Dhan – FICCI Financial Inclusion Conference 2012: An Overview

The Conference in its tenth year is the landmark event focusing on the financial inclusion agenda. Every year the Conference witnesses the presence and support of diverse set of stakeholders including Regulators and Policy Makers, like, Reserve Bank of India, Ministry of Finance, Ministry of Rural Development, Ministry of Corporate Affairs, PFRDA, IRDA, Heads of Apex Development Financial Institutions like SIDBI, NABARD, leading Banks, Micro Finance Institutions, Technology providers, Senior Practitioners, Livelihood support agencies, Think Tanks, Researchers et al.

This year, the Conference, inter alia, would deliberate upon the contemporary issues of financial inclusion with specific reference to the regulatory architecture. The conference also aims at deliberating the key issues on the development and expansion of all the variants of the Business correspondent scheme and the SHG movement. It would not only look at the models, approaches or products but also the client protection and self regulating issues.

Session Themes:

- Microfinance and Inclusive Growth: What are the measures of Success?
- Role and Sustainability of SHG Federations
- Building an Effective Credit Information System
- Promoting Microenterprise and Livelihoods
- Wider inclusion: Social Security for the Poor
- Deepening Capital Markets and Financial Inclusion
- Business Correspondents: A Potential Model
- Overcoming Barriers to Resource Flow
- Microfinance Regulation: The Emerging Landscape
- Responsible Lending and Way Forward

Participants Profile:

The Conference participants include Policy makers and Regulators, industry representatives from Banking, Financial Services and Insurance (BFSI) sector, Micro Finance Institutions (MFIs), Non Banking Finance Companies (NBFCs), Non-Government Organizations (NGOs) & Self-Help Groups (SHGs), Community based organizations, Technology providers, Service Providers, Academia, Consultants, Media et al.

CAPAM 2012 : Ninth edition of FICCI's Annual Capital Markets Conference
October 12, 2012 - Mumbai

FICCI's Annual Capital Markets Conference is a leading event in the Indian capital market space and provides an excellent platform to discuss and debate key issues pertaining to the sector. It is addressed by leading national and international experts who deliberate on the way forward for developing a strong and vibrant capital market in India.

The participants at the conference include senior representatives of industry, FIIs, brokers, investment banks, stock exchanges, financial analysts, fund managers, private equity representatives, legal advisors, investors, economists, academia and media.

For further details, please contact Ms. Sunita Rattan, Deputy Director, FICCI at Tel: 011-2348 7413 or email: sunitar@ficci.com

Indian Banks' Association

FIBAC 2012

Sustainable excellence through customer engagement, employee engagement and right use of technology

4th - 6th September, 2012 – Hotel Trident, Nariman Point, Mumbai

About the Conference

The Federation of Indian Chambers of Commerce and Industry (FICCI) along with the Indian Banks' Association (IBA) invite you to FIBAC 2012, from 4th- 6th September, 2012 at Hotel Trident, Nariman Point, Mumbai. The Boston Consulting Group (BCG), a pre-eminent global strategy consulting firm is the Knowledge Partner to the conference.

The conference is a conglomeration of industry stalwarts and global thought leaders who will address contemporary issues affecting the banking industry worldwide. Over the years, the conference has truly positioned itself as one of its kind in terms of knowledge dissemination and relationship building.

Confirmed Speakers

Dr. D. Subbarao
Governor, RBI

Mr. Pratip Chaudhuri
Chair, FICCI Banking & FI Committee & Chairman, SBI

Mr. Alok Misra
Chairman, IBA & CMD, BOI

Mr. Avinash Persaud
Chairman
Intelligence Capital

For further details, please contact:
Ms Supriya Bagrawat, Sr. Assistant Director, FICCI , Tel: 011-23487525 (D) Email: supriya.chhatwal@ficci.com

Fintainment Section

Crossword

Notes:
Clues ending in "?" imply play on words.
Digits in bracket at the end of the clue indicate number of letters in each word of the answer.
Clues that have an acronym or "abbr." or "in short" imply that answers are abbreviated.

Across

2 National econ. measure (3)

4 Ltd., in London (3)

6 Mutual fund stat., which sounds like a Hindu symbol (3)

8 Reverse ___ (4)

9 Review financial statement (5)

10 Get a new ___ of life (5)

11 Dalal Street watchdog (4)

12 Letters of credit? (3)

14 Levy on realty deals (8,3)

16 Product pitched as insurance cum investment, abbr. (4)

17 Post-tax profit (3,6)

19 Dalal Street order (3)

21 Government's share sale process (13)

24 "Out of order" account, abbr. (3)

25 AMFI member (3)

26 Money making org.? (3)

27 Conjecture OR High-risk-high-return trading style (11)

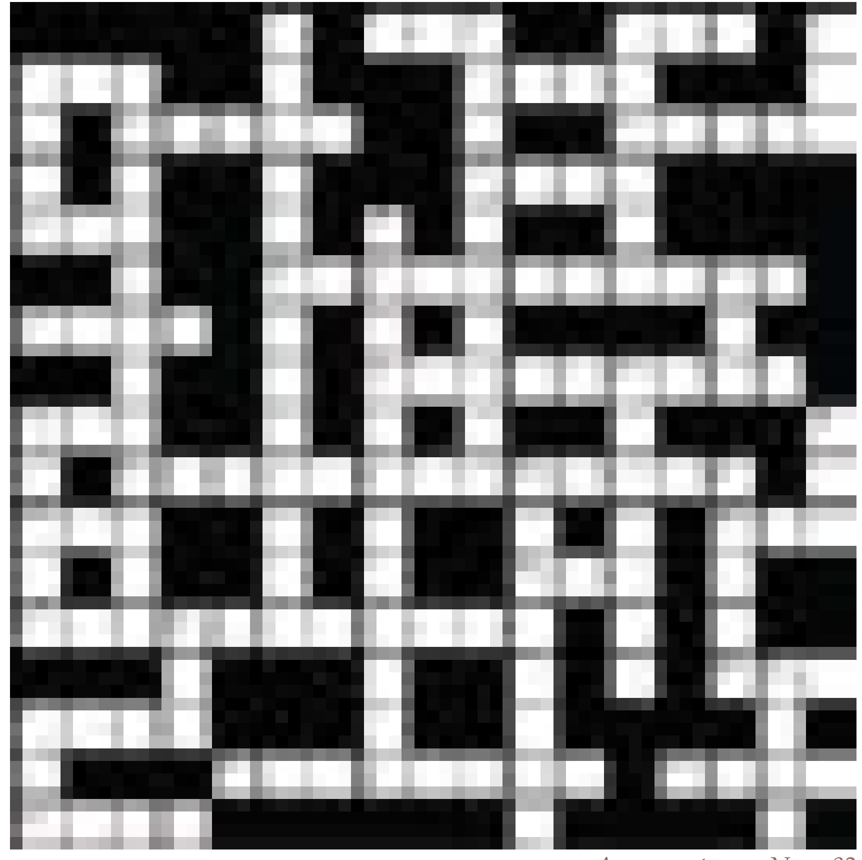
29 Wall St. overseer (3)

31 One who ushers in the fall season? (4)

32 It could turn hostile (8)

33 Legal thriller based on John Grisham novel "The ___" (4)

34 Too much of it could lead to 28-D (4)



Answer at page No. - 82

Down

1 Balance sheet's first schedule item, typically (4-2,7)

3 Part of RHP (10)

4 Dos and don'ts, in a way (6)

5 Future big corp. (3)

6 Indian investment bankers' assn. (4)

7 When a loan's tenure ends (8,4)

13 Flirt at the bar? (12)

15 Shareholder's annual reunion, in short (3)

18 Movie endings? (7)

19 "Gentlemen prefer ___": Andrew Mellon (5)

20 Compliance checklist item, abbr. (3)

22 Traded volume (8)

23 "Nothing in life is certain except death and ___" (5)

28 Lender's ICU? (3)

30 Second most traded currency (4)

31 Auction action (3)

Financial Fundas

Fool in the Shower - Coined by economist Milton Friedman, it refers to a bather who, thinking his shower water is too cold, turns the hot water all the way up and scalds himself in the process. Friedman was using the analogy to caution central bankers against moving too fast with any monetary policy. Policies designed to alter the course of the economy should be done slowly, rather than all at once. When the first stimulus is made, the effect may not be immediate, which can cause decision makers to increase the magnitude of the change, eventually causing too much stimulus.

Macaroni Defense - A company, that does not want to be taken over, issues a large number of bonds with the condition that they must be redeemed at a high price if the company is taken over. The required redemption substantially expands the cost of a hostile takeover just as macaroni expands when placed in boiling water.

Asprin Count Theory - A market theory that states stock prices and aspirin production are inversely related. As stock prices fall, more and more people need pain relievers to get through the day. The Aspirin count theory is a lagging indicator and actually hasn't been formally tested, so it is more a humorous hypothesis than a theory.

Quiz on Film Financing

With Indian cinema celebrating 100 years this year, here's a quick quiz to refresh association of finance with cinema

1. **Established in 1960 and now known as NFDC, which of these is the name of the first government organization formed to finance commercial cinema?**
   a. The Film Finance Corporation of India
   b. National Film Corporation
   c. Film Federation of India
   d. Film Development Company

2 **Based on the 2008 financial meltdown, which 2011 movie was nominated for the Academy Awards in the Best Original Screenplay category?**
   a. Too Big To Fail
   b. Inside Job
   c. The Flaw
   d. Margin Call

3 **Which was the first Hindi movie to be financially insured? To acknowledge the movie's production house, the policy was titled "The Cine Mukta Policy".**
   a. Pardes (1997)
   b. Yaadein (2001)
   c. Taal (1999)
   d. Joggers' Park (2003)

Jumble

Solve the 5 jumbled letters to form 5 financial terms. The circled letters in these terms can be rearranged to form a popular financial buzz word(s) hinted by the clue.

Question. 1

a. ETEURN □□□□□○
b. NBIOULL □○□□□○□
c. ICOMNE □○□□□○
d. OEARITMZ □□○□□□○□
e. TEDAR □○□□□
f. A reporter's quip: the problem in the___ (4,4) has proved a political football no one leader can handle!

Question. 2

a. PICRE □□○○○
b. RCFOAT ○□□○□□
c. UIOSTCND ○○○□□□□□
d. RDTECI ○□□□○□
e. FTOLA ○○□○□
f. One of Indian government's reduction targets - ___(6,7)

Question. 3

a. ELUVA ○□□□○
b. NOEYM ○□□□○
c. HREAS ○□□□○
d. IPTCLAA □□□○○□□
e. NUTREE ○□○□□□
f. An ___(10) in knowledge pays the best interest.

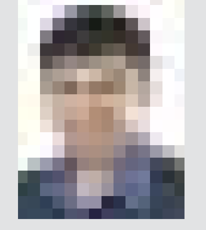
Review of Financial Apps

1. **Bloomberg**
   Access to global financial news, market data and portfolio tracker
   Access to market data across global Equity Indices, Commodities, Bonds, Currencies & Futures.
   Available on iPhone, iPad, Blackberry, Andriod

2. **Moneycontrol.com/Markets on mobile**
   Get real time Indian stock quotes, Indian indices and Global market
   Track Indian Mutual Funds, Currencie s & Commodities
   Customize your Stock Ticker
   Available on iPhone, iPad, Blackberry, Andriod

3. **NSE Mobile**
   Comprehensive trading and market monitoring platform
   Access to Cash, F&O and Currency markets
   Available on iPhone, iPad, Blackberry, Andriod

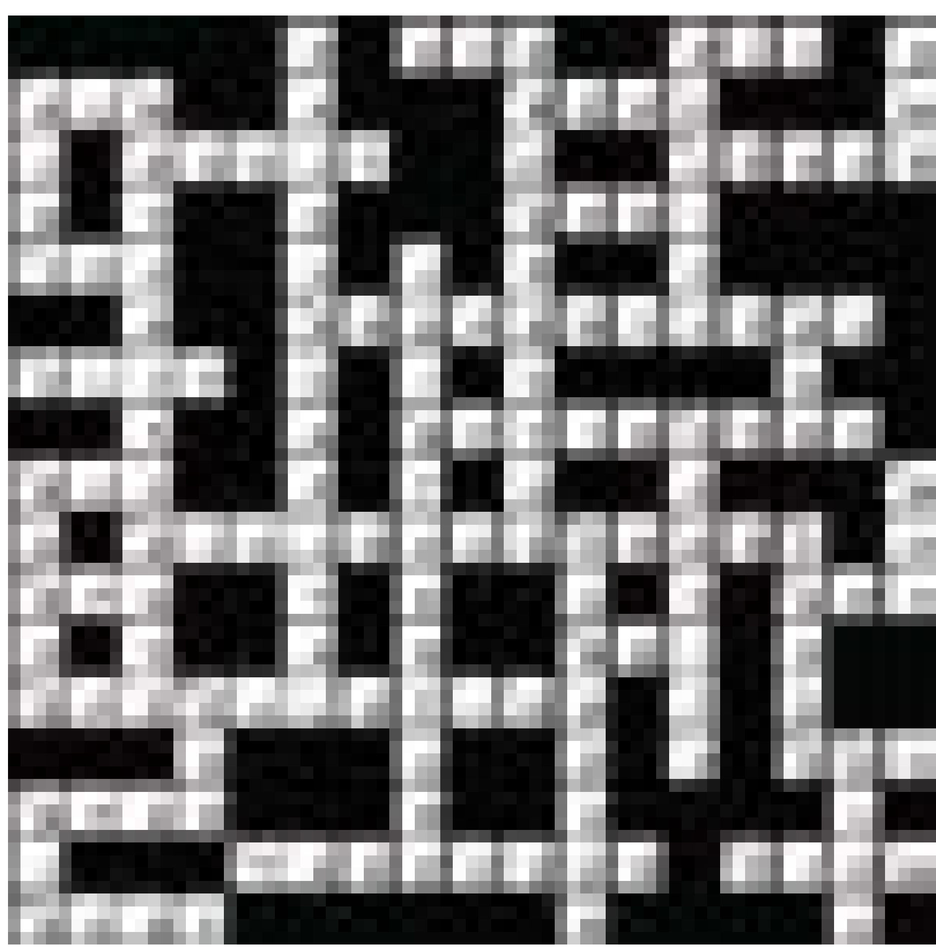
Fintainment Section Credits



Mangesh Ghogre

Mangesh Sakharam Ghogre, an alumnus of VJTI and NMIMS, is a professional investment banker with a passion for equity markets and words alike. He is a cruciverbalist and an international crossword constructor with crosswords published in Wall Street Journal, Los Angeles Times and recent acceptance by The New York Times. He has the unique distinction of being the first and the only constructor from India to be invited by the New York Times to be a judge at the prestigious American Crossword Tournament. He is also a freelance writer and his columns have been published in leading dailies like The Economic Times, The Hindu Business Line, Deccan Herald and The Times of India – including its much-followed Speaking Tree column. His published work is available at www.mangeshghogre.com

Solution of Fintainment Section



Answers of Quiz on Film Financing

Answer: 1 - a

Answer: 2 - d

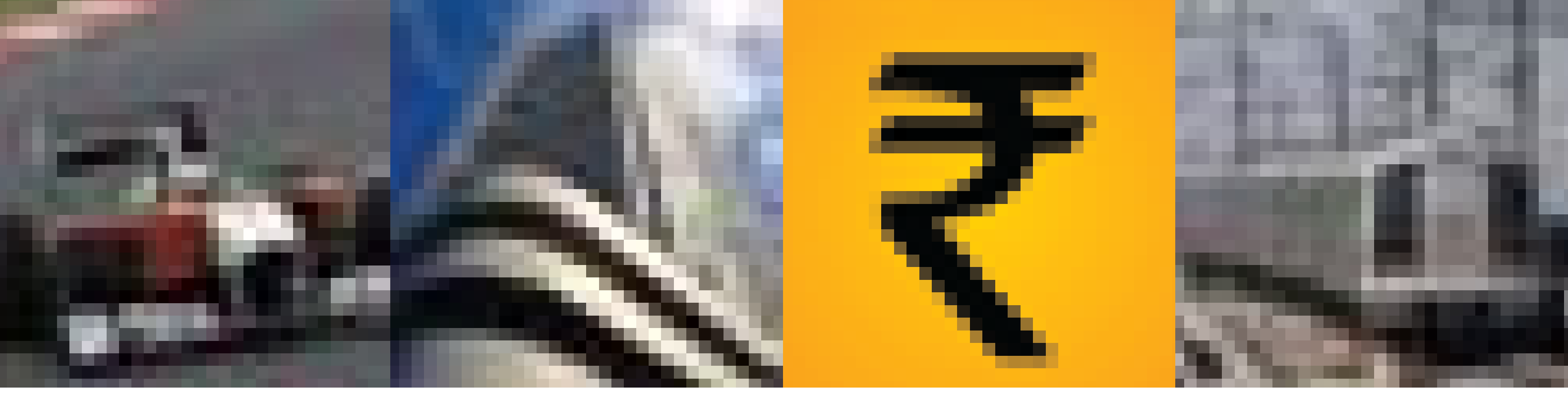
Answer: 3 - c

Answers of Jumble

Answer 1: a - TENURE, **b -** BULLION, **c -** INCOME, **d -** AMORTIZE, **e -** TRADE, **f -** EURO ZONE

Answer 2: a - PRICE, **b -** FACTOR , **c -** DISCOUNT, **d -** CREDIT, **e -** FLOAT , **f -** FISCAL DEFICIT

Answer 3: a - VALUE, **b -** MONEY , **c -** SHARE, **d -** CAPITAL, **e -** TENURE , **f -** INVESTMENT



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Mr. Apoorv Srivastava
Research Associate-Financial Sector
FICCI
Federation House, 1, Tansen Marg
New Delhi 110 001
Tel: 91-11-23738760-70
91-11-23487424 (D)
Fax: 91-11-23320714, 23721504
Email: apoorv.srivastava@ficci.com;
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