Monetary Management and Financial Intermediation

03

CHAPTER

With headline inflation falling, the Reserve Bank of India has been easing the monetary policy rates. Concerns about China's economic growth and financial markets, low levels of global commodity prices and divergent monetary policy stances of the key economies have been periodically rekindling volatility in the global financial markets. Investors by and large are becoming risk averse and prefer to flee to safe havens each time a fresh crisis looms over the markets. India like most other emerging market economies has not been immune. Yet the Indian equity market has been relatively resilient during this period compared to the other major emerging market economies. The market has rebounded time and time again, and it is hoped that as the global financial markets settle down, India can become the leading investment destination owing to its robust macroeconomic fundamentals. Banking sector gross credit deployment has been sluggish during the financial year. Increasing levels of gross non-performing assets have reduced the banking sector's capacity to lend. Sluggish growth and increasing indebtedness in some sectors of the economy have impacted the asset quality of banks and this is a cause for concern. Financial inclusion is proceeding apace under the Pradhan Mantri Jan Dhan Yojana, while the Atal Pension Yojana is extending the reach of the New Pension Scheme.

Monetary Developments During 2015-16

3.2 The agreement on monetary policy framework signed between the Government and Reserve Bank of India (RBI) in February 2015 has shaped the monetary policy stance in 2015-16. The RBI further eased its monetary policy stance during the year 2015. Headline inflation based on the consumer price index (CPI) fell to below 6 per cent much ahead of the January 2016 target. The RBI reduced the statutory liquidity ratio by 0.50 per cent to 21.50 per cent in February 2015 and further eased the policy repo rate during the year to 6.75 per cent, in all making a substantial cut of 125 basis points (bps) between January

Table 3.1: Revision in Policy Rates

Effective date	Bank rate/ MSF rate* (per cent)	Repo rate (per cent)	Reverse repo rate (per cent)	Cash reserve ratio (per cent of NDTL)	Statutory liquidity ratio (per cent of NDTL)
09-08-2014	9.00	8.00	7.00	4.00	22.00
15-01-2015	8.75	7.75	6.75	4.00	22.00
07-02-2015	8.75	7.75	6.75	4.00	21.50
04-03-2015	8.50	7.50	6.50	4.00	21.50
02-06-2015	8.25	7.25	6.25	4.00	21.50
29-09-2015	7.75	6.75	5.75	4.00	21.50

Source : **RBI.**

Notes: ***: Bank Rate was aligned to MSF rate with effect from February 13, 2012. NDTL is net demand and time liabilities.**

Table 3.2: Year-on-Year Change in Monetary Aggregates as on December of Each Year (per cent)	2015	2014	2013	2012	2011	2010
1. Currency in circulation	13.0	9.6	11.1	12.0	12.4	18.2
2.Cash with banks	11.0	15.6	8.3	17.3	12.8	31.5
3. Currency with the public	13.0	9.3	11.2	11.8	12.4	17.7
4. Bankers' deposits with the RBI	17.9	7.4	9.0	-15.3	12.1	35.3
5. Demand deposits	11.9	10.4	7.4	0.1	-0.1	22.4
6. Time deposits	10.6	10.9	16.3	12.6	19.2	18.4
7. Reserve money (M0) (1+4)	14.3	9.4	10.7	4.6	12.2	22.1
8. Narrow money(M1)(3+5)	12.8	10.0	9.8	6.8	6.7	19.6
9.. Broad money (M3) (6+8)	11.0	10.7	14.8	11.2	16.0	18.7

***Source:* RBI.**

2015 and September 2015 (Table 3.1). In the bank's latest monetary policy review held on 2 February 2016, the policy repo rate remains unchanged.

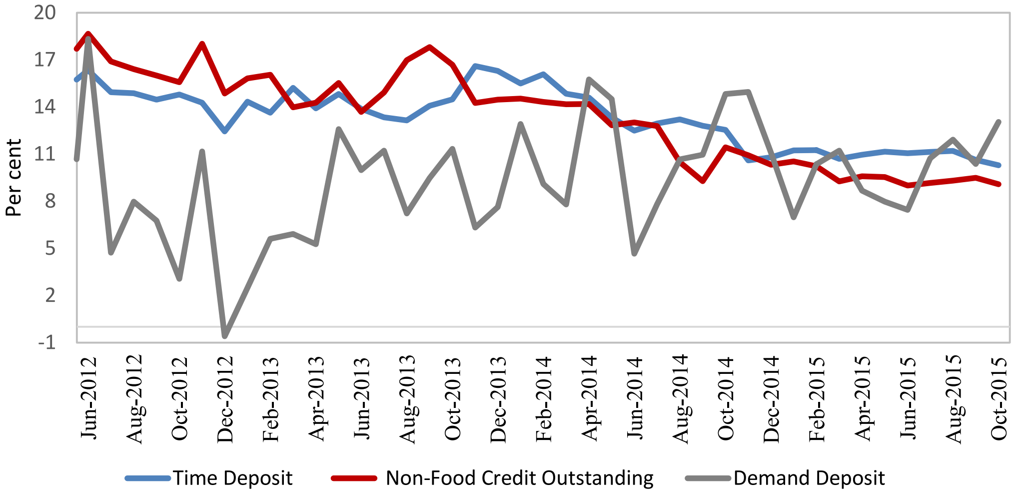
3.3 The easing of the policy repo rate has been accompanied by a pick-up in the growth rates of reserve money (M0) and narrow money (M1) in 2015.The growth in M0 has been higher owing to pickup in growth of currency in circulation and in bankers' deposit with the RBI, while the increase in M1 has been due to a higher rate of growth in demand deposits with banks. In terms of sources of reserve money, net foreign exchange assets (NFA) have been a major determinant of the growth, modulated by net domestic assets. There was a seasonal pick-up in M0 growth to above the 14 per cent mark to accommodate the festive demand at end-December 2015; it has since moderated to a 12 per cent level. However, the growth of broad money (M3) has not picked up (Table 3.2).

3.4 The year-on-year growth in time deposits fell to 10.6 per cent in December 2015. The real rate of interest on deposits turned positive in late 2013 after inflation dropped to below 9 per cent but time deposits have not picked up, partly because households savings are channelized to other avenues like gold and real estate. The slowdown in time deposits has been slowing the growth of bank credit as time deposits remain the most important source of bank funding. Time deposits are cheaper relative to other sources of funding and allow banks to afford higher interest rate spreads (Figure 3.1).

Liquidity Management

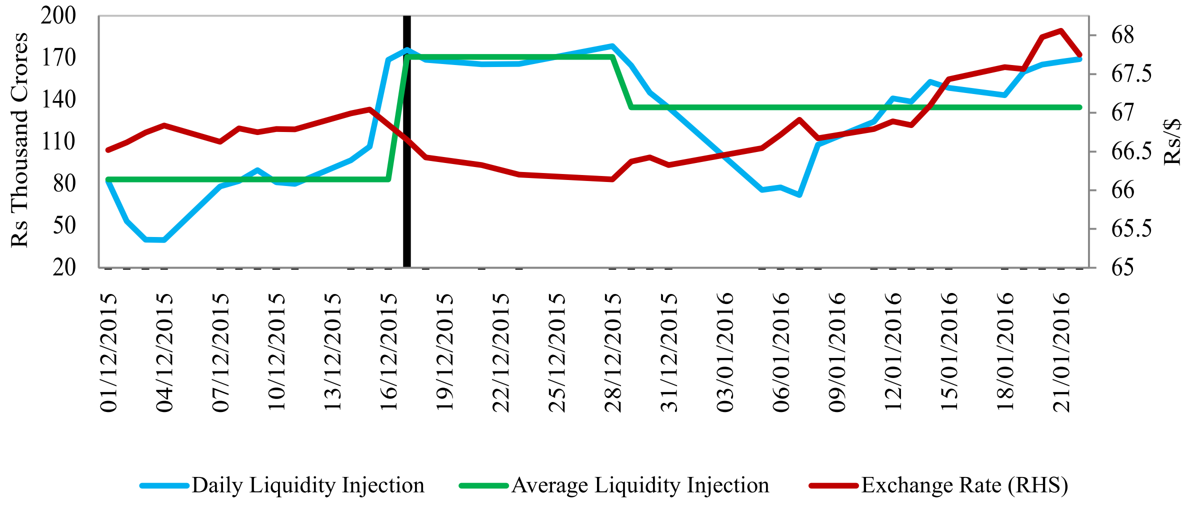
3.5 Liquidity conditions were generally tight during the first quarter (Q1) of 2015-16,

Figure 3.1: Y-o-Y Growth Rates of Selected Aggregates



***Source:* RBI.**

Figure 3. 2: Liquidity Injection and Exchange Rate

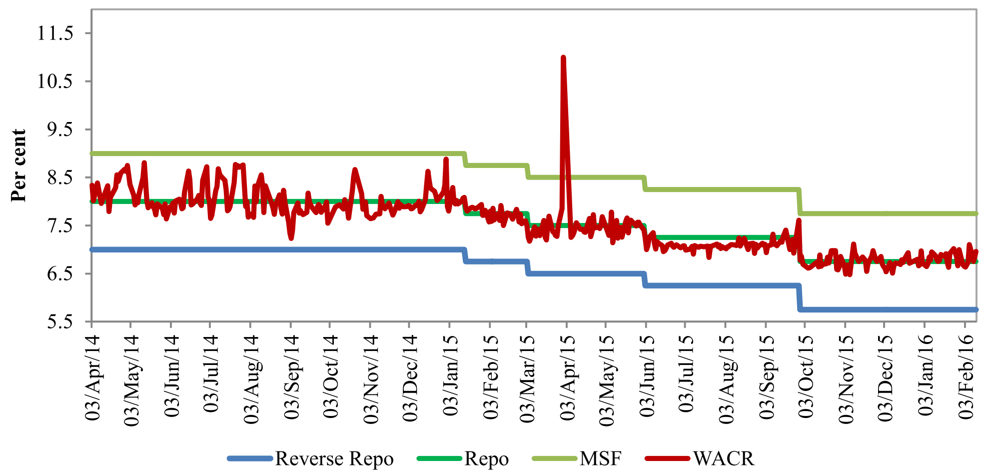


Source: **RBI.**

mainly due to slow government spending in the begining of the year. In the second quarter (Q2) of financial year (FY) 2015-16, however, liquidity conditions eased significantly as public expenditure picked up and deposits exceeded credit substantially. In the third quarter (Q3) of FY 2015-16, liquidity conditions tightened mainly due to the festive season currency demand. The RBI anchored its policy rate to achieve the domestic inflation target consistent with growth. The value of rupee also remained comparatively stable during this period. Figure 3.2 illustrates the value of rupee post the US Federal Reserve (Fed) rate hike of 17 December 2015. Average borrowing by banks have increased significantly in the immediate aftermath of the Fed rate hike compared to the pre-hike scenario, resulting in appreciation of the rupee. However, subsequent to easing of the liquidity conditions, the rupee started depreciating.

3.6 Consistent with the accommodative monetary policy stance since January 2015, the RBI has been actively managing monetary policy tools to ensure adequate liquidity in the system and accordingly the weighted average call rate (WACR),or the operating target of monetary policy, remained closely aligned to the policy repo rate. The RBI conducted variable rate repo and reverse repo (overnight and term) auctions in order to address the day-to-day liquidity requirements arising out of frictional factors, besides regular liquidity operations. The WACR declined by130 bps in response to the 125 bps cut in repo rate by the RBI since January 2015, pointing to perfect transmission at the first leg of the term structure. However, post the 29 September 2015 rate cut, call rate remained above repo rate for some time, implying tightening of liquidity conditions. Other short-term money market rates, in particular market repos and call money, also co-varied with the WACR. The revised liquidity management framework put in place by the RBI since 5 September 2014 has helped in containing volatility in the WACR. Under the new framework, the RBI used variable rate repo/ reserve repo auctions of varying tenors as well as outright open market operations, apart from the normal liquidity operations under the liquidity adjustment facility (LAF) to manage liquidity (Figure 3.3).

Figure 3.3: Policy Corridor and Call Rate



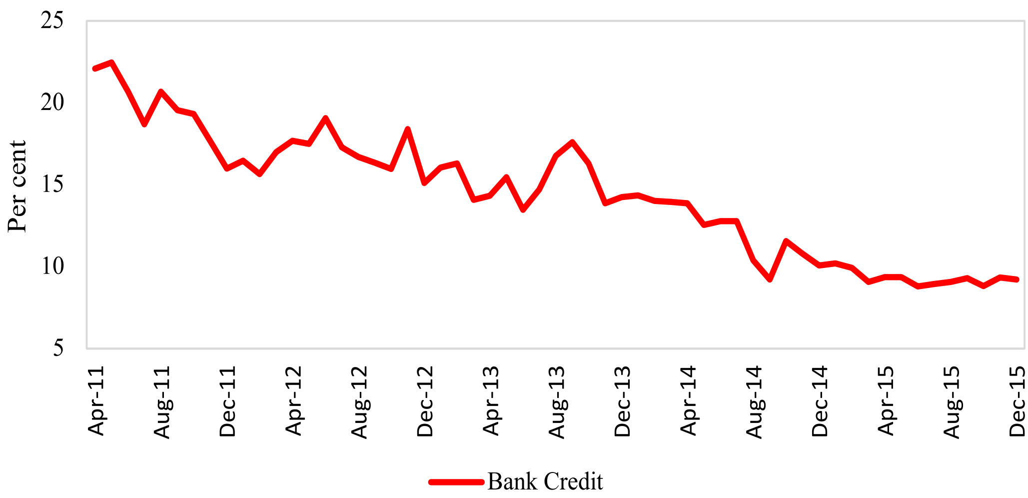
Source: **RBI.**

Bank Credit

3.7 Bank credit is an important indicator of economic activity. The high growth observed in the 2003-08 period was accompanied by a surge in monetary aggregates and credit growth, which usually exceeded the 20 per cent mark year on year. After being impacted sharply by the global financial crisis and the fiscal stimuli over the period 2008-10, credit growth remained at around the 15 per cent mark till February 2014. Subsequently, it has slowed down (Figure 3.4).

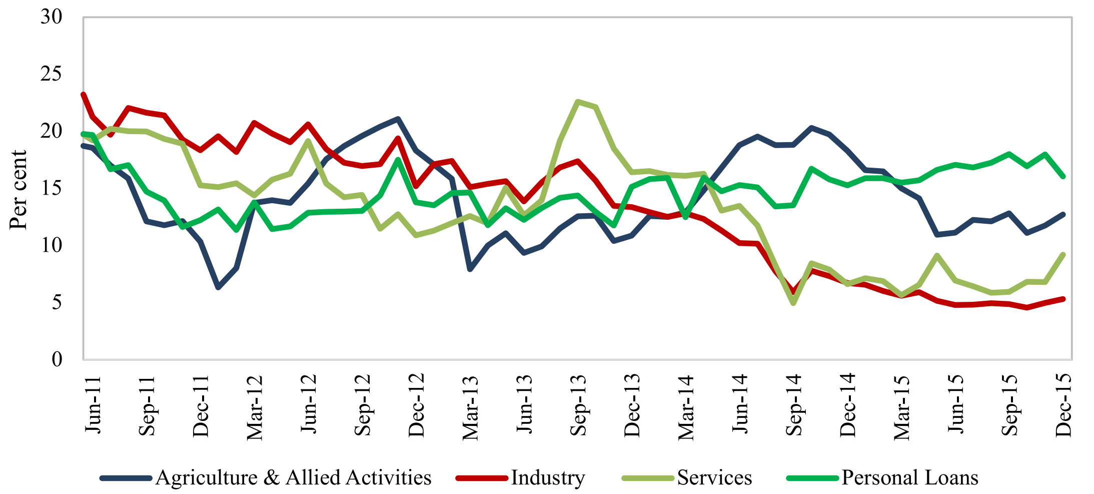
3.8 During the current financial year also, year-on-year growth in gross bank credit outstanding has remained around 10 per cent. The sluggish growth can be attributed to several factors: (a) incomplete transmission of the monetary policy as banks have not passed on the entire benefit to borrowers; (b) unwillingness of banks to lend credit on account of rising non-performing assets (NPA); (c) worsening of corporate balance sheets, forcing them to put their investment decisions on hold; (d) more attractive interest rates for borrowers in the bond market.

Figure 3.4:Growth in Bank Credit Outstanding



Source: **RBI.**

Figure 3.5: Sector-specific growth of NFC



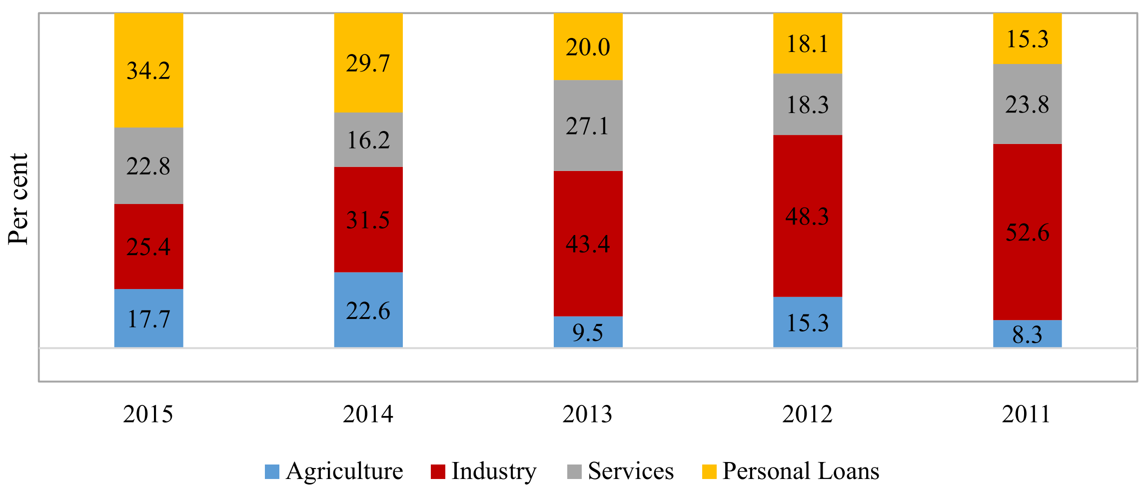
Source: **RBI.**

3.9 The trend in deployment of gross bank non-food credit by major sectors shows that credit off take by the industry sector has been slowing. The deployment of gross bank credit to industry grew at 5.3 per cent year on year in December 2015. Gross bank credit to the services sector had been increasing at sub 7 per cent for the period May-November 2015. However, it picked up in December 2015 with an increase of 9.2 per cent. The agriculture sector too saw a downturn from November 2014. It was only the personal loans segment which could benefit from the repo rate cut and it showed an accelerating growth rate from January 2015. For the month of December 2015, it posted a healthy growth rate of 16.1 per cent (Figure 3.5).

An Analysis of Annual Variation in Non-Food Credit

3.10 Figure 3.6 shows the annual credit outstanding variation of non-food bank credits (NFC) since 2011.A careful look at the sector-wise break up (Figure 3.6) shows that, as compared to earlier years, the NFC issued in 2015 is indicative of the shift in sectoral share of credit off take; in particular, the share of personal loans has increased to 34.2

Figure 3.6: Sectoral Deployment of Non-Food Bank Credit



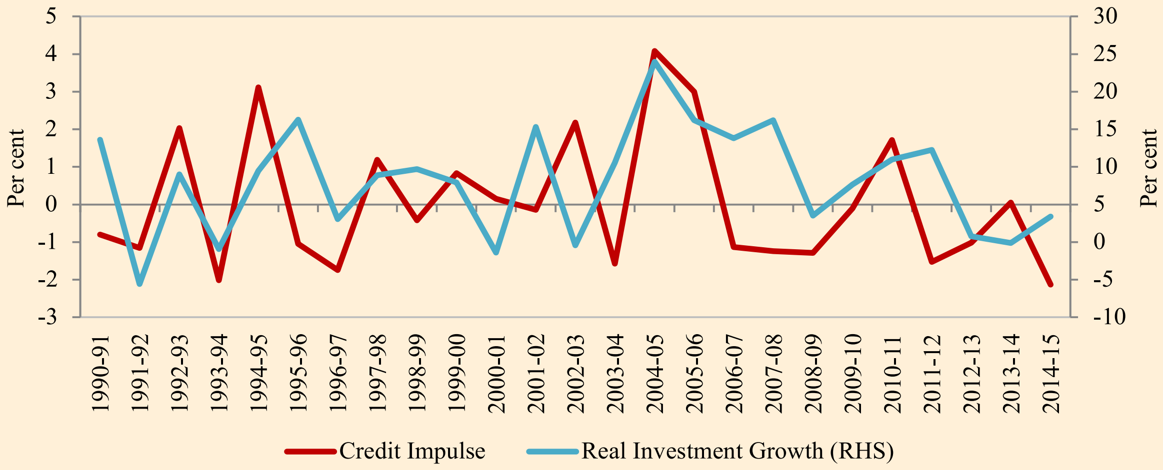
Source: **RBI.**

Box 3.1: Credit Impulse on the Rise

The concept of credit impulse was first introduced by Deutsche Bank economist Michael Biggs, in November 2008. The concept emphasizes that spending is a flow and as such it should be compared with net new lending, a flow, rather than credit outstanding, which is a stock. Credit impulse is measured as the change in new credit issued as a percentage of the gross domestic product (GDP). The studies, analysing credit flow data since 2008 covering several countries, have shown that investment growth is very closely correlated with credit impulse. Studies also show that credit impulse, in comparison with other credit variables, is better able to predict recoveries from a recession.

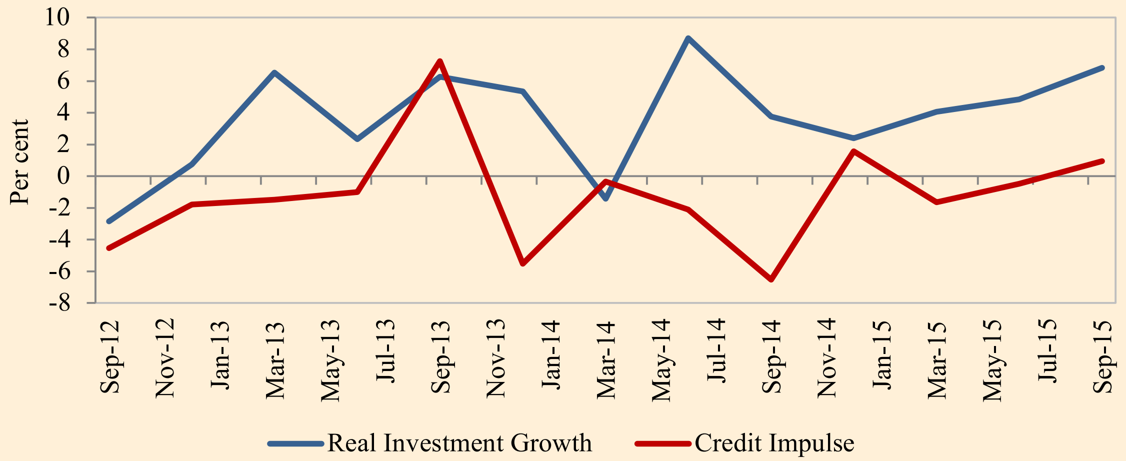
Figure 1 depicts the rate of credit impulse and investment in India post liberalization. The annual variation in gross bank credit outstanding has been used as a proxy for new lending. The figure 1 shows that both these variables have been moving in tandem, sharing similar troughs and peaks. The sharp increases in the credit impulse rate in the post-reform phase of the early 1990s, the peak economic growth phase of 2003-04 to 2007-08 and the credit boom of 2009-10 have been matched by high rates of investment.

Figure 1: Credit Impulse and real investment Growth



Credit impulse has shown a consistent rise since March 2015 and this is also reflected in the real investment growth rate. Given that there is a strong correlation between credit impulse and investment growth, the rise in credit impulse may help push the growth of real investment in the near future, though this may not be a conclusive indicator as several other factors also affect investment.

Figure 2: Credit Impulse and Growth of Investment



per cent in 2015 as compared to 15.3 per cent in 2011. Thus, consumption expenditure has been the key driver of the economy during the current financial year. However, it is a cause for concern that the share of industry has come down significantly from 53 per cent in 2011 to just 25 per cent in 2015. The decline reflects the muted market sentiments leading to slowdown in private investment demand and industrial growth, poor earnings growth of the corporate sector, and risk aversion on the part of banks in the background of rising gross NPAs.

3.11 Sub-sector-wise deployment of non-food credit shows that in the year 2015, ₹ 1.36 lakh crore was issued as new loans (as measured by annual variation in credit outstanding)to the industry sector, of which two sub-sectors, namely power and iron and steel, alone accounted for 58 per cent. The share of iron and steel jumped from just 9 per cent in 2014 to 19 per cent in 2015 whereas the share of the power sector increased from 29 per cent in 2013 to 39 per cent this year.

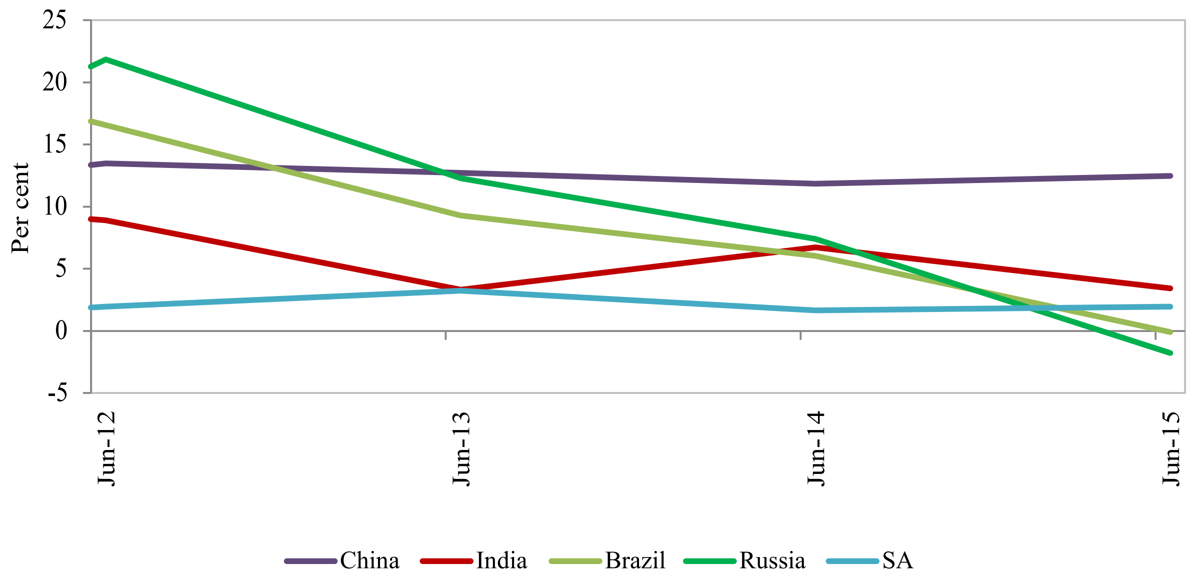
Comparative Credit Flow Trend in BRICS Economies

3.12 A comparative analysis of real credit flows among the BRICS (Brazil, Russia, India, China and South Africa) economies shows that bank credit growth has remained subdued in all but China. Credit flows declined to below 10 per cent in India, South Africa and Brazil. In the case of Russia, credit flow has seen a sharper decline (Figure 3.7).

Interest Rates of Scheduled Commercial Banks Excluding Regional Rural Banks

3.13 In response to the reduction in the policy repo rate by 125 bps since January 2015, scheduled commercial banks (SCB) reduced their median-term deposit rate by 72 bps and median base rate by 60 bps up to 15 December 2015 (Table 3.3). The weighted average lending rate (WALR) on fresh rupee loans sanctioned by banks declined by 60 bps, while that on outstanding rupee loans fell by 53 bps, during January-October 2015. The RBI in its Financial Stability Report of September 2015 has pointed out that full

Figure 3.7: Comparative Year-on-Year Growth of Real Bank Credit Outstanding



Source: **Bank of International Settlements and International Monetary Fund (IMF).**

pass-through has not happened owing to structural rigidities in the credit market. The key reasons for structural rigidities are: (a) mobilization of deposits at fixed rates with only about 20 per cent of term deposits getting re-priced during a year; (b) competition from small savings schemes where the interest rates are revised with considerable lags; (c) savings deposit rates of public sector banks remaining unchanged at 4 per cent despite deregulation in October 2011; and (d) base rate of banks being mostly determined on the basis of average cost rather than marginal cost.

Performance of SCBs

3.14 The performance of SCBs during 2015-16 remained subdued. The slowdown in growth in the balance sheets of banks witnessed since 2011-12 continued in 2015-16. The moderation in the growth of assets of SCBs can mainly be attributed to tepid growth (below 10 per cent) in loans and advances. Growth in investments also slowed down marginally. The decline in credit growth reflected the slowdown in industrial credit off take, poor earnings growth reported by the corporate sector and risk aversion on the part of banks owing to rising NPAs. Further, with the availability of alternative sources, corporate sector companies also switched part of their financing needs to other sources such as external commercial borrowings (ECB), corporate bonds and commercial papers.

3.15 During 2014-15, the capital to risk-weighted assets ratio (CRAR) of SCBs remained well above the stipulated minimum of 9.0 per cent. However, the CRAR of SCBs declined to 12.7 per cent from 13.0 per cent between March and September 2015.

Table 3.3: Deposit and Lending Rates of SCBs (Excluding RRBs)(per cent)

Items	Average Interest Rates					Variation (%ge points)
	Dec-14	Mar-15	Jun-15	Sep-15	Dec 15, 2015	Since end-Dec 2014
A. Domestic deposit rates of SCBs-all maturities	7.50	7.46	7.25	7.08	6.90	-0.60
(i) Public Sector Banks	7.56	7.52	7.15	6.93	6.65	-0.91
(ii) Private Sector Banks	7.50	7.48	7.26	6.99	6.81	-0.69
(iii) Foreign Banks	7.45	7.41	7.35	7.34	7.18	-0.27
Median Term Deposit Rate	7.55	7.50	7.22	7.02	6.83	-0.72
B. Base rate of all SCBs	10.14	10.09	9.96	9.89	9.71	-0.43
(i) Public Sector Banks	10.23	10.21	9.98	9.95	9.69	-0.54
(ii) Private Sector Banks	10.63	10.61	10.45	10.38	10.17	-0.46
(iii) Foreign Banks	9.85	9.77	9.72	9.62	9.49	-0.36
Median Base Rate	10.25	10.20	9.95	9.93	9.65	-0.60
C. WALR (Outstanding ₹ Loans)					Oct-15	
(i) Public Sector Banks	12.05	12.01	11.91	11.67	11.50	-0.55
(ii) Private Sector Banks	12.35	12.25	12.08	11.98	11.85	-0.50
(iii) Foreign Banks	12.01	11.84	11.69	11.57	11.39	-0.62
Scheduled Commercial Banks	12.11	12.06	11.94	11.73	11.58	-0.53
D. WALR (Fresh ₹ Loans)						
(i) Public Sector Banks	11.45	11.10	11.08	11.22	11.05	-0.40
(ii) Private Sector Banks	12.09	11.93	11.68	11.30	11.47	-0.62
(iii) Foreign Banks	10.69	10.50	10.33	10.18	9.76	-0.93
Scheduled Commercial Banks	11.57	11.23	11.15	11.13	10.97	-0.60

Source: **RBI.**

Note: **RRBs: regional rural banks; WALR: Weighted Average Lending Rate. Data on WALR is provisional.**

Given the deterioration in asset quality and gradual implementation of Basel III, banks will have to improve their capital positions to meet unforeseen losses in future. The estimated capital requirement (excluding internal generated profit) for the next four years up to FY 2018-19 is likely to be about ₹1,80,000 crore. Of this total requirement, the Government of India proposes to make ₹70,000 crore available out of budgetary allocations during the current and succeeding years. During 2015-16 the government has so far released a sum of ₹19,950 crore to 13 public sector banks (PSB).

3.16 The asset quality of SCBs have come under stress in recent times. Gross non-performing advances (GNPA) of SCBs as a proportion of gross advances increased to 5.1 per cent from 4.6 per cent between March and September 2015. Restructured standard advances as a proportion of gross advances declined to 6.2 per cent from 6.4 per cent in the same period, while the stressed advances to total gross advances ratio increased to 11.3 per cent from 11.1 per cent. PSBs had the highest level of stressed assets (gross plus restructured assets) at 14.0 per cent of the total, followed by private sector banks (PVB) at 4.6 per cent and foreign banks (FB) at 3.4 per cent at end-September 2015. The net non-performing advances (NNPA) as a proportion of total net advances for all SCBs increased to 2.8 per cent from 2.5 per cent during the period from March 2015 to September 2015. At the bank group level, the NNPA ratio of PSBs increased from 3.2 per cent to 3.6 per cent, whereas, in the case of PVBs and FBs, it remained unchanged at 0.9 per cent and 0.5 per cent respectively during the same period.

3.17 The contribution of five sub-sectors, namely mining, iron and steel, textiles, infrastructure and aviation (which together accounted for 24.2 per cent of the total advances of SCBs as of June 2015) to the total stressed advances was 53.0 per cent. Stressed advances in the aviation sector increased to 61.0 per cent in June 2015 from 58.9 per cent in March 2015, while stressed advances of the infrastructure sector increased to 24.0 per cent from 22.9 per cent during the same period. The performance of these sectors and their impact on the asset quality of banks continue to be a cause for concern.

Financial Inclusion

3.18 The number of new basic savings bank deposit accounts (BSBDAs) rose considerably during the year on account of the government's initiative under the Pradhan Mantri Jan Dhan Yojana (PMJDY). BSBDAs reached 441 million for the period ended September 2015 as against 398 million for the year ended March 2015. The total number of banking outlets went up from 553,713 as at end-March 2015 to 567,530 (517,328 branchless modes and 50,202 branches)as at end-September 2015. Business Correspondent–Information and Communication Technology (BC-ICT) transactions in BSBDAs showed steady progress with 359 million transactions during the April-September 2015 period, as against 477 million recorded for the year ended March 2015.

3.19 Brick-and-mortar branches are an integral component of financial inclusion and for increasing banking penetration. Hence, State Level Bankers Committee convenor banks have been advised in December 2015 to identify villages with population more than 5000 without an SCB branch. The opening of bank branches under a roadmap is scheduled to be completed by 31 March 2017. Box 3.2 discusses the Pradhan Mantri Mudra Yojana (PMMY), an initiative for providing finance to informal sector micro enterprises launched on 8 April 2015.

Non-Banking Financial Companies

3.20 Based on their liability structure, non-banking finance companies(NBFC) are classified into two broad categories: (a) deposit-taking NBFCs (NBFC-D), and (b)

Box 3.2: Pradhan Mantri Mudra Yojana

In pursuance of the announcement in the Union Budget 2015-16 of the setting up of a Micro Units Development Refinance Agency (MUDRA) to refinance last mile financers, the Pradhan Mantri Mudra Yojana (PMMY) has been launched on 8 April 2015. MUDRA seeks to offer refinance products having a loan requirement up to ₹10 lakh and support to micro finance institutions (MFI) by way of refinance. The products designed under the PMMY are categorized into three buckets of finance named Shishu (loan up to ₹50,000), Kishor (₹50,000 to ₹5 lakh) and Tarun (₹5 lakh to ₹10 lakh) based on the stage of growth/development of the micro business units, with about 60 per cent of the allocation to Shishu. The PMMY aims to provide formal bank credit to the more than 5.7 crore existing informal sector micro enterprises and many more aspiring micro entrepreneurs in the country. The total amount disbursed under the PMMY up to mid-January 2016 stood at ₹84,672.36 crore, of which ₹38,057.33 has been disbursed under Shishu, ₹28,359.87 under Kishor and ₹18,255.16 under Tarun. In all 2.19 crore borrowers have benefited so far, of which 1.62 crore are women, 77.12 lakh are new entrepreneurs and 1.10 crore belong to the scheduled caste/scheduled tribe/other backward classes category.

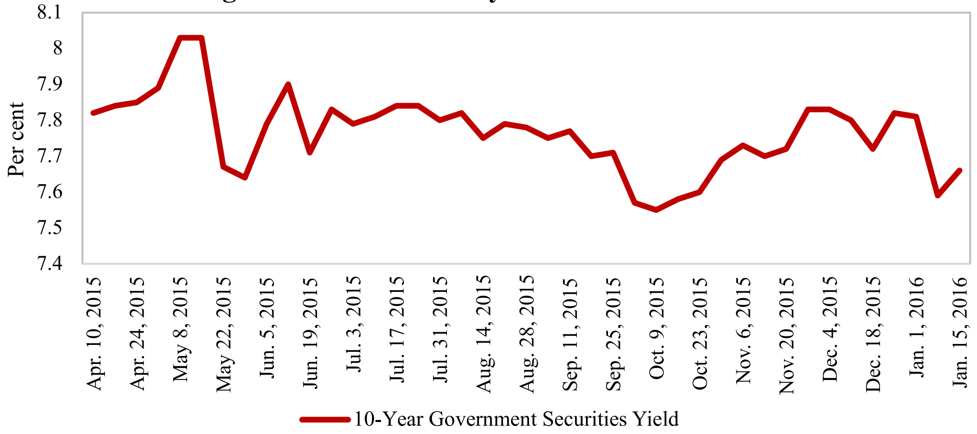
non-deposit taking NBFCs (NBFC-ND). As of 30 September 2015, there were 11,781 NBFCs registered with the RBI, out of which 212 were NBFCs-D and 11,569 were NBFCs-ND. NBFCs accounted for 14.8 per cent of SCB assets and 0.3 per cent of SCBs deposit as on 31 March 2015.

3.21 As at end-March 2015, the consolidated balance sheet of NBFCs-D expanded marginally by 2.1 per cent, year-on-year. On the liability side, borrowing from banks, which is the major source of funds, increased by 5.8 per cent. Notwithstanding the fact that the number of NBFCs-D declined during the year, the deposits mobilized by them increased by 5.8 per cent. On the asset side, loans and advances of NBFCs-D, which constituted close to three-fourths of their assets, increased marginally by 1 per cent at end-March 2015. The assets of systemically important non-deposit-taking NBFCs (NBFCs-ND-SI) expanded significantly by 15.9 per cent as at end-March 2015. Loans and advances, which formed the major part of their assets, grew by 15.5 per cent. Borrowing of NBFCs-ND-SI, which constituted more than two-thirds of their total liabilities, increased by 17.4 per cent as at end-March 2015. The NBFCs-ND-SI raised resources mainly by floating debentures, followed by borrowing from banks, commercial paper and inter-corporate borrowing.

Developments in the Government Securities Market

3.22 Ten-year government bonds reflect the long end of the yield curve and are also proxy for assessing the credit risk of the sovereign. The yields on government securities were affected by a number of factors in the current financial year. The benchmark 10-year yield started the year at 7.78 per cent, reached its highest level of 7.99 per cent on 12 May 2015, before falling to a two-year low of 7.48 per cent after a 50 bps rate cut by the RBI on 29 September 2015(Figure 3.8). The hardening bias on yields till early May 2015 was primarily on account of an increase in crude prices from their multi-year low level in mid-March 2015, a global rise in government bond yields including in advanced countries, turbulence witnessed by global financial markets and a depreciating rupee. It saw a return to some stability post the announcement of a new 10-year paper on 19 May 2015 and continued positive developments on the inflation front. The market witnessed another round of volatility in August 2015, caused by developments in China. The new ten-year benchmark paper breached the 7.91 per cent level towards August end. Subsequently, the RBI's policy repo rate cut by 50 bps on 29 September 2015 and announcement of a medium-term framework (MTF) for staggered increase

Figure 3.8: Yield on 10-year Government Bond



Source: **RBI.**

of foreign portfolio investment (FPI) limits in debt securities increased buoyancy in the market. However, the market continued to lose some of its gains after mid-October, owing to fresh concerns on global cues, as well as some domestic concerns.

Developments in the Capital Market

Primary Market

3.23 In 2015-16 (April-December), resource mobilization through the public and right issues has surged rapidly as compared to the last financial year. During 2015-16 (April-December), 71 companies have accessed the capital market and raised ₹51,311 crore, compared to ₹11,581 crore raised through 61 issues during the corresponding period of 2014-15.

3.24 The small and medium enterprises (SME) platform of the stock exchange is intended for small and medium sized companies with high growth potential, whose post issue paid-up capital is less than or equal to ₹ 25 crore. During 2015-16 (April-December), 32 companies were listed on the SME platform, raising a total amount of ₹278 crore as compared to ₹229 crore raised through 28 issues in the corresponding period of 2014-15.

3.25 Resources mobilized by mutual funds during April-December 2015 also increased substantially to ₹1,61,696 crore from ₹87,942crore mobilized during the same period of the previous year. Table 3.4 provides a picture of resource mobilization in the primary market.

Table 3.4: Resource Mobilization in the Primary Market (₹ crore)

	2013-14	2014-15	2014-15	2015-16
			April-December	
Debt	42383	9713	7348	30421
Equity	13269	9789	4233	20890
of which IPOs	1236	3039	1420	12259
Private placement of corporate bonds	276054	404137	269245	341420

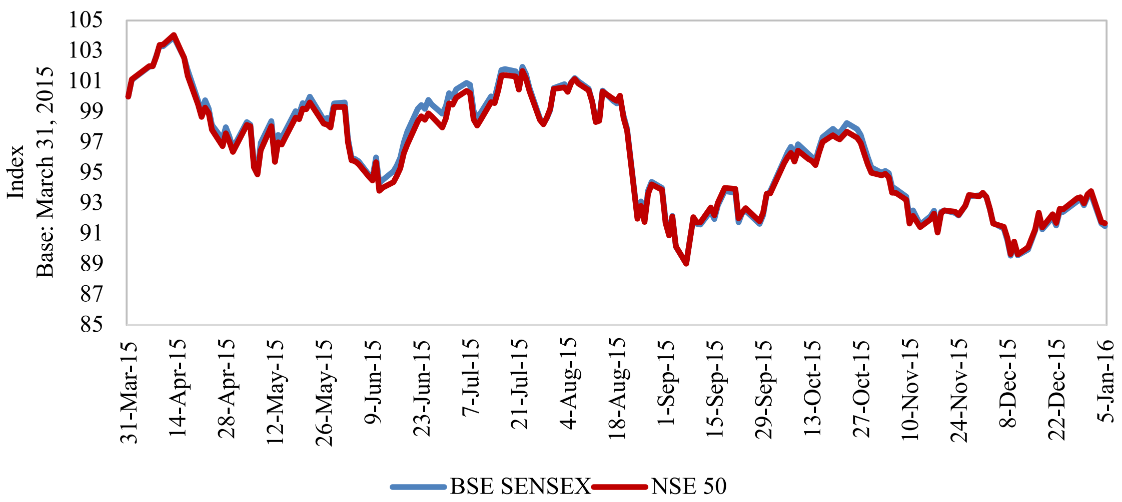
Source : Securities and Exchange Board of India (SEBI).

Note: **IPO stands for initial public offering.**

Secondary Market

3.26 During 2015-16 so far, the Indian securities market has remained subdued (Figure 3.9). The Bombay Stock Exchange (BSE) Sensex declined by 8.5 per cent (up to 5 January 2016) over end-March 2015, mainly on account of turmoil in global equity markets in August 2015 following slowdown in China and its currency devaluation and slump in stocks. On 4 January 2016, weak Chinese manufacturing data again led to a global sell-off which caused the BSE Sensex also to decline by 538 points (2.1

Figure 3.9: Movement in BSE Sensex and Nifty 50



Source: **SEBI**

per cent). The downward trend in the Indian stock market was also guided by mixed corporate earnings for Q1 and Q2 of 2015-16, FPIs' concern over minimum alternative tax (MAT), weakening of the rupee against the US dollar, investor concern over delay in passage of the Goods and Services Tax (GST) Bill, uncertainty over interest rate hike by US Fed and selling by FPIs. However, the Indian equity market has been relatively resilient during this period compared to the other major EMEs. The Indian stock market withstood the US Fed increase in interest rates in December 2015.

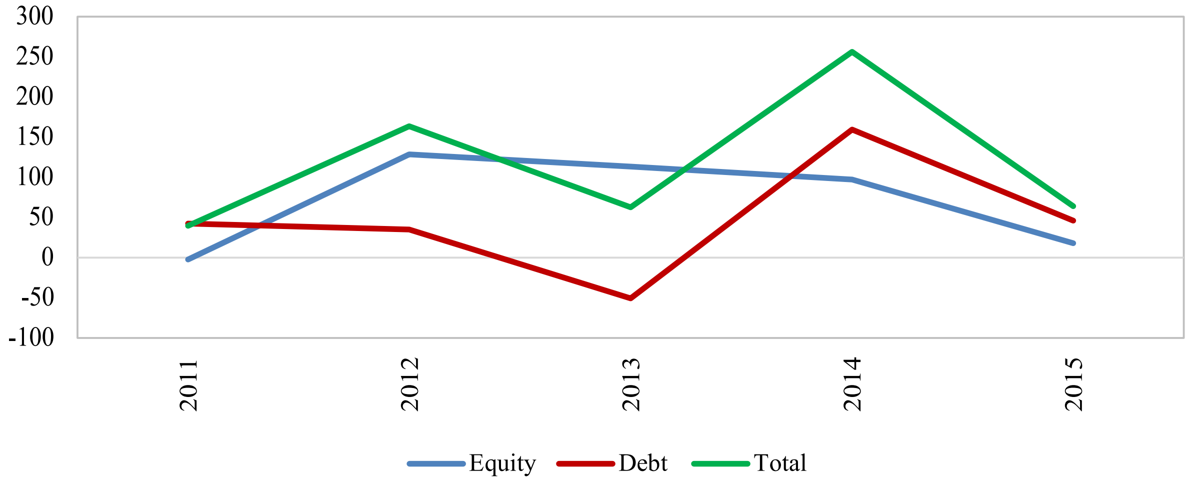
Box 3.3: New Gold Investment Schemes

Government had launched Sovereign Gold Bonds and Gold Monetisation Schemes on 5th November, 2015. The main objectives of the schemes are to reduce the demand for physical gold and shift a part of the gold imported every year for investment purposes into financial savings.

Sovereign Gold Bonds: These are issued by RBI on behalf of the Government of India in rupees and denominated in grams of gold and restricted for sale to the resident Indian entities only both in demat and paper form. The minimum and maximum investment limits are two grams and 500 grams of gold per person per fiscal year respectively. The rate of interest for the year 2015-16 is 2.75 per cent per annum, payable on a half yearly basis. The tenor of the Bond is for a period of 8 years with exit option from 5th year onwards. KYC norms are the same as that for gold. Exemption from capital gains tax is also available. Redemption is made in the rupee value equivalent to the price of gold at the time of maturity. In the first two tranche of SGB total subscription of 3788 kilograms of gold amounting to ₹ 993 crore were received from about 3.90 lakh applications.

Gold Monetisation Scheme: Bureau of Indian Standards (BIS) certified Collection, Purity Testing Centres (CPTC) collect the gold from the customer on behalf of the banks. The minimum quantity of gold (bullion or jewellery) which can be deposited is 30 grams and there is no limit for maximum deposit. Gold Saving Account can be opened with any of the designated bank and denomination in grams of gold for short-term period of 1-3 years, a medium-term period of 5-7 years and a long-term period of 12-15 years .The CPTCs transfer the gold to the refiners. The banks will have a tripartite / Bipartite Legal Agreement with refiners and CPTCs. For the year 2015-16 interest rates has been fixed as 2.25 percent and 2.5 percent for the medium and long term respectively. Redemption is made in cash/gold for short term and in cash for medium and long term deposits. Tax exemption are same as those available under GDS 1999.The difference between the current borrowing cost for the Government and the interest rate paid by the Government under the medium/long term deposit shall be credited to the Gold Reserve Fund. As of 2 February 2016, a total of 1030.2 kilo grams of gold have been mobilized through the scheme

Figure 3.10: Net FII Investment (in Rs. crore)



Source: SEBI

Institutional Investments

3.27 The net investment by FPIs/ foreign institutional investor (FII) in Indian markets has been to the tune of ₹ 63,663 crore in 2015 as compared to ₹2,56,213 crore in 2014.Net FII investment from 2011 to 2015 is shown in Figure 3.10.

3.28 With the objective of putting in place a more predictable regime for investment by FPIs, the MTF for FPI limits in debt securities has been laid out. The limits for FPI investment in debt securities will henceforth be announced/fixed in rupee terms. The limits for FPI investment in central government securities will be increased in phases to 5 per cent of the outstanding stock by March 2018. In aggregate terms, this is expected to open up room for additional investment of ₹1200 billion in central government securities (G-sec) by March 2018 over and above the existing limit of ₹1,535 billion. The existing requirement of a minimum residual maturity of three years for investments being made in G-sec will continue to apply to all categories of FPIs. Aggregate FPI investments in any central government security would be capped at 20 per cent of the outstanding stock of the security.

3.29 In order to facilitate rupee-denominated borrowing from overseas, the government decided to put in place a framework for issuance of rupee-denominated bonds overseas within the overarching ECB policy. The minimum maturity period of these bonds will be five years and the all-in-cost of such borrowings should be commensurate with prevailing market conditions. No end-use restrictions are envisaged except for a negative list which includes investment in real estate and capital markets. Withholding tax of 5 per cent will be applicable on interest income from these bonds, but the capital gains arising in case of appreciation of the rupee will be exempted from tax.

3.30 The RBI in consultation with the Ministry of Finance has put in place a revised ECB framework from 2 December 2015. The new ECB framework is more attuned to the current economic and business environment and is also more simplified and streamlined. From a regulatory perspective, three main clear-cut categories/buckets have been created which include medium-term foreign currency-denominated ECB, long-term foreign currency-denominated ECB (with minimum average maturity of 10 years) and Indian rupee-denominated ECB. The new

Box 3.4: Reforms in the Financial Sector

During 2015, the government has initiated a number of reform measures in the financial sector. The Forwards Markets Commission (FMC) has been merged with the Securities and Exchange Board of India (SEBI) with effect from 28 September 2015 to achieve convergence of the regulation of the securities and commodity derivatives markets and increase the economies of scope and scale for exchanges, financial firms and other stakeholders. A Monetary Policy Agreement has been signed between the government and the RBI in February 2015. Going forward, the government intends to deepen such reforms including amendment of the RBI Act for providing a statutory Monetary Policy Framework and Monetary Policy Committee, strengthening and upgrading the Securities Appellate Tribunal to the Financial Sector Appellate Tribunal and creation of a Resolution Corporation to enable faster dispersal of deposit insurance as well as orderly resolution of financial service providing companies.

As announced in the budget speech of the Finance Minister in 2014-15, for providing an entrepreneur-friendly legal bankruptcy framework for India, the Insolvency and Bankruptcy Code 2015 has been introduced in the Parliament on 21 December 2015. The bill seeks to consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time-bound manner for maximization of the value of assets of such persons, to promote entrepreneurship and availability of credit, to balance the interests of all the stakeholders including alteration in the order of priority of payment of government dues and to establish an Insolvency and Bankruptcy Fund, and for matters connected therewith or incidental thereto.

Financial Stability and Development Council

With a view to strengthening and institutionalizing the mechanism for maintaining financial stability, enhancing inter-regulatory coordination and promoting financial sector development, the Financial Stability and Development Council (FSDC) under the chairmanship of union Finance Minister was set up by the government as the apex-level forum in December 2010. The council maintains macro prudential supervision of the economy, including functioning of large financial conglomerates, and addresses inter-regulatory coordination and financial sector development issues, including those relating to financial literacy and financial inclusion. During 2015-16, the Council held three meetings up to January 2016. The meetings assessed issues related to macroeconomic financial stability and discussed important matters such as corporate bond market development, building effective deterrence in bank frauds, NPAs of banks, corporate sector balance sheet stress, report of activities under the Financial Stability Board (FSB) and Financial Action Task Force (FATF) and follow up on the recommendations of the special investigation team (SIT) on black money.

The FSDC sub-committee set up under the chairmanship of the Governor of the RBI held two meetings in 2015-16.The meetings discussed global and domestic factors impinging on financial stability, the Financial Stability Report, standards and protocol for setting up account aggregation for financial assets, allowing insurance companies and mutual funds as protection sellers in credit default swaps (CDS), corporate bond market development, etc.

framework has an expanded list of recognized lenders comprising overseas regulated financial institutions, sovereign wealth funds, pension funds, insurance companies, etc. and has an exhaustive list of permissible end-users with only a small negative list for long-term foreign currency-denominated ECB and INR-denominated ECB.

Insurance Sector

3.31 The total insurance premium generated by the insurance sector increased from ₹3,94,235 crore in 2013-14 to ₹4,15,252 crore in 2014-15. During this period, life insurance premium registered a growth of 4.4 per cent whereas the general insurance business grew by 9 per cent.

3.32 Insurance penetration, which is premium volume as a ratio of GDP, was 2.71 per cent in 2001 and 3.3 per cent in 2014. Insurance density, which is measured as the ratio of premium to population (per capita premium), increased from US$11.5 in 2001 to US$55 in 2014. Globally, insurance penetration and density were 3.4 per cent and US$368 respectively for the life segment

Box 3.5: New Insurance and Pension Schemes

Three schemes were launched in 2015 in the insurance and pension sectors for creating a universal social security system for all Indians, especially the poor and underprivileged. These were the Pradhan Mantri Suraksha Bima Yojana (PMSBY), the Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY) and the Atal Pension Yojana (APY) and they were launched on a pan-India basis on 9 May 2015. The salient features of the three schemes are as follows:

1. The PMSBY offers a renewable one-year accidental-death-cum-disability cover to all subscribing bank account holders in the age group of 18 to 70 years for a premium of ₹12 per annum per subscriber. The risk coverage available will be ₹ two lakh for accidental death and permanent total disability and ₹ one lakh for permanent partial disability, for a one-year period stretching from 1 June to 31 May. As on 1 January 2016, cumulative gross enrolment by banks under the PMSBY is over 9.28 crore. Over 2200 claims were registered under this scheme, out of which more than 1200 have been paid so far.
2. The PMJJBY offers a renewable one-year term life cover of ₹ two lakh to all subscribing bank account holders in the age group of 18 to 50 years. As on 1 January 2016, cumulative gross enrolment by banks under the PMJJBY is over 2.93 crore. Over 11,600 claims were registered under the PMJJBY, out of which more than 9300 have been settled.
3. The APY was launched in May 2015 and it provides a defined pension, depending on the contribution and its period. The subscribers to the APY will receive a minimum pension of ₹ 1000, 2000, 3000, 4000 or 5000 per month, from the age of 60 years, depending on their contributions, which are themselves based on the age of joining the scheme. The scheme is open to all bank account holders. The central government co-contributes 50 per cent of the total contribution subject to a maximum of ₹ 1000 per annum, to each eligible subscriber's account, for a period of five years, i.e. from FY 2015-16 to FY 2019-20, who joined the APY between 1 June 2015 and 31March 2016 and who is not a member of any statutory social security scheme and is not an income tax payer.

in 2014 and 2.7 per cent and US$294 respectively for the non-life segment.

3.33 An analysis of the claims-position for the life insurance sector during the period 1 April 2014 to 31 March 2015 indicates an increase in settlement ratio to 96.97 per cent from 96.75 per cent in the previous year for individual claims and a decrease to 96.15 per cent from 96.22 per cent in the previous year for group claims. The repudiation ratio during the same period has been 2.08 per cent and 0.76 per cent for individual claims and group claims respectively. Box 3.5 lists the new insurance and pension schemes launched by the government.

Pension Sector

3.34 The National Pension System (NPS) is a defined contribution-based pension scheme launched by the Government of India with the objectives of providing old age income, market-based returns over the long run and extending old age income security coverage to all citizens. The efforts of the government are to widen the reach of the scheme beyond employees who are within the government fold.

3.35 Till 31December 2015, a total of 112.82 lakh members/ subscribers, inclusive of the APY, have been enrolled under the NPS. Assets under management (AUM), which includes returns on the corpus under the NPS, have witnessed an increase of 33 per cent from ₹80,855 crore on 31 March 2015 to ₹1, 07,802 crore on 31 December 2015. The APY has a total of about 18 lakh subscribers and a corpus of ₹262 crore as on 31 December 2015. As on 31 December, 2015, 351 banks are registered as APY service providers which include PSBs, PVBs, FBs, and RRBs, district commercial banks, SCBs, urban commercial banks and the Department of Post.