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1. FROM THE DESK OF CHIEF ECONOMIST

Outcome of Davos World Economic Forum 2024

The global economy is battling various conflicts - weakening growth, high inflation, war in Gaza and Ukraine, deglobalization, fragmented supply chains, climate change threats, AI-generated fake news and deep fakes and their threat to elections, debt crisis in emerging markets, and slowing down of China.

Houthi rebels from Yemen have attacked commercial vessels traveling in the Red Sea since late November. Several cargo ships have halted their transit through the region and are instead moving goods via the Cape of Good Hope in Africa. The diversion adds around 10 days, making it longer and costlier to move items from Asia to Europe and vice-versa.

Volatility in supply chains could mean higher prices for consumers and a greater challenge for central bankers, who have been tackling high inflation since 2022.

In 2024, many countries are set for general elections. At least 64 countries including India, USA, Iran, EU are meant to hold national elections, impacting a combined population of over 4 billion worldwide.

Amidst this backdrop, Davos once again hosted the annual week-long World Economic Forum, where members of the global elite gather to discuss the problems plaguing or facing the world.

The city has hosted the Forum's annual meeting every January for the past five decades, beginning 1971. Davos brings together around 3,000 participants including investors, business leaders, political leaders, economists, celebrities, and others to discuss global issues across 500 sessions. Under the motto "Rebuilding Trust", the 54th annual meeting of the World Economic Forum (WEF) began on January 15, aiming to discuss "the basic principles of trust" – transparency, coherence and responsibility.

Here are some key trends that emerged from the Forum:

1. The USA and global economy are expected to avoid a recession in 2024. The contributing factors to this positive outlook include potential interest rate cuts by the Federal Reserve and an upswing in consumer confidence. Potential risks of another Donald Trump presidency on US and global economy were not discussed.
2. Artificial Intelligence is the next big revolution that will increase human productivity by many folds. The view for the technology was optimistic rather than dystopian. Instead of Artificial Intelligence replacing humans, it will act as a tool to supplement humans with their work and increase their productivity.

   AI-enabled benefits will vary widely across income groups, with notably more optimistic views about the effects in high-income economies. Generative AI will increase the efficiency of output production (79%) and innovation (74%) in high-income economies this year. Though, with surge in adoption of Artificial Intelligence in various businesses, processes and rapid innovation in the technology the political, societal and ethical aspects need to be covered.
3. China's growth has slowed in comparison to its long term trend. China's economy grew at 5.2% in 2023, slower than its pre pandemic growth. The country is fighting semiconductor trade war with the U.S., it's losing foreign direct investment and India just overtook it in terms of population. Economies worldwide are alienating China and are looking for alternatives.

4. One of the key takeaways from the forum meeting was the start of the "Global Good Alliance for Gender Equity and Equality" with the support and endorsement by WEF and the Government of India. The primary and stated objective of this new Alliance is to bring together global best practices, knowledge sharing and investments in the identified areas of women's health, education, and enterprise. These kind of initiatives are essential to increase women's participation in overall economic development.
5. There needs to be a sense of urgency when it comes to climate change. The companies who do not put enough emphasis on energy efficiency will be less competitive. Thus, it is imperative for government and businesses to become energy efficient and reduce environmental footprints. The transition also needs to be equitable and developed nations will need to fund developing countries transition to greener economies.

However, during the conference there were no solutions offered for crisis in the Middle East and Ukraine that is currently disturbing global development. Also, many nations are grappling with high debt levels and no solution was arrived at for such countries.

How India stands to benefit:

'Can India seize its moment?' was the focus of a key session at Davos 2024.

India surpassed China last year as the world's biggest country by population. India is also home to the largest youth population. Now India in Davos displayed its growing strength as a nation of innovation and as a global business hub in front of some of the world's richest and most powerful people.

As China's economy slows down, India's relatively rapid growth stands out as a clear opportunity for investors in Davos looking for bright spots. China's growth came in at 5.2% for 2023, while India is slated to record 7.0% growth for 2023-24. India presented itself as China's alternative as Western nations diversify their supply chains.

States such as Maharashtra, Tamil Nadu, Telangana, and Karnataka have their own presence at Davos, positioning themselves as tech hubs for manufacturing and AI. India is a diverse country with different large states competing with each other to attract businesses in their states.

India also displayed its strength and initiatives in climate action and digital adoption. India plays a key leadership role in global fight against climate change as it launched International Solar Alliance and proposed a global grid for renewables. India also aims to put 600 GWs of renewable energy by 2030. India's digitalization story has been remarkable and other countries are also trying to replicate it.

India is expected to grow in the range of 6-8% in next decade and inflation is expected to be moderate. India further needs to continuously restructure and innovate new policies to enhance ease of doing business. India's demographics will benefit its growth story, though it will require broad labor market reforms and human development measures.

India must continue to engage in multilateral forums as it is on its way to become the third largest economy in less than a decade.

Deepak Singh
(Deputy General Manager)

2. KEY TAKEAWAYS: RBI FINANCIAL STABILITY REPORT

Chapter 1:- Macrofinancial Risks

Global macro-financial conditions remain exposed to risks from slowing growth prospects, increasing geopolitical hostilities and high debt levels and tighter financial conditions.

Despite facing successive shocks and large global spillovers, India remains one of the fastest growing major economies in the world, underpinned by sound macroeconomic fundamentals. India's fiscal position is improving on the back of ongoing fiscal consolidation, strong tax revenue and improved quality of expenditure.

- Real GDP increased by 7.7 per cent in H1:2023-24 and remains on track to expand by 7.0 per cent in FY: 2023-24.
- Headline inflation, which rose to 7.4 per cent in July 2023 declined to 5.6 per cent by November 2023, easing into the Reserve Bank's tolerance band. Core inflation moderated to a 44-month low of 4.1 per cent. The CAD has averaged 1.0 per cent of GDP over the first half of 2023-24 and is expected to remain viable and fully financed.
- Despite overlapping global shocks, the trade deficit improved from US$ 189.2 billion in April-November 2022 to US$ 166.4 billion in April-November 2023.
- In a volatile global economic environment, India continued to attract steady capital inflows.
- The resilience of the domestic financial system has been underpinned by robust balance sheets characterized by adequate capital and liquidity buffers and strong earnings. Healthy balance sheets have enabled banks to maintain a strong and broad-based credit expansion.
- The capital to risk-weighted asset ratio (CRAR) at end-September 2023 remained high at 16.8 per cent vis-à-vis the regulatory minimum of 11.5 per cent (including capital conservation buffer) while the common equity tier 1 (CET1) ratio stood at 13.7 per cent as against the regulatory requirement of 8 per cent (including capital conservation buffer).
- The gross non-performing assets (GNPA) ratio and the special mention accounts - 2 (SMA-2) ratio, respectively, have fallen to multi-year lows of 3.2 per cent and 0.9 per cent, even as improved provisioning drove the net non-performing assets (NNPA) ratio to a multi-decadal low of 0.8 per cent.
- Healthy interest margins, strong credit demand and lower impairments have boosted net interest income (NII) of the banking system through the course of the current monetary policy tightening cycle, and strengthened earnings as reflected in RoA and RoE, which rose to 1.2 per cent and 12.9 per cent, respectively, in September 2023 from historical lows of (-) 0.2 per cent and (-) 2.2 per cent, respectively, in March 2018.
- Domestic financial conditions have remained conducive for growth amidst improving consumer and business confidence and rising corporate profitability.

Chapter 2:- Financial Institutions: Soundness and Resilience

- The Indian Banking system has displayed stability and resilience, with ongoing improvement in asset quality, capital position and profitability during H1:2023-24.
- The deposit growth of all SCBs gathered pace during 2023-24. It stood at 13.4%, net of the impact of the merger of HDFC bank with HDFC Ltd., as at end Sep'23.
- Growth in term deposits remained high at 19.5%, reflective of the pass-through of interest rate hikes alongside efforts to mobilize funds to match credit demand.
- On the other hand, growth in CASA has remained tepid for all SCBs, moderating from 8.9% in Sep'22 to 5.3% in Sep'23.
- Healthy balance sheets enabled banks to sustain a broad based momentum in credit growth during 2023-24. Bank credit growth stood at 19.4%, net of the impact of the merger. While there was some moderation in credit growth by PSBs, (declined from 16.3% in Sep'22 to 13.3% in Sep'23), lending by PVBs gathered pace, rising from 13% to 30.4% in the same period.
- Lending to services and personal loans grew faster than agriculture and industrial sector, led by PVBs. The growth in personal loans was broad-based.
- The capital to risk-weighted asset ratio (CRAR) at end-September 2023 remained high at 16.8 per cent vis-à-vis the regulatory minimum of 11.5 per cent (including capital conservation buffer) while the common equity tier 1 (CET1) ratio stood at 13.7 per cent as against the regulatory requirement of 8 per cent (including capital conservation buffer).
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- Healthy interest margins, strong credit demand and lower impairments have boosted net interest income (NII) of the banking system through the course of the current monetary policy tightening cycle. There was slight moderation in net interest margin (annualized), from 3.7% in Mar'23 to 3.6% in Sep'23 for all SCBs.
- On the back of improved earnings, RoA and RoE rose to 1.2 per cent and 12.9 per cent, respectively, in September 2023 from the lows of 0.9 per cent and 9.7 per cent, respectively, in March 2022 for all SCBs.
- Stress test results reveal that SCBs are well capitalized and capable of absorbing macroeconomic shocks over a one-year horizon even in the absence of any further capital infusion. Stress test results reveal that SCBs are well capitalized and capable of absorbing macroeconomic shocks over a one-year horizon even in the absence of any further capital infusion.

Chapter 3:- Regulatory Initiatives in the Financial Sector

- Post-COVID, consumer credit, especially the unsecured portfolio, has accelerated substantially, further increasing dependency of NBFCs on bank borrowings. RBI announced various measures, including increasing the risk weights of bank loans to NBFCs and commercial banks' and NBFCs' exposure to consumer credit and credit card receivables.
- To address concerns relating to possible ever greening by regulated entities (REs) through AIFs by substitution of their direct loan exposure to borrowers with indirect exposure through investments in units of AIFs, REs have been advised not to make investments in any scheme of AIFs which has downstream investments either directly or indirectly in a debtor company of the RE. If done, they will have to liquidate within 30 days or make adequate (100%) provisions.
- RBI issued Master Direction on classification, valuation and operation of the investment portfolios of commercial banks in view of significant developments in global standards on classification, measurement and valuation of investments.
- In light of recent developments, the revised regulatory framework entails extending the Basel III capital regulations applicable to banks, to AIFIs, replacing the currently applicable Basel I standards. It also consolidates and updates the exposure norms, significant investments, classification, and valuation and operation of investment portfolio norms and resource raising norms.
- RBI issued Master Direction on minimum capital requirements for operational risk that are applicable to all commercial banks. The directions introduce the Basel III Standardized Approach for measuring minimum operational risk capital (ORC) requirements.
- Entities facilitating cross-border transactions conduct their activities as online payment gateway service providers (OPGSPs) through a tie-up with Authorized Dealer (AD) banks. The erstwhile OPGSPs have been renamed as Payment Aggregators – Cross Border (PA–CB). The inclusion of the PA–CBs within the direct regulatory ambit of RBI has brought about regulatory harmonization between domestic PAs and erstwhile OPGSPs.
- Government of India notified the establishment of Guarantee Scheme for Corporate Debt (GSCD) for the purpose of providing guarantee cover against debt to be raised by CDMDF which will act as a backstop in the corporate debt market in times of market dislocation. The CDMDF is notified as an Alternative Investment Fund (AIF) in the form of a Trust under SEBI (AIF) Regulations. The units of CDMDF shall be subscribed to by asset management companies (AMCs) of mutual funds (MFs) and specified debt oriented MF Scheme.
- With increasing usage of technology for availing financial services and upward adjustment in the benchmark lending rates of banks, complaints related to loans and advances, non-adherence to the Fair Practices Code and mobile/electronic banking related issues need to be addressed swiftly and holistically by REs at their end, to further enhance consumers' confidence in the financial system.

3. KEY TAKEAWAYS:

REPORT ON TREND AND PROGRESS OF BANKING IN INDIA 2022-23

Perspectives

- Looking ahead in 2024, major central banks have indicated that monetary policy would remain watchful as inflation, despite easing, rules above target. In this environment, banks need to guard against credit losses although higher capital buffers and provision coverage ratio (PCR) provide cushions.
- The outlook for the global environment remains highly uncertain, the prospects for domestic economic activity appear bright.
- The Indian banking system is well positioned to improve further, with better asset quality, high capital adequacy and robust profitability.
- The financial indicators of NBFCs are also set to strengthen further, underpinned by adequate capital, increased provisions and improved asset quality.
- Financial stability is being underpinned by corporates' stronger financials and deleveraging of their balance sheets.

Global Banking Developments

- Bank failures dented market sentiments notably in 2023. BCBS member jurisdictions have made further progress in implementing the Basel III post-crisis reforms effective from Jan 1, 2023.
- Implementation of G-SIBs leverage ratio buffer has been completed in all relevant jurisdictions. At End-September 2023, all relevant G-SIBs had met the final 2022 minimum external total loss absorbing capacity (TLAC) requirements.
- In most Advanced Economies (AEs), credit growth moderated from the second half of 2022 under the weight of rising lending rates.
- Asset quality of banks remained robust across AEs and in Emerging market & developing economies (EMDEs) it has been improving since 2019.
- Provisioning coverage ratio (PCR) for the US, highest among major AEs, improved further in Q2:2023, indicating greater resilience to stress in the banking book.
- Bank profitability, improved in Q1:2023 as rising policy rates & a faster pace of transmission to lending rates relative to deposit rates boosted net interest margins (NIM) across AEs & EMEs. Also, the CRAR remains above Basel III norms and leverage ratios more than 2x the minimum of 3% required under the Basel III norms.
- Share of AE banks in the top 100 banks worldwide has been shrinking in the post-GFC period while that of Chinese banks has been growing. The profitability of top 100 banks, which had shown marked improvement in 2021, moderated in 2022.
- Global growth is expected to weaken in 2024. Credit growth is likely to remain subdued, bank profitability could dampen and asset quality could see some stress, although banks across jurisdictions are well-capitalized.

Policy Environment

- During 2022-23 and 2023-24 so far, the Reserve Bank's policy focused on withdrawal of accommodation while supporting growth amidst high domestic inflation. RBI made concerted efforts to encourage innovation while retaining focus on consumer convenience & protection.
- The Monetary Policy Committee (MPC) raised the policy repo rate cumulatively by 250 basis points (bps) from 4% to 6.5% during the period. The cash reserve ratio (CRR) was also increased by 50 bps to 4.50%.
- Liquidity conditions eased in May-June 2023 due to the withdrawal of Rs. 2,000 banknotes from circulation. As a temporary measure, RBI also imposed an incremental CRR of 10% on the increase in scheduled commercial banks' NDTL to ensure liquidity is in sync with monetary policy stance.
- To enable better fund management by banks, it was decided to allow reversal of liquidity facilities under both the SDF and the MSF, even during weekends and holidays, with effect from Dec'30, 2023. RBI also issued Master Direction on minimum capital requirements for operational risk that were applicable to all SCBs.
- Further, Reserve Bank on November 2023 announced various measures, including increasing the risk weights of bank loans to NBFCs and commercial banks' and NBFCs' exposure to consumer credit and credit card receivables.
- The other major RBI announcements include a framework for acceptance of green deposits, LIBOR transition, limits in call & notice money markets, Storage & tokenization of actual card data, Expanding the scope of TReDs and Extending UPI to inbound travellers to India.

Operations and Performance of Commercial Banks

- The Indian banking sector's asset quality improved during 2022-23 and 2023-24, with the GNPA ratio of SCBs falling to a decadal low of 3.9% at end-March 2023 and further to 3.2% at end-September 2023. About 45% of reduction in GNPAs of SCBs was contributed by recoveries and upgradations. By sector, agricultural witnessed the highest GNPA ratio, while retail had the lowest.
- The capital to risk weighted assets ratio (CRAR) of SCBs was 16.8% at end-September 2023, with all bank groups meeting the regulatory minimum requirement and the common equity tier 1 (CET1) ratio requirement.
- The consolidated balance sheet of banks grew by 12.2% in 2022-23 - the highest in 9 years, driven by high credit growth in the retail and services sectors. However, the share of PSBs in the consolidated balance sheet of banks declined from 58.6% at the end of March 2022 to 57.6% at the end of March 2023, while private banks gained a share from 34% to 34.7%. At the end of March 2023, PSBs accounted for 61.4% of total deposits and 57.9% of total advances.
- The total amount of frauds reported by banks declined to a six-year low in FY23 while the average amount involved in frauds was the lowest in a decade. Although the number of frauds reported in H1:2023-24 rose over the corresponding period a year ago, the amount involved was only 14.9% of the previous year's amount.

Developments in Co-operative Banking

- The growth of advances of Urban Co-operatives Banks (UCBs) during 2022-23 was the highest in 4 years. During Q1 of FY 2023-24, it accelerated further to 5.9%, but remained lower than that of SCBs.
- The credit-deposit (C-D) ratio and Net profits of UCBs rose for the third consecutive year in 2022-23. Their C-D ratio remained below that of SCBs and the wedge has been widening and the net profit growth rose at a slower pace than in previous years.
- UCBs' profitability, both before and after taxes, has not yet completely recovered from the strain of 2019–20. Net profits increased in 2022–2023 as a result of a recovery in total revenue and a decrease in total expenses.
- During 2022–2023, UCBs had improvements in the main profitability measures of return on assets (RoA), return on equity (RoE), and net interest margin (NIM), even with an increase in provisions and contingencies.
- Asset quality of UCBs' also improved further in FY23, partly reflecting lower slippages & stronger loan recovery. The GNPA ratio has declined from a peak in 2020-21. A significant decline in outstanding GNPAs led to an increase in their PCR.
- The establishment of the National Urban Cooperative Finance and Development Corporation (NUCFDC) as an umbrella organization is also expected to further support the UCB sector.

Non-Banking Financial Institutions

- The consolidated balance sheet of non-banking financial companies (NBFCs) expanded at a fast pace of 14.8% in 2022-23, led by double digit credit growth (where unsecured loans grew at 28.1% which was twice as fast as secured loans growth at 11.5%).
- Aggregate income of NBFCs grew steeply in 2022-23, led by interest income. About 90% of the total income accruing to NBFCs was from fund-based resources, even as the share of fee-based income has seen a gradual rise in recent years.
- Simultaneously, asset quality of the sector showed further improvement as the GNPA & NNPA ratios fell to 4.1% & 1.5%, respectively, at end-September 2023. The sector also remained well-capitalized even with more risk weight with CRAR higher than the regulatory requirement of 15% and the PCR at 65.1% at Mar'23.
- Housing finance companies (HFCs) exhibited resilience in 2022-23, with enhanced asset quality, improved profitability and robust growth in credit disbursement owing to a post-pandemic shift in preference for home ownership.
- The growth in the consolidated balance sheet of AIFIs accelerated from 15.9% in 2021-22 to 19.8% in 2022-23, driven by loans and advances. More than half of this expansion was due to loans by SIDBI, followed by NABARD.
- All PDs achieved more than their minimum bidding commitments in 2022-23 and individually achieved the minimum stipulated annual secondary market turnover ratios.

4. GIST OF SPEECH:
INNOVATIONS IN BANKING - THE EMERGING ROLE FOR TECHNOLOGY AND AI

Remarks delivered by Shri M. Rajeshwar Rao, Deputy Governor, Reserve Bank of India - December 22, 2023 - at the 106th Annual Conference of Indian Economic Association in Delhi.

RBI's efforts to foster innovation in financial ecosystem and how the emerging technologies such as artificial intelligence are likely to reshape the financial landscape:

- Today, India has one of the most advanced state-of-the-art payments system that is affordable, accessible, convenient, fast, safe and secure. This has led to a revolution in banking and financial services making the banking truly 'anytime, anywhere'.
- **UPI** symbolises the ultimate democratisation of a financial product which is available to everyone including to customers who may not have smartphones as well as for undertaking offline transactions. During FY 2022-23, UPI facilitated about 83 billion transactions with approximate value of ₹140 trillion- 43% of total value of retail payment transactions.
- India was one of the few major economies to launch **CBDCs** when we launched pilot phases of wholesale and retail CBDC in October and November 2022, respectively.
- The **Reserve Bank Innovation Hub** (RBIH) is set up to accelerate innovation across the spectrum of financial services. In addition, the RBI has also instituted a **regulatory sandbox** to provide a platform for start-ups, fintechs and others to test and experiment with new products in a controlled environment.
- In the financial sector, we are seeing several banks and non-banks experimenting with AI. The development of **GenAI** – a type of AI technology that possesses general intelligence and cognitive abilities comparable to those of a human being and can produce various types of content– has garnered a very strong interest about its potential economic impact.
- Given its transformative nature and potential, generative AI could have a deep impact on productivity, jobs and income distribution- including increase in income levels, automation of repetitive tasks and obtaining better insights by combining different sets of information and data.

A few concerns and RBI's expectations from financial institutions deploying AI in their processes:

- **Data Bias and Robustness:** Whereas traditional financial models are usually rules-based with explicit fixed parameterisation, AI models drastically change the process as they are able to learn the rules and alter model parameterisation iteratively- making it difficult to decode for audit and supervisory review.

- **Governance:** AI may pose some novel challenges for governance, especially where the technology is used to facilitate autonomous decision-making and may limit or even potentially eliminate human judgement and oversight. Financial institutions would therefore need to institute governance structures that oversee the entire lifecycle of AI systems, specially the GenAI - from data acquisition to model training and continuous evaluation.
- **Transparency:** The AI models are inherently complex and opaque requiring extra caution to ensure accountability. Financial institutions may find it difficult to explain an adverse or biased decision outcome from an AI model to customer or supervisors. The self-learning capability may make the model discriminatory and induce behavioural biases after some time.
- In this context, there are ten aspects which financial institutions looking to deploy AI based models may consider while designing AI solutions:
    - **Fairness:** Conducting regular fairness audits of the algorithms and outcomes;
    - **Transparency:** Making the algorithmic decision-making process understandable and explainable to both regulators and consumers;
    - **Accuracy:** Identifying and understanding the types of errors the AI models make and minimizing false positives and negatives;
    - **Consistency:** Ensuring consistent application of the algorithm across different situations to avoid biases;
    - **Data Privacy:** Adhering to data protection protocols and regulations and ensuring that personal information is always handled securely and responsibly;
    - **Explainability:** Clear understanding of the inputs, processes and output by the entities and establishing channels for redressal of customer queries or disputes;
    - **Accountability:** Entities should implement a comprehensive governance framework that includes regular audits, internal reviews, and external assessments to hold individuals responsible for addressing any issues related to the AI model.
    - **Robustness:** Undertaking rigorous validation and testing to ensure that the algorithm performs well under different conditions and is not overly sensitive to minor changes in input data;
    - **Monitoring and Updating:** Regularly monitoring the performance of AI engines and updating them to adapt to changing market conditions and emerging risks;
    - **Human Oversight:** Include human oversight to address complex or ambiguous cases and to ensure that ethical considerations are taken into account.

As the adoption of AI is increasing, global efforts to develop regulatory frameworks to help guide the use of AI applications, are also increasing and greater cooperation in this process would be required.

5. GIST OF SPEECH:
BUILDING RESILIENT BRAND INDIA AMIDST GLOBAL UNCERTAINTY

Remarks delivered by Shri Swaminathan J, Deputy Governor, Reserve Bank of India - December 28, 2023 - at the 10th SBI Banking and Economic Conclave in Mumbai

- The term **‘Brand India’**, refers to the overall image, perception, and reputation of India as a nation. It encompasses a wide range of elements, including the country's culture, heritage, economy, innovation, tourism, and more.
- Building a resilient brand India from a banking and economy perspective includes the aspects of financial stability, risk management and crisis preparedness, sound corporate governance as well as adaptive regulation complemented by robust supervision, financial inclusion and customer protection.
- As of September 2023, the Capital to Risk Weighted Assets Ratio of Scheduled Commercial Banks stood impressively at 16.8 percent, underscoring the sector's resilience. The Gross Non-Performing Assets (GNPA) at 3.2 percent were at a decadal low with Net NPAs at 0.8 percent. The uptrend in profitability has continued into its fourth consecutive year with Return on Assets at a healthy 1.2 per cent and Return on Equity at 12.9 per cent. As compared to 2018 when 12 banks were placed under the Prompt Corrective Action (PCA) framework, today no SCB is under PCA.

Six areas that banks may need to look further into in the coming months:

1. **Interest Rate Risk-** Removing restriction on HTM have given banks greater flexibility in managing this risk in their investment portfolios. However, considering the dynamic nature of the interest rate risk, banks must proactively manage and mitigate this risk.
    - Increasing **NIMs** that banks are presently enjoying may not be sustained in the future when the interest rate cycle reverses, whenever that happens in future. External benchmark linked loans will be repriced much faster than deposits contracted during the peak of the interest rate cycle resulting in pressure on NIMs and eventually profitability.
    - Banks must endeavour to proactively manage the pricing and duration of their deposits while trying to diversify the sources and optimising the product mix of deposits. Excessive reliance on bulk deposits should be avoided as these are more sensitive to interest rate movements and perpetuate concentration risk while also eroding earnings.

2. **Business models**- Banks need to remain alert to the risks inherent in their business models and mitigate them in a timely manner**.** The growing collaboration between banks, NBFCs, and FinTechs is driving innovation in products, services, and business models. An important consideration is the cautious adoption of model-based lending through analytics. Banks and NBFCs should exercise caution in relying solely on preset algorithms, ensuring that these models are robust, regularly tested, and recalibrated as needed to maintain robust underwriting standards.

3. **Operational Resilience**- Banks and other ecosystem participants must have robust Disaster Recovery and Business Continuity Plans in place and test them periodically. Further, IT infrastructure and channels have to be protected from the emerging cyber threats to ensure operational resilience. I would therefore like to reiterate that the Boards and IT Strategy Committees of the banks need to step up their oversight in this matter.

4. **Outsourcing Risks – Managing third party dependencies**- Banks must ensure that their service providers employ the same high standard of care in performing the services as would be employed by the banks. Banks should not engage in any outsourcing that may result in their internal control, business conduct or reputation being compromised or weakened.

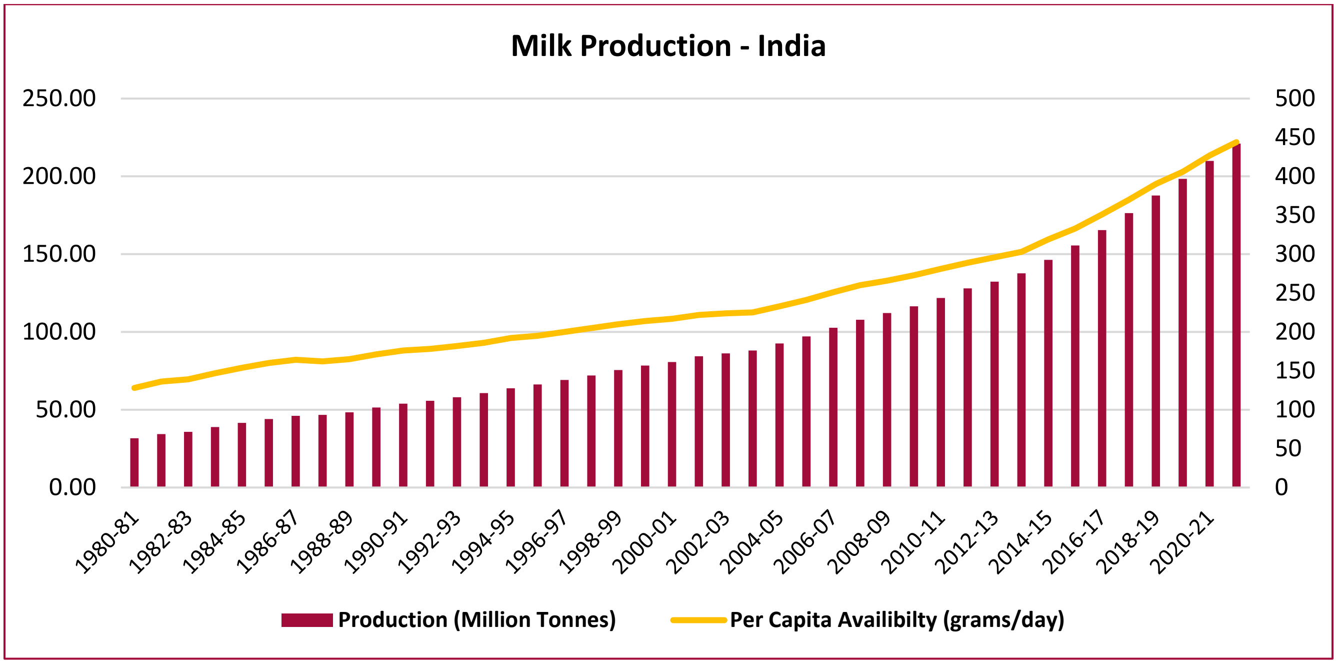
5. **Climate Risk-** Variability in monsoon patterns coupled with temperature change impact crop production and affect our food security. Apart from agriculture, even in other sectors the economic impact of climate change in India could be substantial**.** Climate-related financial risks pose both micro and macro-prudential concerns. Climate change risk is ascending the hierarchy of threats to financial stability across advanced and emerging economies alike and consequently, the need for an appropriate framework to identify, assess and manage climate-related risk has become imperative.

6. **Customer protection -** Banks need to have a proactive approach towards resolving customer grievance issues by identifying and addressing the root cause of these issues. Customer complaints should only be rejected after careful examination by the Internal Ombudsman. To do this effectively, regulated entities must ensure that the Internal Ombudsman is adequately resourced.

Conclusion

Building resilience in the banking and economy sector for brand India is about establishing a foundation of strength, stability, and adaptability. It requires a holistic and collaborative effort from the financial institutions, regulatory bodies, government, and other stakeholders so that India can not only weather global uncertainties but also emerge as a dynamic and resilient player in the international economic landscape.

6. INDIAN ECONOMY: MILK PRODUCTION IN INDIA



Source: Department of Animal Husbandry, Dairying and Fisheries

As an industry, the dairy sector holds significant importance in the country. As the single largest agricultural commodity, milk contributes approximately 5% to India's GDP, employing almost 80 million people, predominantly small and marginal farmers. Notably, women form the majority of the workforce in the country's dairy sector. This industry serves as a crucial source of employment, particularly contributing to women's empowerment by offering substantial job opportunities.

Furthermore, India's dairy product exports reached 67572.99 metric tonnes, valued at $284.65 million in the fiscal year 2022-23, highlighting the country's significant presence in the global dairy market.

The leading states in milk production are Rajasthan (15.05%), Uttar Pradesh (14.93%), Madhya Pradesh (8.6%), Gujarat (7.56%), and Andhra Pradesh (6.97%). Collectively, these states contribute 53.11% to the total milk production in the country.

The government has supported the development of dairy farming infrastructure through multiple initiatives. These include the implementation of the Animal Husbandry Infrastructure Development Fund (AHIDF) aimed at enhancing dairy infrastructure, the distribution of Kisan Credit Cards (KCC) to offer timely and sufficient credit support to farmers, and the launch of the Rashtriya Gokul Mission, which aims to enhance productivity and increase milk output. These efforts collectively contribute to making dairy farming more lucrative and profitable for farmers.

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7. CLASSROOM:

TERM STRUCTURE OF INTEREST RATES & GROWTH

The level of the yield curve measures the general level of interest rates in the economy and is greatly influenced by the policy rate. Slope of the yield curve is considered to be a leading indicator of future economic growth and inflation. An upward sloping yield curve indicates economic optimism and therefore, higher interest rates.

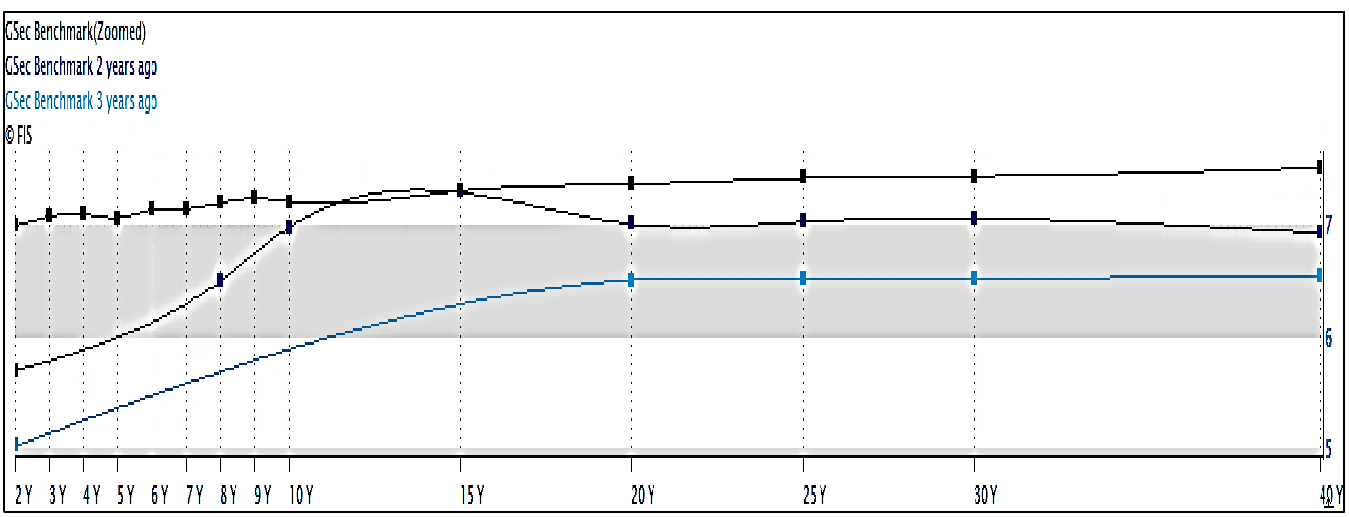
Types of Yield Curves

The slope of the yield curve reflects the difference between yields on short-term bonds and long-term bonds.

- **Normal Yield Curve**: A normal shape for the yield curve is where short-term yields are lower than long-term yields, so the yield curve is convex upwards. A normal yield curve is often observed in times of economic expansion, when economic growth and inflation are increasing. In an expansion there is a greater likelihood that future interest rates will be higher than current interest rates, because investors will expect the central bank to raise its policy interest rate in response to higher inflation.
- **Inverted Yield Curve**: An inverted yield curve is where short-term yields are higher than long-term yields, so the yield curve is concave downwards. An inverted yield curve has historically been associated with preceding an economic contraction as central banks reduce policy rates in response to lower economic growth and inflation, which investors may anticipate will happen.
- **Flat Yield Curve**: A flat yield curve occurs when short-term yields are similar to long-term yields. A flat yield curve is typically an indication that investors and traders are uncertain about the macroeconomic outlook. Yield curve flattening is often observed during transitions between normal and inverted curves.

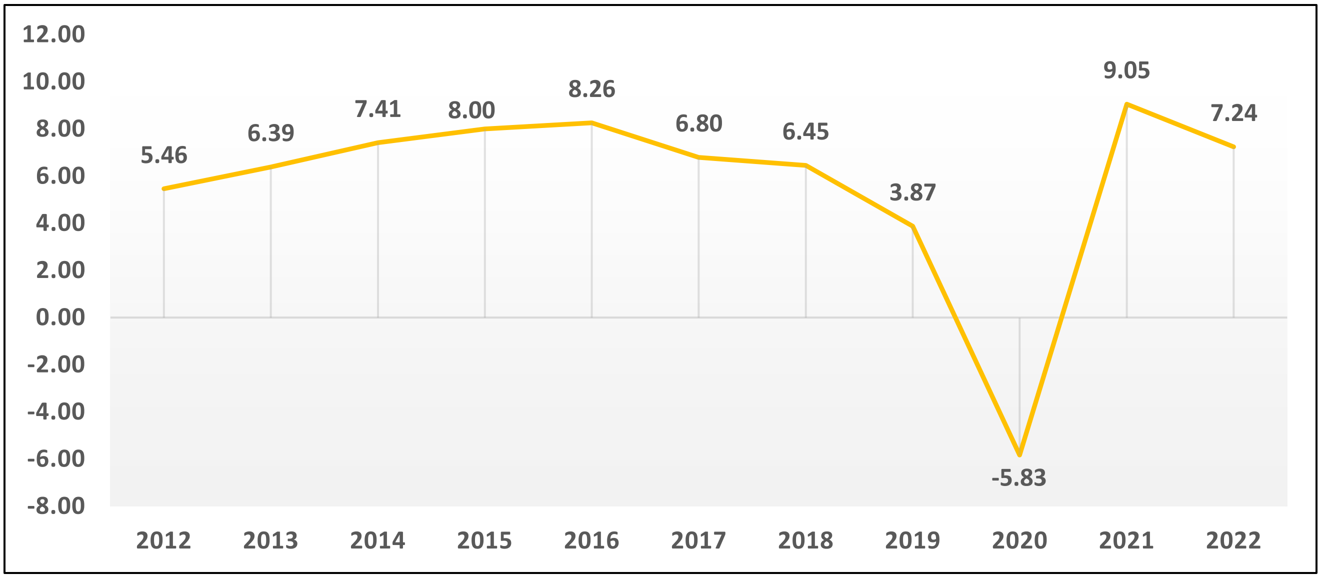
Analysis of Yield Curve & Growth Relationship

Chart 1: Yield Curve of India (Present, 2 years ago & 3 years ago)



Source: Cogencis

Chart 2: India Annual GDP Growth (%)



Note: Year Indicates fiscal year. E.g. 2022 stands for FY2022-23 ***Source: Cogencis***

- From the above two charts, it can be observed that present yield curve (black curve in chart 1) shifts up from the 2 year ago curve (deep blue curve in chart 1) indicating an upward shift in interest rate expectations in response to monetary tightening by the RBI post the pandemic.
- The present yield curve gradually flattens out although it appears to be upward sloping- reflecting uncertainty as the RBI has resolved to maintain status quo on interest rates. Although, with a change in the Fed's stance, the RBI may follow suit.
- The 2 year ago curve is normal at shorter maturities indicating a recovery from the COVID-19 pandemic, while it inverts at longer maturities and later flattens out- indicating expectations of rate cut in the long term as growth gradually tapers.
- The 2 year ago curve is also above the 3 year ago curve (light blue curve in chart 1) as growth in the Indian economy had started faltering even before the COVID-19 pandemic (chart 2).

Inference

- Growth rates as well as interest rates in the Indian economy are presently on an uptrend (and significantly higher) compared to those in advanced economies.
- The economy's near to medium term outlook is therefore favourable for foreign fund inflows (FDI/ FII), currency stability and forex reserve position.
- Adverse movements in the USD/INR exchange rate are likely to be arrested as a result.
- GDP growth numbers are expected to be on the upside going forward.

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8. GIST OF LATEST RBI CIRCULARS FOR BANKS

Date of Circular	20-Dec-2023
Ref. No.	RBI/2023-24/91 CO.DPSS.POLC.No.S-919/02-14-003/2023-24
Subject	**Card-on-File Tokenisation (CoFT) – Enabling Tokenisation through Card Issuing Banks**

Gist: The card tokenisation services are being currently provided by card issuers and card networks. As announced in the Statement on Development and Regulatory Policies dated October 6, 2023, it has been decided to enable CoFT directly through card issuing banks / institutions also. This will provide cardholders with an additional choice to tokenise their cards for multiple merchant sites through a single process. This directive is issued under Section 10 (2) read with Section 18 of Payment and Settlement Systems Act, 2007 (Act 51 of 2007).

Date of Circular	01-Jan-2024
Ref. No.	RBI/2023-24/105 DOR.SOG (LEG).REC/64/09.08.024/2023-24
Subject	**Inoperative Accounts /Unclaimed Deposits in Banks- Revised Instructions**

Gist: The RBI has revised guidelines for classifying accounts and deposits as inoperative accounts and unclaimed deposits by banks. This includes periodic review of such accounts and deposits, measures to prevent fraud in such accounts/deposits, grievance redressal mechanism for expeditious resolution of complaints, steps to be taken for tracing the customers of inoperative accounts including nominees or legal heirs for account re-activation, claims settlement or closure. The revised instructions shall come into effect from **April 1, 2024**.

Banks shall ensure that amounts lying in inoperative accounts or unclaimed deposits and reactivated will be put under concurrent audit, according to the new norms. All transactions in these accounts, which are reactivated, will be monitored regularly for at least six months, at higher levels without the knowledge of the customers and dealing staff. These instructions are expected to complement the ongoing efforts and initiatives taken by banks and the RBI, to reduce the quantum of unclaimed deposits in the banking system and return such deposits to their rightful owners/ claimants.

Date of Draft Circular	02-Jan-2024
Ref. No.	DOR.ACC.REC.No.##/21.02.067/2023-24
Subject	**Declaration of dividend by banks and remittance of profits to Head Office by foreign bank branches in India**

Gist: RBI has released this draft circular proposing new rules for the declaration of dividends by all SCBs [excluding regional rural banks (RRBs)] and the remittance of profits to the head office by foreign bank branches. The proposed guidelines, set to be effective from fiscal year 2024-25 onwards, come as a response to the evolving financial landscape and the need to align with global standards.

Eligibility criteria:

I. **Capital adequacy requirement:** Banks are mandated to declare dividends only if they have met the applicable regulatory capital requirement for each of the last three financial years.

II. **Net NPA criteria**: Dividends can only be declared for a financial year if the net non-performing assets (NPAs) ratio is less than 6% for that specific year.

III. **Other criteria**: Banks must be in compliance with all rules and regulations issued by the regulator, including provisions for asset impairment and employee benefits, transfer of profits to statutory reserves, and other regulatory requirements.

Dividend payout ratio cap: The proposed maximum dividend payout ratios are depending on the level of net NPAs such as 50% if net NPA is zero, 40% if net NPA is less than 1%, 35% if net NPA is greater than or equal to 1% but less than 2%, 25% if net NPA is greater than or equal to 2% but less than 4%, 15% if net NPA is greater than or equal to 4% but less than 6%.

Date of Circular	**04-Jan-2024**
Ref. No.	RBI/2023-24/107 DOR.AML.REC.66/14.01.001/2023-24
Subject	**Amendment to the Master Direction (MD) on KYC**

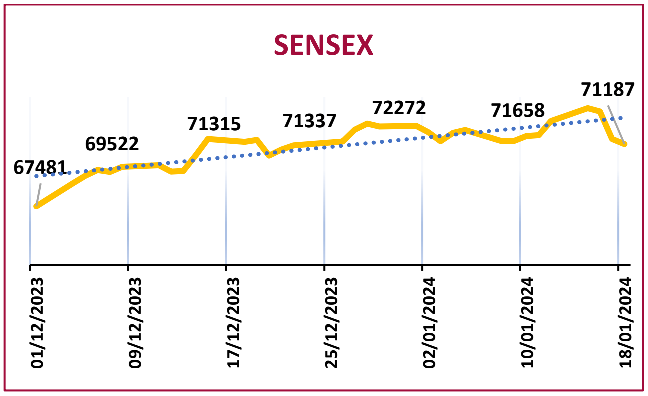
Gist: RBI has made an amendment to the Master Direction (MD) on Know Your Customer (KYC) guidelines, aiming to redefine and provide clearer parameters for identifying Politically Exposed Persons (PEPs). In the extant direction, the definition of Politically Exposed Persons (PEPs) is provided in sub-clause (xvii) of clause (a) of Section 3 of the master direction on KYC. However, in order to provide better clarity, RBI said it has decided to include the definition of PEPs as an explanation to Section 41 of the Master Direction.

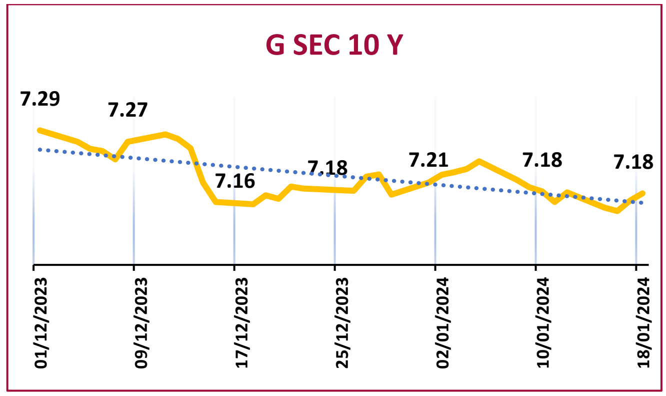
Date of Circular	**15-Jan-2024**
Ref. No.	RBI/2023-24/112 DOR.CRE.REC.70/21.01.003/2023-24
Subject	**Credit/Investment Concentration Norms – Credit Risk Transfer**

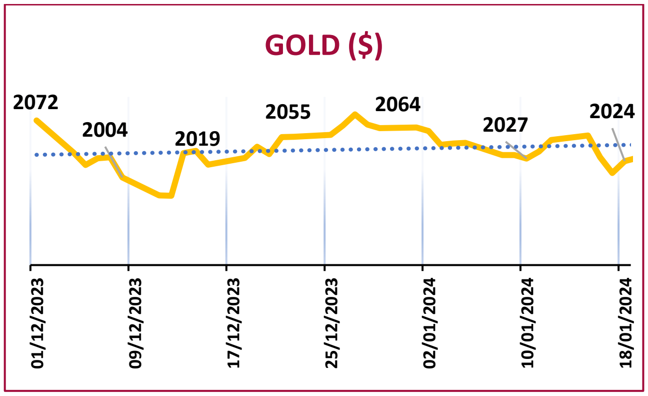
Gist: RBI has permitted middle layer non-bank financial companies (NBFCs-ML) to use credit risk transfer instruments. NBFC-ML will now be able to use these instruments to compute exposure. The Large Exposures Framework was earlier only applicable on upper layer NBFCs. But with this extension, credit risk transfer instruments like cash margin/caution money/security deposit, central government and state government guaranteed claims will be allowed to NBFC-ML too. In order to be eligible as a credit risk transfer instrument, the RBI has said that guarantees shall be direct, explicit, irrevocable and unconditional. Further, the regulator has asked base layer NBFCs to have an internal board approved policy in place for credit/investment concentration limits. These would be applicable for both single borrower/party and single group of borrowers/parties.

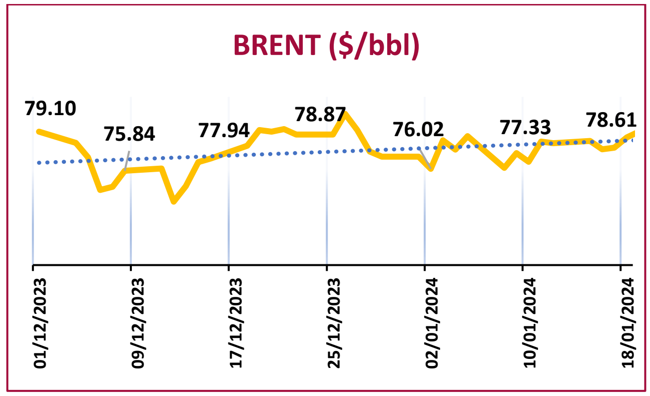
(Duration: 20th Dec’2023 to 19th Jan’24)

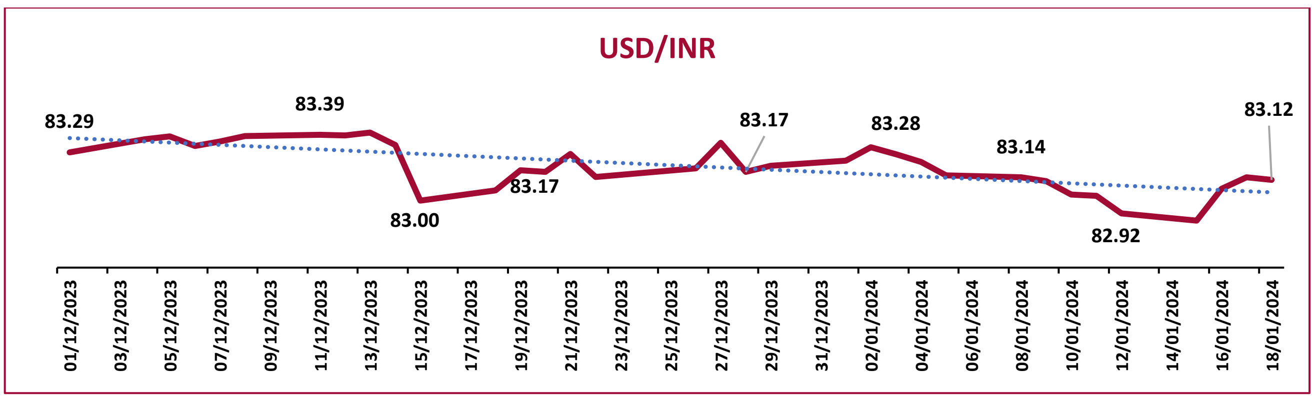
9. DAILY ECONOMIC INDICATORS

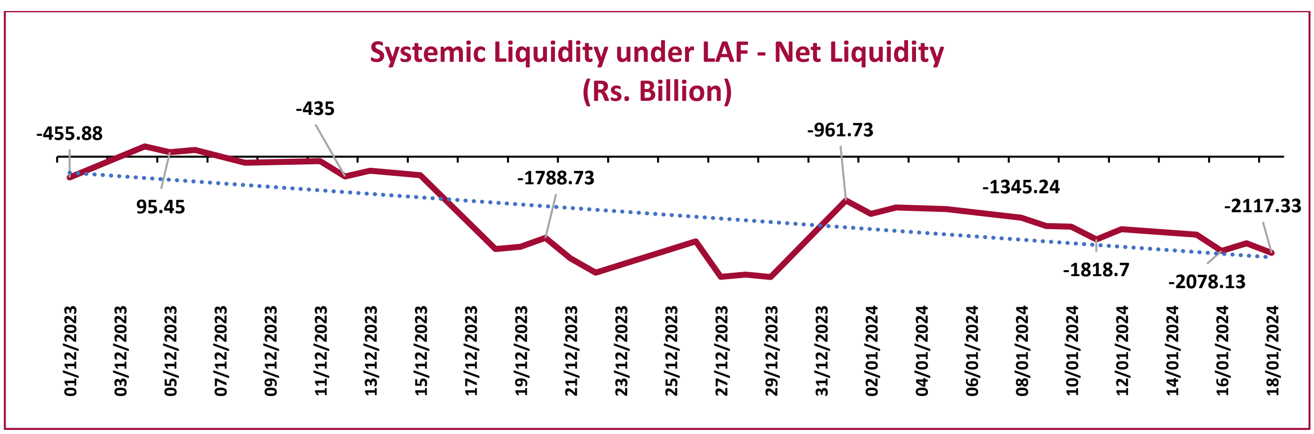








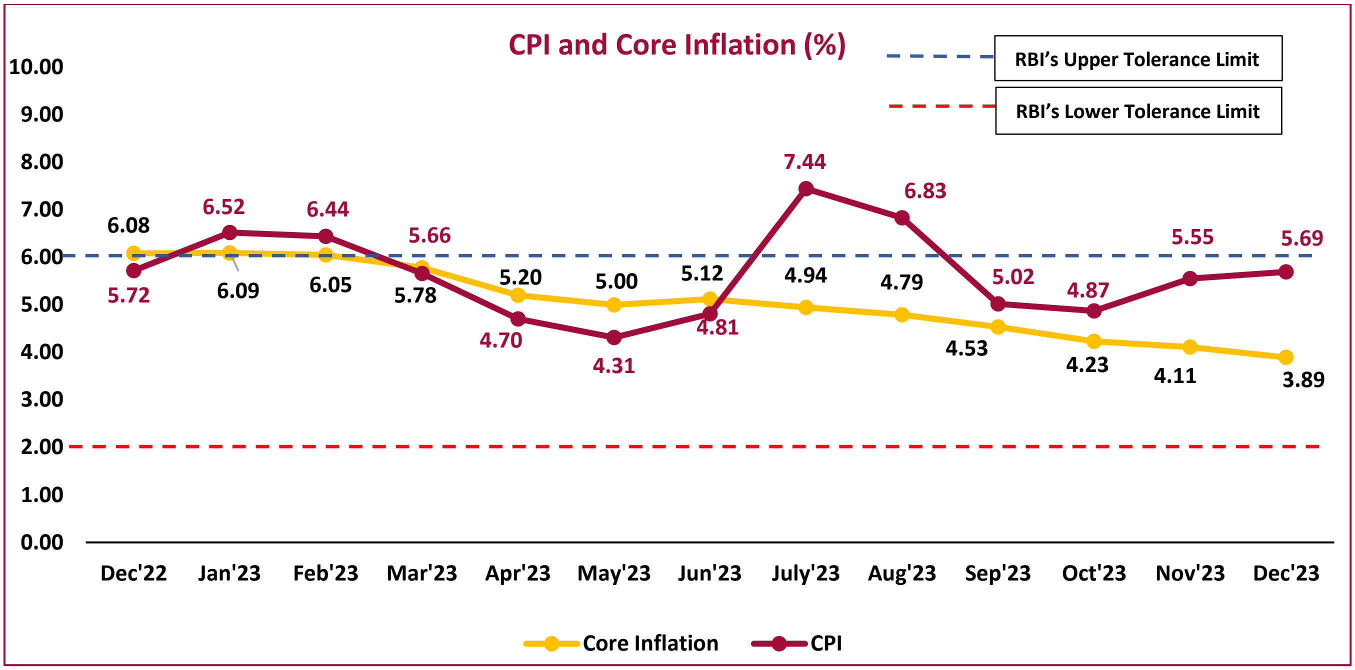


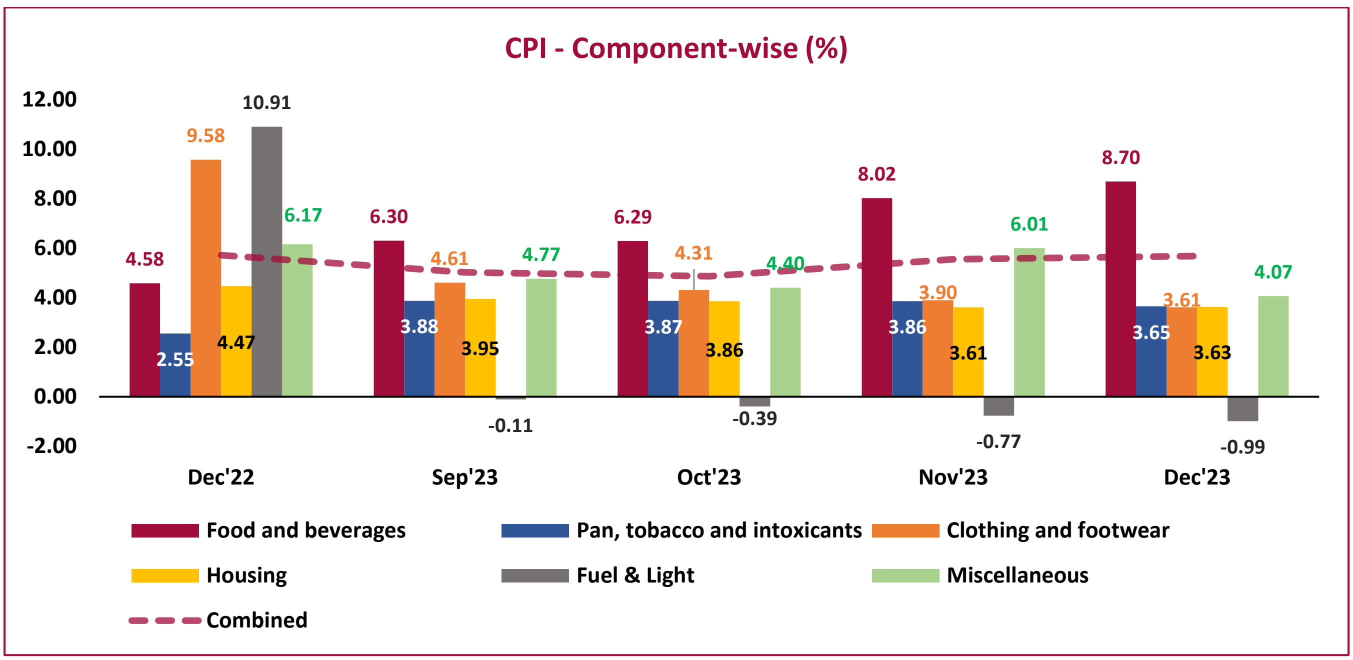


10. MONTHLY & FORTNIGHTLY ECONOMIC INDICATORS

CONSUMER PRICE INDEX (CPI)

Retail Inflation escalates to 5.7% in December'23

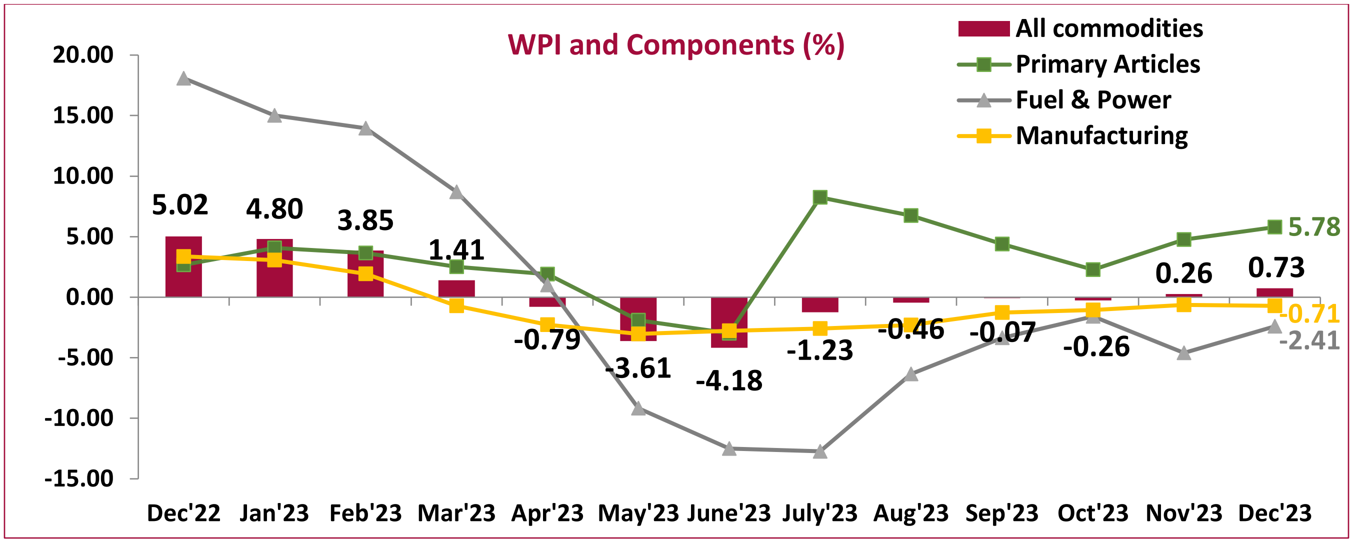




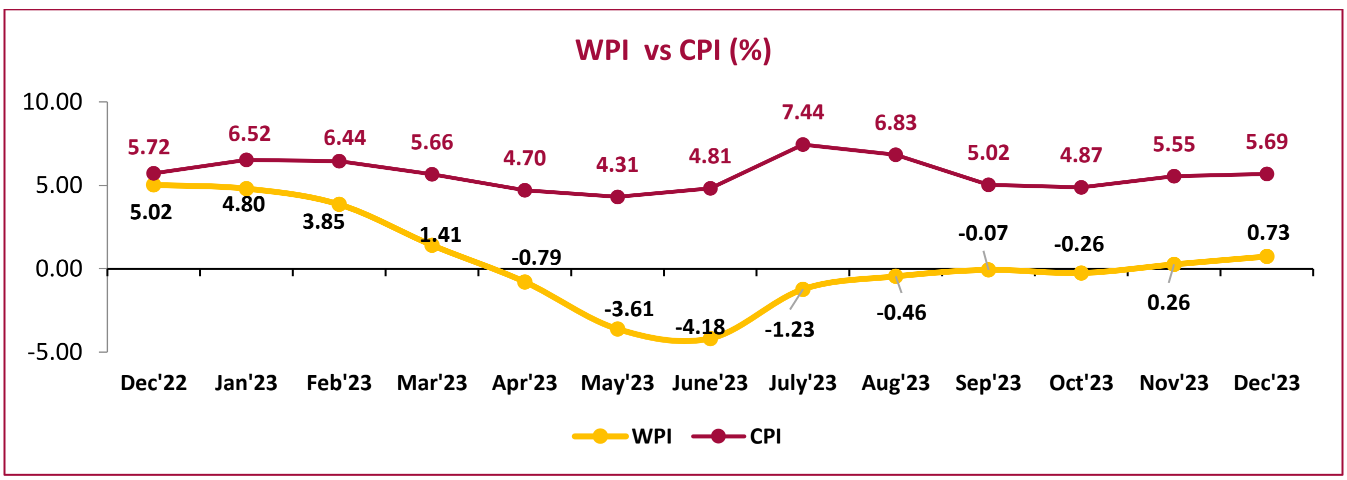
India's consumer price index (CPI) inflation escalated to 5.69 per cent in December 2023, due to high inflation witnessed in vegetables, pulses and spices. Apart from food, a decline was witnessed in all other segments of inflation basket. Major decline in inflation was noted in clothing & footwear category while the fuel & light category witnessed a decline in price levels.

WHOLESALE PRICE INDEX (WPI)

WPI inflation for December at 0.73%



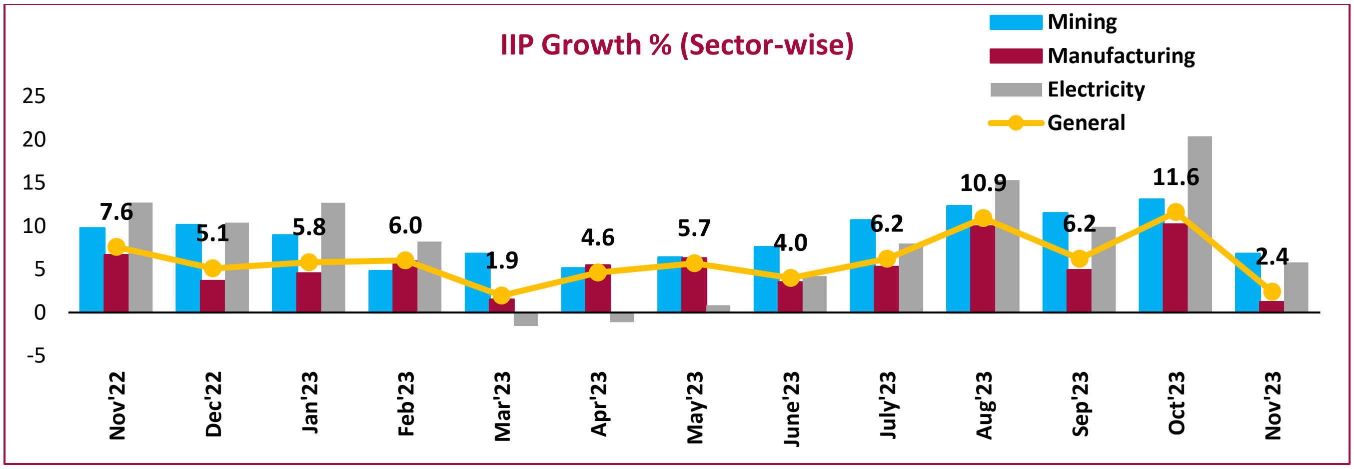
WPI Inflation (%)	Primary Articles		Fuel & Power		Manufactured Products		Food Articles *(Part of Primary Articles)*		All Commodities	
Weights	22.62%		13.15%		64.23%		15.26%		100%	
	2022	**2023**	**2022**	**2023**	**2022**	**2023**	**2022**	**2023**	**2022**	**2023**
October	11.17	**2.26**	25.40	**-1.58**	4.42	**-1.06**	8.45	**1.46**	8.67	**-0.26**
November	5.94	**4.76**	19.71	**-4.61**	3.44	**-0.64**	1.51	**8.18**	6.12	**0.26**
December	2.67	**5.78**	18.09	**-2.41**	3.37	**-0.71**	-1.02	**9.38**	5.02	**0.73**



India's WPI inflation inched up in December 2023. Inflation was primarily led by increase in prices of food articles, machinery & equipment, other manufacturing, other transport equipment and computer, electronics & optical products etc. Fuel and power prices showed continued deflation with 2.41 per cent year-on-year decrease.

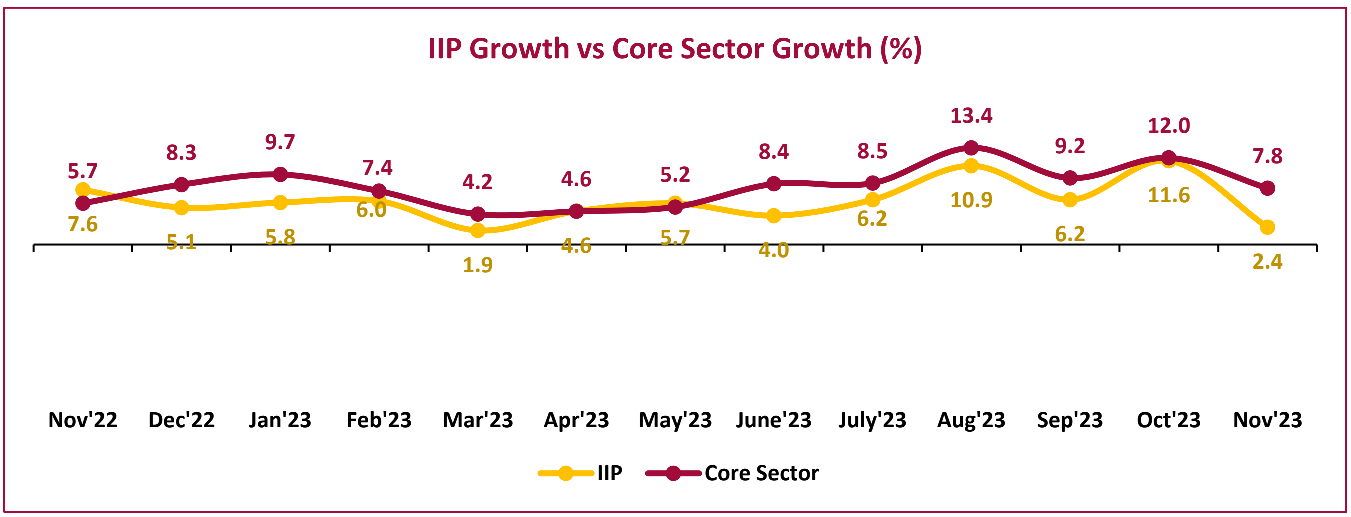
INDEX OF INDUSTRIAL PRODUCTION (IIP) & CORE SECTORS

IIP growth drops substantially in November'23



IIP growth % (Usage-wise)

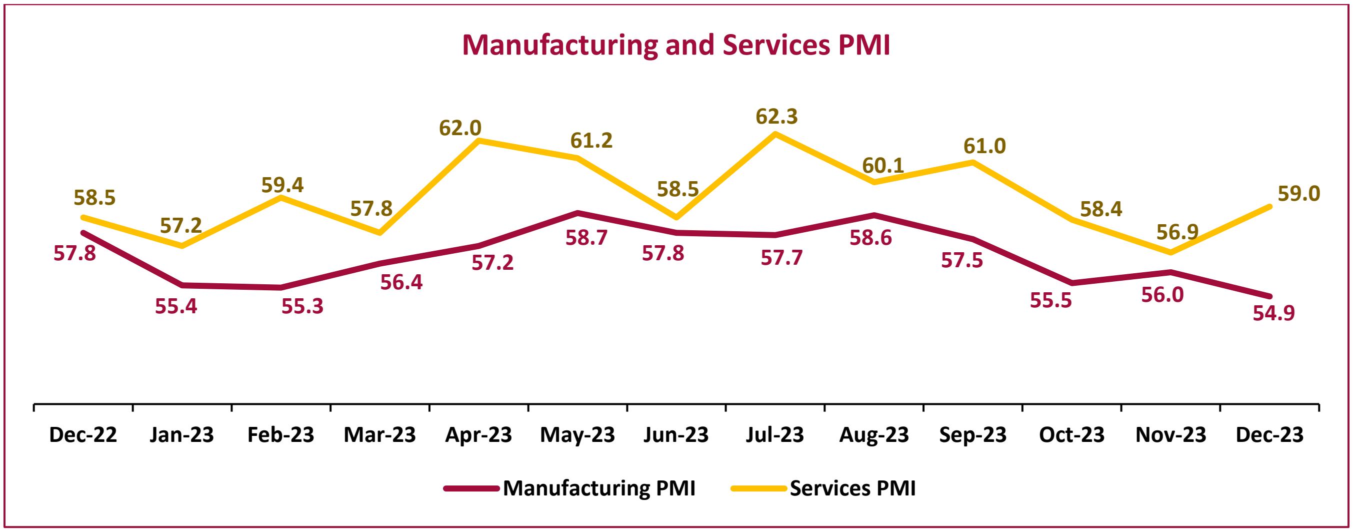
Component	Weight	Nov'22	Oct'23	Nov'23	Apr-Nov'22	Apr-Nov'23
Primary Goods	34.05%	4.8	11.4	8.4	7.7	7.2
Capital Goods	8.22%	20.7	22.6	-1.1	14.8	7.5
Intermediate Goods	17.22%	3.5	9.7	3.5	5.1	4.9
Infra/Construction Goods	12.34%	14.3	11.3	1.5	7.8	11.1
Consumer Durables	12.84%	5.0	15.9	-5.4	5.3	0.6
Consumer Non- Durables	15.33%	10.0	8.6	-3.6	-2.2	5.6



IIP growth significantly moderated to 2.4% in November 2023. Manufacturing sector recorded the lowest growth of 1.2 percent. It has the highest weightage hence has dragged down the performance of IIP as a whole. Capital Goods and Consumer Non-Durables have experienced negative growth. The electricity sector saw a 5.8 per cent growth and the mining sector witnessed a 6.8 per cent growth in November 2023.

PURCHASING MANAGERS' INDEX (PMI)

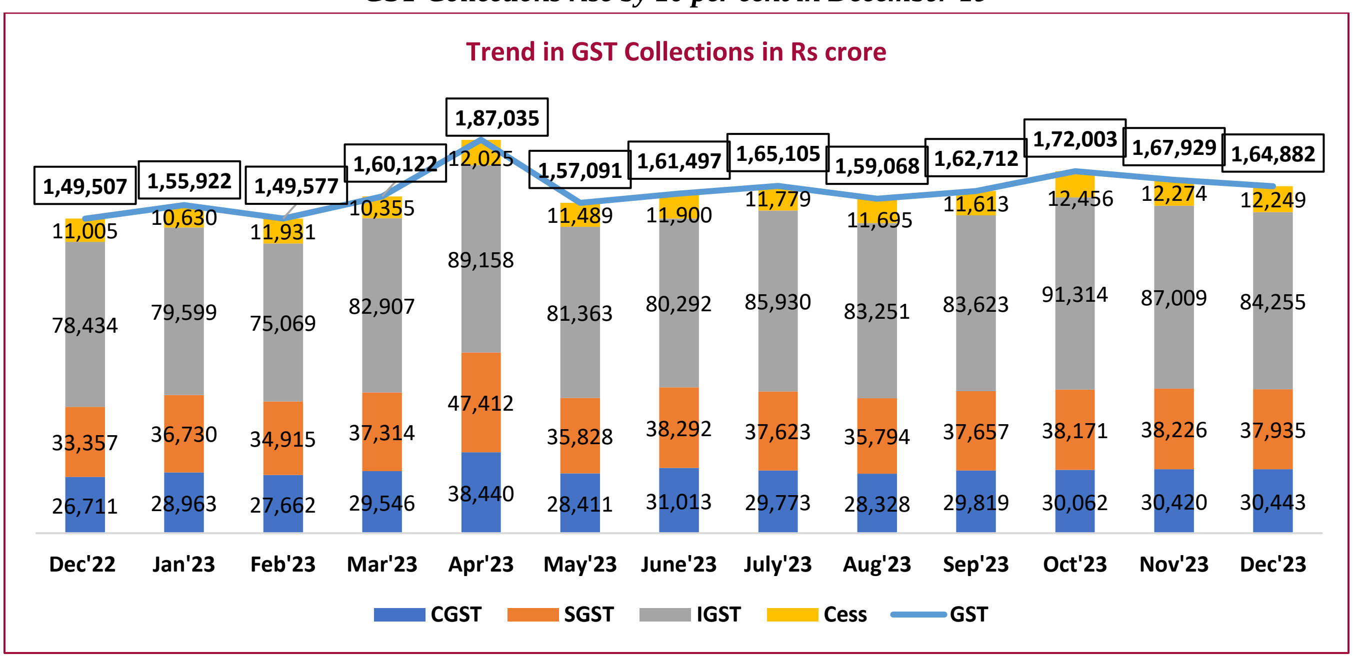
Manufacturing and Services PMI diverge in November'23



PMI manufacturing fell as growth of both output and new orders softened, but on the other hand, the future output index rose since November 2023. This indicates that the economic activities are increasing and the Indian Economy is on a higher growth trajectory. Services PMI rose on the back of new business intakes which reached its highest point in the last 3 months. Rise in new business was on account of continued growth in international sales.

GOODS AND SERVICES TAX (GST)

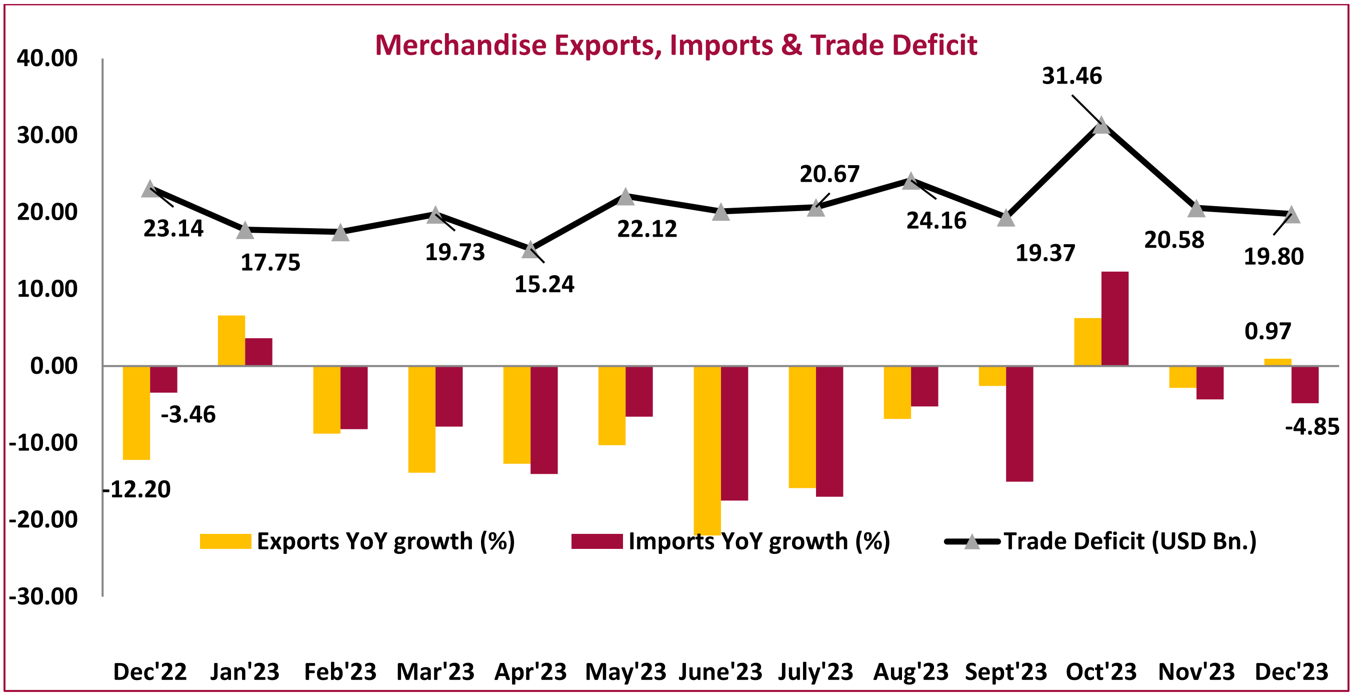
GST Collections rise by 10 per cent in December'23

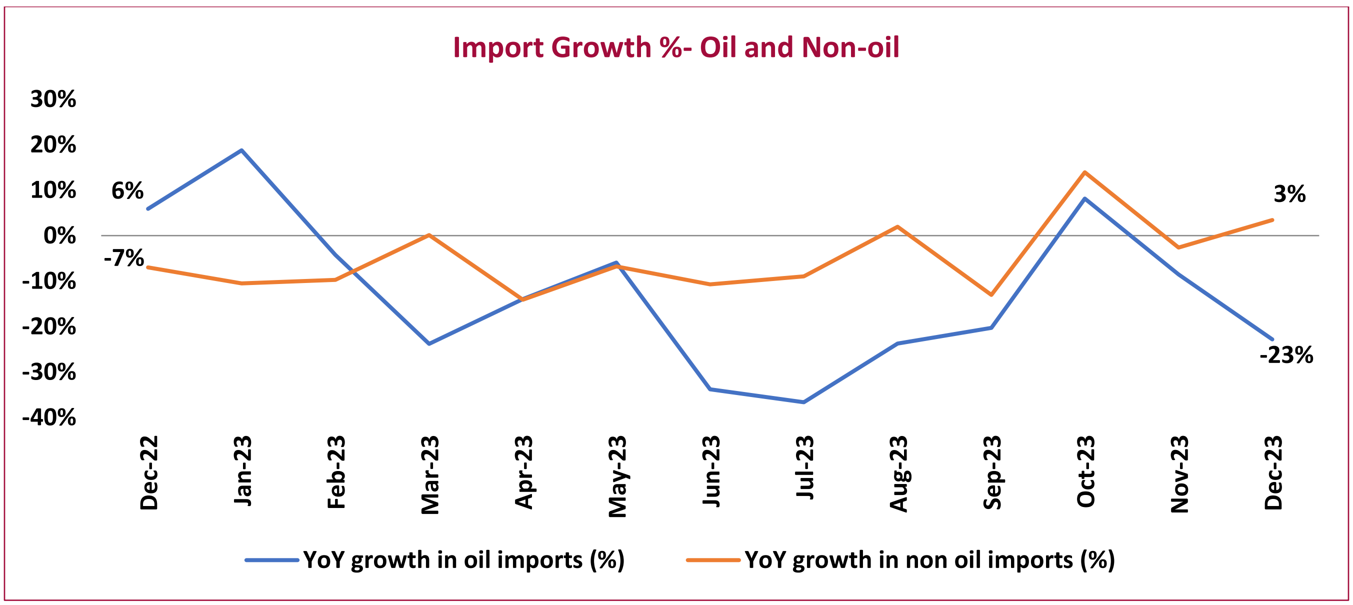


GST collections for November 2023 was Rs.1,64,882 Crore showing a growth of 10.28 percent. Monthly average GST receipts remained above the Rs.1.60 lakh crore mark.

FOREIGN TRADE

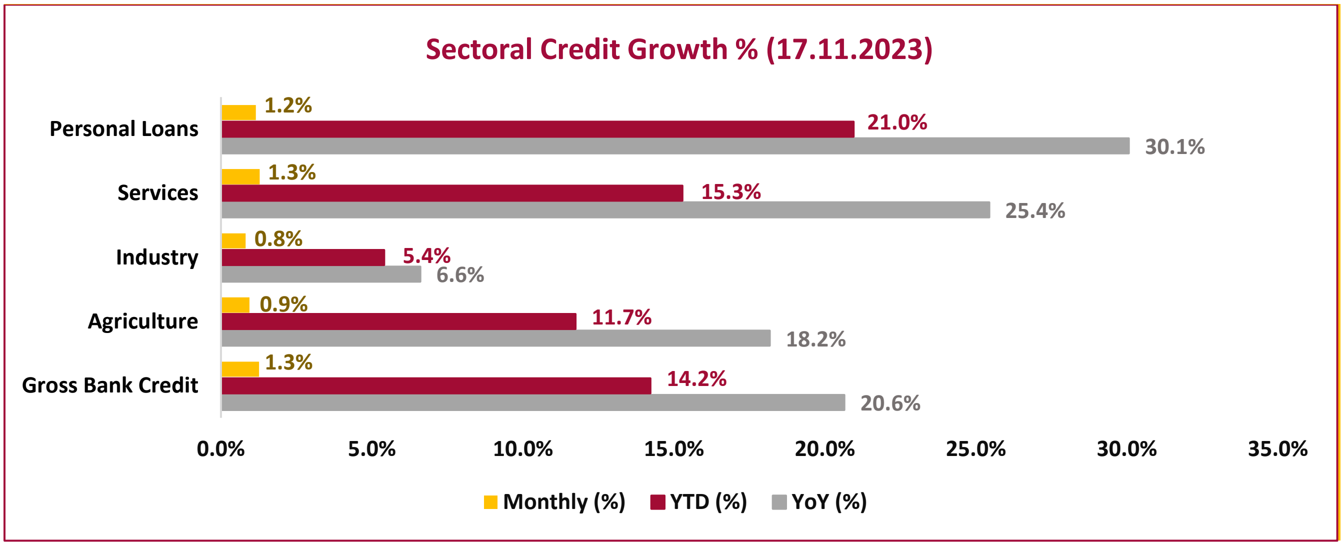
Trade deficit narrows slightly to USD 19.8 Billion in December'23





Merchandise exports rose slightly to $38.45 billion from $38.08 billion, up 0.97% YoY in December'23. Meanwhile Merchandise imports fell to $58.25 billion from $61.22 billion, down by 4.87 % YoY in December'23. Non-oil exports rose to $31.57 billion with 6.19% YoY rise. Non-Oil imports rose to $43.31 billion with 3.44% YoY rise. India's export saw a healthy growth amid global slowdown and uncertainty. Major contributors to export growth in December 2023 included Engineering Goods, Iron Ore, Gems & Jewellery, Electronic Goods and Drugs & Pharmaceuticals.

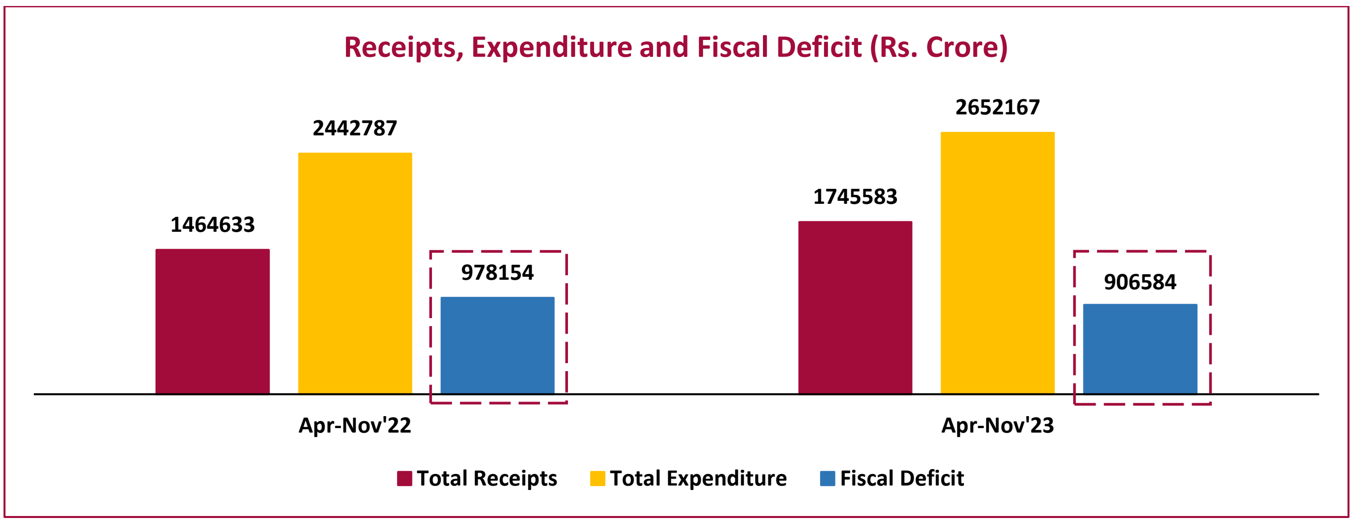
SECTORAL CREDIT



BANK DEPOSIT AND CREDIT

Parameter (Rs. Lakh Crore)	30.12.22	24.03.23	15.12.23	29.12.23	YoY (%)	YTD (%)	Fortnightly (%)
Deposits	177.34	180.44	197.92	200.82	13.2%	11.3%	1.5%
Advances	133.07	136.75	157.79	159.61	19.9%	16.7%	1.2%
Business	310.41	317.19	355.71	360.43	16.1%	13.6%	1.3%

FISCAL DEFICIT

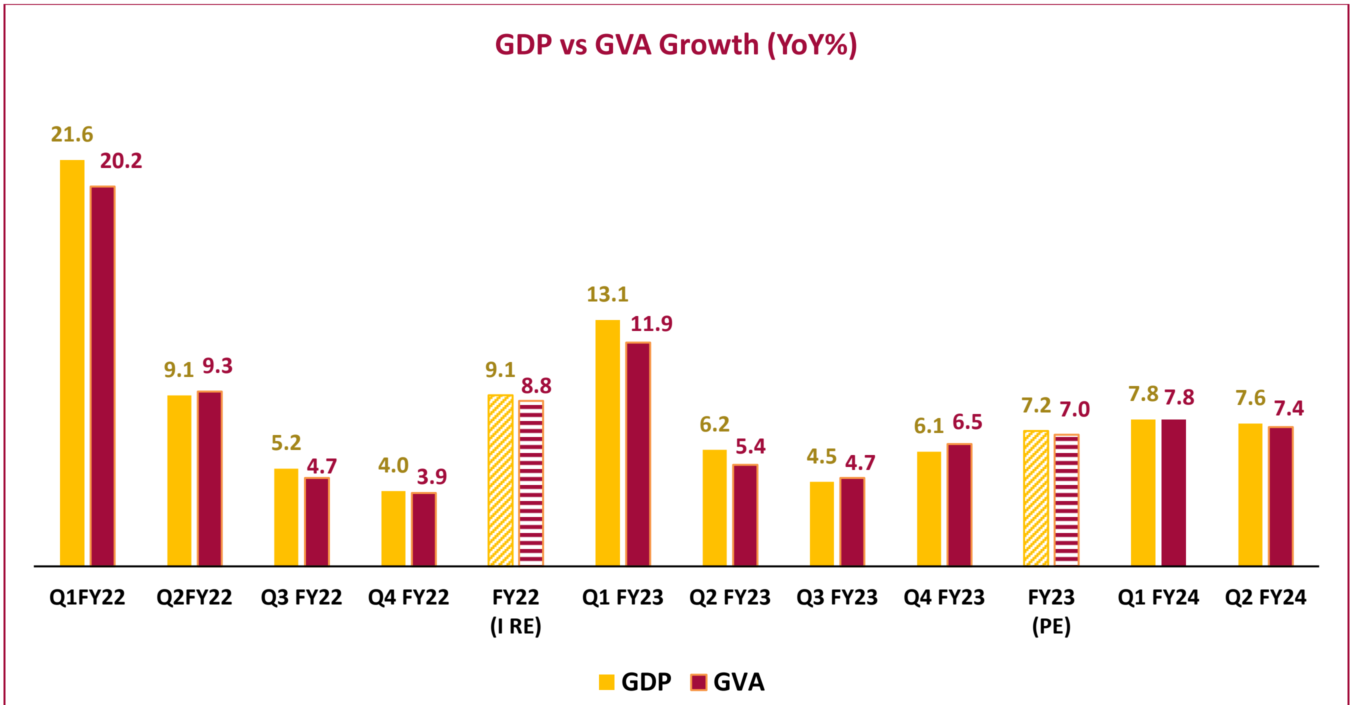


The government's fiscal deficit up to November 2023 at Rs. 9.07 lakh crore was arrested as tax revenue grew in double digits while the outlay on subsidies and other expenditure was in line with budget estimates.

11. QUARTERLY ECONOMIC INDICATORS

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

India's GDP growth surpasses expectations

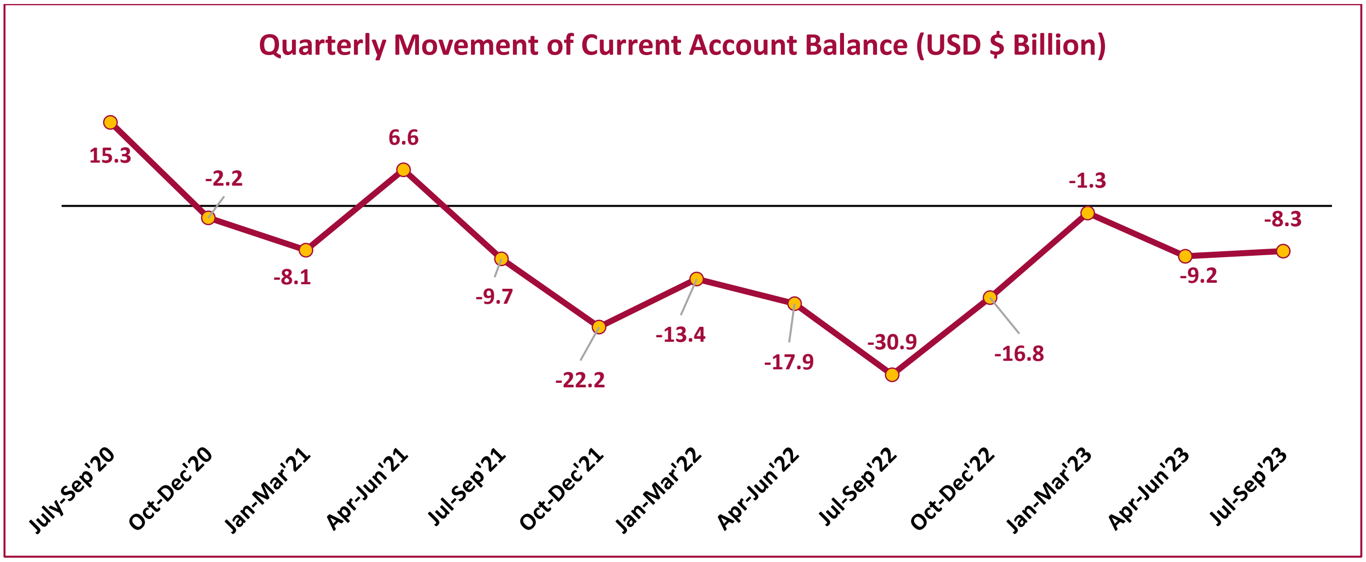


GDP for Q2 FY24 grew by 7.6% as compared to a growth of 7.8% in the previous quarter (Q1 FY24) and a growth of 6.2% in Q2 FY23. GVA growth, which excludes indirect tax and subsidies, was pegged at 7.4% in Q2 FY24. The growth was mainly driven by the manufacturing sector, which expanded by 13.9% as compared to a growth of 4.7% in the previous quarter.

INDIA'S GDP OUTLOOK BY VARIOUS AGENCIES

Agency	FY24
RBI	7.0%
World Bank	6.3%
IMF	6.3%
ADB	6.7%
Economic Survey	6.5%

CURRENT ACCOUNT BALANCE



India's Current Account Deficit (CAD) moderated from $9.2 billion (1.1% of GDP) in Q1 FY'24 and remained significantly lower at $8.3 billion (1% of GDP) in Q2 FY'24 compared to $30.9 billion (3.8% of GDP) in Q2 FY'23. A lower CAD was on account of lower merchandise trade deficit. Merchandise trade deficit stood at $61 billion in Q2 FY'24 in comparison to $78.3 billion in Q2 FY'23. Healthy receipts from services exports, good growth in private transfer receipts (mainly remittances) and robust inflows in non-resident deposits also helped narrow the CAD.

12. 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)	Jan 23, 2024
European Central Bank (ECB)	Europe	4.50	Sep 14, 2023 (25 bps)	Jan 25, 2024
Federal Reserve	U.S.A	5.50	Jul 26, 2023 (25bps)	Jan 31, 2024
Bank of England	U.K	5.25	Aug 03, 2023 (25 bps)	Feb 01, 2024
Peoples Bank of China	China	3.45	Aug 21, 2023 (-10 bps)	-
Reserve Bank of India	India	6.50	Feb 08, 2023 (25 bps)	Feb 08, 2024

13. INDUSTRY OUTLOOK

Automobile

India is a well-recognized Automobile manufacturing hub worldwide because of its low-cost production. Cheap labor, easy availability and low cost of raw materials, and a weak currency are the factors driving the manufacturing Industry. India holds a strong position in the international heavy vehicles arena as it is the largest tractor manufacturer, second-largest bus manufacturer, and third largest heavy trucks manufacturer in the world.

India aims to double its auto industry size to Rs.15 lakh crore by end of year 2024. In the automobile market in India, two-wheelers and passenger cars accounted for 76 percent and 17.4 percent market share, respectively. Export of total number of automobiles in 2022-23 was recorded at 47,61,487 out of which two wheelers accounted for about 77 percent of the total exports.

The Production Linked Incentive Scheme (PLI) scheme (outlay of $3.5 bn) for the automobile sector proposes financial incentives of up to 18% to boost domestic manufacturing of advanced automotive technology products and attract investments in the automotive manufacturing value chain. Some of the challenges and opportunities are enumerated below for Indian automobile industry.

Growth

- Projected market growth: 7-10% increase in domestic sales across passenger vehicles, commercial vehicles, and two-wheelers.
- Strong economic fundamentals: India's all-round economic growth and conducive policy environment are creating a favorable market.
- Exports: Continued growth in automobile exports, benefiting from India's competitive cost structure.

Challenges

- Moderation in sales growth: Some experts predict moderation in growth compared to 2023, particularly in the passenger vehicle segment.
- Rising prices: Input cost inflation and potential price hikes due to the new emission norms (BS-VI Stage 2) could dampen demand.
- Supply chain disruptions: Global chip shortages and other disruptions could still impact production.

Opportunities

- EV boom: The Indian government's push towards electric vehicles (EVs) presents a massive opportunity for manufacturers. By 2030, 30-70% of cars are expected to be EVs.
- Infrastructure development: Government investments in infrastructure like roads and highways will boost demand for commercial vehicles.
- Digital transformation: Adoption of digital technologies in manufacturing, sales, and after-sales services will improve efficiency and customer experience.

Overall, the Indian automobile industry is on a promising trajectory. While challenges exist, the potential for growth is significant, particularly in the areas of EVs and emerging technologies.

(https://www.investindia.gov.in/sector/automobile)

14. 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*
- *Cogencis*

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QUOTE OF THE MONTH

"A room without books is like a body without a soul."

– Cicero

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