Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

News: The reserve Bank of India (RBI) is expected to cut rates further by 25 basis points, after the 135-basis-point cut in its policy rate, at this week’s monetary policy review in the backdrop of the deepening slowdown and projections of a sub-5 per cent growth this fiscal year.

Prelims and Mains focus: about the recent credit slowdown and the efforts to check it, performance of various sectors, about credit offtake

Context

The central bank, which cut the real GDP growth for 2019-20 to 6.1 per cent in October from 6.9 per cent in forecast in August, reflecting the ongoing slowdown in the economy, is set to slash the growth estimate further. The sharp fall in GDP growth to 4.5 per cent in the September quarter from 5 per cent previously provides enough reason for the RBI to cut the rate, analysts said.

Though the RBI has cut rates by 135 bps in 2019, banks have passed on only 29 per cent to customers and growth in credit offtake has declined, indicating that the RBI’s strategy to push up demand has not worked so far. Credit offtake increased by a meagre 0.8 per cent (Rs 75,794 crore) in January-November 8 of FY20, compared to 5.6 per cent (Rs 4.86 lakh crore) in the same period of last year. In the current fiscal year so far, credit growth continued to decline to 8.1 per cent as compared to last year growth of 14.9 per cent, on high base effect.

What does the analysis say?

A deeper analysis of the data indicates that though till the end of August 2019, credit growth was declining, the trend has reversed since September and credit growth has jumped by Rs 1.67 lakh crore,

With the liquidity crunch and defaults rocking the financial sector, NBFC sanctions fell 34 per cent to Rs 1,95,205 crore in the September quarter from Rs 2,93,957 crore in the same period of last year, according to Finance Industry Development Council (FIDC).

Banks, on the other hand, have turned very choosy about credit sanctioning and disbursals, fearing fresh loan slippages.

The sectoral data for October 2019, which accounts for about 85 per cent of the bank credit deployed by 39 banks, indicates that credit to industry and services has declined incrementally by Rs 1.62 lakh crore, while credit to agri and allied and personal loans increased by Rs 1.92 lakh crore. Within industry, credit to paper and paper products, all engineering and infrastructure has increased in October 2019 and credit to all other sectors has
declined.

Manufacturing growth contracted, while both private consumption and investment stayed weak. Given this, and with the just-released index of eight core industries falling 5.8 per cent in October, bottoming-out of growth could be further down the road and recovery is unlikely to be V-shaped as consumer demand, credit supply and risk appetite remains lacklustre. This and the falling core-CPI (consumer price inflation) should allow the RBI focus more on growth.

All the indicators ranging from IIP (index for industrial production), electricity consumption to core inflation rate were pointing towards the fact that the economy has not entered the revival path.

The slowdown in consumption is indeed worrying, as its revival is important for investment to pick up.

What is PFCE?

The Private Final Consumption Expenditure (PFCE) declined to 5 per cent compared to 9.7 per cent. With growth slipping to 4.5 per cent, it is expected that RBI will go for the next round of rate cut in December.

PFCE is defined as the expenditure incurred on final consumption of goods and services by the resident households and non-profit institutions serving households.

The tepid domestic growth has been led by weak investment activity, moderate consumption growth and slow global growth environment. While further policy support can be expected from both the government and the RBI, the recovery is expected to be more gradual than a V shaped sharp recovery.

About credit offtake

Simply put when Trade and Industry and other sectors start using Bank Funds either from the existing limits sanctioned to them or by availing fresh credit limits, Credit portfolio of the Banks increases which in Banking parlance is called Credit Offtake and that results in:

1. Increase in profitability of the Banks as funds mobilised from public through deposits are lent at higher rates. If Credit Offtake remains sluggish, Banks have no option but to pay interest on deposits mobilised to the public which results in lower profits or even losses as Banks are unable to deploy funds affecting their profitability. The main business of the Bank is to mobilise deposits and lend at higher rate to earn profit and stay healthy.

2. Increase in Credit Offtake is an indication that Economy is recovering and purchasing power of the people is increasing resulting in increase in demand of various products. To meet with the increased demand, Trade & Industry and other sectors withdraw more and
more funds from Banks.

Note: to know more about the efforts of the govt. to boost economic growth click on the link below