Selected Topics on Indian Economy and Banking
ERD Note for DMD (IB)

1. Demonetisation

- Demonetization of 86% of the total currency in circulation (in value terms) on 8 November, 2016 is one of the boldest reforms undertaken by the Government.
- There are 4 clear benefits of this move.
    - First, post demonetisation, registration of companies with a smaller capital is gaining pace.
    - Second, the trend in income-tax e-filing shows for the 5 year period ended FY14 approx 50 lakh people were filing returns on an annualised basis that has increased to 77 lakhs (FY14-FY17) and could have now expanded further.
    - Third, the share of small currency notes in circulation that was 28% in FY09 (54% in FY04) and declined to 13% in Nov'16 has now increased to 28% by Mar'17. A larger percentage of smaller notes improves transparency in cash dealings.
    - Fourth, gross financial savings has increased from 10.9% of gross national disposable income (GNDI) in FY16 to 11.8% of GNDI in FY17, a notable climb of 90 bps.
- The exorbitant increase in number of PoS terminals post has resulted in increase in debit + credit cards transactions at PoS by 38% during Oct'16 till Sep'17. Further, the digital payments through the Unified Payments Interface (UPI), has crossed 16 million transactions in volume and Rs 50 billion ($0.8 billion) in value within 11-month of its launch.
- Another benefit of demonetization is the **formalization of the economy** post demonetization. As a matter of fact, more than 70% of domestic remittances were estimated to be channeled in the informal sector in India (before the advent of PMJDY accounts) as against 30% in China, revealing a huge opportunity for banks. This formalization of the economy that began in right earnest since the opening of PMJDY accounts, has gathered robust pace since Nov'16. The latest data indicates 30 crore individuals have been linked to Pradhan Mantri Jan Dhan Yojana (PMJDY) in the last 3 years with Rs 67,016 crore / $11 bn deposited in their accounts.
- Following the footsteps of India, Venezuela also adopted demonetization in Dec'16, but it turned out to be catastrophic. People of India thus must be saluted for their patience during the entire exercise!

2. Recapitalization of PSBs in India

- Government took a massive step to capitalise PSBs in a front-loaded manner, with a view to support credit growth and job creation. This entails mobilization of capital, with maximum allocation in the current year, to the tune of about Rs 2.11 lakh crore ($32 billion) over the next two years, through budgetary provisions of Rs 18,139 crore ($3 billion), recapitalisation bonds to the tune of Rs 1.35 lakh crore ($20 billion) and the balance (estimated potential $9 billion) through raising of capital by banks from the market while diluting non-Government equity

- In August 2015, Government planned 'Indradhanush' to capitalise and revamp PSBs and estimated that PSBs require Rs 1.8 lakh crore ($28 billion) of capital till FY19. Accordingly, Government made a provision of Rs 70,000 crore ($11 billion) and projected market-raising of capital by banks to the tune of Rs 1.1 lakh crore ($17 billion). So far, the Government has infused capital of Rs 51,858 crore ($8 billion) in PSBs.
- For the so called critiques of recapitalisation of banks, there is indeed a case for justification for use of public funds. This is because the benefits of recapitalizing banks are much more than the costs of broad disruption in the real economy in the form of decline in bank lending and others. However, more often than not, the benefits from such an exercise are difficult to quantify as they largely relate to avoiding disruptive effects that is qualitative in nature.
- The Rs 1.35 lakh crore ($20 billion) package in itself seems largely adequate going by the MoF (Ministry of Finance) estimates. The latest figures shown in the Ministry presentation put the increase in NPA to the tune of Rs 4.55 lakh crore ($70 billion) from FY15 till Jun'17. The increased provisioning in the time period 2014-15 to 2017-18 is pegged at Rs 3.79 lakh crore ($58 billion). So, the amount of banking sector recapitalization to the tune of Rs 2.11 lakh crore ($32 billion) seems sufficient for tackling the problem of stressed assets.
- India had used the recapitalization bond before during 1985-86 to 2000-01, wherein the Government recapitalised PSBs with the total amount of Rs 20,446 crore ($3 billion). Government borrowed the amount from the banks and issued special non-marketable securities, which were however converted into marketable securities or perpetual bonds later. The banks subscribed to these bonds in the normal course of their business. The point that needs to be noted is that there was no cash outgo from the budget during the year of recapitalisation. However, it was an addition to the public debt or liabilities of the Government during the year.
- Consequently, the real impact on the budget falls only when interest is paid by the Government to the banks on the securities held by the latter. In total during the earlier period, interest paid by the Government to the nationalised banks on special securities works out to be Rs 7,888 crore ($1.2 billion) / 0.07% of GDP per annum on average. During the period the banks have paid Rs 15,222 crore ($2.3 billion) as dividend to the government / 0.04% of GDP on average. So, the net impact was only 0.03% of GDP.

3. GST

- Touted as the most important tax reform, the impact of GST on banking is massive. Banking services have seen a hike in tax to 18% after GST as compared to the collective tax of 15% earlier. GST implementation demands an enormous operational change requiring significant investments by the banking sector. Moreover, Banks would now have to file for state-wise registration instead of a single centralized registration under the former tax regime. Not only this, number of returns to be filed on monthly basis will increase substantially.

- Introduction of GST would also make Indian products competitive in the domestic and international markets due to reduction in taxes paid on goods and services (around 15-20% reduction in logistics costs of non-bulk goods). GST is expected to increase the investment rate in the economy, thus contributing to 0.5% to the GDP.
- Tax revenues are projected to increase by 1-1.5% due to improved compliance and broader tax base by removing cascading effect, layers of taxes and simplifying structures.
- Overall, GST has the potential to add at least up to 1% to India's GDP. This in turn will lead to the creation of more employment and increased productivity.

4. RERA

- Under the new law Real Estate (Regulation and Development) Act, 2016 (RERA), a developer will have to maintain 70% money collected from home-buyers in a separate account. This would leave them with only 30% of the sales proceeds to be used for any other purpose against 100% earlier. Though RERA will safeguard the interests of home-loan buyers, the new law would affect disbursement of real-estate loans in the short term with some banks seeking additional collateral clause to ensure security. The impact is already getting visible as housing loans which were grew in the range of 17-19% during Jul'15-Jul'16 decelerated to 10-13% recently. However, over a point of time as the economy becomes more cleaner, the impact of RERA would be felt in a positive manner.

*****