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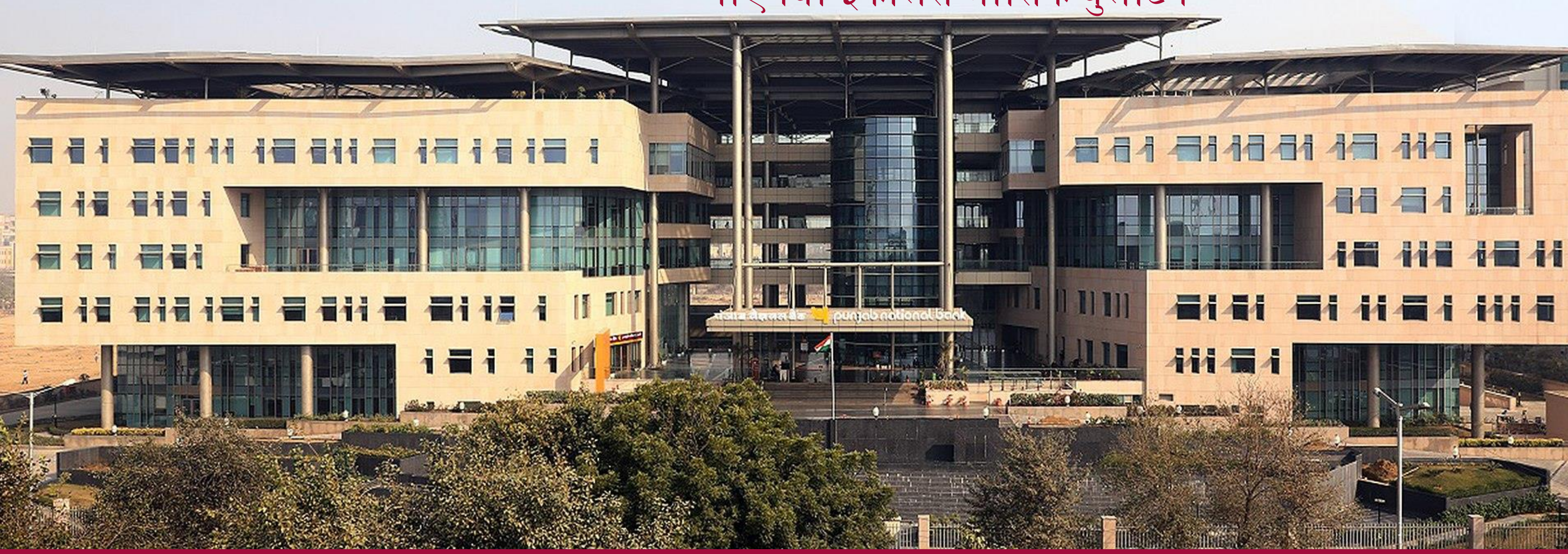

STRATEGIC MANAGEMENT AND ECONOMIC ADVISORY DIVISION

कार्यनीति प्रबंधन एवं आर्थिक परामर्श प्रभाग

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पंजाब नैशनल बैंक
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New Digital Lending Norms-Hope and Scope

In today's time, digital lending has become the buzzword and gained popularity among new-age users due to easy availability of smartphones, credit range flexibility and faster online transactions. In Digital Lending, lending is done through web platforms or mobile apps.

With the growing size and increasing popularity of the market, there was an urgent need to regulate the same in order to keep the faith of the customers alive. In this direction, the framework for regulating the digital lending has been devised to eliminate the constraints such as unchecked third parties commitment, mis-selling, breach of data privacy, no set rules and regulations for business conduct, unreasonably high rate of interest, etc. These guidelines are announced based on the recommendations of the Working Group on 'Digital Lending including lending through online platforms and mobile apps' (WGDL) constituted in January.

The prime purpose of the regulations is transparency while conducting operations so that the trust of the customers is not breached. RBI has mandated that the lending must be carried out by the Regulated Entities (REs) or have a permission to operate under a relevant law. Further directive for execution of all loan disbursals and repayments directly between the bank accounts of the borrower and the REs eliminates need for the pool account of the Lending Service Providers (LSPs). Also, the requirements for informing the borrowers in a standardized format about the fees, charges and annual percentage rate (APR) will ensure that the users have better understanding of the market conditions and help borrowers make informed decisions. The new set of rule also forbids LSPs to raise the credit limit without the consent of the customers. Amongst many other regulations institutionalized include digital loans to come with a cooling-off/ look-up period during which borrowers will have the option to pay the principal and the proportionate APR without any penalty and lending being sourced through Digital Lending Apps (DLAs) to be reported to Credit Information Companies (CICs) by Regulated Entities irrespective of its nature or tenor.

RBI under new regulations, has mandated appointment of a grievance redressal officer. The ecosystem would also fall under the purview of the RBI's Integrated Ombudsman Scheme (RB-IOS) if the grievance is not addressed within 30 days of receipt.

All said and done, in view of the immense potential in the digital lending space and its growing importance especially after pandemic, these were much awaited. There has been increasing trend of acquiring technology even amongst traditional banks and non-banking financial companies (NBFCs) for digitizing the processes like customer onboarding, risk assessment, loan underwriting, disbursement, and repayment in order to reduce operational costs which has also clearly outlined the need for having norms for conduct. These much-awaited regulations are all set to smoothen the operations, promote fair practices and win customer trust in the digital lending ecosystem to ensure a healthy and sustained growth of the sector. This will also provide superior customer experience and also pave way for secured environment under digital lending.

Rajendra Kumar Saboo

Path of future rate hikes by RBI

Monetary Policy Committee (MPC) members voted unanimously last week to increase the policy repo rate by 50 bps to 5.40%, taking it significantly higher than the pre-pandemic level of 5.15%. Repo rate has been hiked by 140 basis points in last three months. Now that a frontloaded policy tightening has been implemented, what might the path of future rate hikes look like? Let's look at the following factors influencing the rate decisions.

Inflation

India's retail inflation moderated to 6.71 per cent in the month of July, down from 7.01 per cent in the month of June and substantially low from the peak of 7.79% in April 2022. The decline is led largely by food inflation while the core inflation remains elevated and sticky.

The slowdown in consumer inflation for the third consecutive month suggests that the inflationary pressures, though elevated, are on a downward trend. Encouragingly, households' inflation expectations also improved in July reflecting the effectiveness of RBI and the government's efforts to tame inflation.

The increase in fuel inflation despite government measures to curb domestic petrol and diesel prices taken a few months ago, is a concerning factor. Though, some early signs of relief in inflation are visible in the near term due to easing commodity and crude oil prices, normal monsoons and improving reservoir levels, and easing global supply-chain pressures.

However, rupee depreciation which increases the import costs and the fall in crop yields due to uneven monsoon this year poses near term risk to inflation in India.

We expect inflation to remain elevated with a return to the sub-6 per cent level not likely before December 2022. We maintain our FY2023 average CPI inflation estimate at 6.5 per cent.

Similar to India, the consumer prices in US rose 8.5 per cent in July from a year ago, a slowing pace from the previous month due largely to a drop in gasoline prices. The peaks of inflation and Fed hawkishness are behind us. The next Fed rate hike is, therefore, likely to be 50 bps and not 75bps. This also increases the probability of a soft landing in the US.

Rupee vs Dollar

RBI's response to the falling rupee, among other things, depends on the policy view of the costs and benefits of a depreciating rupee.

One perspective is that a weaker rupee is an automatic stabilizer, easing some of the effects of domestic policy tightening, largely via increasing export competitiveness. Another view is that it may be futile to fight currency weakness, which is largely due to the dollar's strength.

Then there is the concern on imported inflation with a rupee depreciation. RBI research suggests a 5% rupee depreciation could increase domestic inflation by 20 bps and boost GDP growth by 15 bps via exports. The effects of these impulses will need to be factored into rate decisions.

Transmission of Rates

Among domestic factors, an important one is the transmission efficiency of repo and other short-term funding rates into lending rates.

Transmission of rates is expected to be much faster, with 44% of bank loans (as of March 2022) linked to external benchmarks. For some segments, particularly for MSMEs and home loans, this is much higher.

Faster transmission of rates will also work via deposits. With strong demand for credit, and reduced system liquidity, banks and other financial intermediaries will need to raise deposit rates quickly to mobilise funds. Issuance of short-term markets instruments like certificates of deposit (CDs) has already increased. The higher rates are will gradually spread to wholesale and retail fixed deposits. This will lead to an increase in rates linked to marginal cost of funds based lending rate (MCLR)-linked loans. Hence borrowing costs are going to rise quickly, which will offset the need for the rigorous monetary tightening by the RBI.

State of the Economy

The IMF has lowered India's economic growth forecast for the current fiscal to 7.4 per cent from the 8.2 per cent estimated in April. However, India will remain one of the fastest growing key economies globally in 2022-23 as well as 2023-24.

Several indicators suggest that the Indian economy is making resilient progress in Q1:2022-23 in spite of the drag from global spillovers, elevated inflation. An intense heat wave in major regions limited economic activity, despite which most of the high frequency indicators showed improvement especially in services sector activity.

The manufacturing PMI of India was at 8 month high at 56.4 in July. India's manufacturing sector witnessed an upsurge at its quickest pace in eight months in July owing to robust growth in new orders and output as demand continued to advance on the back of easing price pressures. The Indian manufacturing industry recorded a welcome combination of faster economic growth and softening inflation during July. The service PMI of India was also in expansionary mode at 55.5 in July.

India's monthly goods and services tax (GST) collection hit the second highest ever in July at Rs.1.49 lakh crores indicating that economic recovery remained firm as interest rates inched up. Other high-frequency indicators such as fuel sales, power demand, railway freight, and car sales also indicated economic strength.

This tightrope walk of policy tightening, balancing multiple objectives, will need calibrated management of system liquidity. RBI has, since September 2021, adroitly guided money market rates within the evolving monetary policy corridor and has signaled that these orderly movements will continue within the liquidity management framework.

Considering all the above factors, we expect the repo rate will tend to be at 5.75-6.25% bps by end of FY23.

Deepak Singh

(Deputy General Manager)

EXCERPTS : 3rd BI-MONTHLY MONETARY POLICY-05.08.2022

Highlights of the RBI's Monetary Policy announced on 05.08.2022 are given below:

A. Policy Rate	Rate	Change
Policy Repo Rate	5.40%	**50 bps↑**
Standing Deposit Facility (SDF)	5.15%	
MSF Rate	5.65%	
Bank Rate	5.65%	
B. Reserve Ratios		
Cash Reserve Ratio (CRR)	4.50%	No Change
Statutory Liquidity Ratio (SLR)	18.0%	

a. **Policy Rates and Stance:** The Reserve Bank of India's (RBI) monetary policy commission (MPC) voted unanimously to increase the repo rate by 50 bps. Rep Rate is at above pre pandemic level with the hike of 50 bps highest since August 2019.
b. **Stance:** Withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.
c. **Rationale:** inflation is projected to remain above the upper tolerance level of 6 per cent through the first three quarters of 2022-23 with the resilience back in economic activity.

i. Outlook for Growth and Inflation

GDP Outlook:

- Domestic economic activity remains resilient. Kharif sowing is picking up. High frequency indicators of activity in the industrial and services sectors are holding up.
- Urban demand is strengthening while rural demand is gradually catching up. Merchandise exports recorded a growth of 24.5 per cent during April-June 2022, with some moderation in July. Non-oil non-gold imports were robust, indicating strengthening domestic demand.
- Overall system liquidity continues in surplus, with average daily absorption under the LAF at ₹3.8 lakh crore during June-July.
- Money supply (M3) and bank credit from commercial banks rose (y-o-y) by 7.9 per cent and 14.0 per cent, respectively, as on July 15, 2022. India's foreign exchange reserves were placed at US$ 573.9 billion as on July 29, 2022.
- On the outlook for growth, rural consumption is expected to benefit from the brightening agricultural prospects.

- The demand for contact-intensive services and the improvement in business and consumer sentiment should bolster discretionary spending and urban consumption. Investment activity is expected to get support from the government's capex push, improving bank credit and rising capacity utilization. The projections are as under with risk evenly balanced.

RBI Projection GDP	Q1FY23	Q2FY23	Q3FY23	Q4FY23	FY23	FY'24
June Policy	16.2 %	6.2%	4.1%	4.0%	7.2%	-
August Policy	16.2%↔	6.2%↔	4.1%↔	4.0%↔	7.2%↔	6.7%

Inflation Outlook:

- June 2022 was the sixth consecutive month when headline CPI inflation remained at or above the upper tolerance level of 6 per cent.
- Looking ahead, the inflation trajectory continues to be heavily contingent upon the evolving geopolitical developments, international commodity market dynamics, global financial market developments and the spatial and temporal distribution of the south-west monsoon.
- Domestic edible oil prices are expected to soften further on the back of improving supplies from key producing countries and Government's supply-side interventions.
- Incidence of unseasonal and excessive rainfall, if any, can impact food prices, especially vegetable prices. Greater transmission of input cost pressures to selling prices across manufacturing and services sectors may also create fresh price pressures.
- Moreover, persistently elevated cost of living conditions could translate to higher wages and further price increases, especially if pricing power of firms strengthen.
- Taking into consideration these factors, the projections for the CPI Inflation with risk evenly balanced is as under:

RBI Inflation Projection	Q2FY23	Q3FY23	Q4FY23	FY23	Q1 FY'24
June Policy	7.4%	6.2%	5.8%	6.7%	-
August Policy	7.1%↓	6.4%↑	5.8%↔	6.7%↔	5.0%

ii. Liquidity Measures:

- The introduction of the standing deposit facility (SDF) in April 2022, which raised the floor of the liquidity adjustment facility (LAF) corridor by 40 basis points (bps), along with the policy repo rate hikes of May and June, have effectively resulted in withdrawal of accommodation by 130 bps.

- Surplus liquidity in the banking system, as reflected in average daily absorptions under the LAF (both SDF and variable rate reverse repo auctions), moderated to ₹3.8 lakh crore during June-July 2022 from ₹6.7 lakh crore during April-May. The sharp moderation in surplus liquidity from July 20, mainly on account of tax and capital outflows, resulted in money market rates firming up above the repo rate.
- During the current financial year (up to August 4), the US dollar index (DXY) has appreciated by 8.0 per cent against a basket of major currencies. In this milieu, the Indian Rupee has moved in a relatively orderly fashion depreciating by 4.7 percent against the US dollar during the same period – faring much better than several reserve currencies as well as many of its EME and Asian peers. The Indian financial system remains resilient.
- This will help the economy in emerging out of the shadows of the pandemic and the impact of the war in Europe.
- While the banking system remains well capitalized and profitable, a deleveraged corporate sector augurs well for sustaining the recovery.

iii. External Sector:

- India's external sector has weathered the storm while navigating through the recent global spillovers. Merchandise exports grew in April-July 2022 while merchandise imports surged to record high on the back of elevated global commodity prices.
- Consequently, the merchandise trade deficit expanded to US$ 100.0 billion in April-July 2022.
- Foreign portfolio investment, after remaining in exit mode during Q1:2022-23, turned positive in July 2022.
- India's foreign exchange reserves remain the fourth largest globally.

iv. Additional Measures

a. Regulatory Measures

Managing Risks and Code of Conduct in Outsourcing of Financial Services:

- In view of the increasing trend of outsourcing, the framework for Regulated Entities (RE) to manage the associated risks needs to be suitably strengthened.
- Therefore, to harmonise and consolidate the extant guidelines, a draft Master Direction on Managing Risks and Code of Conduct in Outsourcing of Financial Services will be issued shortly for comments from stakeholders.

Inclusion of Credit Information Companies (CICs) under the Reserve Bank Integrated Ombudsman Scheme (RB-IOS) 2021 and Introduction of the Internal Ombudsman (IO) Mechanism

- In order to make the RB-IOS more broad based, it has been decided to include Credit Information Companies (CICs) under the RB-IOS framework.
- This will provide a cost-free alternative redress mechanism for grievances against CICs and with a view to strengthen the internal grievance redress by CICs themselves, it has been decided to mandate the CICs to have their own internal Ombudsman (IO) framework.

b. Financial Market

Standalone Primary Dealers (SPDs)

- It is proposed to enable Standalone Primary Dealers (SPDs) to offer all foreign exchange market-making facilities as currently permitted to Category-I Authorised Dealers, subject to prudential guidelines.
- This measure will provide customers with a wider set of market makers to manage their foreign currency risk. This will also increase the breadth of the forex market in India
- Standalone Primary Dealers (SPDs) will be permitted to undertake transactions in the offshore Rupee Overnight Indexed Swap (OIS) market with non-residents and other market makers.
- These measures are expected to remove the segmentation between onshore and offshore OIS markets and improve price discovery.

Committee on MIBOR Benchmark

- In view of the recent international efforts to develop alternative benchmark rates, it is proposed to set up a committee to undertake an in-depth examination of the issues, including the need for transition to an alternative benchmark for MIBOR, and suggest the way forward.

c. Payment and Settlement Systems

Enabling Bharat Bill Payment System (BBPS) to Process Cross-Border Inbound Bill Payments:

- It is now proposed to enable BBPS to accept cross-border inward bill payments. This will enable Non-Resident Indians (NRIs) to undertake bill payments for utility, education and other such payments on behalf of their families in India. This will greatly benefit the senior citizens in particular.

EXCERPTS: WEO UPDATE- GLOOMY AND MORE UNCERTAIN

The International Monetary Fund has come out with World Economic Outlook Update July 2022: Gloomy and More Uncertain. The Key highlights of the report is as under

1. **The Forces Shaping the Outlook**

Global slowdown intensifies as downside risks materialize tentative recovery in 2021 has been followed by increasingly gloomy developments in 2022. Performance was slightly better than expected in the first quarter, but world real GDP is estimated to have shrunk in the second quarter—the first contraction since 2020—owing to economic downturns in China and Russia. Downside risks discussed in the April 2022 World Economic Outlook are materializing, with higher inflation worldwide, especially in the United States and major European economies, triggering a sharp tightening in global financial conditions; a sharper-than-anticipated slowdown in China, reflecting COVID-19 outbreaks and lockdowns; and further negative cross-border effects from the war in Ukraine.

Global inflation again surprises on the upside, prompting more central bank tightening. Since 2021, consumer prices have consistently risen faster than widely expected. In the United States, the consumer price index rose by 9.1 percent in June, compared with a year earlier, and it also rose by 9.1 percent in the United Kingdom in May—the highest inflation rates in these two countries in 40 years. In the euro area, inflation in June reached 8.6 percent, its highest level since the inception of the monetary union.

China's economic slowdown has added to global supply chain disruptions COVID-19 outbreaks and mobility restrictions as part of the authorities' zero-COVID strategy have disrupted economic activity widely and severely .Shanghai, a major global supply chain hub, entered a strict lockdown in April 2022, forcing citywide economic activity to halt for about eight weeks. In the second quarter, real GDP contracted significantly by 2.6 percent on a sequential basis, driven by lower consumption.

The food crisis worsens. Global food prices have stabilized in recent months but remain much higher than in 2021. The principal driver of global food price inflation—particularly prices of cereal, such as wheat—has been the war in Ukraine; export restrictions in several countries have compounded global food price increases, although a few of these restrictions have recently lapsed. Low-income countries whose people were already experiencing acute malnutrition and excess mortality before the war, especially in sub-Saharan Africa, have suffered a particularly severe impact.

2. **Downturn ahead, Downside Risks Dominate**

The developments outlined in the preceding section make the current outlook extraordinarily uncertain. The baseline projections described in the following discussion are predicated on several assumptions, including, among others, no further unexpected reductions in flows of natural gas from Russia to the rest of Europe; that long-term inflation expectations remain stable; and no worsening of disorderly adjustments in global financial markets as a result of disinflationary monetary policy tightening.

2.1 Baseline Scenario

Global growth: The baseline forecast is for growth to slow from 6.1 percent last year to 3.2 percent in 2022, 0.4 percentage point lower than in the April 2022 World Economic Outlook. Global inflation has been revised up due to food and energy prices as well as lingering supply-demand imbalances, and it is anticipated to reach 6.6 percent in advanced economies and 9.5 percent in emerging market and developing economies this year—upward revisions of 0.9 and 0.8 percentage point, respectively. In 2023, disinflationary monetary policy is expected to bite, with global output growing by just 2.9 percent

Inflation: The baseline projection for global inflation is also more pessimistic, having been revised up to 8.3 percent in 2022 on a fourth-quarter-over-fourth-quarter basis, from 6.9 percent in the April 2022 World Economic Outlook. The upside inflation revision in 2022 is larger for advanced economies, where it is expected to reach 6.3 percent from 4.8 percent projected in the April 2022 World Economic Outlook on a fourth-quarter-over-fourth-quarter basis, driven by significant increases in headline inflation among such major economies as the United Kingdom (a 2.7 percentage point upward revision to 10.5 percent) and the euro area (a 2.9 percentage point upward revision to 7.3 percent). Forecasts for 2023 are relatively unchanged—up by only 0.2 percentage point on a fourth-quarter over fourth-quarter basis—reflecting confidence that inflation will decline as central banks tighten policies and energy price base effects turn negative.

Global trade: Global trade growth in 2022 and 2023 will likely slow by more than previously expected, reflecting the decline in global demand and supply chain problems. The dollar's appreciation in 2022—by about 5 percent in nominal effective terms as of June compared with December 2021—is also likely to have slowed world trade growth, considering the dollar's dominant role in trade invoicing as well as negative financial balance sheet effects on demand and imports in countries with dollar-denominated liabilities.

2.2 Downside Risks

The war in Ukraine further raises energy prices. Since April 2022, the amount of Russian pipeline gas supplied to Europe has fallen sharply, to about 40 percent of last year's level, which is reflected in downward revisions to the latest forecasts compared with April.

Inflation remains stubbornly high. Inflation is generally expected to return to near pre-pandemic levels by the end of 2024. However, several factors could cause it to maintain momentum and raise longerterm expectations. Further supply-related shocks to food and energy prices from the war in Ukraine could sharply increase headline inflation and pass through to core inflation, triggering a further tightening in monetary policy. Such shocks could, if sufficiently severe, cause a combination of recession accompanied by high and rising inflation ("stagflation"), although this is not part of the baseline scenario.

Tighter financial conditions trigger debt distress in emerging market and developing economies As advanced economy central banks raise interest rates to fight inflation, financial conditions worldwide will continue to tighten. The resulting increase in borrowing costs will, without correspondingly tighter domestic monetary policies, put pressure on international reserves and cause depreciation versus the dollar, inducing balance sheet valuation losses among economies with dollar-denominated net liabilities.

China's slowdown persists the baseline foresees a recovery from the lockdowns in the second half of 2022, with overall GDP growth at 3.3 percent in 2022 and 4.6 percent in 2023. Upside risks to growth include announcements of material fiscal support and a recalibration of the authorities' zero COVID strategy to reduce growth trade-offs, building on their successful campaign to ramp up the rollout of booster shots. Downside risks include larger-scale outbreaks of more contagious virus variants that trigger further widespread lockdowns under the zero-COVID strategy

Rising food and energy prices cause widespread hardship, famine, and unrest. Because energy and food are essential goods with few substitutes, higher prices are particularly painful for households. When the price of other items, such as electronics, furniture, or entertainment, increases, families can simply reduce or even eliminate spending on them. For food, heating, and transportation—often essential to earn a living—this is much harder. As a result, the current situation poses a threat not only to economic, but also to social, stability.

The world economy fragments further. A serious risk to the medium-term outlook is that the war in Ukraine will contribute to fragmentation of the world economy into geopolitical blocs with distinct technology standards, cross-border payment systems, and reserve currencies. So far, there is limited evidence of reshoring, and global trade has been more resilient than expected since the start of the pandemic. Fragmentation may also diminish the effectiveness of multilateral cooperation to address climate change, with the further risk that the current food crisis could become the norm.

2.2 Quantitative Impact: Global Alternative Scenario

Reduced fossil fuel exports, higher inflation expectations, and tighter financial conditions: Beyond understanding the potential sources of risk, a key concern for policymakers is to gauge their likely impact on the global economy. This section addresses this issue by using the IMF's Group of Twenty (G20) Model to analyze the economic effects if four particularly pertinent and plausible downside risks should materialize:

- Increasingly tight sanctions in response to the Russian invasion of Ukraine cause Russian oil exports to drop by a further 30 percent relative to the baseline, starting in the second half of 2022.
- Russian gas exports to Europe decline to zero by the end of 2022, either because European countries prohibit imports or because Russia curtails supply.
- Inflation expectations remain more persistently elevated.
- Financial conditions tighten, as a result both of policymakers' responses to higher inflation and of investors' concerns, pushing up sovereign and corporate risk and term premiums.

Brunt of the impact in Europe: In this scenario, the shock would have a widespread impact, as higher global commodity prices and tighter monetary and financial conditions would affect almost all countries, albeit to different extents. Europe would be particularly affected in this scenario, with 2023 growth in the European Union 1.3 percentage points lower than in the baseline, implying near-zero regional growth.

Preparing for tighter credit and financial instability: Tighter monetary conditions will affect global capital markets and require policy responses on several fronts. As interest rates rise, financial institutions gain from higher net income but suffer losses as loan origination declines and default rates rise. The balance between these factors will determine financial sector health and the appropriate use of macroprudential tools. Even in the best case, firms are more likely to fail as activity slows, making efficient and effective bankruptcy proceedings and resolution frameworks particularly valuable. In economies with bank exposures to sectors with rising vulnerabilities, tightening macroprudential tools may be warranted.

Tackling the food and energy crises: Beyond generalized inflation, specific challenges in food and energy markets will require distinct policy responses. Ending the invasion of Ukraine and the Black Sea blockade would increase the supply of commodities to global markets. In addition, governments should not hoard food and energy but instead look to unwind barriers to trade, such as food export bans, which are applied with the intention of preventing domestic shortages but which in fact drive world prices higher.

Warding off pandemic risks while limiting economic disruptions: Although in much of the world the acute impact of the COVID-19 pandemic is fading, there is still an opportunity to minimize the cost of living with the virus. About 130 countries did not reach the IMF pandemic proposal's mid-2022 vaccination target of 70 percent, and similar inequality persists in access to tests and treatments. Universal vaccination remains the best shield against persistent health-related absenteeism and further variants and should be backed by broad public health campaigns to encourage vaccine uptake

Facilitating transition to a low-carbon economy: Mitigating climate change continues to require urgent multilateral action. Yet the war in Ukraine and soaring energy prices have put pressure on governments to turn to fossil fuels such as coal as a stopgap measure. Policymakers and regulators should make sure that any such measures are temporary and cover only energy shortfalls—and do not increase emissions overall—and facilitate investment in renewables that will reduce emissions. Credible and comprehensive climate policies to increase green energy supply should be accelerated urgently. The energy crisis also illustrates how a policy of clean, green energy independence can be compatible with countries' national security objectives.

GIST: DIGITAL BANKS-A PROPOSAL FOR LICENSING & REGULATORY REGIME FOR INDIA

Lack of financial deepening remains a challenge, especially on the small business financing agenda. The latest MSME census (2015-16) figures indicate India has 63.88 million unincorporated MSMEs, (of which about 99 % (63.5 million) are categorized in the "micro" bucket). A substantial fraction of these 63.88 million remain outside the ambit of formal finance and there is continued reliance on informal money markets. IFC estimates the total addressable credit gap in the MSME segment to be ₹ 25.8 trillion and growing at a CAGR of 37%.

1. Traditional brick and mortar banks face business constraints in evaluating credit risks of small ticket sizes:
   a. MSMEs rely on informal money market instruments. This "opting out" means that the owners never create a credit history with the credit information companies.
   b. MSME debt profile is "blended" in that it is partly funded in formal and partly in informal money markets. Since the informal debt is not visible in the credit bureaus, lenders exercise rational apathy towards funding the MSME segment.
   c. The compliance requirements of applying for a bank loan are onerous for an unincorporated micro and small enterprise owner ("MSE"). Thus there is both demand side and supply-side friction that results in what economists refer to as "market failure" in the formal MSME debt markets.

2. The bill discounting platforms TReDS have failed to take off and create meaningful volumes of invoice discounting. Some of the principal challenges are:
   a. Lack of corporate buyer incentive: The procedural guidelines are too restrictive. They deter corporate buyers with diverse supply chains that may have non MSME suppliers. They may be reluctant to bifurcate and operate two invoice discounting system.
   b. Other Lean proprietary invoice discounting programs on the market: Many corporate buyers have corporate treasury departments that operate their own reverse factoring programs (supply chain financing programs) for their supplier ecosystem. Other banks including SBI also offer such programs for their clients, for vendor and dealer financing.
   c. Shallow pools of financing capital: Only RBI regulated entities can bid on these platforms. In fact, till the recent enactment of the Factoring (Amendment) Act, 2021, only a limited set of NBFCs (NBFC-Factors) other than banks were permitted to finance through these platforms.

3. **Retail Credit:** There is significant room to grow consumption in India and promote credit usage. Out of a total 220 million credit-eligible retail customers, CIBIL found that banks are servicing 33%. As CIBIL notes, the balance 150 million customers are inactive but will have credit needs that need to be serviced.

4. **Digital Banks: A New Kid in Town:** Incumbent commercial banks have inefficient business models as evidenced by high cost to income, and high cost to serve numbers. Banks and fintechs offering digital banking services (so-called, neo-banks) rely primarily on digital channels that organically have high efficiency metrics relative to incumbent commercial banks. This structural feature makes them a potentially effective channel through which policymakers can achieve social goals like empowering the hitherto under-banked small businesses, and enhancing trust among retail consumers.

5. **Challenges With the Existing "Partnership-Based" Neo-Bank Model**
   a. Challenge #1: Limited Revenue Potential Fintechs have a monetization (and therefore viability) problem. They earn fee-based revenue wherever they act as channel partners and potentially earn a fraction of interchange on payments processed through cards; but other than these two buckets, lack any other revenue sources.
   b. Challenge #2: Potential Obsolescence of the Partner Bank Core Banking System Fintechs offering neo-banking services are constrained by product buckets the partner bank can offer within its business and technological infrastructure.
   c. Challenge #3: High Cost of Capital & No Entry Barrier: Neobanks cannot issue low-cost deposits and are constrained to rely on expensive equity capital to fund innovation and operations.

6. **Features/Conditions of Digital Business bank License/Digital Consumer bank Licence**
   a. Minimum paid-up capital:
      i. Digital Business bank may be required to bring in ₹ 20 crore of minimum paid-up capital.
      ii. Upon progression from the sandbox a full-scale Digital Business bank will be required to bring in ₹ 200 Crores.
      iii. RBI may consider asking the licensee minimum capital to bring in minimum capital proportionate to the projected book size and risk profile of borrowers in the business plan, while operating in the sandbox
   b. **Track record & Potential Applicant Pool:** The license may require one or more controlling persons of the applicant entity to have an established track record in adjacent industries such as e-commerce, payments, technology. As with other licenses (eg, Payment banks, NUEs), applicants may have the option to apply in consortium.
   c. **Equal Access to the Infrastructure Enablers**: Digital Business bank should have access to all the key infrastructure enablers in the Indian financial ecosystem, as traditional banks are.
   d. **Phased relaxation of Business Restrictions**: Digital Consumer bank licensees may issue assets and liabilities within the limits prescribed or service the number of customers within the limits prescribed, in the sandbox phase. These restrictions may no longer apply when it graduates from the sandbox and becomes a full-scale Digital Consumer bank.
   e. Prudential / Liquidity risk regulation: Regulatory touch points like capital adequacy, risk weights, liquidity coverage ratio will be included under this head. Being a full-fledged bank, Digital business bank(s) will be required to be fully compliant with the relevant thresholds applicable to them specifically or commercial banks generally.

f. **Technological Risk regulation**:

i. Incorporation of zero trust architecture to mitigate technology risks
ii. Creation of clearly defined processes (leveraging technology) enabling consumers that have encountered a security event, to report the event.
iii. Continuing compliance with industry-grade certifications
iv. Board-level policies and expertise in assessing evolving cyber security risks
v. Additionally, installing and up skilling technology risk supervision personnel

g. **Business Continuity Planning:** Digital Business banks / Digital Consumer banks will be required to submit BCPs to provide for exit strategy for all potential creditors for all financial, operational and saliently, technology risks.

h. **Products and services:** Digital Business bank may potentially offer the following banking services in the restricted phase.

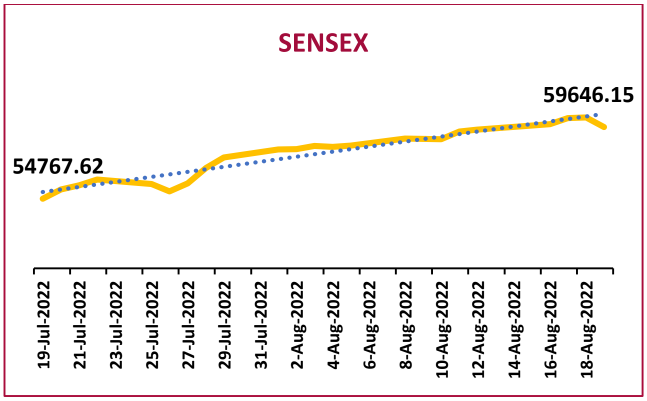
i. Loans to MSMEs / Credit cards (subject to appropriate prudential safeguards) to MSMEs
ii. Current Account services /business banking Services / time deposits from retail consumers, MSME businesses, other corporate and unincorporated entities
iii. Factoring / Distribution (Channel Partner)
iv. Others specified in Section 6 of the BR Act subject to exclusions issued by RBI under the terms of the license

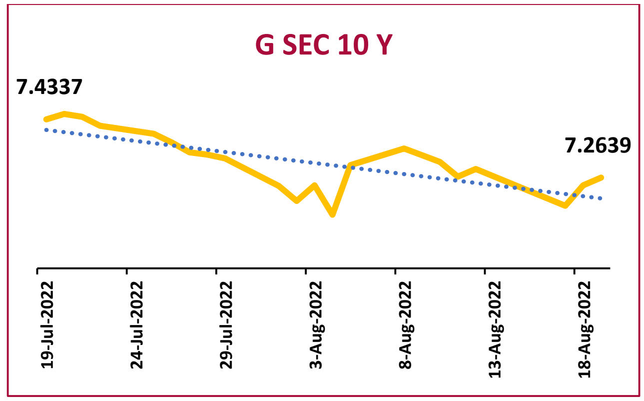
7. **Priority Sector Lending In the Context of Digital Banks** : It is proposed that the RBI may determine the PSL obligations for Digital Business bank licensees on a case by case basis at the time the licensee is ready to begin full-scale banking operations. Additionally, being fully licensed banks under the B R Act, these banks may participate in the market for PSL certificates (recognized as a form of business banks may engage in under Section 6 (1) (o) of the Act).

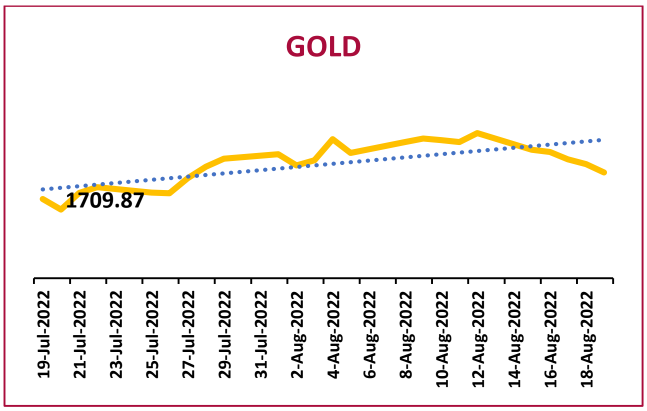
ECONOMIC CALENDAR- INDIA

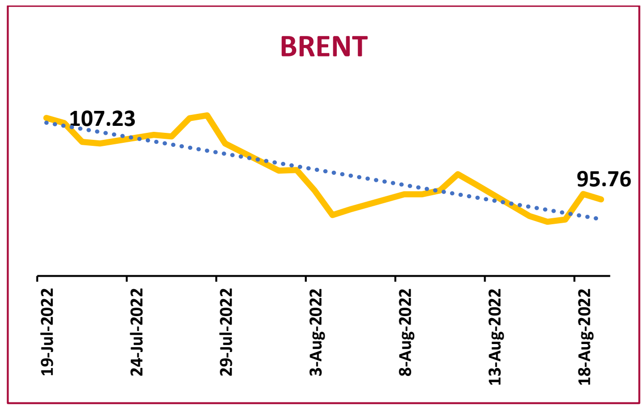
Sr No	Date of Release	Event
1	31.08.2022	Fiscal deficit/GDP Data
2	31.08.2022	Core Sector
2	01.09.2022	Nikkei S&P Global Manufacturing PMI (Aug)
4	05.09.2022	Nikkei Services PMI (Aug)

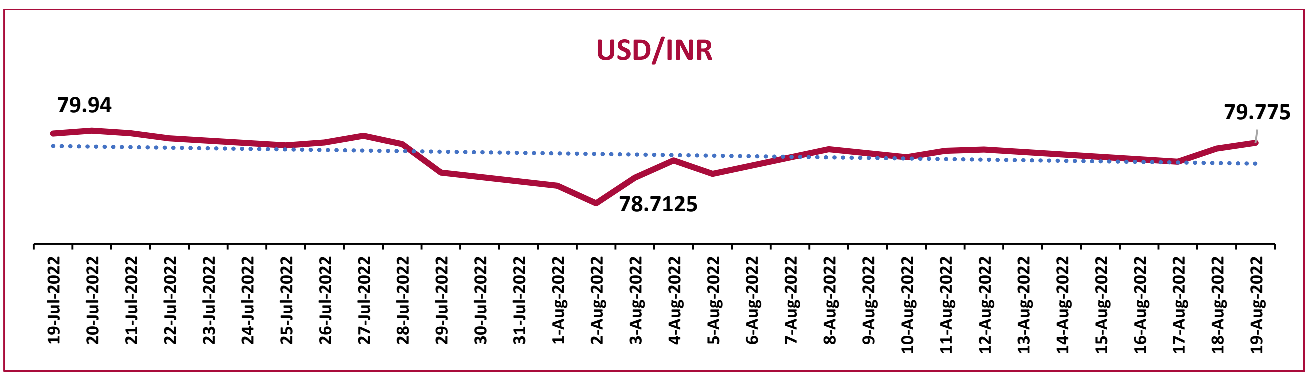
DAILY ECONOMIC INDICATORS

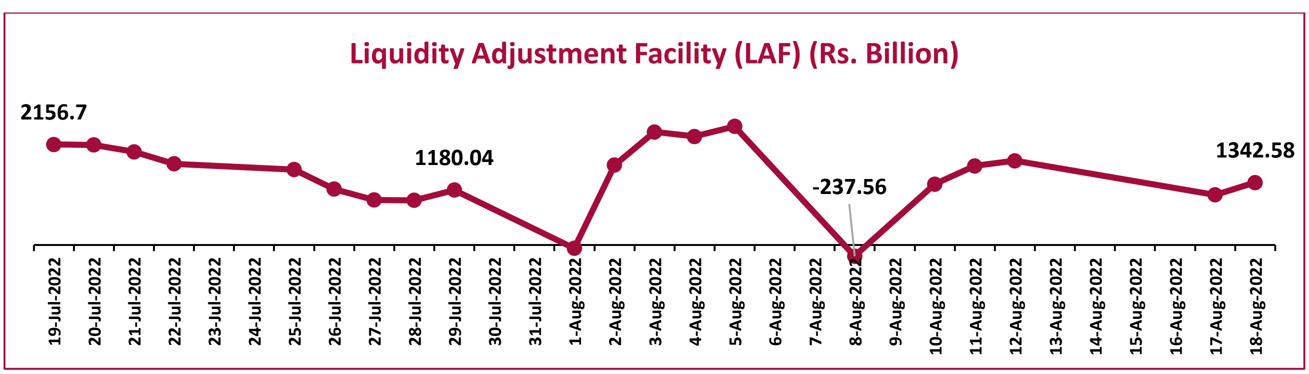








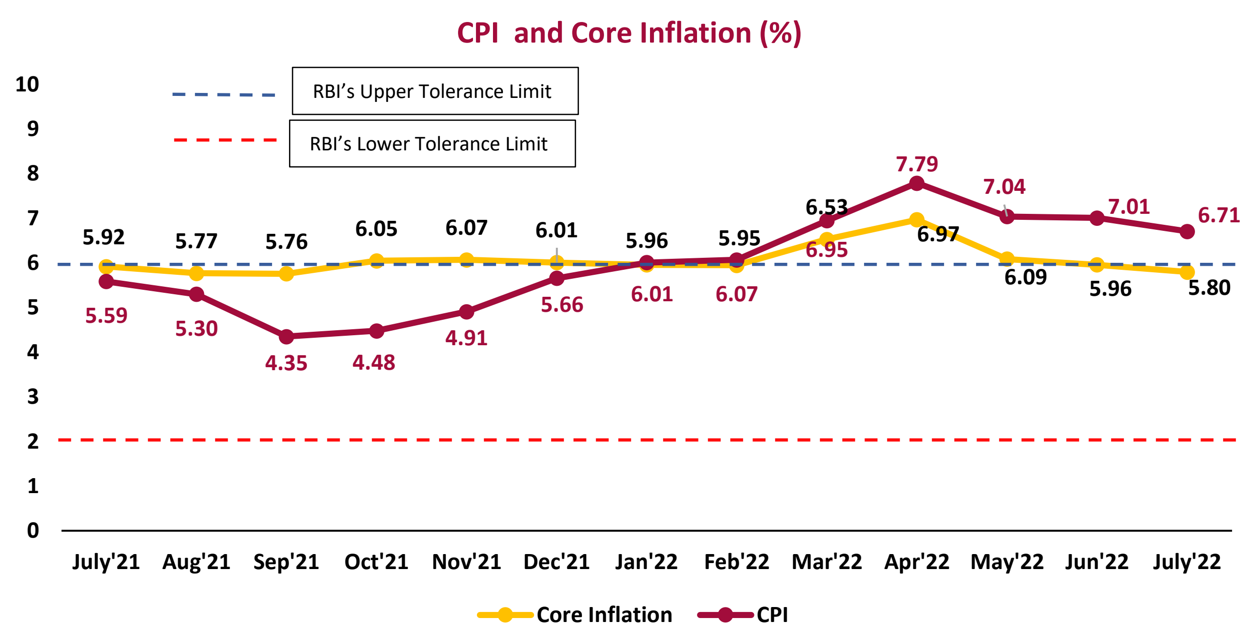


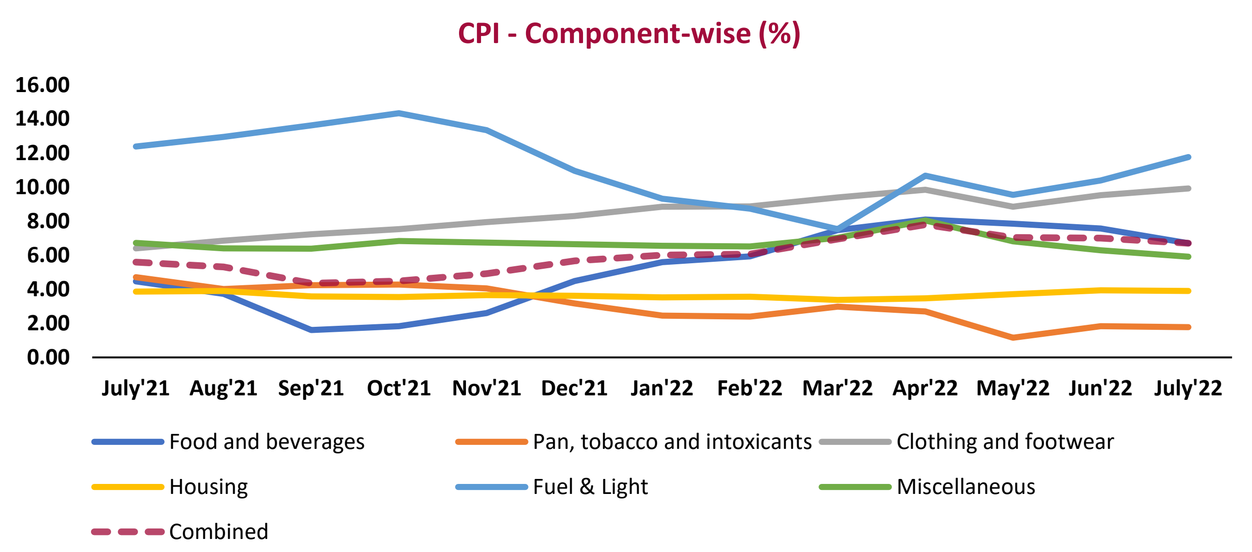


MONTHLY & FORTNIGHTLY ECONOMIC INDICATORS

CONSUMER PRICE INDEX (CPI)

CPI Inflation falling to 6.7%, likely to remain above the upper tolerance limit

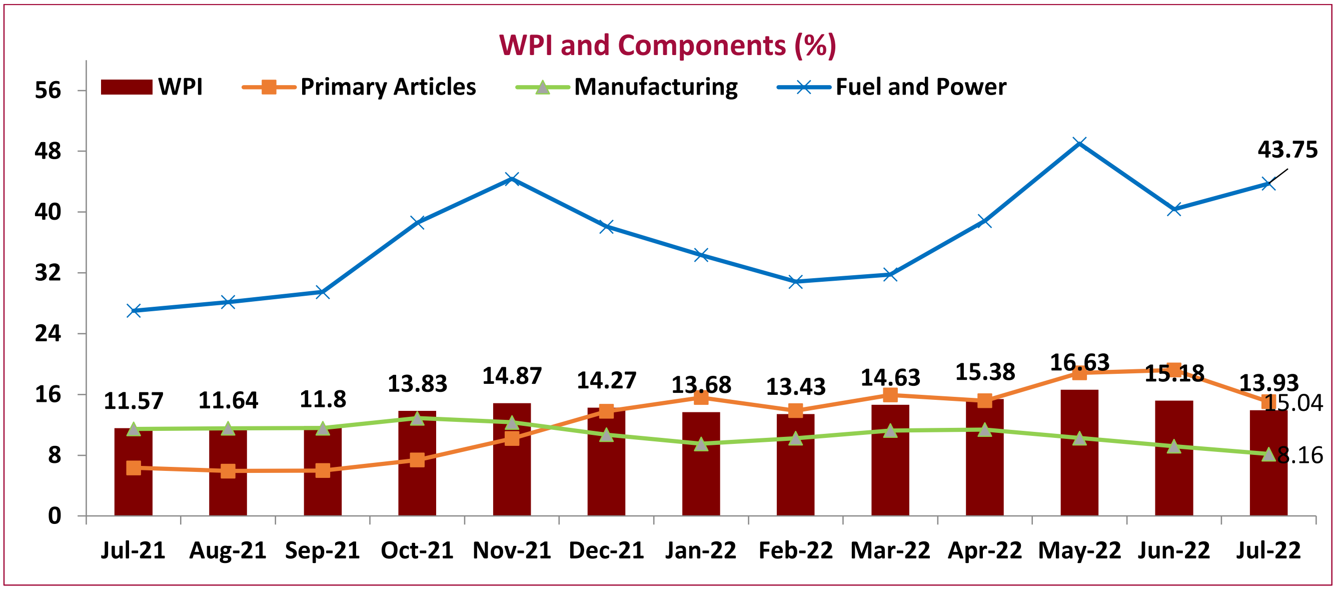




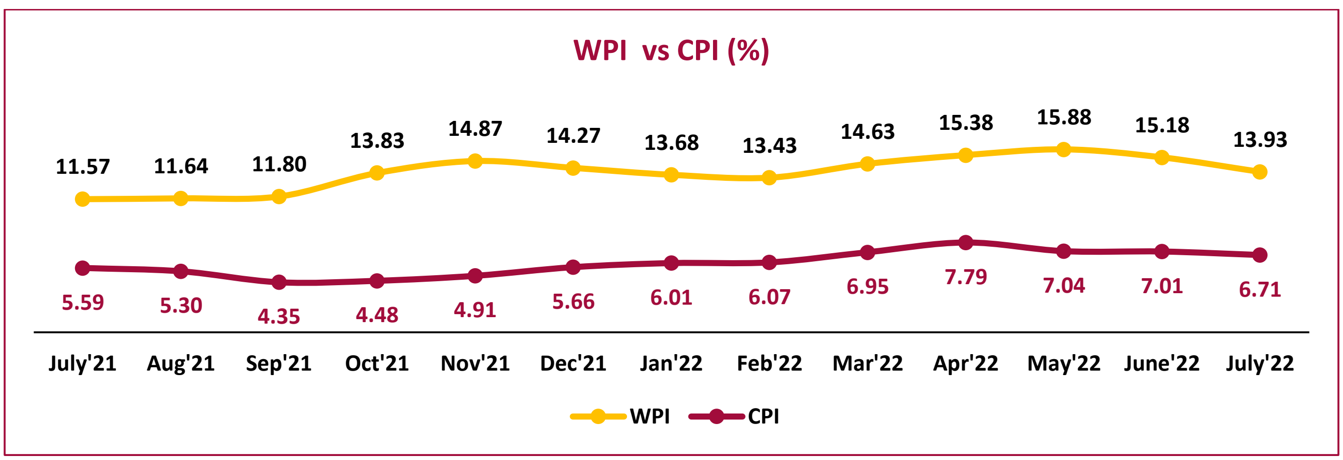
India's consumer inflation dipped to 6.71% in July, on the back of slower increase in food and fuel prices.

WHOLESALE PRICE INDEX (WPI)

WPI inflation slows down to 5 months low, continues to stay in double digit



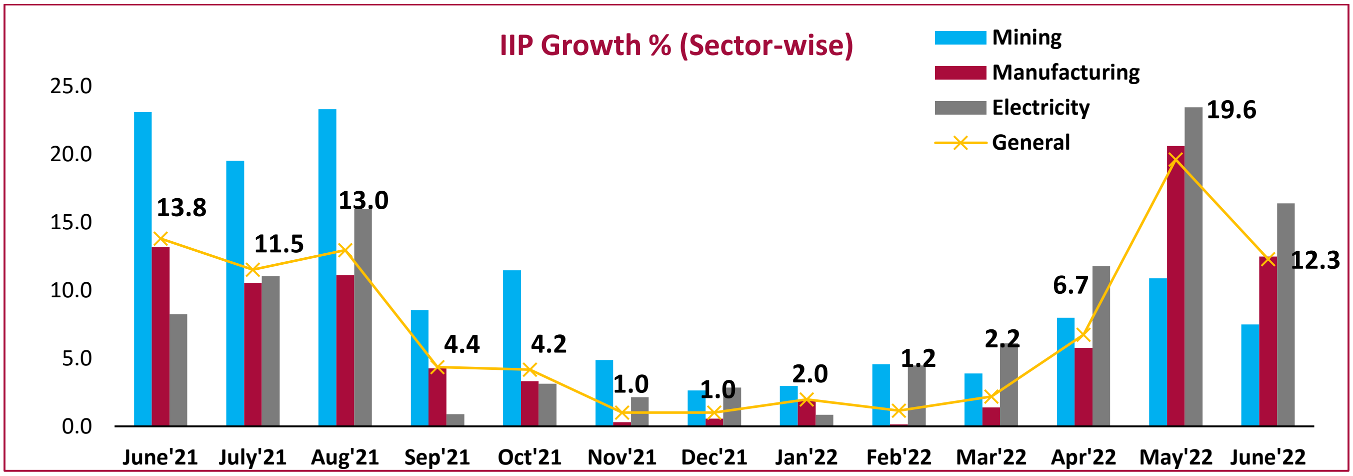
WPI Inflation (%)	Primary Articles		Fuel & Power		Manufactured Products		Food Articles *(Part of Primary Articles)*		All Commodities	
Weights	22.62%		13.15%		64.23%		15.26%		100%	
	2021	2022	2021	2022	2021	2022	2021	2022	2021	2022
May	9.40	**19.71**	36.74	**40.62**	11.25	**10.11**	4.25	**12.34**	13.11	**15.88**
June	8.59	**19.22**	29.32	**40.38**	10.96	**9.19**	3.28	**14.39**	12.07	**15.18**
July	6.34	**15.04**	27.01	**43.75**	11.46	**8.16**	0.12	**10.77**	11.57	**13.93**



Inflation in July, 2022 is primarily contributed by rise in minerals, oil, food articles, crude petroleum and natural gas, basic metals, electricity, chemicals& chemical products and food products as compared to corresponding period last year.

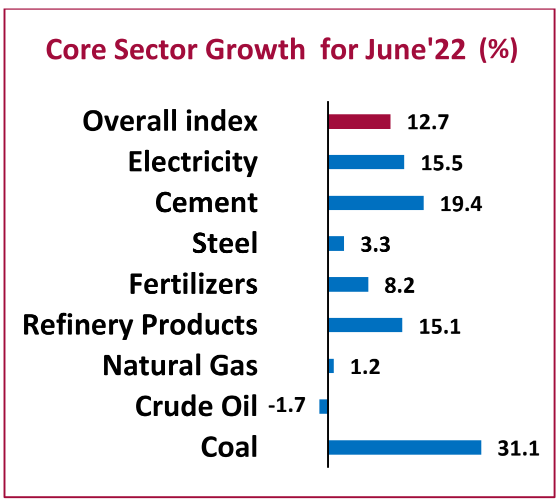
INDEX OF INDUSTRIAL PRODUCTION (IIP) & CORE SECTORS

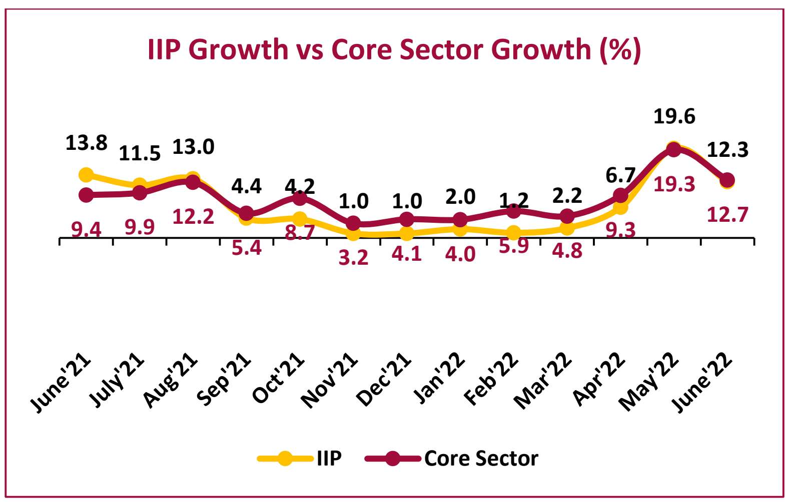
IIP growth remains in double digit, however slows down to 12.3%



IIP growth % (Usage-wise)

Component	Weight	Jan'22	Feb'22	Mar'22	Apr'22	May'22	June'22	Apr-June'22
Primary Goods	34.05%	1.6	4.6	5.7	10.1	17.7	**13.7**	**13.9**
Capital Goods	8.22%	1.8	1.3	2.0	13.3	54.0	**26.1**	**29.5**
Intermediate Goods	17.22%	2.5	4.1	1.8	7.0	17.9	**11.0**	**11.7**
Infrastructure/ Construction Goods	12.34%	5.9	8.6	6.7	4.0	18.2	**8.0**	**9.8**
Consumer Durables	12.84%	-4.4	-9.7	-2.6	7.4	58.5	**23.8**	**26.6**
Consumer Non- Durables	15.33%	3.1	-6.8	-4.6	-0.6	0.9	**2.9**	**1.2**

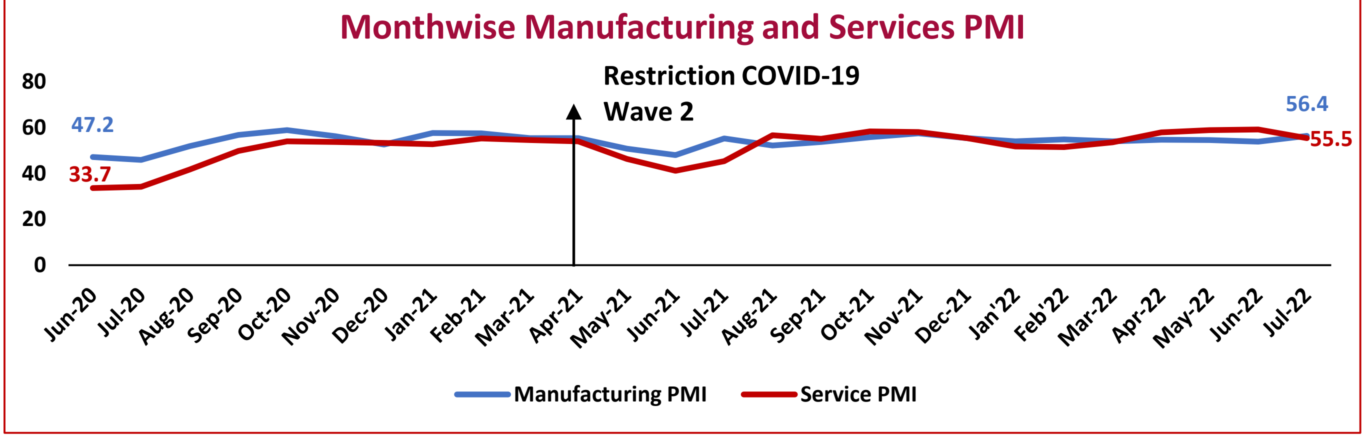




India's industrial production grew in double digit for the second month in a row at 12.3 per cent in June mainly due to strong performance by manufacturing, power and mining sectors.

PURCHASING MANAGERS' INDEX (PMI)

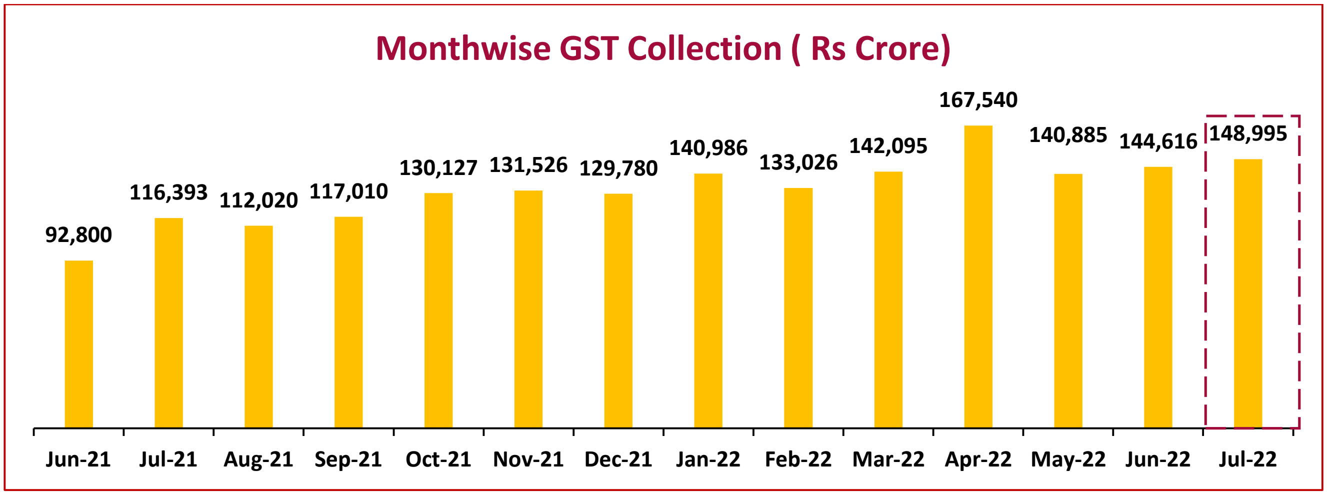
Services PMI again records an 11-year high



India's services sector momentum hit a four-month low as the seasonally adjusted S&P Global India Services PMI Business Activity Index fell from 59.2 in June to 55.5 in July, due to curtailment of demand by competitive pressures, elevated inflation and unfavourable weather while S&P Global India Manufacturing Purchasing Managers' Index rose from 53.9 in June to 56.4 in July, reflecting the strongest improvement in the health of the sector in eight months.

GOODS AND SERVICES TAX (GST)

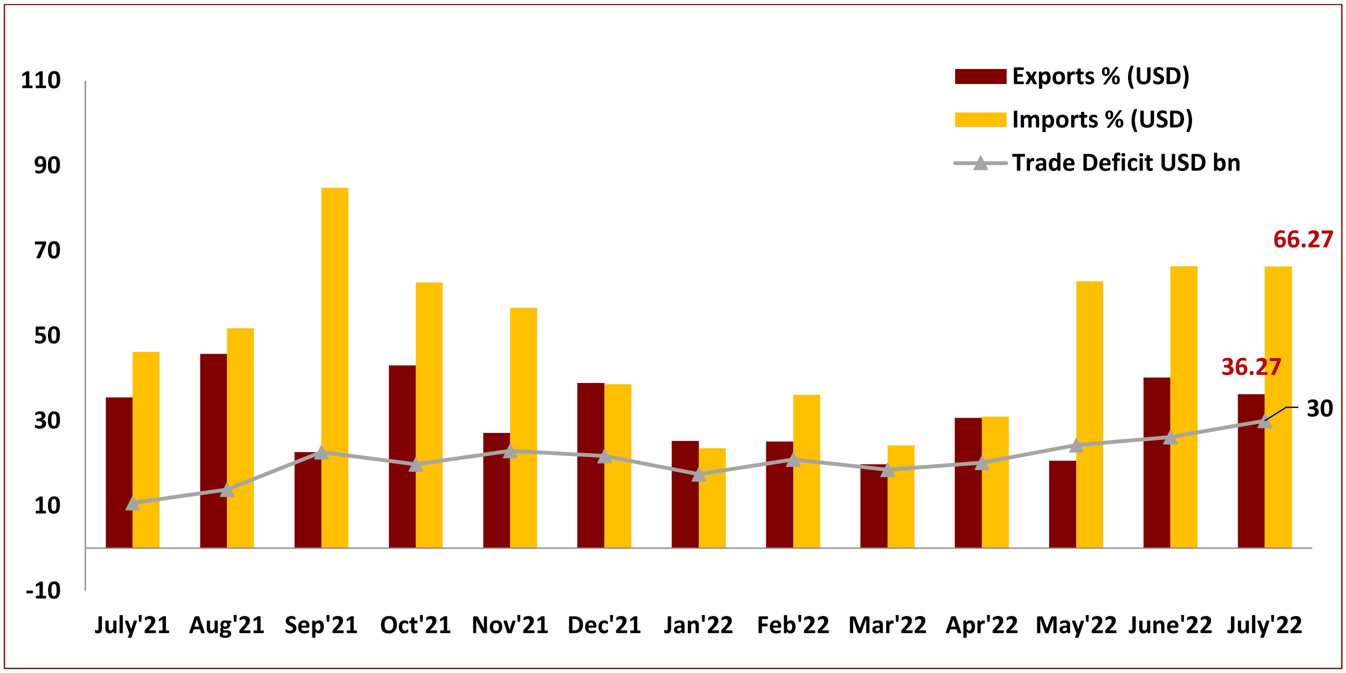
GST collection 28% higher than GST revenues in July 2021

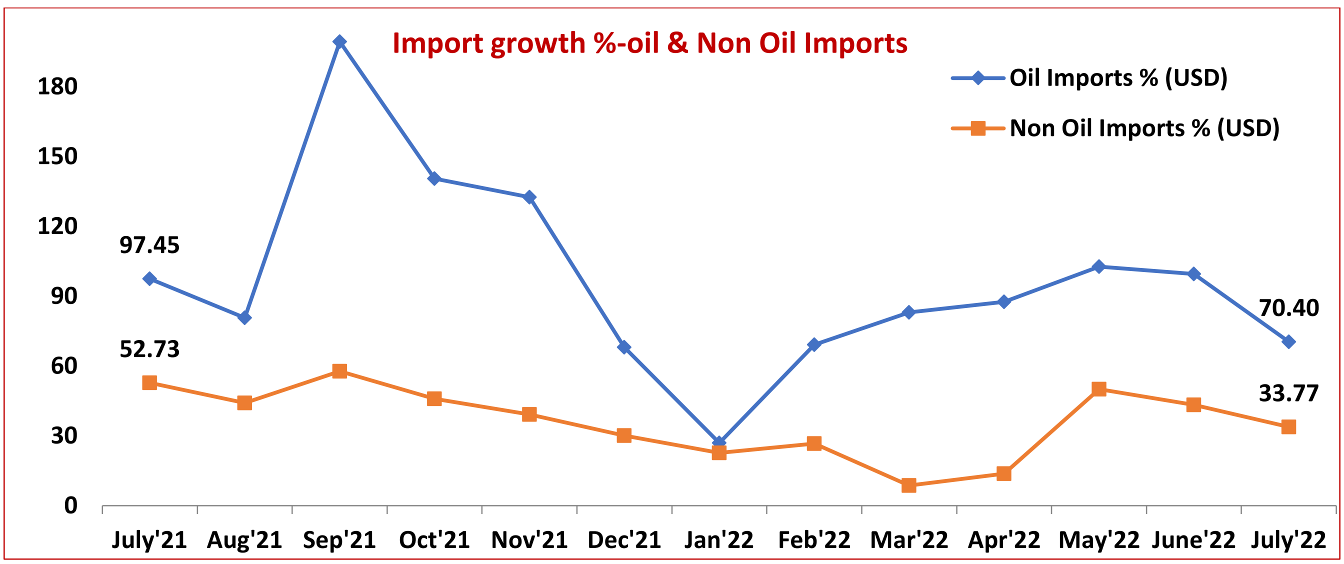


Goods and Services Tax (GST) yielded ₹1,48,995 crore in revenues during the month of July, the second-highest monthly collections since the launch of the GST regime and the highest in three months. July's GST kitty is 28% higher than the same month last year, driven by a 48% surge in revenues from import of goods, while revenues from domestic transactions, including import of services, are 22% higher than a year ago.

FOREIGN TRADE

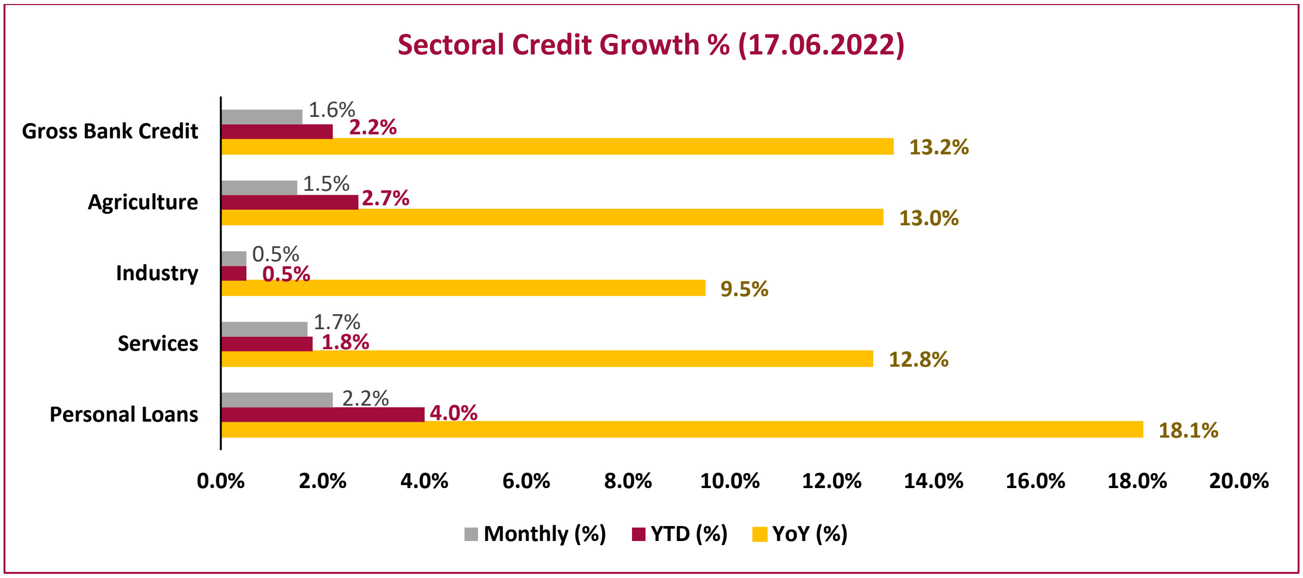
Trade deficit rises further to $ 30 billion





- India's trade deficit swelled further to $30 billion in July as exports grew at a much slower pace compared to imports.
- Merchandise exports declined to a five-month low of $36.27 billion in July but witnessed a marginal increase of 2.14 per cent year-on-year (YoY). The rise in imports has been mainly due to an increase in the purchase of petroleum products, electronic goods, and coal.

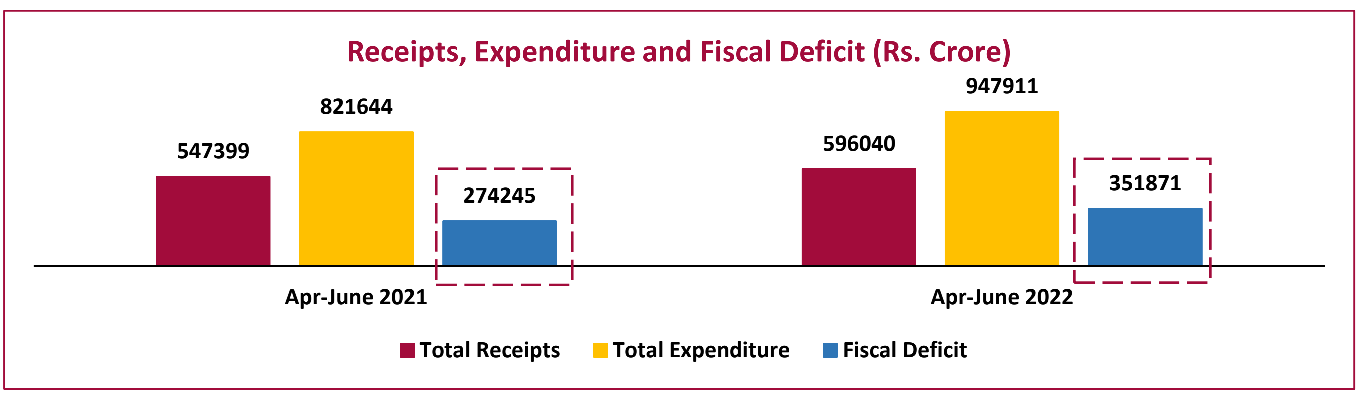
SECTORAL CREDIT



BANK DEPOSIT AND CREDIT

Parameter (Rs. Lakh Crore)	30.07.21	25.03.22	15.07.22	29.07.22	YoY (%)	YTD (%)	Fortnightly (%)
Deposits	155.49	164.65	168.10	169.72	9.1%	3.1%	1.0%
Advances	108.01	118.91	122.81	12.69	14.5%	4.0%	0.7%
Business	263.50	283.56	290.91	293.41	11.4%	3.5%	0.9%

FISCAL DEFICIT

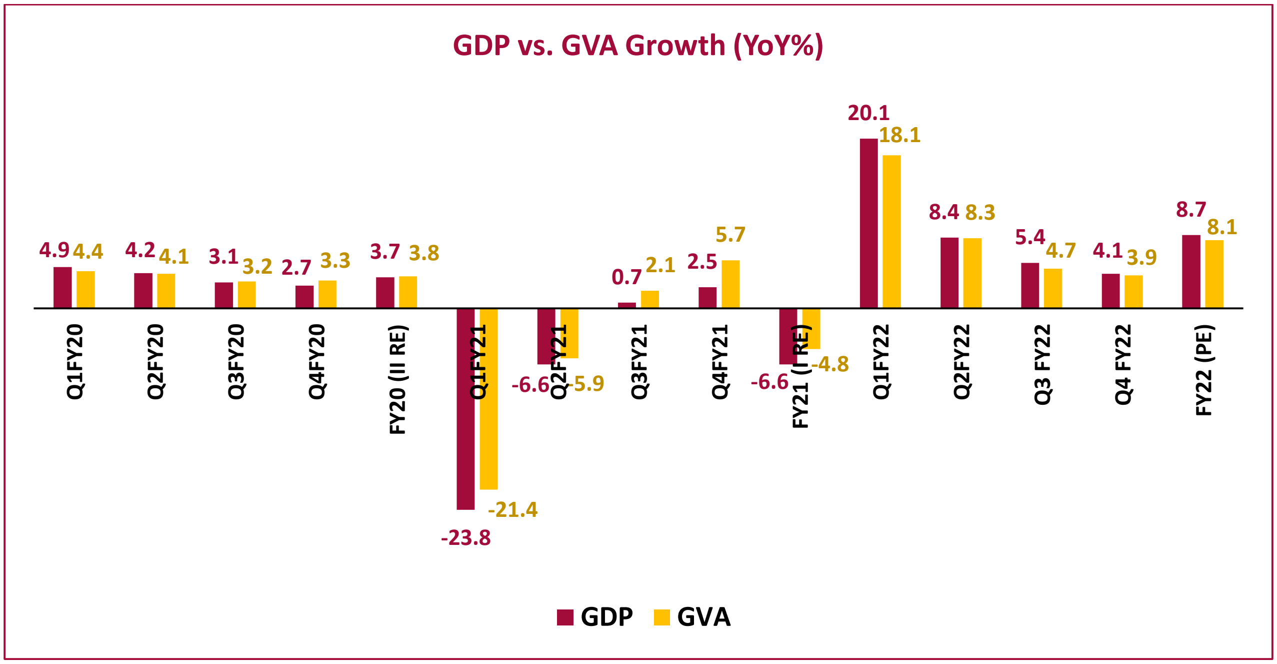


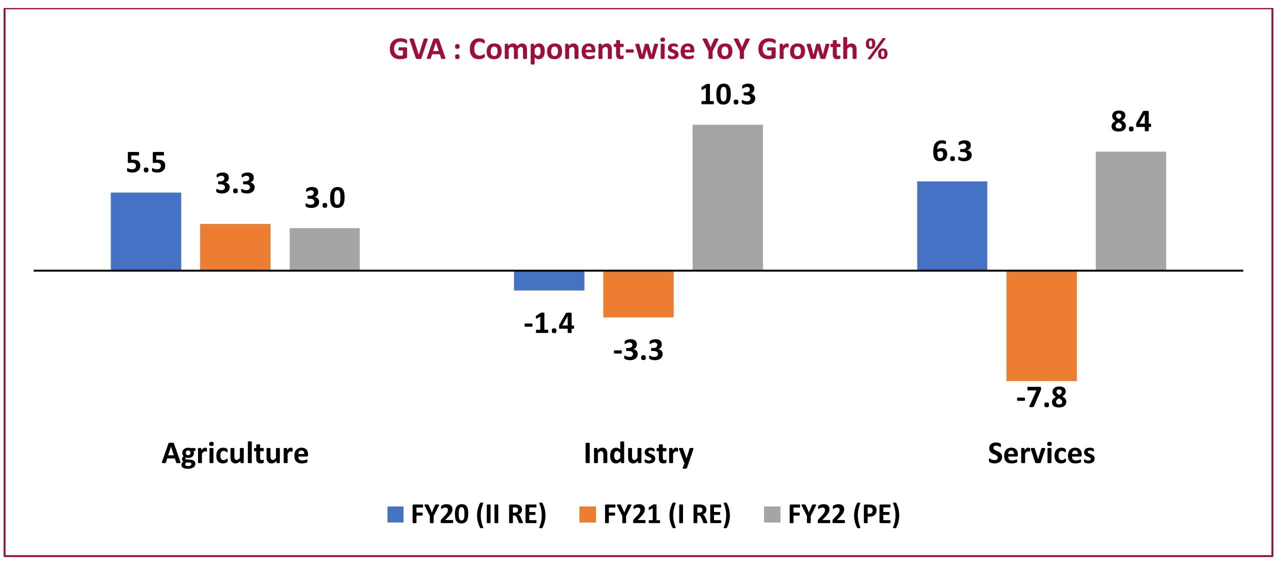
India's fiscal deficit records 21.2 per cent of the annual target in the June 2022 quarter, compared with 18.2 per cent in the year-ago period. In actual terms, the fiscal deficit stood at Rs 3.51 lakh crore at the end of the first quarter of 2022-23 vis-à-vis 2.74 lakh crore in the first quarter of 2021-22.

QUARTERLY ECONOMIC INDICATORS

GROSS DOMESTIC PRODUCT (GDP) & GROSS VALUE ADDED (GVA)

Indian economy grows by 8.7%, above pre-pandemic level



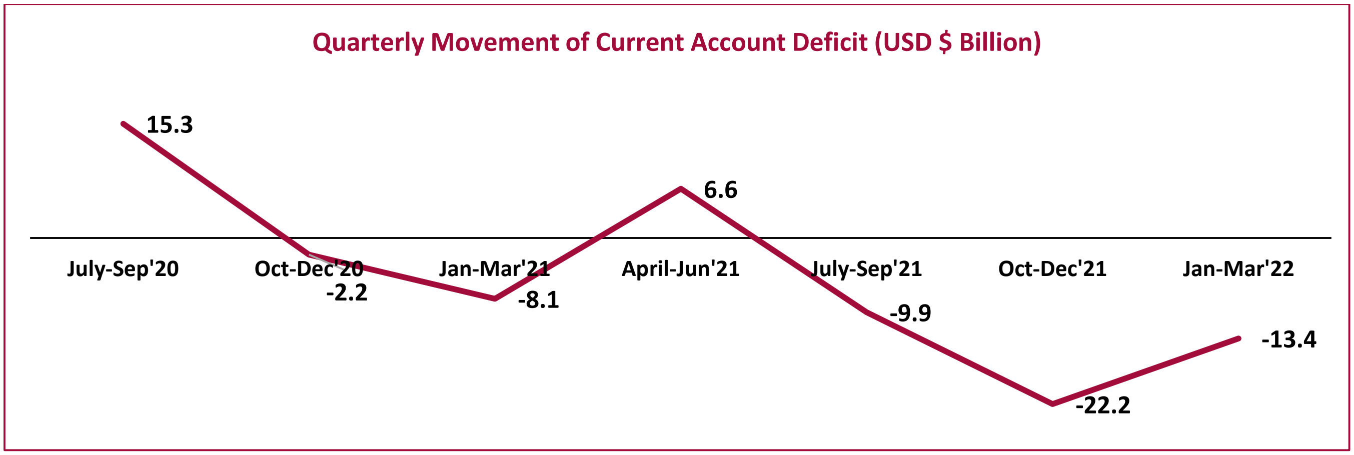


Gross Domestic Product (GDP) for FY22 grew by 8.7 per cent as compared to a decline of 6.6 per cent in the previous year. Also, Real **Gross Value Added (GVA)** at basic prices (which captures what accrues to the producer/service provider before a product or service is sold) **in FY22 grew by 8.1 per cent** in comparison to a decline of 4.8 per cent in FY21. For the last quarter of FY22, GDP grew by 4.1 per cent while GVA grew by 3.9 per cent.

India's GDP Outlook Of Various Agencies

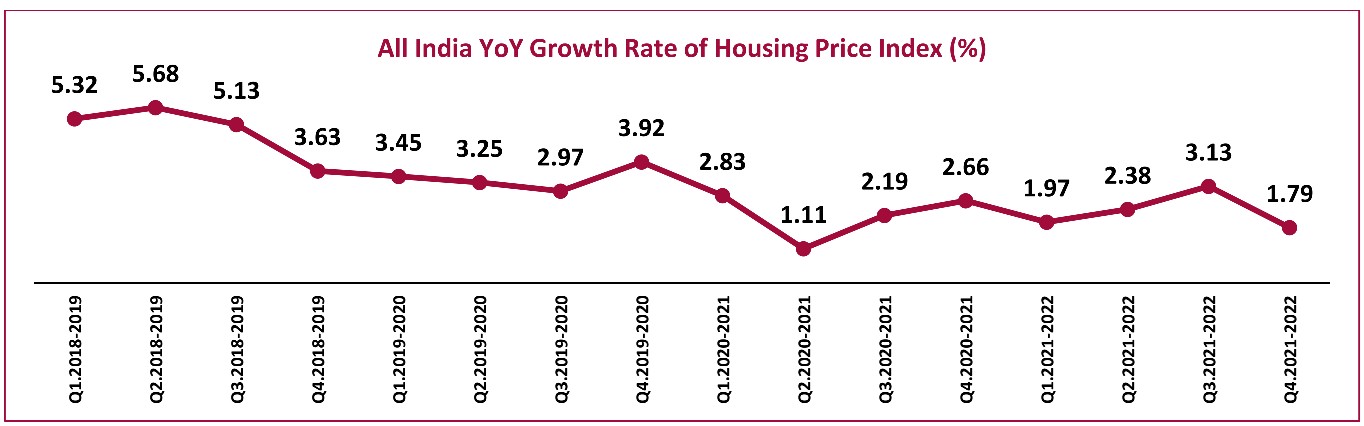
Agency	FY23
RBI	7.2%
World Bank	7.5%
IMF	7.4%
ADB	7.2%
Economic Survey	8-8.5%

CURRENT ACCOUNT DEFICIT



India's Current Account Deficit declined to $ 13.4 billion (1.5 per cent of GDP) in Q4 FY'22 from $ 22.2 billion (2.6 per cent of GDP) in Q3 FY'22 mainly on account of increase in remittances from overseas Indians and software exports. Further, there was a fall in the outflow from dividend and interest pay-outs.

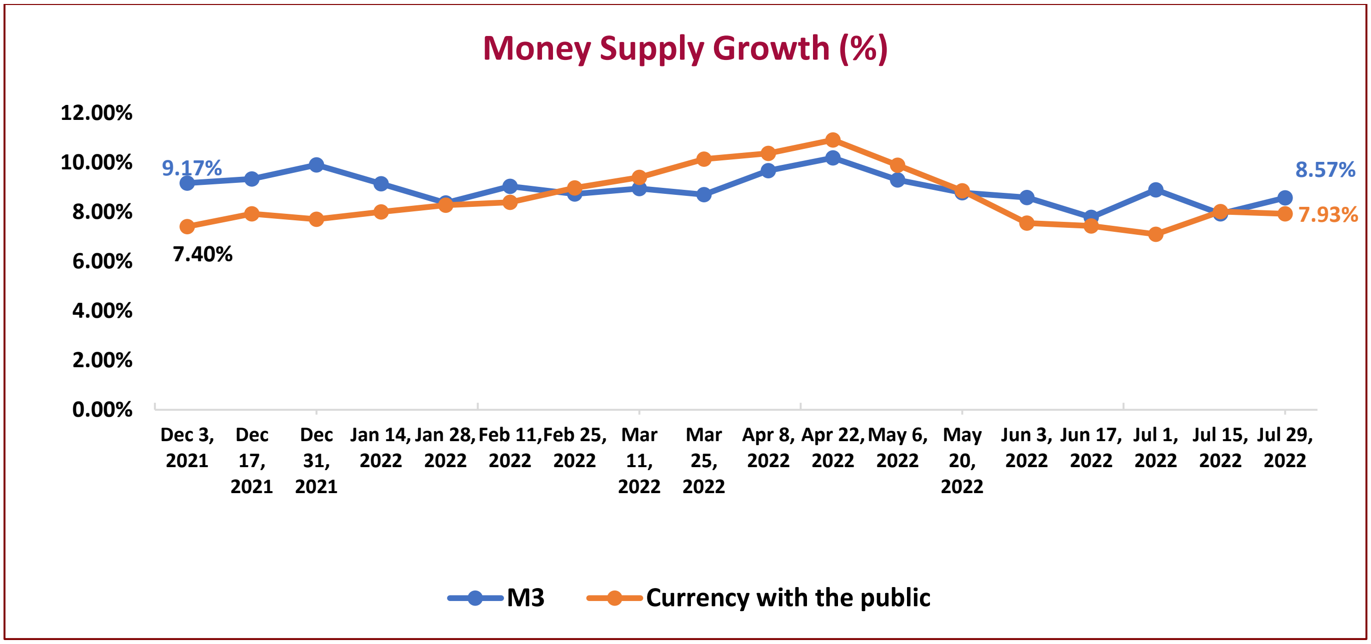
HOUSING PRICE INDEX



All-India HPI recorded 1.79 per cent annual growth (y-o-y) in Q4:2021-22 (provisional data) as compared with 3.13 per cent growth in the previous quarter and 2.66 per cent a year ago.

MONEY SUPPLY

Currency with Public sees marginal downward trend while M3 rises



GLOBAL INTEREST RATES

Central Banks	Countries	Latest Interest Rate (%)	Last Change	Next Meeting Date
Bank of Japan	Japan	-0.10	Jan 29, 2016 (-20 bps)	Sep 22, 2022
European Central Bank (ECB)	Europe	0.50	July 07, 2022 (+50 bps)	Sep 08, 2022
Federal Reserve	U.S.A	2.50	July 27, 2022 (+75 bps)	Sep 21, 2022
Bank of England	U.K	1.75	Aug 04, 2022 (+25 bps)	Sep 15, 2022
Reserve Bank of India	India	5.40	Aug 05, 2022 (+50 bps)	Sep 30, 2022
Central Bank of Russia	Russia	8.00	June 21, 2022 (+150 bps)	Sep 16, 2022

INDUSTRY OUTLOOK

Textiles

India is the world's second-largest producer of textiles and garments. It is also the fifth-largest exporter of textiles spanning apparel, home and technical products. Though the fundamental strength of the textile industry in India is its strong production base of a wide range of fibre/yarns from natural fibres like cotton, jute, silk and wool to synthetic/man-made fibres like polyester, viscose, nylon and acrylic, fibre consumption in India is skewed towards natural fibres with around 65% share unlike global fibre consumption with 70 per cent share of manmade fibre in total fibre consumption.

The textiles and apparel industry contribute 2.3% to the country's GDP, 13% to industrial production and 12% to exports. Textile industries employ more than 18 million people directly and more than 20 million people indirectly, as also 3.5 million people who work on handlooms. Exports (including handicrafts) stood at US$ 44.4 billion in FY22, up by 41% increase YoY and are expected to reach $100 billion by 2026. 100% FDI (automatic route) is allowed in the Indian textile sector and the industry thus attracted substantial FDI over the past two years. While, India enjoys a comparative advantage in terms of manpower and in cost of production relative to other major textile producers, the industry has faced several challenges in the recent past on account of the pandemic.

The Government's Rs. 10,683 crore PLI scheme is expected to be a major booster for the textile manufacturers. The scheme proposes to incentivize MMF (man-made fibre) apparel, MMF fabrics and 10 segments of technical textiles products. The Government has also approved the Mega Integrated Textile Region and Apparel Park scheme worth Rs. 4,445 crore establish seven integrated mega textile parks with state-of-the-art infrastructure, common utilities and R&D lab over a three-year period, which will boost textile manufacturing in the country.

Telecom

The Indian telecom sector is the world's second-largest telecommunications market. The industry is an economic multiplier and is the base of all new-age communications and connectivity. During COVID -19 lockdown the industry had contributed to the GDP growth.

Under the Digital India campaign, the government is focusing on making various platforms digitally available. This would accelerate the adoption of new technologies and the telecom sector infrastructure, on which all disruptive technologies sit.

The tariff hikes in November 2021 would lead to an increase revenue of Telecos in FY23. However, the flip side is that it may slow down the addition/upgrade of subscribers' base. Government reforms for eg. granting moratorium on unpaid dues, redefining Adjusted Gross Revenue (AGR) prospectively and cut in Spectrum Usage Charges augurs well for the sector. Recently, the Department of Telecommunications has already released bank guarantees of Rs 9,200 crore deposited earlier by the telecom operators, thereby improving the liquidity available to them and reducing finance costs.

Department of Telecommunications (DoT) of the Ministry of Communications proposed simplified telecom regulatory framework, uniform infrastructure, overhaul of USOF and spectrum management among other things in its consultation paper, which will smoothen the functioning of telecom sector.

Technological innovations with 5G will redefine the future of telecom in India.

EXTRACTS FROM NEWS ON BANKING AND FINANCIAL EVENTS

1. **RBI moots 'tiered' charge on payments through UPI, seeks public feedback (BS, 21.08.2022)**

- The Reserve Bank of India (RBI) has sought feedback from stakeholders on the possibility of imposing a "tiered" charge on payments made through the Unified Payments Interface (UPI), based on different amount bands.
- The RBI's discussion paper on charges in payment systems, released on Wednesday, seeks to structure its policies and streamline the framework of charges for different payment services or activities, such as UPI, IMPS (Immediate Payment Service), NEFT (National Electronic Funds Transfer), RTGS (Real-Time Gross Settlement), and payment instruments including debit cards, credit cards, and prepaid payment instruments (PPIs).

2. **Large borrowers return to bank fold, help credit growth (ET, 19.08.2022)**

- Large corporates have shifted their focus on banks to fulfil their fund requirements instead of raising funds overseas or from the local bond market.
- The Reserve Bank of India data showed that bank loans taken by large corporations grew 3.3% year-on-year in June, which is the highest growth since the outbreak of Covid-19.
- Bank credit recorded 14.5% year-on-year growth at the end of July, well supported by demand from large and medium corporations. Large corporate loans grew Rs 76464 crore incrementally in the past one year to Rs 23.93 lakh crore while mid-sized corporate loans rose Rs 71115 crore to Rs 2.21 lakh crore, latest data released by RBI showed

3. **RBI issues digital lending norms, reserves space for regulated entities (FE, 10.08.2022)**

- In its effort to mitigate the concerns arising from credit delivery through digital lending methods, the Reserve Bank of India (RBI) came out with guidelines aimed at firming up the regulatory framework for such activities. The banking regulator has categorically specified that the lending business can only be carried out by entities regulated by it or those permitted under the law.
- The central bank has divided the universe of digital lenders into three groups — entities regulated by the RBI and permitted to carry out lending business; entities authorised to carry out lending according to other statutory/ regulatory provisions but not regulated by the RBI, and entities lending outside the purview of any statutory/ regulatory provision.

4. **RBI stays hawkish in fight against inflation; MPC reverses Covid-era cuts (BS, 06.08.2022)**

- The six-member Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) o hiked the policy repo rate by 50 basis points to 5.4 per cent, a three-year high, owing to inflation concern and to shield the exchange rate, which has come under pressure since war broke out in Europe in February.
- The Consumer Price Index (CPI) based inflation, which RBI factors in while fixing its benchmark rate, stood at 7.01 per cent in June. Retail inflation has been ruling above the RBI's comfort level of 6 per cent since January this year.

5. **NRIs can now pay utility bills through Bharat Bill Payment System (BS, 06.08.2022)**

- Non-resident Indians (NRIs) will now be able to make utility bill payments for their family in India as the Reserve Bank of India (RBI) on Friday proposed to enable Bharat Bill Payment System (BBPS) to accept cross-border inward payments.
- More than 80 million transactions are processed on the payments platform on a monthly basis.
- The rationale behind the RBI move is to make it easier for the NRIs who do not have access to a full suite of bill collectors or may not have a NRE account should be able to make utility payments on behalf of their family.

6. **UPI records 6 billion transactions in July, highest ever since 2016 (BS, 02.08.2022)**

- Unified Payments Interface (UPI) clocked over 6 billion transactions in July: the highest ever by India's flagship digital payments platform since its inception in 2016.
- UPI reported 6.28 billion transactions amounting to Rs 10.62 trillion, according to data released by the National Payments Corporation of India (NPCI), which operates the platform. Month-on-month, the volume of transactions was up 7.16 per cent and value increased 4.76 per cent. Year-on-year (YoY), the volume of transactions nearly doubled while value of transactions was up 75 per cent.

7. **GST collection jumps 28% YoY in July to second highest ever at Rs 1.49 trn (BS, 02.08.2022)**

- Above Rs 1.4 trillion for the fifth month in a row, increasing 28 per cent year-on-year (YoY) to nearly Rs 1.49 trillion in July. This was the second-highest mop-up since the rollout of the regime.
- The uptick is mainly on account of improved economic activities, compliance measures and inflation. The highest-ever mop-up was recorded in April this year (Rs 1.68 trillion).
- Of the mop-up in July, Central GST (CGST) stood at Rs 25,751 crore, state GST (SGST) Rs 32,807 crore, integrated GST (IGST) Rs 79,518 crore (including Rs 41,420 crore collected on import of goods), and cess mop-up Rs 10,920 crore (including Rs 995 crore from import of goods).

8. **All 12 public sector banks go live on account aggregator network (BS, 03.08.2022)**

- Following the finance minister's nudge, all the 12 public sector banks have joined the account aggregator (AA) framework, bringing in its fold over a billion accounts. Major private sector banks are already live on the AA ecosystem, which was launched to bolster the lending ecosystem.
- According to Sahamati, an industry alliance for the AA ecosystem, as many as 22 major private sector and public sector banks (PSBs) have gone live on the framework since its launch in September last year.

9. **NITI Aayog moots licensing, regulatory framework for digital banks (BS, 21.07.2022)**

- The Centre's policy think-tank NITI Aayog has made a case for setting up digital banks, which would accept deposits and advance loans through digital means, and suggested a licensing and regulatory framework for such lenders.
- The success India has witnessed on the payments front is yet to be replicated in meeting the credit needs of its micro, small and medium businesses, said a NITI Aayog report titled 'A proposal for Digital Banks in India: Licensing and Regulatory Regime'.

DATA SOURCES

- *Reserve Bank of India (RBI)*
- *Ministry of Statistics and Programme Implementation (MOSPI)*
- *Office of Economic Adviser*
- *Ministry of Commerce and Industry, Department Of Commerce*
- *S & P Global*
- *Press Information Bureau*
- *GST Council*
- *Websites of major Central Banks*
- *Controller General of Accounts (CGA)*
- *Petroleum Planning & Analysis Cell (PPAC)*
- *Investing.com*
- *News from Business Standard, Financial Express, Economic Times, The Mint*

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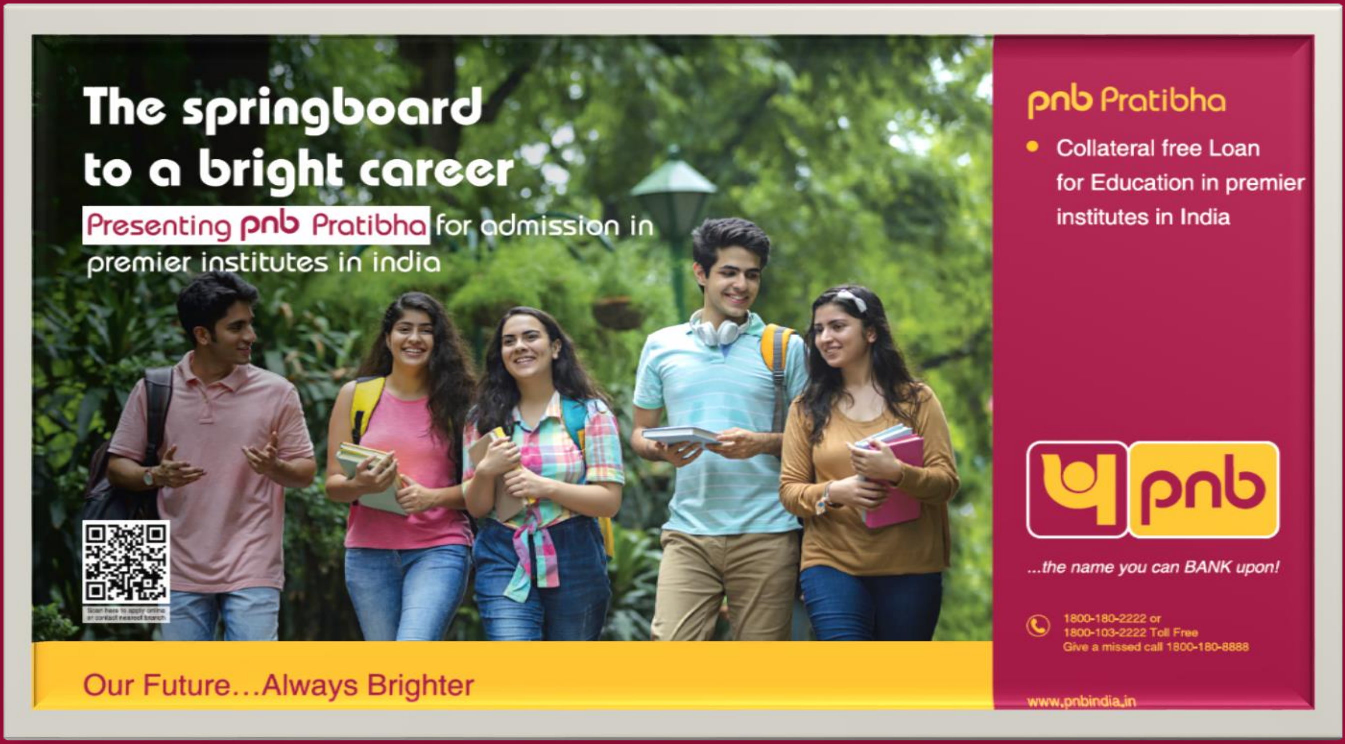
QUOTE OF THE MONTH

"The mind acts as an enemy for those who do not control it."

- Bhagwad Gita



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