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Monetary and Credit Information Review

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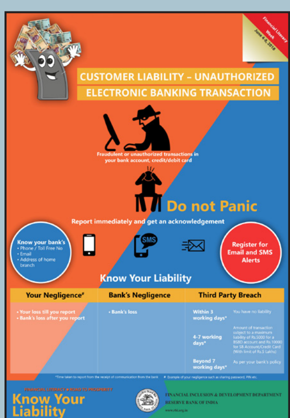
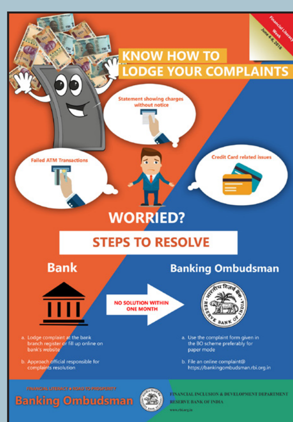
Financial Inclusion and Development

Financial Literacy Week : June 4-8, 2018

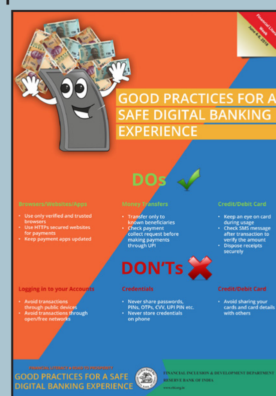
The Reserve Bank of India is observing Financial Literacy Week (FLW) during June 4-8, 2018 with the theme of customer protection. Bankers, Financial Literacy Counsellors (FLCs) and other stakeholders would also observe the FLW at various centres across the nation. The week will focus on four consumer protection messages, namely,





- **Know Your Liability for unauthorised electronic banking transaction;**
- **Banking Ombudsman;**
- **Good practices for a safe digital banking experience;**
- **Risk vs. Return**

The Reserve Bank has advised banks to conduct select activities during the week, that include, conducting special camps by Financial Literacy Centres; displaying posters on these four themes in the local language



by all bank branches in a prominent place inside the branch premises; display of these messages on the respective websites of banks; and hosting quiz for the general public on the four broad themes to generate interest/awareness about financial literacy.

The promotional material for the Financial Literacy Week are available at -

Version 1 (https://www.rbi.org.in/FinancialEducation/Version1.aspx) and

Version 2 (https://www.rbi.org.in/FinancialEducation/Version2.aspx)

Banking Regulation

Setting Up of IBUs – Permissible Activities

With a view to enabling IFSC Banking Units (IBUs) to start their operations, the Reserve Bank on May 17, 2018 advised that the parent bank will be required to provide a minimum capital of USD 20 million or equivalent in any foreign currency to its IBU which should be maintained at all times. However, the minimum prescribed regulatory capital, including for the exposures of the IBU, shall be maintained on an on-going basis at the parent level as per regulations in the home country. The IBU shall submit a certificate to this effect obtained from the parent on a half-yearly basis to the Reserve Bank (International Banking Division, DBR, CO, RBI). The parent bank will be required to provide a Letter of Comfort for extending financial assistance, as and when required, in the form of capital / liquidity support to IBU.

The notification was issued after the Reserve Bank received suggestions from the stakeholders to consider minimum prescribed regulatory capital at the parent level rather than at the IBU level. (https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11277&Mode=0)

NSFR – Final Guidelines

The Reserve Bank on May 17, 2018 issued Liquidity Coverage Ratio (LCR) guidelines which promote short term resilience of a bank's liquidity profile. The Net Stable Funding Ratio (NSFR) guidelines on the other hand ensure reduction in funding risk over a longer time horizon by requiring banks to fund their activities with sufficiently stable sources of funding in order to mitigate the risk of future funding stress.

The NSFR and Liquidity Coverage Ratio (LCR) are significant components of the Basel III reforms. (https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11278&Mode=0)

Foreign Exchange Management

Investment by FPI in Debt - Review

The Reserve Bank on May 1, 2018 stipulated that investments by an Foreign Portfolio Investor(FPI) in corporate bonds with residual maturity below one year shall not exceed, at any point in time, 20 per cent of the total investment of that FPI in corporate bonds. The purpose is to bring consistency across debt categories.

In this regard, the Reserve Bank further clarified that-

- FPIs are permitted to invest in treasury bills issued by the Central Government.
- The requirement that investment in securities of any category (G-secs, SDLs or, in terms of this circular, corporate bonds) with residual maturity below one year shall not exceed 20 per cent of total investment by an FPI in that category applies, on a continuous basis. At any point in time, all securities with residual maturity of less than one year will be reckoned for the 20 per cent limit, regardless of the maturity of the security at the time of purchase by the FPI.
- In case investments in securities with less than one year residual maturity, as on May 2, 2018 (beginning of day), is more than 20 per cent of total investment in any category, the FPI shall bring such share below 20 per cent within a period of six months from the date of this circular; however, the FPI shall ensure that no further additions are made to the portfolio of securities with residual maturity of less than one year as on May 2, 2018 (beginning of day), either through fresh purchases or through roll-down of investments with current tenor of more than one year, until the share of such portfolio of securities falls below 20 per cent of the total investment in that category.
- The term "related FPIs" refers to all FPIs registered by a non-resident entity. Illustratively, if a non-resident entity has set up five funds, each registered as an FPI for investment in debt, total investment by the five FPIs will be considered for application of concentration and other limits.
- As regards the concentration limit for an FPI for its corporate bond portfolio to a single corporate, the following clarifications may be noted:

i. The term "related entities" shall have the same meaning as defined in the Companies Act, 2013.

ii. A newly registered FPI would mean FPIs registered after April 27, 2018.

- The implementation date of online monitoring of utilisation of G-sec limits has been set as June 1, 2018. The existing process for monitoring of limits as well as allocation of limit through auction mechanism will continue in the meantime. (https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11268&Mode=0)

Monitoring of Foreign Investment Limits

In order to enable listed Indian companies to ensure compliance with the various foreign investment limits, the Reserve Bank in consultation with Securities and Exchange Board of India (SEBI), on May 3, 2018 decided to put in place a new system for monitoring foreign investment limits, for which the necessary infrastructure and systems for operationalising the monitoring mechanism, shall be made available by the depositories.

All listed Indian companies are required to provide the specified data/information on foreign investment to the depositories. The requisite information may be provided before May 15, 2018. The listed Indian companies, in non-compliance with the above instructions will not be able to receive foreign investment.

Further, upon implementation of the new monitoring system, all authorised dealer banks would be required to provide the details of investment made by their respective NRI clients to the depositories in the format as provided by the depositories/SEBI. In addition, the reporting to the Reserve Bank in the existing system, would continue.

Background

Currently, Reserve Bank of India receives data on investment made by Foreign Portfolio Investors (FPI) and Non-resident Indians (NRI) on stock exchanges from the custodian banks and authorised dealer banks for their respective clients, based on which restrictions beyond a threshold limit is imposed on FPI/NRI investment in listed Indian companies. (https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11270&Mode=0)

Cooperative Bank Regulation

Lending to Priority Sector for Primary UCBs

The Reserve Bank on May 10, 2018 issued revised guidelines on lending to Priority Sector for Primary (Urban) Co-operative Banks (UCBs).

Salient features of the revised guidelines are as under:

- Target for lending to total priority sector and weaker section will continue as 40 per cent and 10 per cent, respectively, of Adjusted Net Bank Credit (ANBC) or credit equivalent of off-balance sheet exposure, whichever is higher, as hitherto.
- Agriculture: Distinction between direct and indirect agriculture is dispensed with.
- Bank loans to food and agro processing units will form part of Agriculture.
- Medium Enterprises, Social Infrastructure and Renewable Energy will form part of priority sector.
- A target of 7. 5 per cent of ANBC or credit equivalent of off-balance sheet exposure, whichever is higher, has been prescribed for Micro Enterprises.

- Education: Distinction between loans for education in India and abroad is dispensed with.
- Micro Credit ceases to be a separate category under priority sector.
- Loan limits for housing loans qualifying under priority sector have been revised.
- Priority Sector assessment will be monitored through quarterly and annual statements.

Priority sector loans sanctioned under the guidelines issued prior to the date of this circular will continue to be classified under priority sector till maturity/renewal.

Achievement of Priority Sector targets

Achievement of priority sector targets will be taken into account while granting regulatory clearances/approvals for various purposes. With effect from April 1, 2018, achievement of priority sector targets will be included as a criterion for classifying a UCB as Financially Sound and Well Managed (FSWM). For the financial year 2018-19, shortfall in achieving the priority sector target/sub-target will be assessed based on the position as on March 31, 2018. From the financial year 2019-20 onwards, the achievement at the end of the financial year will be arrived at based on the average of priority sector target/sub-target achievement as at the end of each quarter. (https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11274&Mode=0)

Internal Debt Management

Guidelines on Stripping/Reconstitution of G- Secs

With a view to meeting the diverse needs of investors and making Separate Trading of Registered Interest and Principal of Securities (STRIPS) more aligned with market requirements, the Reserve Bank on May 3, 2018 decided to revise the existing guidelines. Accordingly, it is proposed to remove the restrictions on the securities eligible for Stripping/Reconstitution as well as the requirement of authorization of all requests for Stripping/Reconstitution by Primary Dealers (PDs).

Eligible Securities

All fixed coupon securities issued by Government of India, irrespective of the year of maturity, are eligible for Stripping/Reconstitution, provided that:

i. The securities are reckoned as eligible investment for the purpose of Statutory Liquidity Ratio (SLR).

ii. The securities are transferable.

Placing of Requests

- Market participants, having an SGL account with RBI can place requests directly in e-kuber for stripping/reconstitution.
- Requests for stripping/reconstitution by Gilt Account Holders (GAH) shall be placed with the respective Custodian maintaining the CSGL account, who in turn, will place the requests on behalf of its constituents in e-Kuber. (https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11269&Mode=0)

Data Releases

Handbook of Statistics on Indian States 2017-18

The Reserve Bank on May 5, 2018 released the third edition of its statistical publication titled "Handbook of Statistics on Indian States 2017-18". Through this publication, the Reserve Bank has been disseminating wide-ranging data on the regional economy of India.

This publication follows the 'one indicator-one table' approach in 129 tables and it covers sub-national statistics on socio-demographics, state domestic product, agriculture, industry, infrastructure, banking and fiscal indicators across Indian States from 1951 to 2017-18. The Handbook has been updated based on latest available data, sourced from the respective authorities.

The electronic form of the Handbook can also accessed on www.rbi.org.in.

Comments and suggestions on the Handbook are welcome and may please be sent to the Director, Regional Economy Monitoring Division, Department of Economic and Policy Research, Reserve Bank of India, 7th Floor, Central Office Building, Mumbai 400 001. (https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=43846)

Mint Street Memo

Examining GDP Data Revisions in India

The Reserve Bank on May 1, 2018 uploaded on its website the twelfth in the series of Mint Series Memo on 'Examining Gross Domestic Product Data Revisions in India' by Anupam Prakash, Avdhesh Kumar Shukla, Anand Prakash Ekka and Kunal Priyadarshi.

Revisions in gross domestic product (GDP) estimates are not unique to Indian national accounts. Internationally, early estimates suffer from a lack of complete information, an issue that is addressed gradually by successive revisions.

With the release of the first advance estimates (FAE) of national income for 2017–18 on January 5, 2018, the issue of their reliability in assessing the strength of economic activity has come to the fore, especially as new data suggestive of a faster growth pick-up have become available since then. The FAE are used in ratios underlying the Union Budget as well as in analysis supporting monetary policy.

This study attempts a statistical analysis of data revisions of GDP growth rate in India, between the first release and the latest available release, from both the production and the expenditure side, and for annual and quarterly estimates. The analysis is also extended to major components of GDP with a view to ascertain the extent of revision in each sector.

This study documents that on most occasions, the earlier releases underestimate real GVA and real GDP growth. This is mainly because firmer data are captured in successive rounds of revisions accompanied with gradual increase in data coverage. More importantly, we observe a bias when the growth cycle 'turns'.

It may be advisable for data users to read GDP growth numbers carefully along with other high frequency indicators of the real economy. CSO may examine relationship of these indicators with Gross Value Added (GVA) of respective sectors frequently and use the revised coefficients for computing FAE. Furthermore, these sets of new information can be incorporated in state-of-the-art methods such as "Nowcasting" to produce better (potentially unbiased) estimates of economic growth relative to simply employing the reported FAE. (https://rbi.org.in/Scripts/MSM_Mintstreetmemos12.aspx)

RBI Occasional Papers

The Reserve Bank on May 2, 2018 released Volume 37 of its Occasional Papers. RBI Occasional Papers is a research journal of the Reserve Bank and contains contributions of its staff and reflects the views of the authors. This issue contains four articles and two book reviews.

Monetary Policy Transmission in India: Do Global Spillovers Matter?

This paper by Michael Debabrata Patra, Sitikantha Pattanaik, Joice John and Harendra Kumar Behera employs a dynamic factor model to develop an indicator of global spillovers to examine the impact of unconventional monetary policies on transmission of monetary policy in India. Estimates from a Time-Varying Parameter Vector Auto Regression (TVP-VAR) model indicate that monetary policy transmission through money and credit markets is unaffected by global spillovers. In the debt market, however, transmission is impacted, producing occasional overshooting and over-corrections, but market microstructure seems to have a stronger influence and drive mean reversion. Notwithstanding heightened sensitivity of foreign exchange and equity markets to global spillovers, there is no statistically strong evidence of domestic monetary policy losing traction because of global spillovers.

Asset Quality and Monetary Transmission in India

This paper by Joice John, Arghya Kusum Mitra, Janak Raj and Deba Prasad Rath, assesses the impact of asset quality of banks on monetary transmission in India. This is attempted through a detailed analysis of determinants of net interest margin (NIM). Using quarterly data for the period (Q1:2010-11 to Q1:2017- 18) and dynamic panel data regression, the study finds that credit risk, proxied separately by gross non-performing assets (NPA) ratio and the stressed assets ratio (NPA plus restructured assets), has a statistically significant and positive impact on the NIM of scheduled commercial banks, suggesting that deterioration in asset quality impeded monetary transmission.

Operating Target Volatility: Its Implications for Monetary Policy Transmission

This paper by Rajesh Kavediya and Sitikantha Pattanaik highlights that volatility in the operating target of monetary policy could increase uncertainty about the cost of access to liquidity for any given policy interest rate, thereby pushing up the term premium and long-term interest rates. Empirical estimates of the paper indicate that conditional volatility in daily change in the Weighted Average Call Rate (WACR) - the operating target of monetary policy in India - exerts modest but statistically significant influence on volatility in daily change in other interest rates, namely nominal yields on government papers of three-month, six-month, nine-month, twelve-month, two-year and ten-year maturities. In the credit market, a one percentage point increase in WACR volatility (measured in terms of quarterly standard deviation) is estimated to cause about 26 basis points increase in bank lending rates.

Nowcasting Indian GVA Growth in a Mixed Frequency Setup

This paper by Indrajit Roy, Anirban Sanyal and Aloke Kumar Ghosh attempts to nowcast quarterly real non-agricultural Gross Value Added (GVA) growth for India using a dynamic factor model, following two different approaches. Multi-level variable selection using turning-point analysis and elastic-net framework has been adopted to overcome the over-fitting problem while selecting the variables. The paper finds significant improvement in forecast accuracy of one quarter ahead forecast using nowcasting framework as compared with the naive models. The two-factor model is found to be the most precise when compared with other higher-order factor models and naive models. The forecast performance improves marginally when stochastic volatility is introduced in the model.

Book Reviews

Apart from the above four articles, this issue of Occasional Papers also contains two book reviews:

Radheshyam Verma reviews Imad A. Moosa's "Contemporary Issues in the Post-Crisis Regulatory Landscape" which highlights that the global regulatory landscape for the banking sector has changed dramatically after the global financial crisis, creating hope that banking systems that comply with such regulations should become more resilient and sound in future.

Sonam Choudhry reviews "The Curse of Cash" written by Kenneth Rogoff, which examines the role of currency in the modern era and how it can constrain monetary policy to deal with recessions. (https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=43814)

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