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Dear Comrades,

22nd August , 2016

News of Interest 22nd Aug

Quote of the day

“Let us remember: One book, one pen, one child, and one teacher can change the world.”

Malala Yousafzai

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Business Line

1. **‘Hawkish’ Patel will be just as tough on inflation as Rajan**

OUR BUREAU

Urjit Patel’s appointment has come as surprise for many analysts and experts who thought that the Centre would appoint someone more dovish and amenable to demands from various stakeholders.

But Patel’s past record gives an insight as to why the Centre has gone for the man who has been the RBI Deputy Governor since 2013.

Prior to his appointment to deputy governor, Patel worked with the Boston Consulting Group, Reliance Industries and IDFC. He has previously held positions in the IMF, served as an adviser to the RBI (and worked as a consultant in the Finance Ministry. He holds an M. Phil degree from Oxford University and a Ph.D from Yale University.

Patel spearheaded the committee that recommended the current flexible inflation targeting (FIT) monetary policy framework. As the chairman of the committee, Patel clearly supports flexible inflation targeting in India. Patel has been supportive of the Centre's proactive food supply management in controlling food inflation despite weak monsoons (in 2014 and 2015) and that the change in the government's expenditure policy towards alleviating supply side constraints in infrastructure will create incremental disinflation.

More recently, he stated that, while the RBI would be watchful that ongoing stickiness in core CPI inflation does not "set a lower bound to the disinflation process", he believes that weak rural wage growth should create downward pressure on services sector inflation.

"Given his preference for positive real interest rates and his fiscal conservatism, he is generally perceived as hawkish. However, it remains to be seen whether the RBI under his governorship would be as rigid about attaining the CPI inflation mid-point of 4 per cent," said analysts at Nomura.

On banking system

Patel has not spoken much about the banking system but he has highlighted the need to examine the metrics for effective lending. In a speech made in January 2015, he had spoken about the need for banks to revisit the individual company/group credit exposure limits, as well as sector exposures as part of better risk management practices.

Approach to liquidity

According to RBI insiders, he supports the liquidity framework introduced by the RBI in April 2015, under which the RBI has proposed to move from a structural deficit of around one per cent of NDTL to a position of broad neutrality over a period of 1-2 years.

In his report on flexible inflation targeting, he proposed that the RBI should eventually transition from the repo rate (overnight policy rate) to the 14-day term repo as the primary operating rate.

Views on fiscal measures

Analysts say that Patel had opposed the expansion of government subsidies in both food and petroleum products under the previous UPA government.

"He believes that the setting of minimum support prices, programs such as MGNREGS and the National Food Security Act can set off a wage price spiral, increasing the burden on monetary policy to lower inflation," analysts at Nomura said.

In his report on flexible inflation targeting, he stated that the central government must reduce its fiscal deficit to three per cent by FY17 (current target is 3.5 per cent) and commit to eliminating administered setting of prices (MSPs) and wages (MGNREGS) for successful inflation targeting.

The key difference though would be the communication style. Compared to the rock-star image of Raghuram Rajan, Patel has maintained a low profile and is known as man of few words. But now as the boss of RBI, perhaps, that is one thing that will change.

2. SBI merger with associates, BMB exempt from CCI approval

PTI

State Bank of India (SBI) will not need fair trade regulator Competition Commission of India (CCI)'s approval for merging 5 associates and Bhartiya Mahila Bank (BMB) with itself, a move that will create a global sized bank with an asset base of Rs 30 lakh crore.

The acquisition is exempt from the approval of CCI under the Competition Act 2002, sources said.

As per the amendment to the Competition Act, consolidation in the banking sector space is exempt from the approval of CCI, sources added.

Last week, the board of SBI approved scheme of merger of five associate lenders State Bank of Bikaner & Jaipur (SBBJ), State Bank of Mysore (SBM), State Bank of Travancore (SBT) and Bharatiya Mahila Bank (BMB) with itself while protecting the interest of the existing staff.

The consolidated entity will add Rs 8 lakh crore (about USD 120 billion) to SBI's assets and consolidated entity will get catapulted into the top 50 banks globally.

The bank has taken a big step towards the first-ever large scale consolidation in the Indian banking sector by deciding to merge all its associate and BMB to create a banking behemoth with a network of more than 24,000 branches, 2,70,000 employees and total assets of Rs 30 lakh crore, an increase of 36 per cent.

Second-largest lender ICICI Bank post this merger will be almost one-fourth of SBI, in terms of total deposits and advances, it said, adding the mergers will catapult the bank into top 50 banks globally and is in furtherance of the bank's mission statement to be of service in the remotest parts.

As per the merger proposal, SBBJ shareholders will get 28 shares of SBI (Rs 1 each) for every 10 shares (Rs 10 each). Similarly, SBM and SBT shareholders will get 22 shares of SBI for every 10 shares.

There will not be any share swap or cash outgo as SBH and SBP are wholly-owned by the SBI.

In case of Bharatiya Mahila Bank, 4,42,31,510 shares of SBI will be swapped for every 100 crore shares of face value of Rs 10 each.

SBI first merged State Bank of Saurashtra with itself in 2008. Two years later, State Bank of Indore was merged.

3. Punjab National Bank makes locker visiting facility free

PTI

In a customer-friendly move, public sector lender Punjab National Bank (PNB) has made locker visiting facility free for its customers. Earlier, the customers were allowed 12 free visits at lockers in a year.

Now, the PNB locker holders can make any number of visits in an year without paying any additional cost. The new rule has been put in place since August 1, 2016. "It is a customer-friendly move. The new rule has been put in place so as to encourage customers," a bank official said.

"With this, PNB has become the first public sector bank to make locker visiting facility free for its customers," the official added.

PNB used to charge customers Rs 50 per visit after the limit of 12 free visits in a year. Banks in general charge customers to visit lockers beyond a permitted level in an year. "We are getting a very good and positive response from our customers. Particularly, the women customers are really happy with the free locker visit service," the bank official said.

As per PNB locker operational guidelines, a high risk lessee is required to operate the locker at least once in an year while medium risk lessee at least once in three years. "Non-operation of locker within the stipulated period may lead to breaking open of locker, irrespective of the fact that rent is paid by locker hirer regularly," PNB said.

Business Standard

4. Move to change RBI governor ranking

FinMin proposes to treat the rank of Rajan's successor as principal secretary

Subhomoy Bhattacharjee

A move is afoot to change the ranking of the Reserve Bank of India governor to the level of principal secretary in the central government's protocol order, after Urjit Patel assumes office.

A senior government official said the finance ministry had prepared such a plan. The governor currently has the rank of a Union minister of state, a position no other regulator holds.

Accordingly, the four deputy governors, who now hold the rank of secretary, will also slip down the hierarchy by a notch.

The official said this has become necessary as the governor's selection has been institutionalised through a Cabinet secretary-led process. Patel was shortlisted by the Financial Sector Regulatory Appointments Search Committee, chaired by the Cabinet secretary, though the final appointment was made by the Appointments Committee of the Cabinet, chaired by the Prime Minister.

Minister of State for Finance Santosh Gangwar informed Parliament in a written reply last month that from now on, "The committee will recommend names for appointment of chairperson and members of financial sector regulatory bodies, including those of the governor and deputy governors."

It is difficult for a government panel to shortlist or conduct interviews for officers who will be senior to them by rank, the official said.

The finance and home ministries have been considering the change for some time but had decided to delay taking a decision. The proposal has finally been made. The change will not entail any amendment to the RBI Act and can be done by issuance of executive orders by the ministry of home affairs.

The proposed change is also in line with the view of the central government to not offer a minister-level position to any officer. There was internal debate on whether National Security Advisor Ajit Doval and Arvind Panagariya, the deputy chairman of NITI Aayog, should get the rank of a minister. It took considerable time for the NSA to be accorded the rank of a minister of state and the deputy chairman of a Cabinet minister. It was only in June 2015, a full six months after the NITI Aayog was set up, for Panagariya to finally get the full rank of a cabinet minister that allows him to attend all cabinet meetings as a special invitee.

Rajan had argued with the government to maintain the position of the governor equivalent to that of a Cabinet minister, like the NITI Aayog chairman, and that of the deputy governor to ministers of state.

The official also said a change in the rank of the RBI governor could also smoothen relations in the regulatory architecture of the financial sector. Due to the higher rank of the RBI governor, it became difficult for the chiefs of the other regulatory bodies – of the markets, insurance and pension sectors -- to participate as equals in the deliberations of the financial sector development committee, he said.

5. Urjit Patel: The 'known unknown'

The RBI governor-designate may be economical with spoken words, but is known for his sharp and critical writings

Anup Roy

“Known unknown” is an integral part of central banking lingo. Urjit Patel’s public persona fits the category perfectly. In the three years-plus that he has been a deputy governor at the Reserve Bank of India (RBI), not many know about his views on matters outside monetary policy and inflation. And in that too, Patel has always remained economical with his spoken words. There is hardly any Patel interview, and one has to stretch really hard to figure when Patel’s last public engagement outside the policy platform was.

The easiest conclusion to draw could be that his appointment indicates the Modi government’s preference for people who keep their heads down, work quietly and don’t make waves in the media, unlike Raghuram Rajan, who more often than not embarrassed the government through his public speeches.

Besides, Patel matches Rajan’s intellectual heft and is also the man behind RBI’s monetary policy framework that set the inflation target at a central point of four per cent (with a two per cent band), which is now the policy plank for the central bank and the upcoming monetary policy committee.

Rajan and Patel both are around the same age, 52-53, and have the same hawkish stance on inflation. Besides, they have worked very closely. They tweaked the liquidity framework several times, trying to force banks to pass on rate cuts or even develop a term repo market. Patel’s work on real interest rate is something that Rajan has endorsed several times in his addresses and, in fact, the RBI governor has also used the real interest rate argument several times to squash his critics. Their positions about the exchange rate are also in harmony.

But they are complete contrasts in character.

Or, are they? For, what Patel lacks in expression, he more than fills up with his uncomfortably sharp and critical writings. And his criticisms are potent enough

to initiate a series of course corrections by the government. No less than then Prime Minister Manmohan Singh wrote to the home ministry, "He is very important for the country," when Kenya-born Patel applied for an Indian passport in 2013 to become the deputy governor at RBI.

Patel's appointment at RBI, under D Subbarao, surprised many, considering a biting report that he authored with late Gangadhar Darbha just a year earlier, in January 2012. The Brookings report heavily criticised RBI and Subbarao for giving a quiet burial to the medium-term objective of around three per cent inflation. "... what is clear is that persistence of elevated inflation is agreeable to some policy makers. The authorities want to take credit for India's growth performance but stay blameless on the price front — a case of heads I win, tails you lose!"

Or, sample this criticism of Subbarao for stating most of India's inflation was supply-side driven and monetary policy had limited scope for driving it down. "This is an astonishing series of nihilistic statements — unassisted by evidence or even a hint of scientific thoroughness — from the central bank head pleading either hopelessness on account of India being a large and diverse Federal entity, or, a form of muddled eclecticism," wrote Darbha and Patel.

It is safe to assume then that Patel could spring a surprise and turn into a stauncher warrior on central bank autonomy than all the previous governors. As Thomas Bookmakers, director, Asia-Pacific Sovereigns Group, Fitch Ratings, said, "A central bank governor doesn't need to have a rock star status to be successful in reining in inflation or cleaning up the banking sector."

Those who work with him know he has a sharp sense of humour, but not for public expression. In fact, it needs some prodding by others to get to know about Patel's lighter side.

Sample this: In the third-quarter monetary review for 2013-14, when a reporter asked the governor to explain why the policy action was hawkish while the guidance was dovish, Governor Rajan answered the question citing an analogy by Patel. "I think Urjit had a fantastic description, we are neither hawks nor doves, we are actually owls. Urjit would you like to elaborate?" asked Rajan.

"Well, an owl is traditionally a symbol of wisdom, so we are neither doves nor hawks but owls and we are vigilant when others are resting," replied Patel.

Many say as RBI governor, Patel will have to be more voluble on that wisdom as communication is now one of the most important transparency measures to gauge a central bank. The first task before Patel after becoming the governor will be to soothe the nerves of the market by talking and assuring at the time of FCNR (B) redemptions between September and November.

Patel's familiarity with Prime Minister Narendra Modi goes back to early 2000 when he worked as a member of the board (and chairman of the audit committee) of Gujarat State Petroleum Corporation Ltd. He got his Doctorate from Yale University in 1990 and M Phil in economics from Oxford University in 1986.

Unlike other RBI governors of the past, Patel has a hands-on view on the corporate sector, having worked as the president for business development at Reliance Industries Ltd in 2008 and 2009. His responsibilities in that position were to assess macroeconomic risks for overall business envelope, and strategising commercial approaches for hydrocarbon energy companies of

climate

change-mitigation

policies.

In 2006 and 2007 he was the non-resident India Economics Fellow at Brookings Institution, Washington, DC, but could not take up a full-time resident fellowship "due to family reasons," Patel's resume reads.

He was also instrumental in forming the Infrastructure Development Finance Company Ltd (IDFC) and served as its executive director between 1997 and 2006. He has worked in key government departments of the finance ministry and closely worked with RBI much before he joined the central bank.

Patel is remembered by old-timers for backing India aggressively during the reforms period in 1990-92 when he was at the Economist Program for the International Monetary Fund (IMF), working on the US, India, Bahamas and Myanmar desks. He was later given the responsibility of being the deputy resident representative of the IMF in India between 1992 and 1995.

6. RBI's Patra, IMF's Kochhar likely candidates for Dy governorship

The RBI governor can select his team

[Abhijit Lele](#) | Mumbai August 22, 2016

The widely expected policy continuity when Urjit Patel takes over as governor of the Reserve Bank of India (RBI) will reflect in the new team he will put together.

For Patel, being part of RBI means having a ready working arrangement with those at the helm, be it monetary policy or banking supervision and regulation. Senior RBI executives said as a colleague has been elevated, there was a high chance of continuity.

The RBI governor can select his team. But the continuity factor, touted as the reason for Patel being made the head of the central bank, would weigh on his mind while selecting a team, an official said.

First, a replacement for Patel has to be found. The name of the chief of the monetary policy department, Executive Director Michael Patra, is doing the rounds. Patra fits the government's preference for people who can work quietly without making waves. The other name doing the rounds is that of Kalpana Kochhar, a senior economist with the International Monetary Fund. Between 2012 and 2014, she was deputy director in the strategy, policy and review department. Between 2010 and 2012, she was the chief economist for the South Asia Region of the World Bank.

A senior public sector bank executive said given the close engagement with banks to clean up their books by March 2017, the priority would be to stay on course than experiment.

7. Government may nominate 3 MPC members this month

After appointing Urjit Patel as the next RBI Governor, the government is now expected to finalise the names of three members to the interest rate setting panel MPC in the next few days.

By: [PTI](#)

The government nominees to the MPC have been shortlisted by a Search-cum-Selection Committee headed by the Cabinet Secretary with RBI Governor and Economic Affairs Secretary and three experts in the field of economics or banking or finance or monetary policy as its members

The decision is expected in the next few days or may be in the beginning of the next month, sources privy to the development said.

The next bi-monthly RBI policy, scheduled on October 4, will be decided by the Monetary Policy Committee (MPC).

The MPC was set up by amending the Reserve Bank of India Act, 1934, through the Finance Bill 2016. Under this new system, the RBI Governor is ex-officio Chairperson.

Besides, RBI Deputy Governor in-charge of the monetary policy and an office bearer of the Central bank are the other two members in the committee.

Since Urjit Patel has been elevated as the next RBI Governor, the monetary policy department has to be looked after by any of the three deputy governors till the appointment of the fourth regular Deputy Governor.

So, even if the appointment takes time, the MPC can continue the work with regard to setting up interest rate to meet the inflation target fixed by the government.

Under the agreement with the government, RBI is committed to anchoring retail inflation at 4 per cent (plus/minus 2 per cent) and has set itself a target of 5 per cent by next March as part of a 'glide path' to achieving the median mark.

The Governor will have a casting vote once the country shifts to the panel system.

"The MPC is a fundamental institutional reform which modernises our monetary policy framework and builds a strong platform for a strong and sustainable growth," RBI Governor Raghuram Rajan had said while announcing his last policy review earlier this month.

Its collateral benefits besides lower inflation will include stable currency and higher real interest rates, he had said.

Rajan, in his last policy review, had said that it will most likely to be the final one done by the Governor as the Monetary Policy Committee (MPC) will take over from the next policy announcement scheduled for October 4.

The government has already started the process of finalising three members for the panel, while the RBI has nominated executive director Michael Patra to be its nominee on it, in addition to the Governor and the Deputy Governor in-charge of the monetary policy department.

As per the norms for MPC, each member shall have one vote and in case of a tie, the RBI Governor shall have a casting vote. Presently, the Governor has overriding powers to accept or reject the recommendation of RBI's panel on monetary policy.

Members of the MPC will be appointed for a period of four years and shall not be eligible for reappointment.

The idea of setting up an MPC was mooted by an RBI-appointed committee led by deputy governor Urjit Patel in February 2014. Though it had recommended a five-member committee where three members would be from RBI and two

external members would be appointed by the RBI governor and the deputy governor in-charge.

It was also suggested that the governor should have a casting vote in case of a tie.

8. Is rupee volatility about to spike? Hard to see RBI MPC cutting rates

The volatility of the rupee has been subdued for some time now, with its long-term average hovering at a 10-year low of around 5%. Governor Rajan has made it clear that he believes keeping volatility low will...

By: Jamal Mecklai

The volatility of the rupee has been subdued for some time now, with its long-term average hovering at a 10-year low of around 5%. Governor Rajan has made it clear that he believes keeping volatility low will help stabilise inflation and he has been acting on this belief. While there is little hard evidence for this belief—inflation in the Eurozone and Japan are extremely low despite average volatilities exceeding 10%—the important question is how much longer rupee volatility can remain so low.

As is well known, volatility is cyclical and the longer it stays low, the closer it gets to a turning point. Historically, whenever rupee volatility fell below 5%, the percentage play was to buy dollars, even factoring in the forward premium; while the rupee did not always fall as much as the premiums, it generally fell enough to make a profitable trade.

With a change of helm at RBI and, importantly, the structural change of monetary policy decisions being taken by the new Committee, it is likely that the iron hand that was needed to keep this natural cycle from expressing itself could weaken, which suggests that, sooner rather than later, rupee volatility will start to rise. And, as always, there are innumerable real world factors that will explain this after the fact.

Currently, the rupee remains underpinned by a steady improvement in consumer sentiment over the past few months—I note the increased thickness of the daily newspapers, the obviously good monsoon and even some glimmers of energy in the till-recently moribund art market. Business sentiment, which naturally lags consumer sentiment, is looking curiously at all this, but corporate investment still seems a way off, as deleveraging continues to be the name of the game. So, too, export growth, which turned negative after flattering to deceive for one month, will keep corporate sentiment circumspect. Exports have declined in 17 of the last 18 months, and while it is not that different for most other competing countries, it would be hard to make a case for stepped up investment in the face of still weak global growth. And finally, while it is great that banks have been compelled to bite the bullet on NPAs, the fact that they are proudly reporting a “decline in the rate of increase of NPAs” suggests this element still has at least a few quarters to go before it can bring its energy into the game.

In all this, inflation is already showing signs of life, with both the CPI and WPI rising sharply last month. And while much of this is related to food inflation, the reality of higher consumer sentiment and muted investment sentiment would shift the supply/demand equation further in the direction of higher prices. Again, the jockeying around GST will certainly increase some prices while reducing others. In this volatile mix, it is hard to see the new MPC jumping to cut rates early, as some are hoping.

The good news, however, is the improving transmission through the bond market which is bringing borrowing rates down for at least the top end borrowers. This could reduce the attractiveness of rupee yields to foreign investors, who, in any case, have not been hot on Indian onshore debt so far this year.

This could be because of the strong, steady growth in global equities. Last week, all three US indices (the Dow, the NASDAQ and the S&P500) hit all-time highs on the same day, the first time that has happened since 1999, right before the dot-com crash. The beyond abundant global liquidity—with the Bank of England the latest to further open the spigot—continues to support equity prices at what many feel are significantly overvalued levels, but we haven't yet got to the "irrational exuberance" point. It is well known that equities explode higher (or collapse lower) before a major turning point, and, given the general unhealthiness of negative interest rates, there must be an at least even chance that we are on the cusp of a huge equity rally before markets really collapse.

While the dollar has been looking indeterminate buffeted by fluctuating statistics and fears about the global economy, gold is holding steady above \$ 1,300. Oil and other commodities are showing signs of a possible rebound. This could, in the best case, be signaling improving global growth, but these markets could also attract investor money once it becomes clear that equities have peaked.

The nature of markets means that all this could take two weeks, two months or two years. The quicker this long-impending cloud works its way out of the system, the better it would be for everyone, particularly India, where it would clear the way for lower interest rates, a weaker rupee and a slow but inexorable pick-up in domestic investment.

With kind regards,

Yours Comradely,



(N. GOVINDRAJULU)
GENERAL SECRETARY