Economy Watch

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Issue 15

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State of the Economy

More than half way through the year, global economy seems to be treading on a steady recovery course. The mid-year assessments by various multilateral agencies (IMF, World Bank and OECD) indicate a stable global growth outlook, in line with the projections made at the beginning of 2017. Trade, manufacturing output and investments have shown signs of improvement pointing towards a gradual turnaround on the demand side; however a more broad based and balanced growth is yet to find ground.

Even as nations remain committed to mitigating their specific short term and structural risks, some of the recent economic and non-economic developments could challenge the present global order. Addressing these would require a concerted effort from countries. Growing risk from protectionism, unsustainable debt levels, recent escalation in geo-political tensions - can have consequences going ahead.

India has been performing well amid a persistently uncertain global environment. The macroeconomic framework of the country has noticeably improved over the past three years and government has been serious about pursuing structural reforms. However one of the big concerns that remain is the continuing slack in private domestic investments.

Even though public expenditure has been robust, private domestic investments don't seem to be coming in as much.

Nonetheless, with domestic factors remaining conducive – on account of monsoons, forthcoming festive season, pickup in infrastructure investments and recent downward revision in repo rate – the companies should see their capacities being optimally utilised through the second half of the year hopefully making way for fresh investments.

Gross Domestic Product

The provisional GDP numbers released by Central Statistical Organisation in May 2017 reported a growth of 7.1% for 2016-17, indicating a marked slowdown from 8.0% growth observed in 2015-16. While signs of moderation had been setting in since the first quarter of 2016-17; the growth numbers for quarter 4 reported a more evident slowdown. The GDP growth declined through the year from 7.9% in quarter 1 to 6.1% in quarter 4.

The demonetization of high value currency notes in November 2016 came in as a sudden shock with the impact panning out more clearly in the last quarter numbers.

This newsletter is prepared by the Economic Affairs & Research Division, FICCI

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GVA Growth- by sector (% YOY)

	GVA at basic prices	Agriculture forestry & fishing	Industry	Services
Jun-16	7.6	2.5	7.4	9.0
Sep-16	6.8	4.1	5.9	7.8
Dec-16	6.7	6.9	6.2	6.9
Mar-17	5.6	5.2	3.1	7.2
2015-16	7.9	0.7	8.8	9.7
2016-17	6.6	4.9	5.6	7.7

GVA Growth- by Expenditure (% YOY)

	GDP	PFCE	GFCE	GCF	GFCF
Jun-16	7.9	8.4	16.6	6.6	7.4
Sep-16	7.5	7.9	16.5	2.0	3.0
Dec-16	7.0	11.1	21.0	1.0	1.7
Mar-17	6.1	7.3	31.9	-2.2	-2.1
2015-16	8.0	6.1	3.3	5.7	6.6
2016-17	7.1	8.7	20.8	1.7	2.4

Source: MOSPI, CMIE

It has been nine months since the ban and timely remonetisation has assured a swift return to normalcy. With demonetization behind us and its impact waning out progressively, the year 2017-18 is critical to resuscitate from the tremors of last year and prep up to gain more strength.

So far the broad growth conditions have been favourable this year. The monsoon in most parts of the country has been normal. This is expected to be a boon for food grain production and will also aid rural consumption. India witnessed a record food grain production in 2016-17 and the trend is expected to continue in this fiscal year as well.

Then, Goods and Services Tax was implemented successfully on July 1, 2017. This marks the implementation of the single biggest tax reform in the country since independence and will help add to our growth over the medium term.

Further, the Reserve Bank of India and Government remain committed to addressing the issue of non-performing assets. The Banking Regulation (Amendment) Bill, 2017 will help in expediting the resolution process and the passage of the Bill in Lok Sabha is a step in positive direction.

The government is carrying forward the structural reforms process in a committed manner. Also, the ongoing recovery in global economy should support India's domestic growth. Both IMF and World Bank project India to grow by 7.2% in 2017-18 and expect GDP growth to find a more solid footing in 2018-19. Furthermore, FICCI's latest Economic Outlook Survey puts across a GDP growth estimate of 7.3% for 2017-18. Survey results indicate performance of agriculture sector to remain on track and some improvement is cited in industrial sector performance vis-à-vis 2016-17. GDP growth in quarter 1 of 2017-18 is projected at 6.9%. The actual quarter 1 numbers are due to be announced on 31 August 2017.

Index of Industrial Production

Index of Industrial Production (IIP) which is a key indicator of industrial activity in India continues to report a subdued performance. IIP growth has been moderating with latest numbers indicating a growth of 1.7% in May 2017, vis-à-vis 2.8% and 3.8% growth observed in April and March respectively. Segments such as manufacture of pharmaceuticals, medicinal chemical and botanical products, manufacture of computer, electronic and optical products and manufacture of other transport equipment reported double digit growth. However, some of the other major sub-segments of manufacturing, such as, food products, textiles, wearing apparel, chemical and chemical products, basic metals, other non-metallic minerals, motor vehicles, trailers and semi-trailers reported negative/near flat growth during the month of May, pulling down the overall manufacturing sector growth to just about 1.2% in May 2017.

The latest growth numbers for electricity segment reported an improvement. The electricity sector registered a growth of 8.7% in May 2017 which was the highest in about six months.

As per used based classification of the index, except for the primary goods segment all other segments indicated a muted performance. The capital good segment noted deceleration for the second consecutive month in May 2017. Further, the growth in infrastructure/capital goods sector slipped to 0.08% in May 2017 from 5.2% growth recorded in April 2017. The growth in consumer durables segment also remained in negative terrain for the sixth consecutive month in May.

Industrial Performance- Monthly (% Y-o-Y)

% growth rate	May-16	Feb-17	Mar-17	Apr-17	May-17
Index of Industrial Production	8.1	0.8	3.7	2.8	1.7
Sectoral					
Mining	5.7	4.6	10.3	3.2	-0.9
Manufacturing	8.6	0.1	2.4	2.4	1.2
Electricity	6.1	1.2	6.2	5.4	8.7

Use-base industry classification

Primary goods	4.6	0.8	5.9	3.1	3.4
Capital goods	13.9	-2.0	9.6	-2.9	-3.9
Intermediate goods	4.5	2.2	2.8	4.2	0.6
Infrastructure/ construction goods	7.4	-1.9	0.9	5.2	0.1
Consumer durables	14.7	-7.9	-3.9	-5.4	-4.6
Consumer non-durables	12.4	9.9	6.2	8.4	7.9

Source: CMIE

In order to give an impetus to growth and employment, it remains very critical that fresh investments come in. Even though there has been a sizeable increase in the public spend over the past year, the domestic private investments is yet to pick pace.

The results of FICCI's latest Business Confidence Survey further corroborate this trend. The companies continue to operate at sub-optimal capacities and the capacity utilization rates have not seen an improvement for some time now. In the latest round, less than half (43%) of the participating companies indicated that they are operating at over 75% capacity.

The survey results also report a strain in demand conditions. Around 73% of the respondents cited weak demand to be a constraining factor for businesses in the latest round, vis-à-vis 59% stating likewise in the previous round.

Nonetheless, rural demand is expected to pick up going ahead backed by a good monsoon. Also, the upcoming festive season will provide some thrust to consumption activity.

The government's thrust on infrastructure sector is likely to continue. The government has recently approved a plan to build 34 mega multi-modal logistics parks at an investment of Rs 2 lakh crore via public-private-partnerships. This should give some reprieve to ancillary sectors like cement, steel, iron ore. Moreover, the Reserve Bank of India in its latest monetary policy review (August 2, 2017) announced a 25 bps cut in repo rate. Even though the current situation warranted a steeper rate cut of 50 bps, this is a welcome move. A further decline in lending rates will send a positive signal to investors as well as consumers. Additionally, the announcement to set up an Internal Study Group to study the marginal cost of funds based lending rate (MCLR) system with the objective of improving monetary transmission is an encouraging step.

Inflation

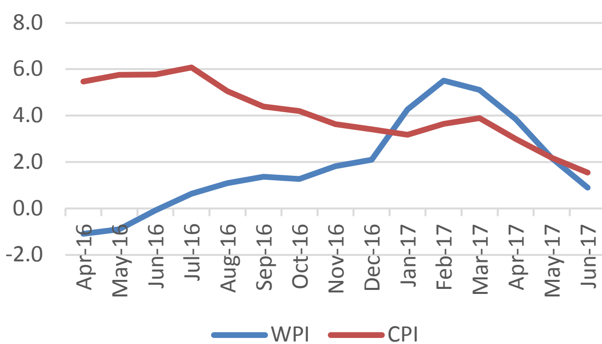
Both wholesale and retail prices moderated to lower than expected levels in the month of June 2017. The wholesale price index based inflation rate was reported at 0.9% in the month of June, vis-à-vis 2.2% inflation rate reported in May 2017. Likewise the consumer price based index registered a growth of 1.5% in June – which is a historic low in the new CPI series.

The decline in prices has been broad based, with all the major sub segments reporting moderation in price levels. However, the fall in food segment inflation rate has been most pronounced. In case of both wholesale and retail indices, food prices noted a decline on back of a sharp fall in vegetable prices. Some moderation was noted in food grain prices as well.

As of now, the upside risks to inflation stand fairly alleviated. Good monsoons will help keep a check on the likelihood of pressure arising from food segment. Moreover, the government is keeping a close tab on the progress made on irrigation projects, cold chain projects etc. and improvement in these areas is likely to yield positive results.

Also, the outlook on global commodity prices is stable at this juncture. Oil prices remain range bound even amid a rise in demand given the continuing supply glut. The production quotas led by the Organization of the Petroleum Exporting Countries came into effect earlier this year. However off late, some producers have not been meeting their production cut pledges.

Inflation Trends



Source: CMIE

Further, the Reserve Bank of India's latest monetary policy assessment reported that average headline inflation projections have tracked the actual outcome for quarter 1. The central bank cites moderation in core inflation and smooth GST implementation to bode well for inflation trajectory.

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Foreign Trade

India's exports performance has been modest amidst a highly uncertain global environment. India's merchandise exports grew by 4.4% in June 2017 and stood at US$ 23.6 billion. Exports had registered a growth of 7.2% in May 2017.

While growth in engineering goods, agriculture and allied, chemical and machinery exports remained strong during the month; growth in some of the other major exports segments – gems & jewellery, transport equipment, readymade garments, textiles and drugs & pharmaceuticals noted deceleration.

Region wise analysis of India's export indicates that a consolidated global recovery is still to shape up. India's exports to America increased by 13.9% in June 2017, vis-à-vis 16.2% growth in May. However, India's exports to Europe noted a decline in June. The share of these two regions in India's total exports is about 42%.

Imports, on the other hand, were valued at US$ 36.5 billion observing 18.2% growth in the month of June 2017. India's non-oil imports reported a growth of 20.3% in June 2017. Gold imports continued to surge and reported a growth of 103% in the month of June 2017, though this was lower than over 200% growth registered in May. The jewellers were replenishing their inventory and stocking up before the implementation of GST.

The improved outlook for global growth should have a positive impact on India's export performance. However, risks do remain on horizon on account of geo-political factors and increasing protectionist tendencies in some of the major developed economies and it remains critical for India to revisit its export strategy. The review of the foreign trade policy (to be announced in September 2017) especially in light of the introduction of Goods and Services Tax is being looked forward too.

Wholesale and Long-Term Finance Banks: Promoter Selection and Funding Sources hold the key

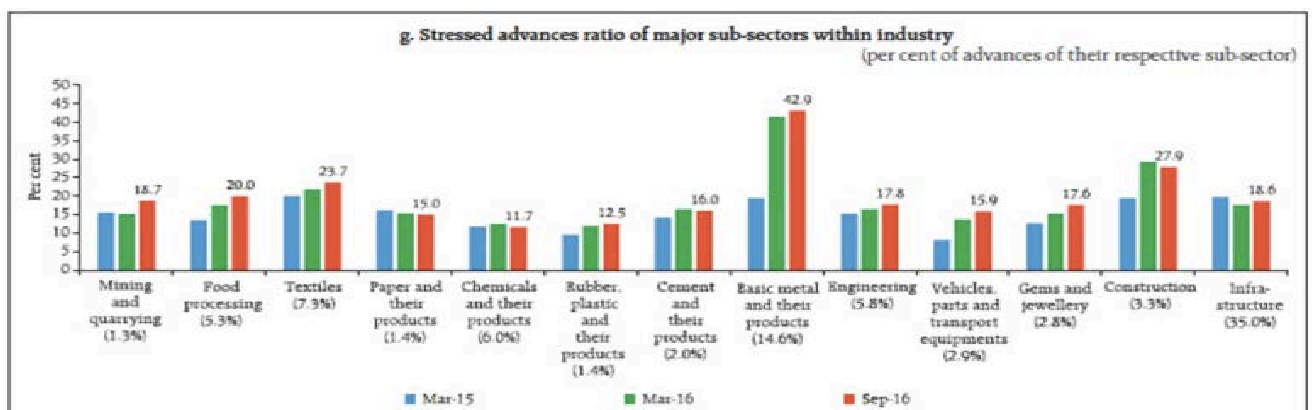
Healthy condition of the banks is very essential for a well-oiled economy and strong economic growth. Indian banking system has recently come under the spotlight due to a significantly high percentage of NPAs. RBI has been assiduously working along with the Government and the banks to resolve the NPA problem. Recently RBI also identified 12 insolvent accounts, which are responsible towards 25% of the NPAs of Indian Banking system. These accounts will immediately be referred to Insolvency and Bankruptcy code for resolution. The move is laudable as it will help banks to focus their energies on specific accounts to recover their money. However, it is equally important to understand the root cause of the NPA problem so that the banking system is better prepared for any such situations in future.

One of the notable things about the insolvent accounts contributing to the stressed assets is that these primarily belong to Infrastructure and manufacturing sector like Power, Telecom, Transportation, Aviation, Steel and Textile. As per the Financial Stability report by RBI in December 2016, Infrastructure, Metals and Textile contribute the maximum towards the stressed assets.

Projects undertaken by companies in these sectors are typically long gestation and linked to economic cycles. The very nature of projects make it unsuitable for commercial banks to lend to these projects as banks depend upon short term deposits to fund them. According to Report on Trends and Progress of Banking in India 2015-16, almost half of the deposits and borrowings of the banking sector were short term in nature as of March 2016. Further long term assets financed by short-term liabilities showed an increased in 2015-16. This presents Asset-Liability Mismatch (ALM) risk for the banking system. These projects are best funded by Financial Institutions that have access to patient long-term capital.

India has a long history of specialized long term financing institutions from IDBI, IFCI and ICICI to newer financing vehicles like Infrastructure Debt funds and Infrastructure Finance companies. Some of these institutions morphed into retail banks while others vehicle could not take off as expected. Globally also specialized development financial institutions take up the role of funding long-term projects. For example, China Development Bank (CDB) played a critical role in infrastructure development not only through capital contribution but also enables capital to flow into the long gestation projects by providing technical assistance, risk mitigation, credit support and risk mitigation instrument for projects.

Given the magnitude of funding requirement to sustain India's growth rate for next few decades we surely need to have differentiated institutions for long term financing of infrastructure and various other sectors. The current banking system has neither sufficient capital nor the capacity to fulfill the needs of India's economic growth. RBI took a great first step in this direction by granting licenses to 11 payment banks in 2015 and 10 small finance banks, which would address niche areas in the banking system. In April 2017, RBI released a discussion paper on setting up of Wholesale and Long-Term Finance (WLTF) Banks



Note: Numbers given in parenthesis with the legend is share of the respective sub-sector's credit in total credit to industry.

to fund long term Infrastructure and corporate projects. A clear focus in objectives would help these institutions in raising resources and deploying them more efficiently. This initiative could not have come at an opportune time. Due to the ongoing NPA issues, commercial banks are already wary to take further long-term exposures thus creating a critical funding gap for these projects. RBI data on industry-wise deployment of Gross Bank Credit shows that Bank Credit growth is charting a Year-on-Year (Y-o-Y) decelerating trend. In March 2017, Y-o-Y credit growth rate of Banks was 7.4% as against 9% in March 2016. According to a recent estimate, India needs over $1.5 trillion for infrastructure alone over the next ten years leave aside the funds required for long gestation projects in industrial and commercial sector.

Designing the WLTF banks

The discussion paper by RBI on WLTF banks lists out certain key design elements for these institutions. RBI proposes an initial minimum capital of Rs 1000 crore which sounds reasonable given the nature of business. However, in the long term the capital maintenance requirement should be linked to percentage of the performing and non-performing assets. This would enable these banks to always have the requisite liquidity at all times. Many would agree that a key skill in lending to long gestation infrastructure and corporate loans is deep understanding of financial appraisal of these projects. It should be ensured that the promoter group for WLTF banks is selected with strong focus on their capability to appraise long-term projects and associated challenges. RBI should also spell out eligibility criteria of projects that can be funded by WLTF banks. The criteria could be around sectors, nature of project like Greenfield vs. Brownfield and minimum tenor of say 10 years etc. RBIs proposal of relaxing Cash Reserve Ratio (CRR) maintenance and Priority Sector Lending norms for these banks is welcome, however, deposit insurance maintenance requirements should also be relaxed for these banks. Regulations around NPA and provisioning norms, security pledge of project equity and recovery processes should also be adapted keeping in mind the purpose of these banks.

There are two key critical areas that deserve attention to make WLTF banks a success. Firstly, identifying the right source of funds for WLTF banks would help define their business model. A key ingredient for WLTF banks would be its ability to raise cheaper long-term source of capital. The discussion paper proposes that these banks can raise current account and deposits above Rs 10 crore as one of the funding sources. This could prove to be counter-productive for the commercial banks. On one hand commercial banks would lose lucrative lending business to WLTF banks and losing the current account and deposit business would only lead to financial hardship for the sector which is already being challenged by niche players like payment and small finance banks. In our zeal to create WLTF banks, we should not weaken the commercial banks and destabilize financial system, which are lifeblood for our economy. Instead the best-suited source of capital for WLTF banks would be insurance companies, pension funds, sovereign wealth funds, international capital markets and long-term bond markets. This would enable them to avoid the trap of asset liability mismatches. To enable WLTF banks to raise funds from these markets, sovereign guarantee should be explored. For example, most of the European development financial institutions funding infrastructure and long-term projects benefit from government guarantees for enhancing credit worthiness. A suitable structure needs to be worked out for private participation such that proposed banks can avail the benefit of sovereign guarantee without overly depending on it.

Secondly, selecting the right promoter group for granting the license holds the key. The universal banking license criteria excludes large corporate houses. Assuming commercial banks are kept out of the promoter group, there would be very few players in the eligible promoter group which have the financial wherewithal and capability required for WLTF banks. Some of these institutions are already sponsors of Infrastructure Debt Funds (IDFs) and Infrastructure Finance Companies (IFCs), which have not performed as per expectation. It is also important to think how WLTF banks would be different from IDF and IFCs.

Project in Infrastructure, commercial and industrial sectors have a significant impact on the GDP growth and job creation in the economy. Setting up of specialized vehicles like WLTF banks would surely give a fillip to the overall economic activity, however it is very important that this initiative is implemented in the right way avoiding mistakes which traditional commercial banks have made funding long term projects. Detailed due diligence on the promoter group and appropriate financial structures for raising long term funds would go a long way to make WLTF banks a success.

The article is written by Prof. Gourav Vallabh. Professor of Finance, XLRI, Jamshedpur and Mr. Suraj Chatrath, Management Professional and Stanford alumnus with global experience across banking, financial services and technology.

Wholesale and Long-Term Finance (WLTF) Banks: Are both the bottle and the Wine new?

While conceptualizing the financial intermediary called "banks" there are perhaps two distinct views. In one view, a bank typically caters to the short-run working capital requirement of a firm while the long-term finance will come from capital market either in the form of debt or equity. In the financial folklore this model is often referred to as 3-6-3 banking, wherein a banker accepts deposit at 3 per cent, gives a loan at 6 per cent and having earned the spread, proceeds to the gold course at 3 pm! But what happens when the private capital market (both corporate bond and equity) is not sufficiently deep to have the adequate risk appetite to cater to non-working capital needs of a firm. Do we need special type of banks? Or, could a bank act as some sort of a one-stop shop like a financial "Wal-Mart" where depending upon her need and capability, the borrower will go to the appropriate stack and pick up the most suitable "loan" for her needs? This is perhaps the model of 'universal banking'. Country experiences have taught us that the outcome will typically depend upon the historical context of an economy and that there are successful instances of both bank-based and market-based financial systems. Thus, depending upon its requirements and purpose / sector -specific risk-return profile, an economy may have universal banks or differentiated banks. The recent *Reserve Bank of India (RBI) discussion paper on wholesale and long-term finance (WLTF)* banks can perhaps be traced in this broad philosophy of differentiated banking.

The concept of WLTF banks as articulated in the RBI discussion paper of April 4 2017 can be traced in the Report of the *RBI Committee on Comprehensive Financial Services for Small Businesses and Low Income Households (Chairman: Dr Nachiket More; June 2014)* that envisaged a class of differentiated banks called "Wholesale Banks". Looking into cross-country experience, the present RBI proposal views extends that vision WLTF banks that would focus primarily on "lending to infrastructure sector and small, medium & corporate businesses." As far as their functions are concerned the report noted, "They will also mobilize liquidity for banks and financial institutions directly originating priority sector assets, through securitization of such assets and actively dealing in them as market makers" (p.10). It may be useful to note the following specific features of these WLTF banks:

a) **Activities**: The primary activities of WLTF banks will be deposits or loan products for wholesale clients and financing of infrastructure sector and core industries. These banks also act as "market-makers in securities such as corporate bonds, credit derivatives, warehouse receipts, and take-out financing etc" and will provide refinance to lending institutions. These banks may also offer investment banking services related to equity / debt investments and forex / trade finance. But unlike investment banks these services will be of ancillary interest to WLTF banks.
b) **Sources of Finance**: Primary sources of funds for WLTF banks could be a combination of "term deposits, debt / equity capital raised from primary market issues or private placement, and term borrowings from banks and other financial institutions".
c) **Deposits:** These banks may be permitted to accept deposits only "above a large threshold amount" and are expected to have negligible retail segment exposure. Deposits of these banks will have deposit insurance cover.
d) **Regulatory Requirements**: These banks are expected to have a higher level of initial minimum paid-up equity capital, say Rs. 1,000 crore or more. While these banks may be required to maintain CRR they would be eligible for exemption from CRR requirement for the liabilities under infrastructure bonds. Finally, some relaxation in respect of prudential norms on liquidity risk (e.g., Liquidity Coverage Ratio / Net Stable Funding Ratio) may be considered for WLTF banks. Opening of rural and semi-urban branches and compliance to priority sector lending norms would not be mandated for these banks.

Curiously in so far the financial sector reforms process is concerned, the April 4, 2017 RBI proposal for WLTF Banks connotes both continuity and change. Two interrelated questions may crop up in this context: (a) what is the need of these WLTF banks?; and (b) how are these WLTF bank different from the erstwhile pre-merger developments financial institutions (DFIs) like IDBI or ICICI?

While rich in cross-country experience, the present RBI paper is reticent about the Indian context of necessity of such WLTF banks. It may be useful to get a historical perspective here. It is important to note that one of the key outcomes of the financial sector reforms in India has been the demise of the so-called development banks. This was in line with the report of the Narasimham Committee II, which recommended that the IDBI should be corporatized and converted into a Joint Stock Company under the Companies Act on the lines of ICICI, IFCI and IDBI. In some sense, the Narasimham Committee II echoed the spirit reflected in the World Bank's *World Development Report*, 1989 which commented, "Nonbank financial intermediaries, such as development finance institutions, insurance companies, and pension funds, are potentially important sources of long-term finance.....most of the existing development banks are insolvent, however" (p. 4). Development banks were winded up in India primarily due to lack of sources of non-concessional finance which in turn emanated from a binding fiscal constraint. Put simply these development banks became unaffordable and their concessional sources of funds dried up. Accordingly in January 2001, the RBI permitted the reverse merger of ICICI with its commercial bank subsidiary. Later on October 1, 2004, IDBI was converted into a banking company and subsequently in April 2005 it merged its banking subsidiary (IDBI Bank Ltd.) with itself. With the demise of the IDBI and the ICICI, the term lending of the country had experienced a distinct transformation.

Who filled up the void of terms-lending / wholesale funding? In an economy with well-developed financial markets, private corporate bonds could have come up. But despite various attempts, corporate bond market in India remained largely a private placement market catering primarily to blue-chap corporates. Thus, commercial banks had to come up to fill-up this void. But commercial banks have typically short term deposits as their main source of funds; hence any exposure to long term lending created a serious asset liability mismatch in their balance sheet. Long-term loan to infrastructure is a major issue here. Such exposure to long-term infrastructure lending has been a key reason behind the accumulation of non-performing assets (NPAs) in commercial banks in India in recent times. The problem is a serious one as the RBI *Financial Stability Report* of June 2017 noted that the gross NPAs of scheduled commercial banks in India rose from 9.2 per cent in September 2016 to 9.6 per cent in March 2017 - it is anticipated to rise to 10.2 per cent by March 2018. Furthermore, their stress tests indicated that to loans to infrastructure could considerably impact the profitability of banks so much so that a severe shock could completely wipe out the recorded profits of 2016-17. Faced with such a situation WLTF banks seem to be the right answer.

Development of corporate debt market is not the only way to fund longer term financing needs – there are complementary approaches. It is in this context that the RBI Discussion Paper flagged the instances of a number of globally successful WLTF banks - Brazil, South Korea, Japan to name a few. When commercial banks in India are burdened with NPAs and infrastructural needs of the country are huge to reap the full growth potential, the proposal to set up WLTF banks is really opportune at the current juncture. Nevertheless, going forward, the viability of their business model and the extent of involvement of the government in this venture will determine whether both the bottle and wine are new in this proposal for establishment of WLTF banks.

The article is written by Prof. Partha Ray, Professor of Economics, IIM Calcutta for FICCI's Economy Watch.

Government holds the key to tackling climate change, but solutions will come from business

Climate change has no borders or bias. It does not care whether you are rich or poor, big or small. Last month, the world's second-largest emitter of greenhouse gases, the US, withdrew from the Paris Climate Agreement.

It now becomes even more relevant for the rest of the world to accelerate their efforts towards climate change mitigation and adaptation. India has taken the lead by firming up its stance to follow a low-carbon growth trajectory to fulfil the aspirations of its growing economy. The ambitious climate targets of lowering the emissions intensity of its economy by 33-35 per cent by 2030 under the Nationally Determined Contributions of the Paris Agreement — and carrying out one of the most mammoth renewable energy expansion programmes in the world that seeks to install 175 GW of renewable energy by 2022 — is reflective of GoI's stance: that no matter what the world does, India won't free ride on the efforts by other nations.

Changing Business Climate: Under the rubric of the UN Framework Convention on Climate Change's (UNFCCC) Paris Agreement, all stakeholders, governments, businesses, citizens and civil society have embarked on the journey to chart out a strengthened global partnership to reach the targeted net zero emissions over the course of the next half-century.

This is reflected by the emphasis given to non-State actors in the agreement for the first time, which calls on businesses and corporate conglomerates to partner with governments.

But governments can only contribute to a small chunk of the pie by formulating policies, giving stimulus to climate-sensitive sectors and clean energy, building and assimilating the knowledge repository of climate-friendly solutions and technologies. These solutions will ultimately need to be put into action by large and small businesses, the financial world and the manufacturing industry.

Influential global conglomerates and business houses have recognised the threat climate change poses to their survival over the longer term. They have realised the only way to sustain themselves will be to integrate climate-friendly and climate-resilient approaches of doing business.

This is the silver lining and has set the tone of these large organisations playing the role of climate evangelists to demonstrate to smaller players that an energy-efficient, clean energy, low emissions way of doing business will not only reduce their ecological footprint on the planet but also enhance their competitiveness and lead to energy savings.

The private sector, innovating business models that deliver affordable climate-friendly solutions to remote areas and to people deprived of electricity, water and sanitation and last-mile connectivity, are the real champions. They are challenging the traditional approach and have taken on the risks that come with uncharted territory.

The business models have the potential to be replicated and scaled with the right policy measures by governments.

Climate concerns have now become an integral boardroom consideration for those businesses ahead of the curve. Climate-related risks will impact all sectors and require tangible actions to address these issues. A recent report demonstrated that it was vital for financial institutions to understand that addressing stranded assets and other financial risks and opportunities associated with climate change is not a one-off action, but it needs to become a permanent feature of everyday decision-making.

Reaching a New Summit: At least US$ 1trillion is required every five years, half of which needs to come from the private sector. Some of the key challenges that have precluded this from happening are the mismatch between long-term assets and short-term credit provision, as well as attracting additional flows of foreign public and private capital. A clear roadmap based on strategic sector-specific needs for channelling sustainable, adequate and predictable finance across key sectors -such as waste, low-carbon infrastructure, agriculture, sustainable transportation

--- and to build on innovating and developing scalable and replicable climate-proofed business models are needed. Businesses have already embarked on this journey. However, a push will be required from governments in devising policies, giving stimuli to clean energy, fiscal and regulatory assistance towards developing affordable environmentally sound technologies and finance from developed to developing nations to enable the transitions. Action must be taken now before it's too late.

This calls for a synergised effort by all stakeholders. One such collaborative effort is the Business and Climate Summit (BCS). Launched in Paris in 2015, and held in London next in 2016, the summit brought together businesses, investors and policymakers to mobilise the business community in support of climate action ahead of the UN climate negotiations and emphasise swifter government action on policies.

The third BCS to be held on August 31-September 1 in New Delhi will bring this discourse to Asia for the first time in the run up to UNFCCC COP 23. The discourse will focus on key areas relevant not only to businesses around the globe, but also will be contextual for the developing world, dealing with topics ranging from urban mobility, buildings and spatial planning, clean energy, circular economy, climate finance, markets for waste, to innovative business models for mitigation, and role of carbon markets.

The summit will essentially bind the discourse around a public-private partnership framework where government holds the key, while business brings the solution.

The article is written by Ms. Naina Lal Kidwai, Past President, FICCI. It was published in The Economic Times on July ,6 2017.

Surveys and Realities

It's a season for surveys and research. The latest tranche of the Economic Survey is a balanced document that shows a candle at the end of a misty road. It is optimistic, but reasonably candid on limited growth prospects in the short term, lower than its predicted ceiling of 7.5%. This is not a happy tribute to the fastest growing economy.

But a survey is just that - an assessment. Even as the Economic Survey gives careful attention to facts and detail its analysis and commentary must be duly qualified to remain within the confines of government policy and motives, and we must read it accordingly.

Now the Survey is over, the GST regime has launched, real interest rates remain high, industrial growth is feeble, private investment is scant, government may not be able to invest much more, a peaked stock market does not necessarily represent the economy, while good monsoons may lead to robust agricultural outcomes and broad-based demand.

What next ?

Considerable ink and airtime is expended on the premise that lower interest rates and resolving the balance sheet problem of the banks (forget company balance sheets for a moment) will be the most important kick-starter for private investment. But this may not follow automatically.

Sure, investments are taking place but neither are they broad-based nor sufficient to propel the economy and jobs to the desired levels.

Lets understand the mind of an entrepreneur. For this analysis I focus on the kind that build plans around sustainable profitability commencing in the short to medium term, and need to invest a mixture of capital and debt in the business. To bleed capital is not their game plan.

I make this distinction because there is more than enough capital available (no debt is needed) for business plans either funded by foreign capital or which revolve around raising and bleeding capital for the most part of a decade. Interest rates or lender health would not matter to them.

Entrepreneurs *(whether old, new, with large or small businesses) are diligent. Their intentions are* not undue enrichment but to earn risk-weighted returns on invested capital. More often than not they undertake building sustainable enterprises and value that span at least a generation or two.

Surveys exude confidence; many economic participants and commentators wax eloquent about better times, but always *"in the future". However, it is not surveys but assessment of reality by* an entrepreneur that drives him to assume business and investment risk.

Numerical and soft factors combine to trigger either an action mode or a wait-and-watch mode. Perception becomes a stronger driver than reality.

Enthused by a post-2008 anticipation of high growth, and easier availability of resources, much business capacity was created (both manufacturing & services).

But capacity utilization in many manufacturing sectors languishes below 75% with lasting increase not visible, which is surprising at our growth levels. Unless capacities fill up to over 85-90% levels, neither can debt overhang of existing business be serviced nor will anyone consider investment.

Capacity expansions are not incremental, but quantum. So, how can a businessman be convinced that a (say) 3-50% expansion in capacity or an entirely new capacity will generate a viable volume and price combination ?

Whether India can endure assaults from many far more competitive economies which must drool at even the lower end of our growth projections, is far from a given at this point.

The concept of a seamless market and end-to-end value-chain capture via GST is sound; efficiency will hopefully emerge in a few months after birth pangs.

But this is a structural change improving competitiveness, while factors of production have not been aggressively attended to.

There is perhaps truth to the notion that while ease of doing business measured by the needs of a fresh entrant has improved, anecdotal and murmured signals suggest otherwise for conduct of existing businesses. We still spend disproportionate time in fine print and tick boxing.

Despite government efforts to simplify laws, regulation and procedures, one is unable to exude confidence that an intrusive and micro-management mentality has dissipated; explicit or implicit command-and-control may be on the rise.

One perceives that everything is not broken, yet almost everything is being fixed. One may also need more confidence that the political economy will not be unkind to enterprise and there will be no major policy-led distractions.

In essence, key insecurities and limitations must be examined to find complete truth behind lack of investment enthusiasm, and business also needs to be forthright. Government articulators can present reasoned clarifications and evidence-based confidence boosters - more relevant than the proverbial candle of the survey.

At the same time, one expects that domestic businesses and potential entrants will also evaluate afresh and dispassionately the real market potential and breed plans based on sustainable profits and debt service.

When one concludes that investment is worth making, it will invariably be financed by capital and debt. Assuming the banks sort out their financials, the key question going forward will be the terms and conditions at which debt will be available and whether a prudent entrepreneur will actually raise debt at those terms ?

In recent experiences of banks and businesses, a few have queered the pitch for many. But I feel lender terms and conditions need to be quickly aligned with contemporary safety structures and ever-increasing obligations of governance for borrowers. Otherwise, no matter what the interest rate or availability of money, a prudent person may find it safer to not borrow or invest.

Loss of peer or systemic respect is as big a risk to entrepreneurs as a financial one. It is vital to respect that entrepreneurs (old and new) will shun risk if they perceive that business difficulty or failure can classify them as delinquent, threaten personal slur or even personal ruin.

I relentlessly argue that commitment of *desi entrepreneurs is the surest mantra to prompt future* investment. As accompanying reality they must also introspect on the longer-term socio-political economic scenario and meaningfully exert to occupy their rightful place of pride and relevance.

The article is written by Mr. Sidharth Birla, Past President, FICCI. It was published in The Hindu Business Line on August 16, 2017.

Let's strengthen BRICS

The G20 leaders' meeting held earlier this month in Hamburg attracted a lot of attention. There were several important economic and geo-political issues that were on the table for discussion. Another important engagement that took place on the sidelines of the G20 meet was the informal meeting of the BRICS heads of states. This meeting was equally important as it was held in the run-up to the summit meeting in Xiamen. At the meeting, the leaders agreed to carry forward co-operation activities amongst the five BRICS countries and play an increasingly important role in global economy, committing to support a rules-based, transparent, non-discriminatory, open and inclusive multilateral trading system and oppose protectionism.

This is important from a business perspective too. Improved economic relations amongst BRICS countries will help enhance trade and investments within the bloc, and contribute to growth and development. BRICS Business Council, set up in 2013, comprising business representatives from BRICS has been engaged through dialogue and exchange of ideas to strengthen trade, investment and economic co-operation.

Last year's BRICS Summit under India's presidency set a new benchmark of taking BRICS co-operation to a much higher and wider scale, with the launch of initiatives like the first BRICS trade fair, first BRICS film festival, first BRICS under-17 football cup, etc. Prime Minister Narendra Modi laid a strong emphasis on people-to-people exchange under BRICS co-operation and it is good to see that several such co-operation mechanisms have been carried forward this year by China, which currently holds BRICS presidency. In-fact, at the second BRICS film festival held in Chengdu, China in June 2017, the first BRICS co-production, Where Has Time Gone, was premiered, which is a joint collaboration of directors from BRICS countries. The filmmakers agreed to continue their joint work in the coming years. On a related note, the Indian film Dangal's premiere in China met with astounding success, setting an example of fostering closer connect amongst BRICS countries and how soft power can be leveraged to enhance understanding about our societies and cultures. Likewise, BRICS games opened in Guangzhou, China in June 2017, where 300 athletes participated. Continuing such people-to-people exchange is essential as this brings our countries closer and enhances trade and investments.

On BRICS economic and business engagements too, several activities are ongoing at the government and business levels. At the BRICS Summit last year in Goa, the BRICS Business Council made several recommendations to the BRICS leaders. Some of these recommendations have found reference in government's agenda and are progressing well. One of the proposals of the Council was to establish a BRICS Rating Agency, to provide a more thorough and complete credit rating analysis of companies in BRICS economies and facilitate cross-border investors to take a more informed decision. The proposal found a reference in BRICS Goa Declaration. At the informal meeting of BRICS leaders on the sidelines of the G20 meet, PM Modi called for action to establish the BRICS Rating Agency. On this subject, a special expert group has been set up under the aegis of the BRICS Business Council to work out the modalities of such an agency based on market oriented principles. We expect the group to present its progress report at the BRICS Summit in China.

The Business Council had also supported bilateral Social Security Agreement amongst BRICS countries to ease the burden of dual social security contributions in member countries. Earlier this year, the negotiations for the first bilateral Social Security Agreement among BRICS nations were officially concluded between India and Brazil and the agreement is expected to be in force by early 2018. We hope that more such agreements between BRICS nations will materialise in due course.

One of the most significant achievements of BRICS has been setting up of New Development Bank, which is progressing at a steady pace and is expected to play a critical role in supporting developmental projects in the BRICS economies. The BRICS Business Council has been interacting with the NDB to build closer partnership and facilitate funding for key developmental projects. Earlier this year, BRICS Business Council members met NDB president and vice-presidents at New Delhi, where they deliberated on areas of co - operation, especially

for project identification, pipeline development and knowledge exchange. In fact, it was proposed that BRICS Business Council and NDB should enter into a formal agreement for strategic co-operation. Once accomplished, this will be another major step forward.

Over the last four years, the work of the BRICS Business Council has expanded and engagements are not limited to business to business levels, but also include meaningful interactions with the government and the New Development Bank. It is heartening to see an alignment of businesses led discussions and activities and government's work agenda in BRICS. Private sector engagement at various ministerial conferences of BRICS has been on a rise. A BRICS Agricultural Cooperation Forum involving private sector was recently held in Nanjing on the sidelines of the meeting of BRICS Ministers of Agriculture. Likewise, the BRICS Communications Ministers' meeting scheduled in July 2017 has exclusive industry dialogues as part of the agenda.

BRICS Business Council is committed to strengthen business and economic co-operation and will continue to work with our respective governments to create a favourable business environment through reforms, facilitate trade through easy visas, exchange of information, single window mechanism, and to eliminate administrative barriers to investment. Some of the other areas that are being actively pursued under the Chinese Presidency of the Council include creation of a mechanism to share experience in digital economy, provide support to SMEs through financial services platform as well as leverage e-commerce tools for greater business engagements.

The article is written by Mr. Onkar S. Kanwar, Chairman, BRICS Business Council (India Chapter) and Past President, FICCI
It was published in Sunday Guardian, Jul 22, 2017 .

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Can Online Markets Make Trade More Inclusive?

Introduction

Global inequality can impact economic growth and there exists inequality both within and between countries. Some of the global trade models (based on heterogeneous firms) have indicated that international trade can actually lead to increase in income inequality. This is primarily due to the fact that smallest firms are often forced to go out of the market while trading with other countries and only the larger and more productive companies remain to benefit from access to world markets. For instance, data for US firms shows that only the top 4% of the firms benefit directly from exports market. In recent years however, technology driven online trade has been found to be helping in reducing income inequality by providing smaller firms access to international markets at low costs.

ADB has brought out a research paper named '**Can Online Markets Make Trade More Inclusive?'** to understand the impact of online trade on income inequality. The paper has been developed based on the hypothesis that large fixed entry costs into export market could probably be the reason that only a few very productive large firms benefit from access to a larger global market, whereas many less productive and smaller firms are limited to smaller domestic markets only. On the other hand, technology supplied by online markets such as eBay helps in lowering the fixed entry costs of exporting to foreign countries and enables large share of smaller firms get access to these markets at relatively low cost which in turn leads to reduction in income inequality. The paper by ADB explains this phenomenon with the help of empirical evidence and concludes that online markets have the potential of making globalisation more inclusive. The paper also provides recommendations to facilitate online trade.

Online versus offline trade costs

ADB in its paper has explored the differences in online and offline trade costs using country and firm level data. In online markets, the need to search for clients or to establish a distribution channel is much less as compared to offline markets. The cost for the seller of finding the right customer is also negligible in case of online trading. Finally, establishing a reputation as a seller who is worth trusting is much easier in this case due to the reputation building mechanisms embedded in most online markets, such as eBay's power-seller or top-rated seller mechanism. These features allow the prospective customers to observe the number of transactions made by a seller and view ratings assigned to these sellers by other customers. Thus it becomes easier for the customers to detect the unreliable or fraudulent sellers. These mechanisms compensate for the disadvantages that customers otherwise face when they do online transactions, and in particular cross-border transactions.

Cross-country evidence:

To understand the benefits of online trading, the ADB paper has analysed country level trading data in detail. All eBay trade flows between 61 developing and developed countries (including all large developing countries which trade widely through online platforms) for the period 2004-2007 have been considered for analysis, which represented more than 90% of the world trade. The same set of goods traded through online and offline platforms during the said period, categorised under 40 different groups have been studied to understand the trend.

Multiple factors/variables such as geographic distance between two countries, whether they share borders, have colonial link, common language, legal system, are part of any free trade agreement etc. have been analysed to estimate the differences in the impact of trade costs in online and offline trade. Analysis of these factors suggests a flatter world on the eBay platform and indicates that distance matters less in case of online transactions (elasticity of distance is 65% less in case of online trade as compared to offline trade). Similarly, the study also finds that absence of colonial links and common legal systems matter significantly less for online trading.

This is probably due to the fact that offline trade flows are persistent over time and continue to follow historical links (like colonial links), while new online trade results from completely new match of buyers and sellers.

However, the study finds stronger effects of language for online trade, probably because buyers and sellers have to interact directly for online transactions whereas offline trade is mostly conducted by larger companies with the support of intermediates. With respect to free-trade agreements, the effects have been found to be smaller for online trade either because they mostly consist of small shipments which are less likely to actually benefit in a meaningful way from tariff reductions (no import duties are applied anyway on small shipments), or because fulfilling requirements for preferential rates is overly complicated or disproportionally expensive for small shipments, and those trade barriers are not usually addressed by today's free-trade agreements.

The paper highlights another interesting finding: shipping costs on eBay apparently do not have any significant impact on trade flows. This is despite the fact that the average shipping costs are actually very high (above 10%) for online trade as there is less scope for bulk shipping; (shipping costs vary little with distance in case of online trade as shipments are mostly made through postal systems, where cost differences among international destinations are often relatively small).

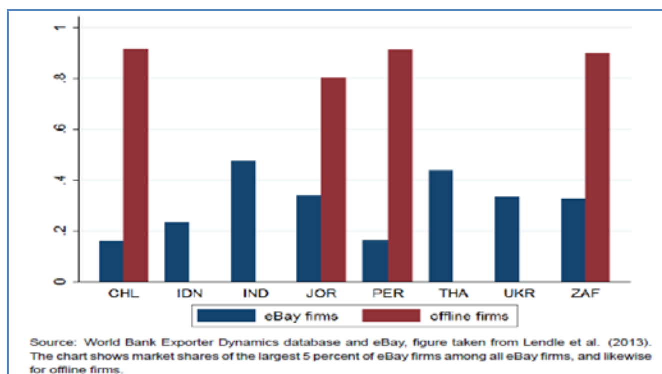
Thus, the overall findings show that new technologies can help firms overcome geographic distance and other trade barriers, and it is plausible to believe that small or medium-sized firms and entrepreneurs are gaining disproportionately more from such technologies because large firms are likely to be less constrained by the various trade barriers studied above.

Firm-level evidence - Distribution of sales online and offline

The ADB paper further explores the difference in the size distribution of US based firms which are engaged in online and offline trading. The findings suggest that mid-sized eBay exporters tend to have a larger share of exports, while small and large firms have a smaller share of sales, indicating that mid-sized firms are benefiting most from smaller trade costs online. The paper also adds that the share of total exports in the hand of the top 10% exporters is much smaller online than offline and medium sized firms have a larger share in total exports.

The same observation has been found in case of those developing countries for which both online and offline data have been studied. The analysis show that share of largest 5% of firms in overall exports from these countries is much smaller online than offline (similar to that in the US). The paper cites the example of Chile and Peru where for offline trade, top 5% of exporters represent 90% of total sales, whereas for online trade it is much lower at only around 30%. Analysis suggests that sales are more evenly distributed online and therefore gains from trade are more likely to be evenly distributed rather than being concentrated amongst a small number of 'exporter superstars'.

Market share of largest 5% firms (exporters): eBay versus offline exporters



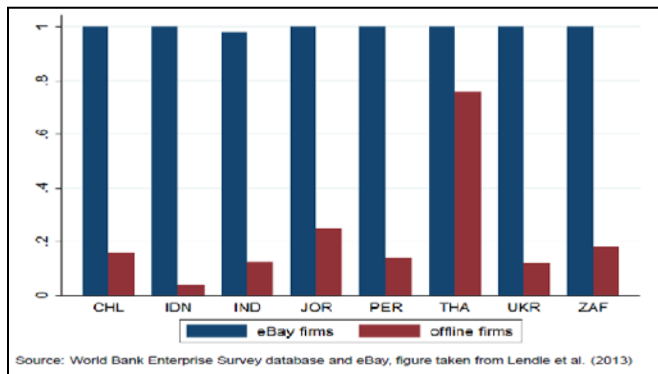
Source: World Bank Exporter Dynamics database and eBay, figure taken from Lendle et al. (2013). The chart shows market shares of the largest 5 percent of eBay firms among all eBay firms, and likewise for offline firms.

The ADB paper presents two probable reasons for research results depicting more equal distribution of sales for online firms; first that online market is fairly new and just developing, and second, that the analysis considered only a sub selection of e-commerce while sales of giants such as amazon.com have not been considered for the study. It adds that some characteristics of online markets such as low entry barriers, economies of scale (likely to be more limited) are likely to limit concentration and adds that eBay platform is less likely to be dominated by just a few sellers.

Firm level evidence: E-Commerce, fixed costs to export and market entry costs

Analysis of firm level eBay data shows that online firms face much lower fixed costs of exporting and also lower entry costs into foreign markets. The study compared the probability of exporting and the number of markets to which a firm exports between eBay traders and offline firms and found that 85% of the US firms on eBay are exporters while in case of traditional US (offline) firms, the percentage is only around 4%. No big differences have been found across sectors and product categories. The trend is similar for other developed and developing countries as well, with all the countries studied showing that large share of online firms from these respective countries are involved in exporting.

Share of firms exporting: eBay versus offline firms



Source: World Bank Enterprise Survey database and eBay, figure taken from Lendle et al. (2013)

The ADB paper also highlights that eBay exporters face practically no country-specific fixed costs to enter particular markets and that average commercial eBay seller (with a threshold of annual sales of US$ 10,000) reaches 30-40 different countries. In contrast, data available through the World Bank's "Exporter Dynamics Database" shows that the average offline exporter reaches only around 3-5 different foreign markets.

However, analysis also shows that many exporters, online and offline only have limited export transactions in a single year however, for comparable numbers of export transactions too, sellers on eBay reach many more markets as compared to their offline counterparts. The paper cites the example of Peru, where traditional Peruvian exporters with around 100 export transactions reach only 4-6 different foreign markets, while on eBay, sellers based in Peru with 100 export transactions reach around 20 different markets, which is quite close to what one would expect if exports were purely random. The paper states that these results indicate that there are no, or at least much lower, fixed entry barriers into particular markets when using online platforms.

Policy Recommendations

The ADB paper states that promoting access to online markets by small and medium size firms can help connect firms - including those in remote areas - not only to domestic customers, but also to international markets. Traditional trade costs or trade frictions appear to be much less online, making it easier, cheaper and faster for small firms to build reputation. As a result, a much larger share of online firms are able to export by reaching out to large number of foreign markets. Also, the new online firms tend to be much smaller in size than traditional firms and exporters. The paper further adds that if a larger number of firms benefit due to larger demand from foreign markets, then it implies that smaller firms too benefit from international trade.

It is evident from the analysis that trade provides a channel through which inequality can decline by way of providing firms the opportunity to enter and export in new foreign markets at reduced cost. Further, the fact that the actual distribution of exports among online sellers is more equal than among traditional exporters provides even more direct evidence that online trade can lower inequality.

Thus, it is recommended that governments should take an active role in spreading the benefits of online trade further. The paper highlights examples of Export Promotion Agencies/Councils that are working towards promoting exports by SME firms through reducing the information asymmetry which is relatively high in case of SMEs. The paper further suggests that programs which could make it easier for SMEs to access online markets should be incorporated by the governments. While citing an

example, the paper gives reference of "Easy Export" scheme offered by national postal services in several Latin American countries, which allows for simplified export procedures for small shipments sent through the postal system and is used successfully by commercial exporters.

The paper also mentions about a report done by eBay highlighting a wide range of other barriers to e-commerce in a number of developing countries and how these can be overcome. For instance, some countries impose very low "de minimis" threshold values for small shipments, above which complicated customs procedures apply, sometimes including fixed collection fees that can be very high compared to the value of the imported good. Though this is primarily an issue relevant for the importing country, low thresholds in a developing country can also harm their own small-scale online exporters as return shipments are affected. Hence, it is suggested that fees and "de minimis" thresholds should be structured in a way that does not disproportionally affect small shipments. Overall, the paper recommends that having affordable and high-quality access to the internet is among the most important requirement for e-commerce to thrive.

While highlighting numerous benefits of online trade, the paper states that consumers (or SMEs that purchase inputs for production) are one of the main beneficiaries of e-commerce, particularly in small countries with limited number of local distributors and limited local competition. Within a country too, online trade helps in reducing inequality as it provides access to same range of products for consumers in isolated or remote communities as compared to urban consumers. However, the paper emphasises that for the success of e-commerce, reliable internet connections, functioning and affordable international and domestic postal distribution networks and border procedures are a prerequisite.

To summarise, the research findings suggest that new trade opportunities driven by e-commerce can disproportionally benefit small and medium-sized firms, who are rarely participating in international markets otherwise. It allows the benefit of trade to spread more widely within countries, including to small entrepreneurs and their employees. Technology-driven online trade can thus reduce income inequality and make trade more inclusive. But to fully realize these new gains from trade, governments and export promotion agencies need to address remaining barriers to e-commerce. Thus, online markets, by offering smaller firms the opportunity to benefit from the larger global market have the potential of making globalization more inclusive.

The full paper can be accessed at: https://www.adb.org/sites/default/files/publication/320046/adbi-wp742.pdf

Infrastructure Financing Modalities in Asia and the Pacific: Strengths and Limitations

Introduction

Asia and the Pacific is the world's fastest growing regional economy for over a decade now. A major challenge for sustained regional growth and development is increased investment in economic and social infrastructure. Infrastructure investment averages around 3.9% of gross domestic products (GDP) in global industrialised economies and is even higher among the developed nations in Asia and Pacific region.

Infrastructure Investment as % of GDP

Country	%	Country	%
Malaysia	10.5	Indonesia	29.0
Australia	6.0	Thailand	21.0
Canada	6.0	Vietnam	19.0
Japan	5.0	Philippines	15.0
New Zealand	5.0	People's Republic of China	8.5
Republic of Korea	4.0	India	4.7

The majority of infrastructure is provided by government as a quasi-public good but governments globally are struggling to maintain the rate of investment necessary to meet present and future needs. The infrastructure gap or future funding requirement is estimated at around US$ 800 billion annually for Asia and the Pacific region. The region which was affected by the global financial crisis of 2008 continues to face other challenges such as changes introduced by Basel III norms which have created impediments for long-term, limited-recourse bank lending for infrastructure projects in the region. Private investment provides an important option, although investment has mainly taken place in the telecommunications, energy, and transport industries.

ADB in its paper **'Infrastructure Financing Modalities in Asia and The Pacific: Strengths and Limitations'**, presents a detailed report on the various methods of infrastructure financing being followed in Asia and the Pacific Region along with their respective strengths and weaknesses.

Government provision

According to the observations presented in the ADB paper, around 50% of infrastructure investment is incurred by the government, while 30% is funded by the government business enterprises, and private investment accounts for the remaining. In most countries in Asia and the Pacific region, the demand for new and replacement infrastructure exceeds the financial capacity of most governments, especially in developing countries facing high transaction costs, inadequate port infrastructure, and the need for upgraded transport infrastructure in cities and towns. Governments have been adopting multiple ways to meet this escalating cost of new infrastructure such as reordering budget appropriations; raising taxes (both direct and indirect) or levying special taxes, privatization, Initial Public Offerings, and capital recycling of brownfield assets, increasing public borrowings, introducing tax-exempt bonds

Government Business Enterprises (GBEs)

GBEs are independent legal entities, which Governments traditionally use to finance infrastructure investment in specific sectors, such as energy, transport, and water resources. Their borrowings are not treated as public debt of the shareholding government. GBEs finance their activities with retained earnings, budget appropriations (usually as equity or payment for community service obligations), and borrowings. In many countries in Asia and the Pacific region, GBEs usually spend more on infrastructure than do national and sub-national government agencies. The GBE option gives the governments the opportunity to generate revenue from user charges, professionally implement projects, and quarantine GBE debt from public-sector borrowing ceiling. However, the ADB paper highlights that GBEs may be an unsustainable option for financing long-term infrastructure investment as these entities serve as captive government agencies and are therefore exposed to expedient government interventions and operate at low levels of efficiency. Long-term studies have shown that GBEs often fail to earn rate of returns that exceed government bond yields, suggesting enterprise inefficiency.

Private Investment

- **Bank Loans and Project Finance**

The ADB paper also shares the fact that there has been a change observed in the pattern of infrastructure financing in Asia and Pacific region. As against the earlier trend of government providing nearly 70-80% of the capital required, private capital now provides up to 40% of infrastructure investment in these regions. Banks have provided most of the global project finance since the 1960s, and syndicated project finance remains the most common method for financing private infrastructure investment in Asia and the Pacific region, the paper highlights. In 2014, global project finance lending stood at US$ 260 billion, the highest level in 10 years with Asia and the Pacific region accounting for US$ 72 billion (27.7%), the largest share among global regional markets. During 2004–2014, in Asia and the Pacific region, most lending was for power (34%), transport (23%), oil and gas (15%) and the telecommunications (6%) sectors.

Some notable characteristics of project finance market in Asia and the Pacific region, especially since the global financial crisis include the rise in the importance of regional banks and greater share of bank-lending being increasingly allocated to home country projects where debt is mainly priced in local currency, the paper states.

In project finance, lenders are more active in asset management and performance, and play an important governance role to ensure borrower compliance and play an important facilitation role providing over-the-counter risk management instruments to hedge borrower exposure to refinancing, currency, and interest rate risks. The paper states that many project finance transactions in Asia and the Pacific region are delivered as PPPs ensuring a high level of rigor in project selection, evaluation, and implementation and adds that 19 economies in Asia and the Pacific region significantly improved the effectiveness of their PPP policies and supporting institutions from 2011 to 2014.

Strengths: An advantage of bank lending being a source of project finance lending is that it is well understood by institutions, central regional governments and their agencies, and borrowers. Debt servicing requirements over the project's economic life are matched to project cash flow and the financial economics of long-term infrastructure investments. Thus ADB report points out that project finance has been a major source of infrastructure provision in Asia and Pacific region and it appears that finance will remain available for bankable infrastructure projects.

Weakness: However, there are some disadvantage of bank lending as well which is its inflexibility and limited scope for managing change. These loans cannot be retired early or refinanced without penalty, few conversion options exist for such loans, and interest rates for them could be linked to floating rate indicators that, without hedging in place, expose borrowers to interest rate risk over the term of the loan.

Challenges of bank lending for infrastructure

Sustainable bank lending for infrastructure in Asia and the Pacific region faces the challenge of transaction flow as many lenders have been found to be willing to lend to the domestic market in local currency. This indicates a financing gap for future regional cross-border transactions.

Bond Finance

Bonds including tax-exempt bonds, revenue bonds, or corporate bonds are financial instruments which are either issued by a government or corporation to raise capital for infrastructure projects. Asian bond markets experienced strong growth in the post-crisis (Asian Financial) years, due to improvements in the regulatory framework and clearing and settlement facilities. In 2015, corporate bond issues for "Emerging Asia" (excluding Japan) stood at US$ 8.78 trillion (around 61% of regional GDP), with most issues in local currencies. Bonds accounted for around 20% of the project finance arranged in Asia and the Pacific region in 2014, having declined to less than 10% of the market in 2009–2010, the paper adds. The average tenor of bonds in the region is around 6 years, although longer maturities are available in some regional markets, notably the Philippines, Thailand, and Indonesia and the PRC; the Republic of Korea; Hong Kong, China; Malaysia; and Singapore are the largest bond markets in the region. The majority of bonds in the region are rated

investment grade with low credit risk and low rates of default, the paper states.

Strengths: ADB states that as a financial security, bonds are an attractive investment for passive institutional investors, it may be issued in a number of configurations (different tenors, currencies, and security options); may be fully or partially guaranteed by the issuing institution, and may be issued with an indexed payment stream, a convertibility option, or discount. Bonds may also be listed on securities exchanges and their performance measured by tracking market indexes. A recent study confirms that infrastructure bonds in the region generally have significantly better credit ratings and lower default risk than do corporate bonds, the paper adds.

Limitations: As compared to corporate bonds, the risks of infrastructure bonds are a little different, consisting primarily of sovereign and political risk. Historically, bonds played an important but not a dominant role in project finance, observes the paper. Investor preference for brownfield risk and investment grade credit standing suggests that listed bonds may have a limited role as a future source of infrastructure finance. The paper also adds that the recent entry of investment funds managed by investment banks specializing in infrastructure is expected to grow the unlisted market in the next decade.

Multilateral Development Banks (MDB)

The ADB paper also highlighted the critical role that the MDBs like ADB and the World Bank have played in facilitating infrastructure development in Asia and the Pacific region. In 2011, ADB and World Bank provided US$ 7.5 billion and US$ 25.2 billion in infrastructure loans respectively. However, MDBs have certain strengths as well as weaknesses. For instance, MDBs have a sound understanding of the Asia and the Pacific region's economic, political, and social drivers, as well as the capacity to support projects with technical assistance and financial and nonfinancial support services and provide grants, equity, and debt on concessional terms (greater flexibility in designing debt servicing requirements). But these development agencies have limited resources to meet the region's infrastructure financing needs.

Pension Funds

Global pension funds have emerged as significant global investors with an estimated US$ 64.0 trillion in assets; sovereign and public funds accounting for 67% of assets under management, private corporate funds 19%, and private independent funds 14%. Around 64% of the funds have been invested in countries of Asia and the Pacific region in the form of direct and indirect equity investment, debt, or through the agency of specialist infrastructure funds. Though infrastructure investments are well matched to pension funds' long-dated liability curve and yield preferences, there are certain limitations of pension fund lending as well.

Limitations: Pension funds favour debt and equity participation in unlisted infrastructure, which accounts for 56% of their allocation to this asset class. Fund managers have difficulty identifying robust investment and lending opportunities; at the same time, infrastructure lending can also attract high transaction costs. Pension fund lending to infrastructure is essentially passive and they are not significant lenders to infrastructure either globally or in Asia and the Pacific region, the paper adds; Pension funds actually prefer brownfield projects and avoid lending for construction. Pension funds and institutional investors also experience difficulty with regulatory and political risks associated with these projects, and are expected to be a limited source of future infrastructure finance going forward.

Sovereign Wealth Funds

SWFs came to global prominence in the wake of the 1997–1998 Asian financial crisis when the number of funds increased from 8 to 21, and during the 2007–2008 global financial crisis they stabilized many nations in Asia and the Pacific region, the paper mentions. In April 2015, SWFs controlled US$ 7.1 trillion of assets in diversified portfolios which generally include infrastructure assets. SWFs are now contributing to the reshaping and decentralization of global capital markets and fiscal architecture.

Strengths and Limitations: SWFs possess the capital required for long-term equity and debt investment in infrastructure as an asset class. As with pension funds, the attraction of infrastructure for portfolio investors is its strong diversification characteristics and the funds are designed to support the national interest and should maintain a high portfolio allocation to domestic infrastructure projects, the paper states.

As portfolio managers, SWF managers, unlike banks, lack the retail apparatus to issue or trade in bonds, annuities, or derivatives, or to exercise the lender's traditional credit assessment and governance roles. These constraints limit the SWFs' capacity to serve as arm's-length providers of debt finance for domestic infrastructure projects, as suggested by the relatively low average allocation of 4.5%–4.8% to this asset class.

Initial Public Offering

IPO or securitization of privatized former government business enterprises and listing on global securities exchanges was one of the methods of raising equity capital in the 1990s. Transactions using the IPO option have occurred in countries with mature capital markets, which limits the feasibility of this option in countries with less well-endowed capital markets, the paper states. In most cases, the IPO option is used to raise equity capital for privately financed infrastructure projects.

Strengths: IPOs provide an additional source of debt capital, while stapled securities provide issuers with the opportunity to offer separate equity and equity securities within a corporate group structure. Listed bonds bring liquidity and the issuer has the option of issuing bonds in a variety of coupon and tenor configurations to reduce most project financing risks, the paper mentions.

Limitations: Market for listed infrastructure projects is limited for single-asset infrastructure projects. Debt finance options include listed bond markets in which infrastructure securities have demonstrated robust credit and performance characteristics. IPOs imply greenfield project risk, and market evidence in Canada and Australia indicates a high failure rate as recent transactions have resulted in significant loss to equity and write-downs for lenders, the paper mentions. Low institutional support is another limitation of the IPO. Portfolio investors favour pre-commitment or sub-underwriting participation at a discount to the issue price for stapled debt and equity securities, an option not available to smaller portfolio investors and the retail market. Given the dominant position of institutional investors in capital markets throughout the region, the infrastructure IPO market has a limited pool of investors to draw from as compared with offerings for other sectors.

Public–Private Partnerships (PPPs)

In Asia and the Pacific region, PPPs are an important source of infrastructure finance and are widely used to deliver economic infrastructure including motorways and roads, power stations, ports and airports, rail infrastructure, and urban transport, the paper mentions. In PPPs, private firms earn revenue either through user charges or a government availability payment, however, transactional evidences suggests that market risk projects in which a private party relies entirely on user tariffs are difficult to finance, and have a high probability of failure, the paper says.

Strengths: PPPs are delivered under a procurement policy that brings some uniformity to the project selection, bid, and implementation process. From the perspective of lenders alternative dispute resolution mechanisms for the speedy resolution of problems that arise over the life of the contract is an important aspect of PPPs. The paper mentions that PPPs experience lower failure rates than do projects financed with conventional corporate loans and evidence suggests that PPPs deliver innovations in design and construction, achieve significant risk transfer away from governments, and deliver better services relatively more sustainably.

Limitations: However the paper mentions that PPPs are not suitable for all infrastructure applications and deliver their best returns when projects offer economies of scale, significant risk transfer including lifecycle cost and operational risk, and the ability to be financed in capital markets It adds that PPPs are not suitable for projects under US$ 50 million and, if financed with tenors of less than 10 years, are

vulnerable to refinancing risk. Another disadvantage of PPPs is the implied lack of flexibility with incomplete contracts of 20, 30, and 40 years in duration, and governments' capacity to manage planning and change over such long operational periods, in particular, the paper states

Conclusion

Thus the above discussions highlight that in Asia and the Pacific region, governments still provide the majority of infrastructure finance, however private infrastructure finance in the form of project finance, bonds and PPP models have assumed a more important role since early 2000s. Private management of infrastructure increases efficiency, improves productivity, and eliminates high-risk lifecycle costs for the state. However, private capital also has limitations. Data on infrastructure financing also reveals that pension funds and SWFs are not widely used to finance infrastructure projects, either globally or in Asia and the Pacific region; however, a majority of funds intend to increase equity participation in the medium term.

The paper also highlights that specialized infrastructure investment funds are potential sources of future debt, although passive investment is not always optimal for limited-recourse infrastructure projects. Bond finance brings many attributes to infrastructure transactions but, unlike bank loans, lenders do not bring the same level of experience, market knowledge, and governance to the lending transaction.

The paper mentions that the governments of the region (Asia and Pacific) face multiple challenges including fiscal repair, mechanisms for the recognition and funding of the contingent liabilities of national and subnational governments, the refinement of PPPs, and the integration of policy frameworks with a view to adopt common policy principles to facilitate regional connectivity and simplify cross-border transactions. The paper therefore recommends that the model used by the Association of South East Asian Nations which has made considerable progress in this respect, could be applied more widely in the Asia and the Pacific region.

The full paper can be accessed at
https://www.adb.org/sites/default/files/publication/296031/adbi-wp721.pdf

Insurance for Micro, Small and Medium-Sized Enterprises

Small and medium-sized enterprises (SMEs) are a key component of every economy and are relevant in developed and developing countries alike. It is estimated that more than 95% of enterprises around the world are SMEs, accounting for about 60% of private sector employment. The proportion is even higher for some countries. For instance, data for 27 countries of the European Union shows that SMEs accounted for as high as 99.8% of enterprises in 2012 which provided employment to 67% of the workers.

In the developing countries, a very high proportion of these SMEs operate in the informal sector. According to a World Bank study, out of estimated 365-445 million MSMEs operating in the emerging markets, nearly 70% belong to the informal sector. It has been observed that informal small enterprises suffer from poor risk management capabilities and the insolvency rate and proportion of non-performing loans among these firms are significantly high. This restricts their ability to access finance which is often difficult and costly; the credit gap is very high which is estimated to be about US$ 2.5 trillion globally. In most of the cases these smaller firms have to resort to informal financing mechanisms for their finance needs.

Efforts are therefore being made at various levels to improve the access to finance for SMEs mainly through improving the ability of banks and other financial institutions to assess credit risk and have easily executable collateral. A research brief titled - ***'Insurance for Micro, Small, and Medium-Sized Enterprises'*** published by ADB has analysed the role that better risk management by SMEs, including insurance can play in improving their access to finance.

Risk Management

The paper highlights the fact that though risk management in MSMEs is poor and professional expertise can therefore be considered, hiring a risk manager and suggested risk prevention measures could add to their operation costs, and if the risk assessment outpaces the benefits, it can limit MSME's ability to grow.

However, in the medium term, proper risk management can reduce the likelihood of risks and help in reducing or eliminating the financial impact of such risks, thus making MSMEs resilient to shocks and making them financially sound. Greater ability to deliver on time and improved reliability are the other benefits which firms could get due to proper risk management. The challenge is to make risk management beneficial in the short term as well. So, there is a need to recognise the higher creditworthiness of MSMEs with sound risk management system, even for those still lacking proven experience, by way of offering them cheaper loans and ease of access to such loans. However, this rarely happens for MSMEs, points out the paper. This is primarily due to the limited ability of the traditional lending institutions in assessing the quality of risk management system adopted by MSMEs while assessing the overall credit risk.

The paper suggests that insurers however are better equipped to do such analysis. They can quantify the risk reduction effect and accordingly adjust the probability of default and related credit risk. Moreover, insurers can assess the quality of risk management systems even before the effectiveness of these systems are proven and provide insurance coverage to complement those risk management systems. Thus, according to the research paper, participation of insurers in lending activities to MSMEs, either directly or along with the traditional lending institutions, assessing the quality of risk management systems can help in reducing the credit gap for MSMEs.

Insurance for the MSME Sector

Adapting Regulation to MSME Insurance

The paper shares the view that MSMEs are often neglected in financial regulation. Though special regulations have been developed to improve access to insurance for low-income people, but little effort has been made in insurance for MSMEs. Some needs of MSMEs call for insurance products that cannot be offered under most existing insurance regulations. Stating instances, the paper highlights that it might be necessary to allow distribution channels to provide

advice or premium payment patterns might need to be adjusted to the economic cycle of MSMEs, etc. which could be contrary to current regulatory requirements on maintaining the validity of coverage.

Consumer protection regulations are usually tailor-made to protect individuals and not enterprises. So, they may require revisions to reflect the specifics of MSMEs, the brief states. SME risk profiles strongly commingle individual and business risk and require innovative insurance products. Therefore the paper suggests that MSME insurance regulation should be developed to encourage insurers to design tailor-made and innovative insurance solutions for MSMEs as well. Regulations can allow for experimenting with products, reduce regulatory costs, use of digital technology applications, etc. Tailor-made regulations on insurance products that specifically target SMEs can contribute to increased uptake. However, it is essential that products offered should add value and are affordable to targeted consumers.

Addressing Uninsurable Risks

MSMEs inherently face a wide spectrum of risks, many of which are commercially uninsurable, highlights the paper. These could include terrorism, floods in flood-prone zones, property in landslide-exposed areas, or pandemics, riots, strikes, energy blackouts, or any external force that can limit business. Due to these uninsurable risks in insurance policies, a firm may remain vulnerable to shock and end up facing severe risk, inspite of purchasing insurance.

The paper therefore suggests developing a special fund to provide financial support for uninsurable risks, which could enhance the value of insurance. Complementing the uninsurable risks with financial programs for those risks can also boost insurance use and MSME industry resilience, the paper adds.

Educating without Penalizing

Among MSMEs, proper understanding of insurance products remains extremely low. This is despite the efforts made by governments, nongovernment organizations, and donors to improve insurance literacy. Policyholders having inadequate knowledge about their policies sometimes make claims which are not admissible and carry the perception that they have been misled. This misunderstanding hinders the acceptance of insurance policies by people and thus hampers the development of the sector. At the same time, insurers cannot allow uncovered claims to be paid out, as this could affect pricing.

The ADB paper therefore suggests that it is critical to create a fund that preserves the image of insurance without compromising the legality of products or their technical pricing and which does not penalize policyholders (new) for inadequate understanding of insurance products. The paper further recommends that such a fund should allow settlement of claims outside the strict interpretation of policy wording for affected policyholders that have genuinely misunderstood the coverage or whose claims fall on the borderline of exclusion. Also, the fund can be engaged in collection of data on exclusions or policy wording causing difficulty in understanding or acceptance, and this information can be used to target education, disclosure, or removal of exclusions or policy wording with the proper price adjustment of the product.

The Right Products

In terms of product offerings, the paper reveals that insurers have not sufficiently targeted the MSME sector barring a few exceptions; only standard insurance products are usually offered and no tailor-made products for targeting specific MSME needs have been developed. A thorough understanding of the value chain of different MSMEs and innovative thinking is necessary to develop appropriate products. It is therefore suggested that successful products that address MSME sector should have the following features:

i. They should be based on a detailed analysis of the business model of the targeted MSMEs
   - Value chain processes and their inherent risks
   - Risks selected that the insurance product intends to protect
   - Risks that will be or are covered by other schemes, such as government programs, structured financing, and risk management techniques
   - Uncovered risks

ii. They should take product characteristics into consideration
  - Costs at an affordable level in accordance with targeted consumer
  - Accessible and trusted distribution channels
  - Premium payment patterns that reflect economics of the targeted consumers
  - Complaints handling that is readily available and accessible in location, media, and language to the targeted consumers
  - Claims settlement timeframe that guarantees the effectiveness of the benefit, avoiding the need for temporary high cost credits
  - Renewals that are simple and that reflect possible changes in the risk profile
  - Religious and cultural preferences.

iii. Traditional MSME protection products, such as business interruption, partner insurance, and key man insurance - with riders covering re-education expenses, business transition costs, and entrepreneurial advice—should be available at affordable prices.

iv. The design of insurance products that address the special needs of MSMEs after a catastrophic event should be encouraged. Certain products that help maintain income, such as business interruption, re-educational benefits, and access to loans in case of catastrophic events, should be stimulated. If mandatory coverage is required for MSMEs, those products should be included.

Lowering Insurance Costs

The paper cautions that for successful uptake of the MSME insurance, it is essential that products offered should add value and are affordable to targeted consumers. While high distribution cost of insurance products needs to be addressed, at the same time, any cost reduction should not be a detriment to coverage or service quality.

The proposed measures should consider the following:

i. The design of products should target sufficient potential business volume. If needed, government or donor intervention could be considered to achieve critical business volume in the initial years.

ii. The concept of indemnity of a lesser value of the actual loss should be present to avoid incentives that motivate fraud.

iii. Additional services or marketing strategies which add excessively to costs without commensurate benefits for the consumer should be avoided.

iv. Insurers should be allowed to carefully provide loans to MSMEs as this can create important synergies, help in lowering distribution costs and creating additional income.

Addressing the Cost Associated with Lack of Statistics and Pricing Data

Expected claims experience is an important factor considered by actuaries and insurance professionals while pricing a product and the same is based on data from past claims. In cases where data or statistics is not readily available like in countries with low insurance penetration, insurers add a margin to the price that should protect them from possibly underestimating the future claims experience. Another technique adopted to price products is to use rates from reinsurers'. However this adds to the costs of the product and the consumer bears this additional cost due to limited data.

To deal with this situation, the paper recommends introduction of a mechanism that avoids additional insurance costs due to lack of statistics, pricing data and claims experience that is transferred to MSME consumers. A conservative pricing in turn can help MSMEs develop proper risk management by increasing the protection that they would be able to purchase. The paper also suggests that establishment of an experience pricing fund could act as a reinsurer, which would cover deviation of fair pricing, allowing insurers to price products for MSMEs without adding surcharges for lack of credible pricing data. At the same time, the fund will gather claims statistics to allow for more accurate technical pricing without its direct intervention. Aggregated statistics thus developed would serve as a common benefit for the development of MSMEs insurance with fair pricing, the paper adds.

Conclusions and Recommendations

The paper concludes that in addition to initiatives targeting availability of executable collateral and credit risk assessment for MSMEs, improvement of MSME risk management system is important. MSMEs with prime risk management systems in place, even in the early stages of their existence, can benefit from cheaper financing. Risk management experts, including insurers, are ideal candidates to properly assess existing risk management systems and help in better pricing of credit risk, suggests the paper. In addition, allowing insurers to provide credit to MSMEs can create competition and open avenues for greater supply of credit, thereby helping narrow the credit gap, the paper states.

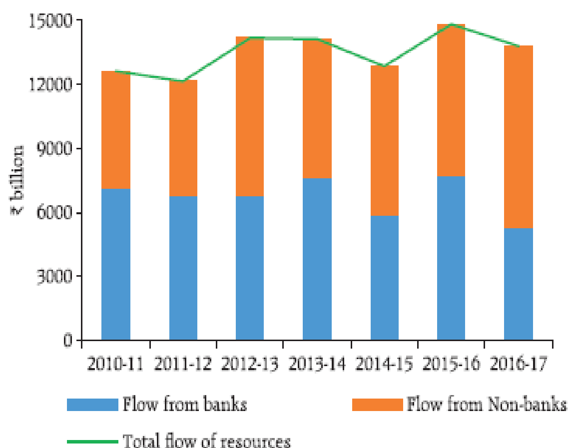
The full paper can be accessed at https://www.adb.org/sites/default/files/publication/298101/insurance-msmes.pdf

NBFC Sector

Introduction

The NBFC sector has evolved over the years and has become an important intermediary in the Indian financial system. Amidst growing credit demand in the country and retrenchment of credit by public sector banks owing to asset quality issues, NBFCs have emerged as one of the prime sources of credit in the recent years. This is evident from the latest results revealed by the Financial Stability Report released by RBI, which shows a sharp decline in the share of banks in flow of credit to 38% in 2016-17 from around 50% in 2015-16, while NBFCs recorded a 14.5% expansion in their aggregate balance sheet size during the same fiscal, over and above the increase of 15.5-15.7% recorded in the preceding two years.

Flow of resources to the commercial sector



Source: RBI Financial Stability Report June 2017

Consolidated balance sheet of the NBFC sector (yoy growth)

Particular	Mar-15	Mar-16	Mar-17
Total Borrowings	16.9	15.3	15.0
Total liabilities/assets	15.7	15.5	14.5
Loans & advances	17.1	16.6	16.4
Investments	11.5	10.8	11.9
Income/Expenditure			
Total income	15.3	15.8	8.9
Total expenditure	15.5	15.8	9.6
Net profit	15.0	15.6	-2.9

Asset quality and capital adequacy of the NBFC sector (%)

Particular	Mar-15	Mar-16	Mar-17
GNPA to total advances	4.6	4.6	4.4
NNPA to total advances	2.5	2.5	2.3
Capital to Risk-weighted Assets Ratio (CRAR)	27.0	24.3	22.0

During 2016-17, the loans and advances extended by the NBFC sector recorded a growth of 16.4%, while investments increased by 11.9%. NBFCs also emerged as the largest net receivers of funds from the financial system with the scheduled commercial banks accounting for 41% of the funds, followed by asset management companies managing mutual funds (AMC-MFs) contributing 35% and 20% by insurance companies, while pension funds accounted for nearly 2% of the net borrowings. The sector continued to raise funds through commercial papers, debentures and borrowings from banks; commercial paper outstanding expanded by 70.3% and debentures outstanding increased by 28.3%, while, bank borrowings declined by 3.7% as of March 31, 2017.

Unlike in case of banks, the asset quality of the non-banking finance entities has been much better; this is also due to the difference in NPA norms followed by NBFCs and banks. The gross non-performing assets (GNPAs) of the NBFC sector as a percentage of total advances were low at 4.6% in March 2016, which further declined to 4.4% by March 2017. Similarly, net NPAs too have showed a decline from 2.5% to 2.3% during the same period. In contrast the GNPAs of the banking sector (SCB) stood at 9.6% in March 2017 which could further increase to 10.2% by March 2018 as mentioned in the RBI report.

Enabling factors propelling the growth of NBFCs in India

The NBFC sector which consists of a heterogeneous group of companies provides a range of services, catering to a large portion of the unbanked sectors (including SMEs). India has a significant latent demand

for credit, which the banking sector has been unable to cater due to various factors. The micro and small industries sector (small businesses), non-salaried, self- employed and low-income households are the segments that face difficulties in accessing formal credit. The NBFCs stepped into this space by providing a diverse product portfolio to meet the specific credit needs of these customers (vehicle finance, others), especially in the semi-urban and rural areas. Due to their strong connect with customers, the NBFCs have been able to understand the credit needs of their customers better and have accordingly been able to design innovative product offerings (customised to the customer needs) for them. Used vehicle financing, equipment financing loans, loan against property, loan against shares, loans with gold as collateral are some of the products that have been developed in line with the requirements of different borrower categories.

In addition, the simpler processes and procedures to avail credit, along with relatively lower costs and flexibility in repayment options offered by the NBFCs have also played a major role in more customers availing credit from these institutions. Greater market awareness has also enabled the NBFCs to rate borrowers and price the credit appropriately, monitor them and effect recoveries from them as well. The wide distribution reach and robust risk management capabilities of NBFCs have enabled them to maintain their steady growth and emerge as market leaders in most of the retail segments in which they have presence. Moreover, by adopting innovative business models, these organisation have been able to cater to a large so far underserved market. Over the past 5 years they have doubled their market share in SME loans and wholesale finance. In recent years, many companies have set up operations in the non-banking space while many have augmented their presence in this space. Large players have adopted the franchisee model while others have adopted a model similar to business correspondent model, the latter having two distinct benefits – one, the company does not have to open a physical branch and second, the correspondent is more familiar with the local conditions and specific customer needs and hence can serve them better.

NBFCs have also strengthened their risk management systems and processes which include – origination and underwriting and collection and portfolio monitoring. This helps them manage the gaps that exist in the credit profiles of the borrowers.

Regulations for the Sector

The various structural changes which have been instituted by the regulator over the years particularly for the NBFC sector, has helped the sector register growth while mitigating risks. The RBI regulates the NBFCs that are registered with it, while other NBFCs are governed by various other institutions. A number of guidelines have been prescribed by RBI (as well as other regulators) which vary according to the type of NBFCs. These norms include guidelines on income recognition, asset classification and provisioning requirements applicable to NBFCs, exposure norms, disclosures in the balance sheet, requirement of capital adequacy, restrictions on investments in land and building and unquoted shares, loan to value (LTV) ratio for NBFCs predominantly engaged in business of lending against gold jewellery, etc.

With a gamut of regulations, the RBI has adopted a cautious approach towards the NBFCs and this has actually led to a reduction in the number of NBFCS in recent years. RBI has also been discouraging NBFCs from engaging in public deposit mobilisation activities, with a view to protecting depositors' interests. As of March 2017, there were 11,517 nonbanking financial companies (NBFCs) registered with RBI (as compared to 12029 as of March 2014), of which 179 are deposit-accepting (NBFCs-D) and 220 Systemically Important Non-Deposit accepting NBFCs (NBFCs- ND-SI). All NBFC-D and NBFCs-ND-SI are subjected to prudential regulations such as capital adequacy requirements and provisioning norms along with reporting requirements. In September 2016, the RBI formulated a new category of NBFCs - NBFC-account aggregators (AAs), aimed at facilitating a consolidated view of individual investors' financial asset holdings, especially for the entities falling under the purview of different financial sector regulators.

The government and the regulator/s have also been bringing in reforms in the NBFC guidelines according to the evolving business models of the companies as

well as to ensure that the sector grow in a healthy manner. The effort has been towards encouraging the smaller players in the sector by rationalising norms for them, while strengthening the norms for the systematically important NBFCs as per the global standards. This was evident from the revision which was brought about in the threshold level for systemic significance from Rs. 100 crore to Rs. 500 crore in 2014. Under this revised norm, non-deposit accepting NBFCs with total assets less than Rs. 500 crore are considered as not being systemically important and hence are required to follow less stringent regulations.

However, for the systematically important and deposit accepting NBFCs, minimising the regulatory arbitrage between banks and NBFCs (to further harmonise the regulatory framework) has also been one of the major guiding principles towards designing the regulations for these categories of entities. Some of these guidelines include regulations on asset classification and provisioning norms which has been prescribed to be brought at par with the banks (90 days) by March 2018 in a phased manner, Tier 1 capital requirement for capital adequacy purposes which too has been enhanced, framework for revitalising distressed assets, reporting frauds and options on refinancing of project loans.

Besides, the SME loans (loans to MSEs) above Rs. 10 lakh and upto Rs. 2 crore extended by NBFCs has been covered under the CGTMSE guarantee scheme (January 2017) and systemically important NBFCs have been covered under the SARFAESI Act. These measures would strengthen NBFCs' ability to lend and mitigate losses in case of default. The RBI has also come up with an Information Technology Framework for the NBFC sector focusing on implementing several operational requirements to enhance safety, security and efficiency in processes for NBFCs. Systemically important NBFCs have to comply with it by 30th June, 2018 and other NBFCs (with asset size below Rs. 500 crore) by 30th September, 2018. NBFCs which are in the process of implementing these requirements have been suggested to conduct a formal gap analysis between their current status and stipulations and put in place a time-bound action plan to address the gap and comply with the guidelines.

To further enhance the flow of credit to the small businesses, the RBI is also deliberating on a framework for co-origination of loans by banks and NBFCs/MFIs with risk participation which would leverage upon the strength of both entities while benefitting the entrepreneurs in the form of lower credit costs. As per this model, banks would not only provide loans to NBFCs or MFIs for on-lending to ultimate borrowers, rather both banks and NBFCs together would provide loan directly to the end borrower under a loan-sharing agreement.

Challenges

While there is enormous potential for NBFCs, the sector also has its fair set of challenges. The sector operates under certain regulatory constraints that place them at a disadvantage as compared to banks. The sector could face stiff competition from banks offering finer pricing in the medium term.

In the near term, the impact of recent changes like demonetisation and implementation of Goods and Service Tax (GST) could negatively impact the asset quality of the NBFCs. The cash crunch following de-recognition of high value currency notes impacted the NBFC sector; there was moderation in disbursements and loan delinquencies. Following demonetization, RBI had temporarily relaxed the asset classification norms and offered deferment by 90 days for classification of loans as sub-standard, which also affected the repayments. Consequently, the profitability of the sector was adversely affected during 2016-17; net profits of NBFCs were down by 2.9% and net profits as a percentage of total income was 4.3 percentage points lower at 14% in 2016-17 and RoA and RoE was also down at 1.8% (2.1%) and 6.8% (7.9%).

On the other hand SMEs, which form the largest borrower category for NBFCs could see a slowdown in business, during the transition phase as they adjust to new GST regime, which may limit their debt servicing capabilities in the short run. In the medium to long term, implementation of GST, and better tax compliance and thus availability of formal data for SMEs would enhance the process of assessing customer creditworthiness. This could reduce/lower entry barriers for the segment and thus intensify

competition in the segment and have an adverse impact on profitability.

Another major challenge for NBFCs is ensuring availability of adequate debt funding at competitive costs as it could affect profitability of the sector. Following the government measures, as more of informal economy shifts/integrates into the formal economy, some of the competitive strengths of the NBFC sector may become less relevant (medium to long term) and as a result participation of banks could increase in this segment. Also, as digital adoption increases, due to the digital initiatives of the government, NBFCs would need to work on their strategies (product portfolio, positioning, pricing, processes, and customer interaction) and align them with the emerging trend of increasing adoption of digital platforms. It could open up a new customer segment for NBFCs as well.

Outlook

NBFCs have substantially improved the credit availability for the smaller businesses, in spite of this it is estimated that still over three-fourth of the finances used by the MSMEs is met by informal sources or self-finance even today. On one hand this indicates the presence of a large untapped market which NBFCs can look to serve in future, on the other, it also highlights the huge demand for formal credit in India, which is only likely to grow in the coming years and hence can help in the future growth of the NBFCs.

Government initiatives including thrust on infrastructure; business reforms; digital initiative and related growth in e-commerce sector too are expected to give impetus to credit demand in the country. The government's focus on innovation and entrepreneurship would further lead to incremental credit demand generation. Moreover, the country is expected to witness higher consumption driven by favourable demographics and rising middle class and this is expected to shift to semi urban areas and tier II cities. NBFCs which traditionally have a strong presence and customer connect in these regions could benefit from the resultant increase in demand for consumer finance in these cities.

Overall it is estimated that NBFCs could see a credit growth of around 15-20% over the next few years. Also, the sector which has been instrumental in gradually substituting credit extended by the unorganized sector and thus been playing a significant role in furthering the cause of financial inclusion, would continue to do so in the near future as well and would remain a significant contributor to the state exchequer.

Survey Highlights

Business Confidence Survey, July 2017

Source: FICCI Business Confidence Survey, July 2017

Latest survey results indicate a marginal dip in overall sentiment of the respondents. FICCI's Overall Business Confidence Index stood at 66.1 in the present round, vis-à-vis 68.3 in the previous round.

While the latest survey reports improvement in the assessment of respondents with regards to current conditions at the economy level, assessment at the industry and firm level noted moderation. The results also point towards moderation in the near term expectations of the respondents.

Feedback received on operational parameters indicate that a turnaround is yet to find firm ground. Except exports, outlook on other parameters - sales, investments, employment and profits – has moderated. 59% of the companies participating in the present survey cited an increase in sales over the next two quarters. In the previous round, 65% participants had stated likewise.

Outlook on investments remains weak in the current survey round. About 38% of the participating companies indicated that they foresee higher investments over the next two quarters. The corresponding figure in the previous round was 40%. Further, about 17% of the participants anticipated lower investment during the period July to December 2017, 13 percentage points higher than the proportion of participants stating likewise in the previous round.

A sustainable turnaround in the domestic private capex cycle is critical for growth and employment generation in the economy. However, the companies continue to operate at sub-optimal capacities. In the present round, less than half (43%) of the participating companies indicated that they are operating at over 75% capacity.

Survey results report a strain in demand conditions. 73% of the companies participating in the present survey reported weak demand to be a worrying factor; in the last round 59% participants had stated the same. However, an uptick in demand could result from good monsoons, expectation of a robust agri-production and the forthcoming festive season

Around 39% participants reported cost of credit to be a bothering factor in the present round, which was same as the last survey. The survey findings indicate that the companies are still paying an average interest rate of 12.0% on term loans and an average interest rate of 11.5% on working capital loans.

With respect to GST, the mood of the industry seems upbeat. About 64% of the respondents expressed satisfaction with the GST rate allotted to their respective sector/product. 44% of the participants said that they were fully ready for the transition to the new tax system.

Majority of the respondents cited reconfiguring IT systems and training of F & A personnel to be key focus areas in preparing for the transition.

The current survey drew responses from companies with a wide sectoral and geographical spread. The survey drew responses from about 200 companies with a turnover ranging from Rs 5 crores to Rs 10,000 crores. The participating companies belonged to an array of sectors such as textiles, real estate, steel, oil & gas, agricultural equipment, food processing, pharmaceutical, IT & telecom and electronic products.

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For detailed report you may contact:
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Economic Outlook Survey, May 2017

ANNUAL FORECASTS FY18

Gross Domestic Product	7.4%
Wholesale Price Index (Avg. 2017-18)	5.0%
Consumer Price Index (Avg. 2017-18)	4.8%
Index of Industrial Production	3.0%
Export Growth	5.9%
Import Growth	7.1%
Trade deficit as % of GDP	4.9%
Current Account Deficit as % of GDP	1.2%
Fiscal Deficit as % of GDP	3.2%
USD/INR Exchange Rate (End of Period)	Rs 66.8/USD

QUARTERLY FORECASTS Q1 FY18

Gross Domestic Product	6.0%
Wholesale Price Index (Avg.)	5.2%
Consumer Price Index (Avg.)	4.1%
Index of Industrial Production	1.6%
Export Growth	5.6%
Import Growth	7.8%
Trade deficit as % of GDP	4.2%
Current Account Deficit as % of GDP	0.4%
Fiscal Deficit as % of GDP	-
USD/INR Exchange Rate (End of Q1 FY18)	Rs 66.5/USD

Source: FICCI Economic Outlook Survey, May 2017

FICCI's latest Economic Outlook Survey puts across a median GDP growth forecast of 7.4% for the current fiscal year, with a minimum and a maximum range of 7.0% and 7.6% respectively.

The projected numbers indicate an improvement in industry as well as services sector growth in 2017-18. Agricultural sector growth is also expected to remain robust during the year. With the process of remonetisation almost complete, demand is gradually gaining strength.

The median growth forecast for IIP has been put at 3.0% for the year 2017-18, with a minimum and maximum range of 1.5% and 6.8% respectively. Outlook of economists on inflation remained benign. Wholesale Price Index based inflation rate is projected at 5.0% in 2017-18, with a minimum and maximum range of 3.6% and 5.9% respectively. Consumer Price Index has a median forecast of 4.8% for 2017-18, with a minimum and maximum range of 4.0% and 5.3% respectively.

Participating economists were optimistic about the prospects of the external sector. Based on the responses of the economists, the median growth forecast for exports has been put at 5.9% for fiscal year 2017-18 and for imports at 7.1%.

Additionally, economists were asked to share their views on the idea of Universal Basic Income as included in the Economic Survey 2016-17. Majority of the participating economists were supportive of the idea of Universal Basic Income. It was felt that UBI can be an efficient substitute which would help reduce poverty and transfer the choice/decision to spend on the individual. It would also promote employment generation by promoting labour flexibility.

However, it was agreed by majority that the implementation of such a scheme in India would be a colossal task. Several challenges would emanate, right from stage of selection of beneficiaries to deciding on an acceptable income level and its distribution.

Further on the rising wave of protectionism and its impact on India, economists believed that as India is a part of the globalized world and any disruptions in the global arena will have ramifications for the country as well. They unanimously felt that that protectionism is becoming a new normal led by certain advanced economies to propel growth and increase employment.

Participating economists felt that while protectionism is a challenge, India needs to keep its focus on implementing reforms. The situation calls for improving the investment climate in the country, enhancing hard and soft infrastructure and continuing the efforts on tackling the issue of non-performing assets.

The present round of FICCI's Economic Outlook Survey was conducted in the month of March/April 2017 and drew responses from leading economists primarily from industry, banking and financial services sector. Economists were asked to share their opinion on a number of issues such their assessment about the final growth estimate for 2016-17, views on Universal Basic Income and recipe for its success, and impact of rising protectionism on India.

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Economy Fact Sheet – GDP

GDP grew by 7.1 percent in 2016-17

- *Gross Domestic Product reported a growth of 7.1 percent in 2016-17 as against a five year high growth of 8.0 percent reported in 2015-16. Likewise, Gross Value Added at basic prices recorded a slower growth of 6.6 percent in 2016-17 vis-à-vis 7.9 percent growth noted in the previous fiscal.*

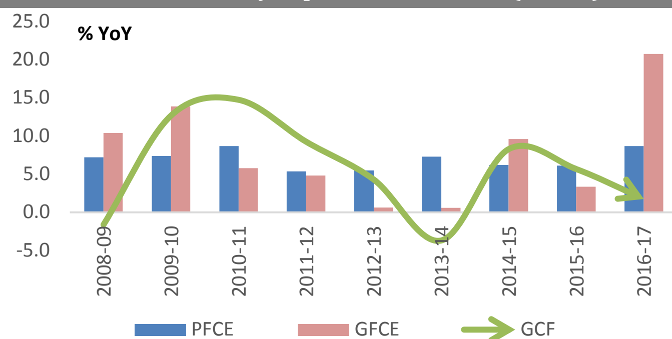
- *Supported by good monsoons as well as greater budgetary allocation towards promoting various agricultural schemes, agriculture (and allied activities) sector reported robust growth numbers in 2016-17. The segment grew by 4.9 percent in 2016-17 vis-à-vis a meagre 0.7 percent growth in 2015-16.*

- *Growth of industry was seen at a three year low of 5.6 percent in 2016-17 after witnessing a six year high growth of 8.8 percent in 2015-16. Companies have been reporting weak capacity utilization rates for quite some time now and the same has been corroborated in FICCI's latest Business Confidence Survey. In fact, Q1 2017-18 was the fifth consecutive quarter when more than half of the participating companies reported a capacity utilization rate of less than 75%.*

GDP and GVA Growth- Annual (% YoY)

	GDP	GVA at basic prices	Agriculture, forestry and fishing	Industry	Services
2012-13	5.5	5.5	1.5	3.4	8.3
2013-14	6.5	6.2	5.6	4.2	7.7
2014-15	7.3	7.1	-0.2	6.9	9.7
2015-16	8.0	7.9	0.7	8.8	9.7
2016-17	7.1	6.6	4.9	5.6	7.7

GDP Growth by Expenditure- Annual (% YoY)



There is a need to boost private investments in the country to enhance industrial and economic growth. Sub-optimal levels of capacity utilization rates and high cost of credit are the major constraints facing businesses. The problem gets elevated with the twin balance sheet problem persisting in the economy.

With CPI based inflation rate at historic low levels, there is a need to cut the repo rate by at least 50 basis points.

Additionally, the government should continue to spend on infrastructure creation which will ultimately crowd in private investments.

- *Services sector also noted moderation in 2016-17, registering a growth of 7.7 percent as compared to 9.7 percent growth registered in 2015 -16.*

- *On the expenditure side, gross capital formation grew by 1.7 percent in 2016-17 vis-à-vis 5.7 percent growth noted in 2015-16. Government final consumption expenditure surged and recorded 20.8 percent growth in 2016-17 vis-à-vis 3.3 percent growth noted in 2015-16. Growth of private final consumption expenditure also increased with the segment growing at 8.7 percent in 2016-17 vis-à-vis a growth of 6.1 percent in 2015-16.*

GDP grew by 6.1 percent in Q4 2016-17

	GVA at basic prices	Agriculture, forestry & fishing	Industry	Services
Jun-15	7.6	2.5	7.4	9.0
Sep-15	6.8	4.1	5.9	7.8
Dec-15	6.7	6.9	6.2	6.9
Mar-16	5.6	5.2	3.1	7.2

- *GDP growth for the fourth quarter of 2016-17 was observed at 6.1 percent vis-à-vis 9.1 percent growth noted in the corresponding period previous year. Gross value added at basic prices was reported at 5.6 percent in Q4 2016-17.*

- *Agriculture (and allied activities) sector posted a growth of 5.2 percent in Q4 2016-17 as compared to 1.5 percent growth noted in the corresponding quarter previous year.*

- *On the expenditure side, while gross capital formation contracted by 2.2 percent y-o-y during Q4 2016-17, government final consumption expenditure grew by a whopping 31.9 percent y-o-y.*

The Government has completed three years in office and the spate of reforms being undertaken is laying a solid foundation for future. The implementation of GST from July 1, 2017 is expected to lower costs for the industry and facilitate higher GDP growth in coming years. FICCI's Economic Outlook Survey, May 2017 puts across GDP growth at 7.4 percent for the fiscal year 2017-18.

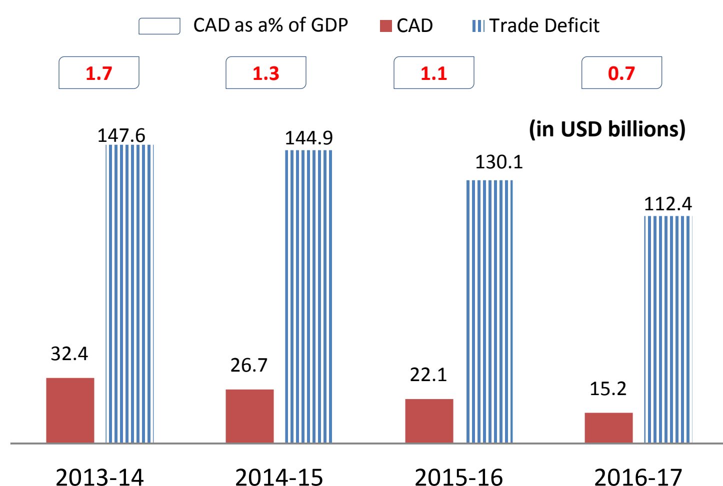
Source: MOSPI, RBI, Economic Outlook, CMIE and FICCI Research

Economy Fact Sheet – Balance of Payments

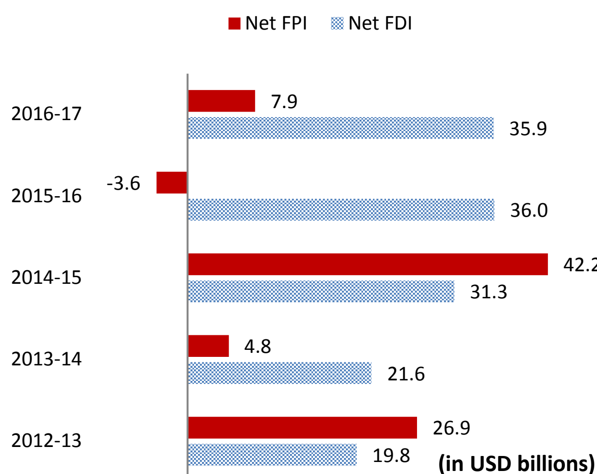
CAD stood at 0.7 percent of GDP in FY17

- *India's CAD narrowed down to 0.7 percent of GDP in FY17 as compared to 1.1 percent in FY16. It declined to USD 15.2 billion in FY17 from USD 22.1 billion in the previous financial year.*
- *Net foreign direct investment in FY17 stood at USD 35.9 billion, as compared to USD 36.0 billion in FY16. As compared to this, net foreign portfolio investments stood at USD 7.9 billion in FY17, up from a net outflow of USD 3.6 billion in FY16.*
- *As on 30th June, 2017, India's foreign exchange reserves stood at USD 386.5 billion.*

Snapshot of trends in India's Current Account Balance



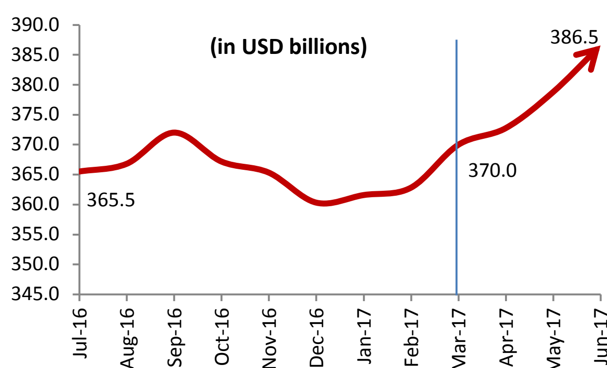
Net FDI and FPI Inflows



Balance of Payments - Key Indicators

USD Billion	FY16	FY17	Q1 FY17	Q2 FY17	Q3 FY17	Q4 FY17
Current account	-22.1	**-15.2**	-0.4	-3.4	-8.0	-3.4
-Goods	-130.1	**-112.4**	-23.8	-25.6	-33.3	-29.7
-Services	69.7	**67.5**	15.7	16.2	17.7	17.6
Net Foreign Direct Investments	36.0	**35.9**	3.9	17.0	9.7	5.0
Net Foreign Portfolio Investments	-3.6	**7.9**	2.1	6.1	-11.3	10.8

Forex Reserves



Trade deficit declined to USD 112.4 billion in FY17 from USD 130.1 billion reported in the previous year, which has also led to a decline in the current account deficit. Services receipts too fell from USD 69.7 billion in FY16 to USD 67.5 billion in FY17. Private transfer receipts also declined by 10.3 percent to USD 55.3 billion in FY17 vis-à-vis the previous year. Workers remittances, which form the major part of private transfers were USD 35.3 billion in FY17 as compared USD 35.5 billion in the previous financial year.

Going forward, CAD is expected to widen on the back of higher imports growth, slowdown in private remittances and possible moderation in services exports due to rising protectionist policies in key economies. As per FICCI's Economic Outlook Survey, CAD is expected to rise to 1.2 percent of GDP in FY18. Given India's healthy forex reserves and expectation of higher FDI inflows, the current account situation is expected to remain largely manageable.

Source: RBI, Economic Outlook CMIE

Economy Fact Sheet – Index of Industrial Production

IIP grew by 1.7 percent in May 2017

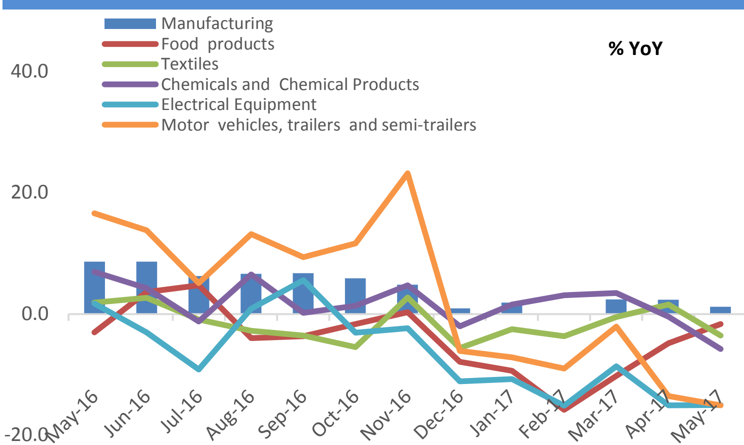
- *Index of Industrial Production grew by 1.7 percent in May 2017 after witnessing 2.8 percent growth in the previous month. On a cumulative basis, the index reported dismal growth of 2.2 percent during April-May 2017 vis-à-vis 7.3 percent growth reported in the corresponding period previous year.*

- *Mining and manufacturing reported weak growth numbers during the month. Index for manufacturing sector grew by 1.2 percent in May 2017 as compared to 2.4 percent growth registered in the previous month. Mining activity contracted by 0.9 percent in May 2017 which is the lowest in eight months. On the other hand, electricity generation reported robust growth of 8.7 percent in May 2017 as compared to 5.4 percent growth noted in April 2017.*

- *As per use based classification of industrial production, primary goods noted 3.4 percent growth in May 2017 vis-à-vis 3.1 percent growth noted in the previous month. Intermediate goods and infrastructure /construction goods recorded a near flat growth of 0.7 percent and 0.1 percent respectively during the month. Growth in capital goods continued to contract in May.*

- *Growth in the consumer goods segment improved slightly to 2.2 percent in May 2017 as against 1.8 percent growth witnessed in the previous month. While consumer durables continued on its path of contraction (contracting by 4.6 percent in May 2017), consumer non-durables segment noted growth of 7.9 percent during the month.*

Major Manufacturing Sectors (%YoY)



- The subdued growth in manufacturing is worrying as some of the major sectors like chemicals and chemical products, capital goods, automobile and textiles have shown deterioration in growth. This underlines the for taking urgent policy measures to increase investments in the country.

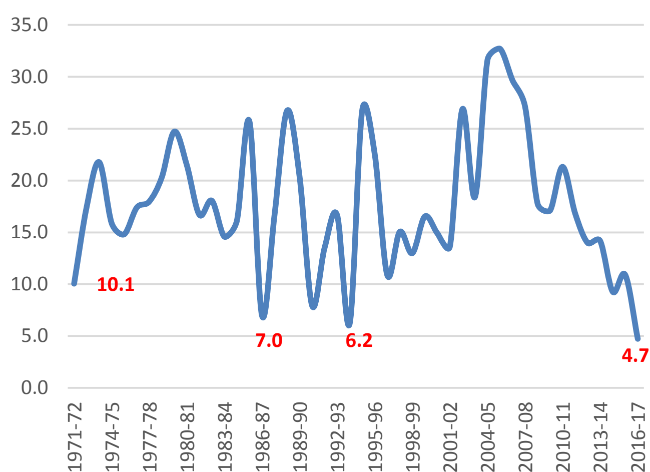
- Introduction of GST since July 1, 2017 is likely to provide a boost to the economy in the near term, thus raising the prospects of growth in industrial production.

- Further, given that outlook for inflation remains benign, it is an apt time to reduce the lending rates to stimulate non-food credit growth (which reached to its lowest point of 4.7 percent in decades in 2016-17).

Industrial Performance- Monthly (% YoY)

% growth rate	May-16	Feb-16	Mar-16	Apr-17	May-17
Index of Industrial Production	8.1	0.8	3.8	2.8	1.7
Sectoral					
Mining	5.7	4.6	10.3	3.2	-0.9
Manufacturing	8.6	0.1	2.4	2.4	1.2
Electricity	6.1	1.2	6.2	5.4	8.7
Use-base industry classification					
Primary goods	4.6	0.8	5.9	3.1	3.4
Capital goods	13.9	-2.0	9.6	-2.9	-3.9
Intermediate goods	4.5	2.2	2.8	4.2	0.7
Infrastructure/construction goods	7.4	-1.9	0.9	5.2	0.1
Consumer durables	14.7	-8.0	-3.9	-5.4	-4.6
Consumer non- durables	12.4	10.0	6.2	8.4	7.9

Growth in Non-food Credit (% YoY)



Source: MOSPI, Economic outlook CMIE and FICCI Research

WPI eases to 0.9 percent in June 2017

- *WPI based inflation eased to 0.9 percent in June 2017 which was the lowest in eleven months. All major sub-segments reported moderation in prices during the month.*

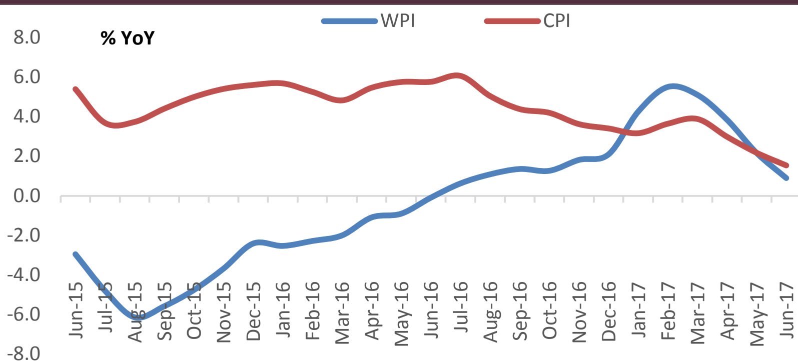
- *WPI based food inflation entered the contractionary zone in June 2017. WPI food group index contracted by 1.3 percent in June 2017 as compared to a flat growth of 0.2 percent in the previous month.* While prices of fruits and vegetables and food grains contracted by 12.6 percent and 4.7 percent respectively in June 2017, prices of eggs, meat and fish increased by 1.9 percent. *Prices in the non-food articles segment deflated by 5.2 percent in June 2017 vis-à-vis 0.9 percent deflation reported in the previous month.*

- *Price rise in fuel and power has moderated to 5.3 percent in June 2017 in comparison to double digit inflation since January 2017. This can be attributed to a fall in the inflation rate of mineral oils (from 19.3 percent in May to 6.9 percent in June) and deflation to the tune of 0.8 percent in the electricity segment.*

- *Inflation in manufactured products moderated to 2.3 percent in June 2017 as against 2.6 percent inflation reported in May 2017. This is the fourth consecutive month when the price pressure of the index cooled.*

- *Retail CPI inflation touched a historical low of 1.5 percent in June 2017, beating its previous record of 2.2 percent inflation in the May 2017. All broad sub segments reported a moderation in prices during the month.*

Trend in CPI and WPI Inflation



The continuous moderation in prices across segments bodes well for the economy. FICCI feels that there is a clear case for the central bank to consider moving to an accommodative stance and introducing a rate cut by at least 50 basis points immediately.

The latest IIP numbers report a further slowdown in industrial activity and the investment cycle is yet to gain momentum. A cut in the repo rate at this juncture will help in improving the demand situation and support growth.

ADB Cuts India's Inflation Outlook

The Asian Development Bank (ADB) report released in July 2017 has cited sharp moderation in food prices, softening of global crude oil prices, lower gold prices and discounts offered by retailers to clear inventory ahead of the implementation go the goods and services tax together contributed to a drop in the inflation rate during the first quarter of 2017-18.

India's inflation outlook now stands at 4.2 percent in 2017-18 from 5.2 percent projected in the Asian Development Outlook Report in 2017.

For the next fiscal, 2018 -19, ADB projects India's inflation rate to rise to 4.6 percent in.

Key WPI Components (% change Y-o-Y)

	Jun-16	Apr-17	May-17	Jun-17
Primary articles	5.7	1.0	-1.8	-3.9
Food group	8.0	2.4	0.2	-1.3
Fruits & Vegetables	13.1	-4.3	-10.8	-12.6
Pulses	27.4	-13.6	-19.7	-25.5
Fuel and power	-11.6	17.1	11.7	5.3
Manufactured products	-0.3	3.1	2.6	2.3

Key CPI Components (% change Y-o-Y)

	Jun-16	Apr-17	May-17	Jun-17
Food and beverages	7.5	1.3	-0.2	-1.2
Fruits	2.8	3.8	1.4	2.0
Pulses	26.9	-15.9	-19.5	-21.9
Clothing & footwear	5.0	4.6	4.4	4.2
Housing	5.5	4.9	4.8	4.7
Fuel & light	2.9	6.1	5.5	4.5

Source: MOSPI, PIB, Economic Outlook – CMIE and FICCI Research

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Economy Fact Sheet – Foreign Trade

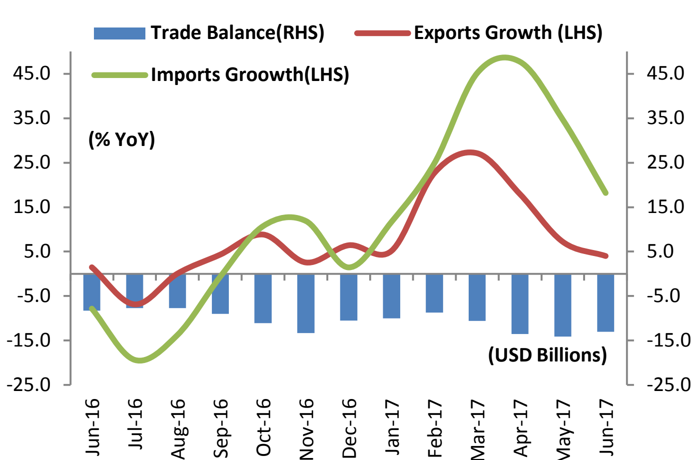
Trade deficit stood at USD 13.0 billion in June 2017

- *India's trade deficit widened to USD 40.5 billion in Q1FY17, up from USD 19.1 billion in Q1FY16. Trade deficit in June 2017 widened to USD 13.0 billion, up from USD 8.3 billion in June 2016.*

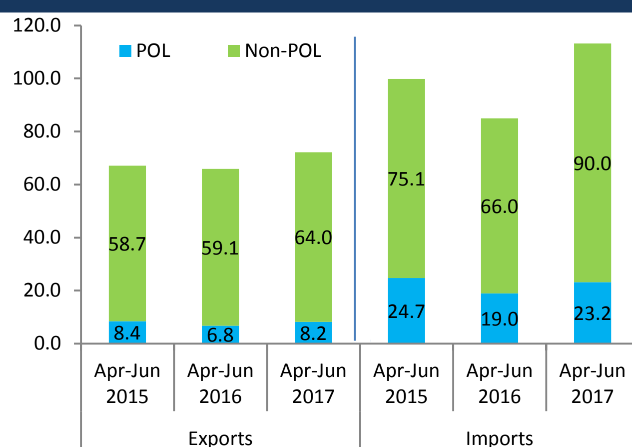
- *Total merchandise exports grew 4.4 percent YoY in June 2017, as compared to 1.5 percent recorded in June 2016. In terms of value, merchandise exports stood at USD 23.6 billion in June 2017. Petroleum products exports registered a YoY growth of 2.9 percent in June 2017, as compared to a decline of 13.4 percent in June 2016. Non-POL exports saw a growth of 4.2 percent in June 2017 as compared to 3.8 percent growth in June 2016.*

- *Total merchandise imports for the month of June 2017 amounted to USD 36.5 billion, up by 18.2 percent from USD 31.0 billion in June 2016. Oil imports saw a YoY growth of 11.5 percent, while non-oil imports grew by 20.2 percent for June 2017.*

Trend in India's Merchandise Trade



Oil and Non Oil Trade (in USD Billion)



Exports have now grown consecutively for three quarters ending June 2017. The major items exported in June 2017 were Engineering Goods, Petroleum Products, Organic and inorganic Chemicals, Rice and Marine Products. Major non-oil import items for the same period consisted of electronic goods, pearls, precious and semi-precious stones, electrical and non-electrical machinery and gold. Gold imports grew YoY by 103.0 percent in June 2017, mainly due to lower gold prices which led to a shift in demand towards gold and stock build up ahead of GST implementation.

The Government has taken various measures to boost international trade. Four think tanks have been constituted under the Indian Institute of Foreign Trade in June 2017. These centers, set up by the Commerce Ministry, will focus on trade and investment law, trade promotion, regional trade and capacity building. Alongside, the Finance Minister also released the National Trade Facilitation Action Plan in July 2017, which is a major step towards implementation of WTO Trade Facilitation Agreement and aims to align border procedures with international best practices and improve Ease of Doing Business.

Trade in Major Commodities

Exports (USD Billions)	Apr-Jun 2016	Apr-Jun 2017	YoY Change (%)
Engineering Goods	15.1	17.3	14.9
Petroleum Products	6.8	8.2	20.4
Organic Chemicals	1.1	1.4	29.5
Rice	1.6	2.0	24.7
Marine Products	1.2	1.6	38.6

Non-Oil Imports (USD Billions)	Apr-Jun 2016	Apr- Jun 2017	YoY change (%)
Electronic Goods	9.6	13.6	40.9
Pearls, Precious, Semiprecious stones	6.3	10.1	58.5
Machinery	6.2	7.4	19.4
Gold	3.9	11.3	187.4

Source: Ministry of Commerce and Industry, Economic outlook CMIE and FICCI Research

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