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Dear Comrades,

5th October, 2016

NEWS OF INTEREST 5TH OCT

QUOTE OF THE DAY

“DO NOT WAIT TO STRIKE TILL THE IRON IS HOT; BUT MAKE IT HOT BY STRIKING. “

WILLIAM BUTLER YEATS

1. RATES HAVE COME DOWN MORE IN CASE OF NEW LENDING: URJIT PATEL
2. PATEL DEBUTS WITH RATE CUT
3. S4A GUIDELINES TO BE REVIEWED
4. REJECT PROPOSAL FOR 'BAD BANK' TO TAKE OVER NPAS: SITARAM YECHURY TO PM NARENDRA MODI
5. CYBER SECURITY SUPERVISION: RBI TO SOON COVER ALL BANKS
6. SMES' ABILITY TO PAY BACK GOES UP
7. TRANSMISSION IS FASTER IN BOND MARKETS
8. AT 4.5%, RBI PREDICTS INFLATION HIGHER THAN FY18 TARGET

Business Standard

1. Rates have come down more in case of new lending: Urjit Patel

Interview with RBI Governor
Business Standard

Addressing the media at his first monetary policy conference as the governor of the Reserve Bank of India, **Urjit Patel** spoke about inflation, transmission of rate cuts by banks, as well as steps taken to resolve the issue of burgeoning bad loans. Edited excerpts:

How has the Monetary Policy Committee (MPC) taken off and how are you going to navigate it?

We have been meeting over the past day and a half, going through presentations, discussions and coming to a conclusion on the repo rate. We have a great MPC. The three external members are of outstanding pedigree. They are well-known academics and have been involved in policymaking for a long time and bring value and a dispersion of opinion, which is what the MPC is about. Our discussions were frank, often intense, but always friendly. We allowed each other to speak and ensured that we agreed on a resolution.

Cuts in the past have not resulted in meaningful transmission by banks. Do you expect banks to pass on this cut?

The answer can be given in two parts. One, the transmission through money markets has been swift and decisive and corporates are using those parts of the financial system more compared to vanilla bank credit. I agree that transmission to borrowers has been less than what anyone of us would have liked, and we are hoping that over the next quarter or two this will improve. Also, keeping in mind the government has reduced the small savings rate, its intention to bring that money into more market-related investments is also amplified. The MCLR (marginal cost of funds-based lending rate) calculation itself will now throw up more transmission. One thing to distinguish is that transmission has been much more in case of new lending.

How much of this policy is a continuation of the previous policy? Are you persisting with removal of liquidity deficit and maintaining neutral liquidity?

Yes, we will continue with the policy of removal of liquidity deficit. We have not referred to it in the policy document because there is no change in stance.

Do you expect the 150-200 basis points positive real rate to persist?

The neutral rate is a time variant and changes with factors such as demographics or potential output. The world over this rate is going down and that is why you see many countries putting in place negative interest rates. As far as we are concerned, in continuation with what has been articulated before, if you look at our risk-free rate, that is the Treasury bill rate, is 6.5 per cent and RBI's projection of inflation stands at five per cent, which translates to a neutral rate of 1.5 per cent. But, factoring in the global situation, wherein neutral rates are declining, the real neutral rate could be around 1.25 per cent or thereabouts.

What is your view on the NPA (non-performing assets) issue?

The NPA situation is important for RBI and we will deal with it with firmness and also with pragmatism, so that the economy does not feel any lack of credit to support the economy's growth. We must remember that this situation has not appeared overnight and, therefore, will require skill and thoughtful endeavour to resolve.

There are four stages — identification, recording and reporting of NPAs has been done satisfactorily, but we need to work more on the fourth leg, which is resolution. In fact, back in 2007 and 2008, the banking sector lent its balance sheets to support investments in infrastructure. Just five sectors — infrastructure, steel, textiles, power and telecom — contribute 61 per cent to stressed assets. The sectors are individually important and dealing with stressed assets will require skill and creativity. We are working with banks and the government in this regard. We have been at the forefront of improving creditor

rights in India and the bankruptcy code is an example of this. But like all legislation, it will take time to settle.

2. Patel debuts with rate cut

Repo rate cut 25 bps to six-year low of 6.25%; unanimous decision by new monetary policy committee; India Inc hails move, all eyes on banks

Anup Roy

In its maiden review on Tuesday, the monetary policy committee (MPC) decided to cut policy rate by 25 basis points as the recent fall in inflation seemed more durable than just an outcome of positive base effect.

All six members of the committee, including newly appointed Reserve Bank of India (RBI) Governor Urjit Patel, met and deliberated for two days before unanimously voting in favour of a cut in repo rate, which now stands at 6.25 per cent.

ALSO READ: S4A guidelines to be reviewed

"The decision of the MPC is consistent with an accommodative stance of monetary policy in consonance with the objective of achieving consumer price index (CPI) inflation at 5 per cent by Q4 of 2016-17 and the medium-term target of 4 per cent within a band of +/- 2 per cent, while supporting growth," the fourth bi-monthly monetary policy statement read.

ALSO READ: Rates have come down more in case of new lending: Urjit Patel

"The accommodative stance of monetary policy and comfortable liquidity conditions should support a revival of credit to the productive sectors." **(ANALYSING THE 25-BP CUT IN REPO RATE)**

ALSO READ: Rate cut could save India Inc Rs 6,300 crore in interest outgo

Patel, conducting his first monetary policy review as RBI governor, expressed hope that banks would pass on the rate cut. However, the bankers did not appear ready to commit immediately and said transmission "would happen eventually".

"Banks will continue to transmit rates based on evolving liquidity scenario," said Arundhati Bhattacharya, chairman, State Bank of India.

ALSO READ: RBI steps up focus on cyber security & fraud prevention

"For the busy season of the financial year, a cut in repo rate by 25 basis points is indeed a welcome sign. With MCLR already stabilised, the pass through of this cut is expected to be quite swift," said Ashwani Kumar, chairman and managing director, Dena Bank.

The rate cut was not entirely surprising but not everyone could predict it. In a poll of 10 economists, bankers and market participants, six had expected the central bank to pause but move decisively towards a rate cut in December policy review.

ALSO READ: Cheaper credit only after deposit rate cut

Retail inflation for the month of August fell to 5.05 per cent from 6.07 per cent in July. Food prices, which constitute roughly 50 per cent of the headline number, fell to 5.91 per cent from 8.35 per cent in the same period as prices of pulses and vegetables tumbled.

"It (MPC) notes that the sharp drop in inflation reflects a downward shift in the momentum of food inflation - which holds the key to future inflation outcomes - rather than merely the statistical effects of a favourable base effect," the policy statement read.

Even as fuel inflation has moderated steadily through the year so far, inflation excluding food and fuel remained sticky around 5 per cent, mainly in respect to education, medical and personal care services, which led the household expectation of inflation to inch forward.

On the corporate side, even as input costs in the manufacturing sector have firmed up slightly, "but the presence of considerable slack has restrained their transmission into corporate pricing power."

In short, the low inflation is here to stay and the committee "envisages a trajectory taking headline CPI inflation towards a central tendency of 5 per cent by March 2017, with risks tilted to the upside albeit lower than in the second and third bi-monthly monetary policy statements of June and August respectively," the central bank said.

The markets cheered the rate cut. The yields on the most traded 10-year bond fell six basis points and rupee strengthened to close at 66.46 a dollar from its previous close of 66.58 a dollar.

Patel started the post-monetary policy conference, a brief and rather hurried affair, with a warning that global growth is in a downhill trajectory, led by weak trade.

"For the first time in a long time the weak global demand is actually going to drag down trade volumes to decline. It is possible that at the IMF meetings this week there will be a further possible downgrading of global growth. I will be surprised if there isn't," Patel said, adding the global central banks "continue to pose uncertainty for emerging markets causing volatility in EMs due to mixed US macro data as it also in the EU."

But India may not have to worry as much. The RBI said the momentum of growth was expected to quicken with a normal monsoon raising agricultural growth and rural demand, as well as by the stimulus to the urban consumption spending from the pay commission's award.

Nevertheless, the continuing sluggishness in world trade would further slacken external demand going forward and RBI chose to retain the projection of growth of real gross value added (GVA) for 2016-17 at 7.6 per cent.

In the policy press conference, RBI executive director Michael Patra said globally the 'neutral' rates of various economies are coming down and India should not be an exception. The neutral rate can be defined as the real interest rate at which an economy can grow at its full potential without incurring destabilising high inflation. Real interest rate is calculated roughly as the policy rate minus inflation. RBI previously had said the neutral real interest rate of the country is between 1.5 and 2 per cent. Now it seems RBI favours a neutral rate of around 1.25 per cent. When the policy rate was 6.5 per cent and inflation was close to 5

per cent, the real interest rate was 1.5 per cent.

However, Michael Patra said the neutral real interest rate for India could be brought down to 1.25 per cent, which is the case now with a cut of 25 basis points. "We need to take into account the global situation where in the neutral rates are actually declining. So it could be around 1.25 or thereabouts," said Patra at the post policy conference.

Nomura India economist Sonal Varma termed the rate cut as a 'surprise'. According to Nomura, even as RBI has offered no forward guidance, Patra's statement on neutral rate "has increased uncertainty over the policy path... We currently do not expect another cut," Nomura said.

"... RBI's cut today and the changed stance on real rates suggest that the tenets of the flexible inflation targeting framework, as interpreted by the previous RBI governor (Dr. Rajan) and the current governor (Dr. Patel), have implicitly changed," Varma of Nomura wrote in her research report.

In the fourth bi-monthly policy, RBI also initiated several measures, including tweaking a restructuring norm, that will help the banking system clean the bad debt in their books. "The NPA situation is an important issue for the RBI. We will deal with the situation with firmness but also with pragmatism so that the economy does not feel any lack of credit to support the growth of the economy," Patel said in his statement.

"We must remember that the situation has not appeared overnight and therefore will require skill and thoughtful endeavour to resolve," said the RBI governor.

WHY RBI DECIDED TO CUT RATE

- Expects global growth forecast to be lowered
- IMF has retained 2017 world growth forecast at 3.4%, compared with 3.6% in Jan
- Says sharp downturn in food prices will lead to softer inflation numbers
- Food inflation fell to 5.91% in August from 8.35% in July
- Cites low fuel inflation
- Crude oil prices steady at around \$50 a barrel
- Input costs firm up but companies don't have pricing power
- Capacity utilisation of manufacturing firms at 72.9% in Q1 FY17 from 74% in Q4 FY16

3. S4A guidelines to be reviewed

This comes at a time when bank credit to the corporate sector has remained sluggish, dragging overall credit offtake to single digits

Nupur Anand & Abhijit Lele

The Reserve Bank of India (RBI)'s stance in dealing with bad loans seems to have shifted from an aggressive approach under former governor Raghuram Rajan to a more pragmatic one under Urjit Patel, the current chief.

"We will deal with the situation with firmness, but also with pragmatism so that the economy does not feel any lack of credit to support growth. We must remember that the situation has not appeared overnight and, therefore, will require skill and thoughtful endeavour to resolve," he said.

This comes at a time when bank credit to the corporate sector has remained sluggish, dragging overall credit offtake to single digits. This is because the large amount of non-performing assets (NPAs) in the corporate sector is making banks wary of lending to certain segments and the slow pace of economic activity has resulted in low credit demand. Patel added that helping banks deal with this situation is of utmost importance.

"Just five sectors contribute 61 per cent to the stressed assets of the banking sector. Infra, steel, textiles, power and telecom. The sectors are each individually important and dealing with stressed assets will require skill and creativity," said Patel.

Gross NPAs of public sector banks (PSBs) have risen from Rs 5.02 lakh crore in March to Rs 5.59 lakh crore in June.

In the past few years, RBI has devised several measures such as Joint Lenders' Forum, Strategic Debt Restructuring, 5/25 scheme, etc., to tackle the problem. Recently, the Scheme for Sustainable Structuring of Stressed Assets (S4A) was unveiled. However, RBI has now decided to review these guidelines to make them more effective.

"There was this idea that the sustainable portion of this debt, irrespective of what it was before, should be classified as standard. So, they have agreed to that and we will be coming up with final guidelines by end of October. There will be certain conditions subject to which it will be done so that it is not used for wrong cases," said RBI Deputy Governor N S Vishwanathan. In the S4A scheme, banks are to divide the existing debt of a company into a sustainable (which can be serviced by the company even if cash flow remains the same) and an unsustainable portion. An independent oversight agency will ascertain the viability of a project and the resolution plan.

Bankers have welcomed the tweaking of S4A norms. "The smoothening of S4A guidelines will help in easier resolution of stressed assets and will be a relief to the banking system," said N S Venkatesh, executive director, Lakshmi Vilas Bank.

B Sriram, managing director of SBI said the proposed modification in the rules for S4A will be beneficial to take up cases for restructuring. However, it is too early to specify if more cases would be dealt.

Financial Express

4. Reject proposal for 'bad bank' to take over NPAs: Sitaram Yechury to PM Narendra Modi

Trashing the proposal for creating a "bad bank" to take over non-performing assets (NPAs) of financial institutions, CPI(M) today demanded that Prime Minister Narendra Modi reject the move and start recovery of pending loans from top 100 borrowers on priority.

By: PTI

Trashing the proposal for creating a "bad bank" to take over non-performing assets (NPAs) of financial institutions, CPI(M) today demanded that Prime Minister Narendra Modi reject the move and start recovery of pending loans from top 100 borrowers on priority.

"The need of the hour is...to put into practice an urgent action plan to start recovery of pending loans from top 100 borrowers. We hope you will reject this proposal of creating a 'bad bank' and start recovery of bad loans on priority.

"Anything less would be tantamount to dereliction of your constitutional duty as the PM of this country," CPI(M) General Secretary Sitaram Yechury said in a letter to Modi.

Yechury referred to recent reports that bad loan provisioning for most state-owned banks "doubled and even trebled" in some cases during 2015-16.

But the government waived loans to the tune of Rs 59,547 crore of big borrowers during the fiscal, he said.

"You must begin by making public their names with the due amount. A failure to do so would mean that your government is making our working people pay for the criminality of the rich defaulters. This is an inversion of the principle of natural justice," he said.

The CPI(M) leader suggested that the big borrowers have viable assets that can be easily recovered by banks "if backed up with political will and determination".

Instead, Yechury said, the government has come up with a proposal to divert all the bad loans from state-owned banks by creating a single "bad bank".

He said the idea is an "attempt" to portray a clean-up of bank account books by diverting bad loans to a separate entity which will still be government-owned and furnished by public money even as big borrowers would be allowed to go scot-free.

"This amounts to cronies being rewarded for their profligacy, bad business practices and their lavish personal lifestyles by the hard-earned savings of the vast majority of the middle classes and the poor of this country," he said.

According to media reports, setting up of a "bad bank" is being proposed to help absorb "toxic assets" from loss-laden state-owned banks and lenders.

The "bad bank" is meant to buy non-performing assets (NPAs) from lenders to free up their books. This would help banks do fresh lending and then suitably dispose of the toxic assets, the reports said.

5. Cyber security supervision: RBI to soon cover all banks

With instances of cyber attack rising, the Reserve Bank today said it has decided to increase its supervisory coverage on IT risks for banks with an aim to eventually cover all the lenders.

By: PTI

With instances of cyber attack rising, the Reserve Bank today said it has decided to increase its supervisory coverage on IT risks for banks with an aim to eventually cover all the lenders.

"This year, the supervision coverage is being extended to over 30 banks and going forward we intend to cover every bank from an intent of information technology risk and cyber security risk," deputy governor SS Mundra told reporters after the fourth bi-monthly policy review.

He said the RBI had started a special supervision of banks' cyber security last year on a pilot basis in which it had covered a few largest banks. The RBI is also in the process of setting up a dedicated IT subsidiary which may help with such issues.

It can be noted that there has been a spurt in cyber security attacks in the recent past, including at Union Bank of India and also a large-sized lender in the recent past.

In both instances, the frauds were averted midway.

To tackle the menace of all financial frauds, Mundra said a dedicated monitoring cell has been set up in the RBI's Department of Banking Supervision which will look into such issues, with a focus on large scale frauds.

It will coordinate with other agencies to take the matter to a logical conclusion at the earliest, he added.

From a supervisory perspective, there will be additional focus on mis-selling and know your customer/anti-money laundering fronts as well, Mundra said.

6. SMEs' ability to pay back goes up

OUR BUREAU

In a big boost to emerging entrepreneurs and start-ups, the RBI on Tuesday announced its decision allowing start-ups to raise external commercial borrowings (ECBs) up to \$3 million or equivalent per annum.

Entrepreneurs look at ECBs as a competitive source of finance as compared to domestic funds. The RBI move is expected to improve the ability of start-ups to pay back loans and make their businesses more economically viable.

Significant role

In its Statement on Developmental and Regulatory Policies, the RBI recognised the potential of start-ups to play a significant role in economic growth and job creation by spurring innovation and injecting competition.

"Taking into account the available funding channels from overseas for start-ups, the Reserve Bank, in consultation with the Government of India, will allow such entities to raise ECB up to \$3 million or equivalent per financial year, either in INR or in any convertible foreign currency or a combination of both. Guidelines will be issued by end-October 2016," the RBI statement said.

Sources said the move is designed to help the Centre's push to encourage entrepreneurship in the country and generate large employment opportunities through start-ups.

"The decision will open the minds of people to look outside Indian boundaries to raise funding. Also, we are seeing a large amount of foreign money seeking

Indian projects. A push like this shows the government's intention to bring such money in India," said Anupam Jalote, Chief Executive Officer of the International Centre for Entrepreneurship & Technology (iCreate), a non-profit conceptualized by then Gujarat Chief Minister Narendra Modi in 2011 under the guidance of Infosys co-founder NR Narayana Murthy.

"A certain portion of the total project cost was already allowed for ECB. But by specifying a limit, such as \$3 million, the RBI has increased the scope of definition of a start-up," said Jalote.

The IT industry, under which a large number of start-ups fall, welcomed the RBI decision.

"This opens a vast avenue for entrepreneurs to raise funds. Also, unlike earlier years when India was looked at as an outsourcing destination, it is now looked at as a place with new and forward-looking technologies and innovations. Such a move will surely boost the prospects for SMEs in the IT and ITeS fields," said Jaimin Shah, former president of the Gujarat Electronics and Software Industries Association (GESIA).

He added that in the IT space, the next level of growth would come from SMEs, who will drive most innovations.

7. Transmission is faster in bond markets

RADHIKA MERWIN

While borrowers of loans from banks have been benefiting in fits and starts from the RBI's rate cut over the past year, the transmission has happened much faster in the bond markets, benefiting certain borrowers.

The yield on one-year commercial paper, for instance, has fallen by about 70-80 basis points so far this year even as banks have been dragging their feet, cutting lending rates by 10-15 basis points. This has aided corporate borrowers who have a good rating and have been able to raise funds from the bond market.

According to data put up by the RBI recently, while credit from the banking system has grown by 19.2 per cent between March 2014 and March 2016, credit from the non-bank system — corporate debt and commercial papers, among others — has gone up by 37.4 per cent during the same period.

Bankers say that many corporate borrowers have been able to make the best of lower rates in the bond markets to raise funds. Yields on top-rated AAA corporate bonds have fallen by about 80 basis points this year to 7.4 per cent, with much of the reduction happening post the April policy, when the RBI last cut its key policy rate. AA rated companies, which rank a notch lower and pay about 30-40 basis points more than top-rated companies to source funds from the secondary market, have also gained from the notable fall in rates.

Yields on these bonds too, have fallen by about 40 basis points this year.

Punjab National Bank, which shows the rate it charges its SME customers based on the risk profile, gives some indication of the wide disparity in banks' lending rates and bond market yields.

According to PNB's website, for corporate borrowers rated highest at AAA, it charges a loan rate that is 20 basis points higher than the respective MCLR (marginal cost of funds-based lending rate). For instance, loan rates on working capital loans, benchmarked against one-year MCLR, add up to 9.5 per cent. This is far higher than the rate at which AAA borrowers are able to borrow from the bond market currently. This, to some extent, highlights the wide difference in rates in different markets though the gap could be wider or narrower.

More downside?

While the transmission of rates will continue to happen at a smoother pace in the bond market than through banks, a sharp fall from hereon is unlikely despite the RBI's rate cut on Tuesday.

Short- to medium-term bonds react more nimbly to policy rate actions as they are more sensitive to rate cuts and liquidity infusion. As we near the end of the rate easing cycle, markets are likely to factor in current rates rather than future expectations and this should limit the downside in bond yields.

"We expect one year CP to move up to 7.7 per cent by March next year from the current 7.4 per cent, reflecting stronger refinancing pressure that is typically the case over January-March," said Suyash Choudhary, Head, Fixed Income, at IDFC Mutual Fund.

The market reaction to the rate cut on Tuesday has been muted as the yield on the 10-year G-Sec remained more or less unchanged at 6.7 per cent levels. But the bond market has already rallied sharply this year in anticipation of rate cuts and because of the RBI's open market operations (OMOs) — buying of government bonds to provide liquidity — since its April policy.

This helped suck out the excess supply of government bonds, leading to bond prices moving up and yields sliding. From 7.7 per cent levels in the beginning of this year, yield on the 10-year G-Sec has fallen to 6.7 per cent, a notable one percentage point fall. While markets are factoring in another rate cut, a sharp fall in yields as the one seen in recent months, is unlikely.

"For one, OMOs will not be bunched up as before. Also, if the market believes that 6 per cent is the terminal repo rate (and doesn't expect further easing from thereon), then the appetite for duration after the next 15-20-basis point fall in yield may be limited," said Choudhary.

8. At 4.5%, RBI predicts inflation higher than FY18 target

By [Gayatri Nayak](#), ET Bureau

The Reserve Bank of India has forecast consumer inflation at 5% for FY18, which is in sharp contrast to what Indian households expect -9.5% in three months from now, and may even rise to 11% one year down the line.

"In the September round, in fact, inflation is expected to be 9.5% three months ahead and 11.4% one year ahead," said the RBI's monetary policy report released on Tuesday. The report noted that food prices during the May-July quarter appear to have been in line with inflation projections. The central bank's projection for medium term is 4.5% by March 18 against its medium term target of 4% within a band of +-2% Producers' or manufacturers' expectations appear to be more forward-looking than households. The July-September round of the Reserve Bank's industrial outlook survey indicates that the proportion of

respondents expecting higher input prices during the third quarter of FY17 has increased. But the survey also shows few expect higher selling prices.

However, professional economists' forecast is closer to RBI's inflation targets. They expect inflation to ease to 4.7% by Q4 of 2016-17, and to 4.4 % by Q2 of 2017-18, both matching with RBI's target band.

The central bank's staff forecast of 4.5% CPI inflation by March '18, which factors in expectations by all segments of the economy , also takes into account other economic indicators.

This time, its projections incorporate the pay commission's award on salaries and pensions. It is expected to work through aggregate demand and expectation effects and add around 10 basis points (bps) to the baseline CPI inflation path from Q4 of 2016-17. The projections also factor in cost-push effects of the proposed increase in minimum wages which would add 5 bps to baseline inflation within two months of implementation.

With kind regards,

Yours Comradely,



(N. GOVINDRAJULU)
GENERAL SECRETARY