

FICCI/IBA Annual Banking Conference 2014

Economic & Financial Outlook

September 15, 2014

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Outline

- Macroeconomy
- Changes in Banking Sector
- Developments in Financial Inclusion
- Two recent regulatory decisions that should be explained
- Conclusion

Macroeconomy

- World economy picking up hesitantly
 - Nearing the resumption of the rise in interest rates in industrial countries
 - Could be slower than warranted by domestic conditions – differentiated situations and exchange rate effects
 - Lower oil prices are helping consuming countries
 - Lower CAD and stronger rupee
 - Lower oil subsidies – need to seize the moment and eliminate diesel subsidies
 - Lower inflation
 - Geo political risk abounds: Ukraine, Middle-East

Macroeconomy

- Domestic economy
 - Stable government makes us stand out relative to emerging market peers.
 - Recovery still uneven – industrial production especially durable consumption goods. But auto sales?
 - Monsoon strengthened in September, perhaps too much unfortunately in J&K.
 - Exports strong.
 - Need investment – why credit growth does not give full picture.
 - Inflation coming down, consistent with our forecasts.
 - Bottom line: Macro-indicators improving but still some way to go.

Changes in Banking Sector

- 2 new universal banks, more to come.
- Payment banks, small banks, PPI providers.
- Mobile-bank alliances: USSD technology.
- Business correspondents liberalized
 - NBFCs
 - Distance criteria

Changes in banking sector

- Large firms using markets and external borrowing. Shift focus to:
 - MSME
 - Receivables Exchange
 - Retail
 - Bharat Bill Payment System
- Large Projects and Infrastructure will pick up: Key contribution of banks -- Project evaluation, financial structuring, and monitoring.
 - Better evaluation – In-house skills not intermediaries. Engaged, not lazy, banking.
 - Better structuring – more genuine equity, longer payback, financed with long term debt: recent RBI relaxations.
 - Better monitoring – early recognition of diversion or distress, quick coordinated action, effective project restructuring.
 - ARCs
 - Selling loans post construction – credit enhancement through liquidity facilities.

Changes in Banking Sector

- NPAs have increased.
 - Significant portion in large infrastructure projects especially in PSBs.
 - Bad economy, poor structuring, slow down in government.
 - But also, allegations of malfeasance – Syndicate Bank.
 - Lots of good people in PSBs, but need to root out bad apples, bad practices, and weak capabilities.

Changes in Banking Sector

- Governance Reform in PSBs (Nayak Committee):
 - Splitting Chairman and CEO
 - Lengthen CEO tenure
 - Change appointment process and talent pool for management and boards of PSBs
 - Strengthen board oversight and powers and allow it to hold management accountable
 - Focus of boards on important issues
 - Compensate board members adequately
 - Human resource development through pay, incentives, and skill building – Role for Lateral Entry
 - Cut costs
 - Allow PSBs independence to make commercial decisions – government mandates should be backed by financial payments:
 - Infrastructure
 - Branch opening

Developments in Financial Inclusion

- Biggest recent development is Pradhan Mantri Jan Dhan Yojana.
- Why universal financial access is a national priority: if every Indian household is connected to the financial system:
 - Increased financial savings
 - Direct benefits transfer: Less leakage, less price distortion, more empowerment
 - Less cash economy -- Rupay
- Targets: Universality, not just speed or numbers essential.
 - Waste if duplicate accounts
 - Waste if not full coverage
 - Waste if accounts not used
 - Will work with banks to ensure effectiveness

Developments in Financial Inclusion

- Equally important for financial inclusion
 - Customer grievance handling: especially important for very poor
 - Control over BCs essential
 - RBI Code of conduct will have teeth
 - Customer literacy
 - Not just camps handing out material
 - Closer engagement on inculcating savings, investment, and security habits, and even basic business sense
 - Work with NGOs, NABARD

Developments in Financial Inclusion

- Many sectors in the economy get too little credit. Solution is to develop the financial framework across the board.
- Less effective:
 - Offer interest subventions: Interest subventions distort the price of credit and lead to misuse.
 - Waive loans instead of improving the incomes of borrowers through better governance.
 - Promise easier credit to particular sectors:
 - Should a student loan for study abroad come under priority sector?

Two recent regulatory decisions

- ATM fees:
 - RBI mandated 5 transactions per month free at any ATM.
 - Cost your bank – approx Rs.75 – because it had to pay the bank where you did the transaction.
 - No such thing as a free transaction.
 - Since this increases your bank's costs, it is passed back to the customer in some form.
 - Ultimately, those who transact more are subsidized by those who transact less.
- Should RBI mandate such cross-subsidy?
- Are we also not subsidizing the use of cash?
- Partial and very measured withdrawal of mandate in areas that are likely to be well-served by banks.
- No compulsion on banks to charge.

Two recent regulatory decisions

- Two factor authentication:
 - Introduced two factor authentication on credit cards.
 - Recently told firms who are by passing this, and indeed clearing transactions abroad, that they were contravening rules.
 - RBI against innovation!
 - Rule of law means we should enforce the rules on the books, not allow them to be violated just because the innovation is “cool”.

Two recent regulatory decisions

- Why two factor authentication: Two-factor is innovation, has enhanced peace of mind even if not universally well used.
 - Bank had not moved to two factor.
 - Lady whose credit card was stolen.
 - Tried contacting bank.
 - Bank line busy. Filed police complaint .
 - Large losses, who bears?
 - People more at margin, less trained to be secure.
 - Unless providers willing to accept liability for losses...
 - Don't take innovation in the West and say it should be implemented here unquestioningly. Take the totality of our systems into account.
- Can we do better? Of course. We also are adapting to innovation.
 - Working to allow easy use for small value payments.
 - Provider has systems to protect against misuse.
 - Provider bears costs if misused.

Conclusion

- We are in the process of picking up growth, even if the journey is likely to be bumpy at times.
- Inflation is coming down, consistent with our forecasts.
- Many opportunities in the banking sector, but also challenges.
- These are exciting times for banking in India.