<u>Vasant Vyakhyanmala 2018</u>

Indian Economy & Role of Banking Industry

A very good evening to one and all who are present here today in person or shall read about or listen to this event through other modes of communication.

I am extremely humbled to be given this opportunity to stand before you on this most coveted public speaking platform which has carved out a distinct place for itself with its rich legacy of 144 years in the city of Pune.

I salute the founders like Justice M.G.Ranade, Tilak and others and thank the present day organizers for inviting me as a speaker today on the concluding day of this month long Vyakhyanmala.

Over the last 29 days, a series of great thinkers, management experts, successful social workers, bureaucrats, economists and opinion makers have enthralled the audience of this iconic town hall.

Banking is an integral part of the overall financial system which also includes, insurance, capital market, mutual funds, NBFCs, Micro finance institutions, chit funds, foreign exchange etc. So all the monetary transactions between people, organizations and countries are captured by the banking system in some form or the other. Rightly so, therefore, the financial system in general and banking industry in particular is called as the backbone of any economy

The ancient philosophy of our country has given us the dictum of “*Vasudhaiva Kutumbakam*”, which means the whole world is one family. Even the eight millennium developments goals of the United Nations, are universal in nature and can be achieved without any boundaries and barriers.

The eight goals are:

1. Eradicate extreme hunger and poverty.

2. Achieve universal primary education
3. Promote gender equality
4. Reduce child mortality
5. Improve maternal health
6. Combat HIV/AIDs, Malaria
7. Ensure environmental sustainability and last but not the least
8. Develop global partnership for development.

If these goals are country agnostic, then why this world is divided into nations and why economy has taken prominence over the country or the nation. Why every economy is pursuing everything but these basic goals. I think economics plays the key role.

The study of economics starts with the study of human wants and means to satisfy these wants. Human beings have unlimited wants but the means to satisfy these wants are limited and the limited means or resources have alternate uses which leads to the problem of choice, both by the consumers and producers who create demand and supply for various goods and services, and the market decides the prices based on the equilibrium of the demand and supply of the commodity exchanged. And the prices are expressed in terms of monetary medium of exchange i.e. money or currency which can take any shape like a coin, note, cheque, bill of exchange, Debit Card, Credit Card, Letter of Credit, Bank Guarantee, LOU or LOC or Bitcoin or JPmiles etc.

So the study of economics is the study of wealth which is stored in various good and services which every economy wishes to possess and maximize with the given availability of resources i.e. the various factors of production. Income, consumption, savings and investments are like four wheels of the economy. The fiscal and monetary policy are the twin levers to manage the four wheels cited above. While the fiscal policy controls the supply side, monetary policy control the demand side.

It is against this broad canvas of fundamental concepts of income, consumption, savings and investments that I will speak about our country's economic growth and role of banking system.

The Indian economy has covered a good amount of gap on the scale of development moving from being called an underdeveloped country to developing country to emerging marking economy. Today India is seen as the fastest growing economy recording a quarterly growth rate of 7.2% p.a. for December 2017 against China's 6.80%. At nominal GDP of US $ 2.6 Trillion, India is the sixth largest economy after US, China, Japan, Germany & U.K In terms of purchasing power parity, we are the third largest economy with GDP of US $ 9.5 Trillion. While the last five year's average GDP growth is seen at 7.2%, the expected growth during 2018-19 is pegged at 7.4%.

A sustained high GDP growth has been achieved through a variety of factors driven through fiscal as well as monetary policy. As far as fiscal discipline is concerned, the economy has managed to bring down its fiscal deficit to 3.5% with a promise to take it to 3% in three years' time. The debt to GDP ratio is brought under 50% with a promise to bring it down to 40% by 2024-25. For the second most populous country with 1.35 billion people, attaining such fiscal prudence is not an easy task. However, the government has shown the commitment to comply with the guidelines of Fiscal Responsibility and Budget Management Act. During last four years till FY 18, the total revenues have grown by 50% whereas the total expenditure grew only by 39%. On the three major items of expenditure i.e. interest payments, pensions & subsidies, the rise in expenses was still lower a 30%.

The GDP growth is mainly influenced by the year-on-year volatility in agriculture sector. During last four years, Agriculture sector growth has oscillated from -0.2% in 2014-15 to 4.9% in 2016-17. The sector-wise average growth between 2014-15 and 2017-18 has been 1.19% in Agriculture, 6.60% in Industry, 8.90% in Services and 6.50% overall GDP

Govt. has taken a series of steps to bring stability and sustainability of farm incomes which are aimed to be doubled by 2022. Every year, the budget provides funds for various schemes for improving rural roads, markets, insurance of crops, institutional finance, minimum support prices, support to food processing units, setting up food parks, tax rebates for farmer producer companies and farm mechanisation. However, the task is daunting. The dependence on rainfall, non-institutional sources of credit, lack of storage and processing facilities and sub-division/ fragmentation of land holding always make the farmers a vulnerable lot with adverse terms of trade. A co-ordinated approach and support from all the stakeholders is required to realise the dream of doubling farm incomes by 2022. Banking industry is playing a vital role as far as provision of production and investment credit is concerned but when the farm loans are not repaid and not rolled over, it creates difficulties for banks, the State Govt. and the farmers at large.

The Industry sector which contributes 31% to GDP is growing at 6 to 7% p.a. is also getting lot of attention be it the core sector like mining, ,steel, cement, energy or infrastructure sector like roads, ports, railways, telecom or the MSME sector. The Govt. has been giving various incentives to different sets of industries or regions in terms of preferential land allocation, tax breaks, duty drawbacks, labour reforms, technology upgradation support, capital and interest subsidies, reservation for SSI, single window clearances, etc. The make in India, Stand-up India, Skill Development programme, MUDRA, UDAY, changing the definition of MSME are very supportive steps to promote faster industrialisation and employment generation.

Some of the constraints, the industrial sector has faced are labour market rigidities, infrastructure bottlenecks, lack of PPP ventures, higher cost of institutional finance, lack of R&D expenditure, lack of stable policies of & tax structure. Many of these bottlenecks are being addressed by the Govt.

I cannot stop mentioning the two most important steps i.e. Demonetisation and GST which attracted the attention of whole world. International Rating Agencies, World Bank, IMF everyone praised the bold step and said it will be growth positive in the long run. In a recent report dated March 11, 2018, IMF said Indian economy is recovering from disruptions caused by demonetisation and GST. The reforms in other key sectors like education, health & banking are also appreciated by IMF. A study conducted by NCAER has suggested that GST alone can push up the country's GDP by 1 to 1.5%. A sharp jump of 38 points from 138 to 100 on Ease of

Doing Business rankings is a testimony of the success of industrial sector reforms ushered in by the Government.

This is not to suggest that we as a country have arrived. But the direction of change and pace of change gives lot of optimism and one can look forward to more reforms in the years to come.

The Service sector which comprises IT Services, construction, hotels, shipping, banking, insurance, health has always been in the forefront as far as its contribution to GDP and GDP growth is concerned. Growing at around 9% p.a., it contributes more than 52% to the GDP. The Nikkei India purchasing managers' index has jumped from 47.80 in February to 50.30 in March 2018. The services sector has a huge potential for growth and employment as can be gauged from the amount of FDI India is attracting in this sector especially telecom, e-commerce, insurance, healthcare, hospitality, transport and real estate industry.

All in all, Indian economy is poised for a high growth trajectory and moving fast towards becoming third largest economy in 10 years' time. This growth in real economy would have not been possible without a strong and stable financial system which withstood various financial crises faced by other countries like US, Russia, Japan, Greece, South East Asia or Latin America. Nationalisation of major banks in 1969 and 1980, tight policy on bank licensing, strict regulatory regime, high statutory pre-emptions, withholding the full Capital Account Convertibility and a tight supervision and control by RBI, SEBI, IRDA & PFRDA have all enabled the country's financial system to stand firmly on its ground.

Though the Indian banking industry is as old as 250 years, 20th July 1969 marks a turning point when 14 major private banks were nationalized to sub serve the needs of agriculture and rural development on one hand and industry and exports on the other. Between 1969 and 1995 public sector banks scaled commanding heights taking banking facilities to every nook and corner of the country. Trust was the hallmark of banking and bank frauds or defaults were exceptions rather than the rule.

Two three events around early and mid-nineties changed the shape of Indian banking industry. The economic reforms of 1991 were closely followed by banking sector reforms which were based upon the recommendations of Narasimham

Committee. For the first time, international norms of Capital adequacy and Income Recognition - Asset Classification were introduced. The impact was so high that 14 out of 20 banks reported losses in 1993-94. Public Sector Banks were encouraged to make IPOs of their shares. RBI also issued new banking licences to ICICI, HDFC, Axis, Global Trust, IndusInd Bank. And the third major event was the introduction of core banking technology. These three reforms namely introduction of new technology, entry of private sector banks and regulatory reforms by RBI put the banking industry on a higher growth trajectory.

The past two decades upto 2017-18 have been quite eventful. There have been structural changes, technology changes, market segmentation with a sharper focus on retail, rapid growth of core industries, road, telecom, power, textiles, growth of NBFCs and Micro Finance Institutions, external commercial borrowings, buyers credit and borrowing through CPs. Today we can say that we have witnessed the <u>rise and fall</u> of many a players including public sector banks, private sector banks, business conglomerates, export houses as well as distress in the MSME and agriculture sector.

The Reserve Bank of India, as a regulator, also has been a witness to this roller coaster of the Indian banking industry and has brought about a series of strict measures to contain the contagion or insolvency of banks. Strict implementation of BASEL III guidelines, early recognition of NPAs, withdrawal of all restructuring schemes, pushing weak account to NCLT, weekly reporting of daily default, penalizing banks for non-compliance of Master Directions and putting 11 banks under the framework of Prompt Corrective Action are some of the important measures which are today routinely discussed in business newspapers and TV Channels.

The Govt. of India, being the owner of Public Sector banks, has also taken a large number of steps to strengthen public sector banks and bring about socio-economic change through financial upliftment of the masses. Some of the noteworthy actions are as under:

1) <u>Financial inclusion</u> which the present Govt. is implementing, is an extremely exemplary effort to focus on the bottom of the pyramid. Starting from opening

a basic savings bank account of every adult in every household, to provide a Rupay Card which comes with insurance of Rs.2.30 lacs, transferring all the subsidies directly to the beneficiary's bank account, providing an overdraft loan facility, covering every willing account holder under insurance and pension schemes at affordable rates (PMSBY & PMJJBY), making available Mudra loans, Fasal Bima cover, SHG funding. The list is endless. No other country today can boast of such a massive financial inclusion programme on such a large scale which is monitored directly by the DFS on a weekly basis. Banks in general and public sector banks in particular are playing a critical role in this socio-economic metamorphosis.

2) <u>Resolution of Bad Loans –</u>

After the so called policy paralysis and outbreak of various scams around 2013-14, there was an abrupt halt of many large projects in Road, Ports, Mining, Steel, Telecom and Textiles sectors. Simultaneously RBI withdrew the umbrella of financial forbearance and started wielding the stick of Asset Quality Review (AQR). The natural outcome of this double whammy has been a sudden spurt in NPAs especially in Public Sector Banks. The Gross NPAs of Banks surged from a low of Rs. 2.5 trillion in December 2013 to Rs. 8.40 Trillion by September 2017.

While the Regulator cracked the whip by invoking PCA on half of the PSBs, the owner got busy in finding solutions for the problem. It started with holding meetings with the Bankers and borrowers in high level fora headed by Govt. officials right up to Secretary level in various ministries. Then the DRTs were strengthened and lastly a very bold step was taken to introduce the Insolvency & Bankruptcy Code. As per the latest report more than 9000 cases are registered with NCLT which is mandated to conclude the Insolvency process in maximum 270 days. This step is going to be a game changer for banks and corporate world.

3) <u>Recapitalization of Public Sector Banks. :</u>

A natural fall out of surge in NPAs was, increasing provisions for the bad loans and mounting losses which eroded the net worth of many PSBs. Realizing the critical position of Banks and their need to maintain minimum capital adequacy, the Govt. look yet another bold step to infuse Rs. 2.11 Trillion of equity capital into various Banks. This capital infusion has literally proved to be the proverbial stich in time. But for this timely support, many a PSBs would have slipped on their CRAR numbers.

Looking at the above two most important policy interventions followed by massive capital infusion, one can only say that the Public Sector Banks have been compensated or supported for the role they have played in the socio–economic transformation of the country over the past 47 years. But the agenda is incomplete and PSBs will have to get up and start running with renewed vigour and wisdom. There is enough stimuli for them to reform due to tough competition from Private Banks, NBFCs, MFIs and Fintechs on one hand and fast changing tastes and expectations of the customers on the other. Every Bank is working hard on new strategies and leveraging of technology which will be vetted by the Banks' Board of Directors. Public Sector Banks need a complete overhaul in terms of their business model, a model which takes care of business risk, in a cost effective and capital efficient manner. The customer today is willing to pay the price provided he gets service at his place of choice, at a time convenient to him, and at his desired speed.

While I have elaborately discussed the <u>present state</u> of the economy and banking, we are sitting at the tipping point of rapid transformation of the economy. Banking will continue to be the key carrier of this change, if not the driver. Ten years down the line, we may not need brick and mortar branches or ATMs but we will continue to have banking The block chain technology, crypto-currencies , high speed data network, mobile technology, internet of things, machine learning, crunching of travel times between cities, countries, continents and may be planets, will produce highly intelligent business models with its attendant risks and pain points. As one says, Change is the only constant. The journey of transformation and evolution will continue. There will be failures along the journey. But as Winston Churchill has said, <u>success is going from failure to failure without losing the enthusiasm</u>. The country may not have financial capital but certainly has huge untapped intellectual reservoir.

If we worship Ma Sarswati, Ma Laxmi cannot be far behind in showering her blessings.

As I conclude may valedictory address, I thank each one of you for your patient audience. I thank Dr. Tilak for organizing 144th edition of Vasant Vyakhyanmala.

Ethe upasthit sarva bandhu bhagininche manapasun aabhar and abhinandan.

Dhyanyavaad.