Opinion

WEDNESDAY, JANUARY 8, 2020

DEADLY WARNING

Chief minister of West Bengal Mamata Banerjee

"I am your *pehradaar*... as your *pehradaar*, if anyone comes to snatch your rights, they will have to do it over my dead body. Not before that. It is not going to be easy. Don't fear fake rumours, conspiracies"

RationalExpectations

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Modi wants more oil, govt doesn't play ball

The PM wanted import-dependence to be cut from 77% in FY14 to 67% by FY22 but it has, instead, risen to 85%

THOUGH CRUDE OIL prices fell a third since Narendra Modi came to power in 2014, import volumes rose a fourth and ensured that India's import bill fell by just a sixth. So even though the oil price spike has been temporarily halted—after US defence secretary contradicted president Trump's threat of targeting 52 Iranian cultural sites—India's oil balances could start going out of whack if the price exceeds $75-80. This is because, while Modi wanted India to reduce its import-dependence from 77% in FY14 to 67% in FY22 and to 50% by 2030, this has instead shot up (see graphic) thanks to unfriendly government policy, including stripping ONGC of its cash and the various hobbles on its operations due to it being a PSU.

When Modi took over, though gas was imported at $12-13 per mmBtu, he refused to implement the UPA proposal to double prices for domestic gas to $8.4 since he believed this was a UPA scam, to primarily benefit Mukesh Ambani even though ONGC would also benefit enormously. Fresh investment dried up and Modi was forced to raise prices after two years. But thanks to various caveats—it applied only to new gas discoveries, that were in deep-water, etc—over three-fourths of India's gas output gets just around 40% of the market price. Even in the case of oil where prices are supposedly freed for everyone, the Petroleum Pricing and Analysis Cell points out that ONGC gets $10 per barrel less than what it could get if it was selling to more sophisticated refineries than the PSUs to whom it supplies; Cairn-Vedanta is beset with similar problems (*bit.ly/2tytFsK*).

Other unfriendly policies include asking Cairn-Vedanta to raise its revenue share payments by 10 percentage points—it already pays around 85% of its revenue after deducting opex and capex—when it wanted its lease extended since it had found more oil; didn't the country benefit by more local oil production and, given the government got a revenue-share anyway, its earning would go up significantly as output rose.

At one point, the government even asked oilcos to pay service tax on 'cost petroleum' (the share of oil/gas oilcos get to compensate for their costs), cash calls (the amount a consortium leader asks others to pay for production costs) and even royalty paid to the government! The government even tried to cap the cost that firms could recover even though the rules are clear that all costs have to be deducted from revenues in a producing field (*bit.ly/2FutYYg*).

While some of these issues have been fixed, more get added from time to time. In February 2019, the government said an empowered coordination committee would streamline approvals and a dispute resolution mechanism would be set up. The latter was finalised a few weeks ago; but with the caveat that anyone using the panel could not go in for arbitration against the government. Given that all the big private players have disputes with the government, why would anyone opt for a process that is controlled by a government-appointed panel? As for speeding up clearances, just 30 or so of the 55 blocks that were awarded under the OALP in October 2018 have got even an exploration license so far.

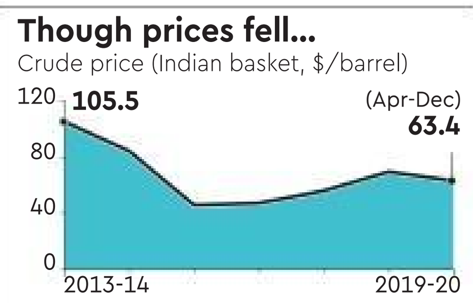
Another policy that hits production is the cess levied on pre-NELP fields like those owned by ONGC and Cairn; unlike a revenue-share on profits, the cess has to be paid on the production. Till 2012, the cess was ₹2,500 per tonne — this was 8-10% of the price of crude— but this was jacked up to ₹4,500 in FY13 and then converted to an ad valorem rate of 20% in March 2016. This may have protected government revenues when oil prices were low, but if oilcos end up paying a roughly double share of revenues as compared to earlier, they have a lot less to invest.

A recent Federation of Indian Petroleum Industry note to the finance ministry points out that, were the cess to be scrapped, the government share (assuming a $60 per barrel price) falls from $35.3 to $33; but since oilcos will have more money to invest as a result, if the production goes up by even 20%, the government gets more by way of the royalty, share of profits etc.

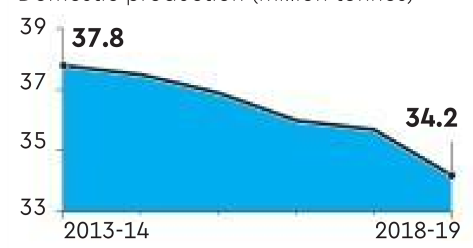
How much will production rise if various imports are lowered? Cairn-Vedanta estimates it can raise output by 50-60%—that's 200 mn barrels over a decade—if the cess is abolished. Early last year, BP's India head Sashi Mukundan said their analysis suggested that India could produce 100 tcf of gas, or nearly double the present estimate; and, if Indian oilcos used better recovery techniques, this alone would give another 4 bn barrels of oil, a figure that is roughly the current estimate of how much oil India can extract. All of this, however, presupposes a policy environment that is not full of caveats and subject to the interpretation of sundry bureaucrats. But, none of this can happen as long as the government's aim is to protect its revenue-share and not to maximise production; the last OALP round, not surprisingly, never got even a single private sector bid.

Crude awakening

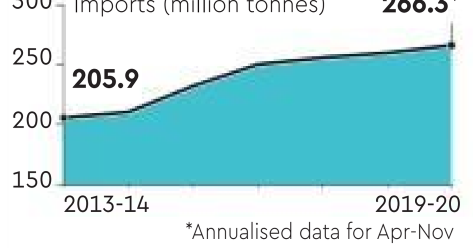
Though prices fell...



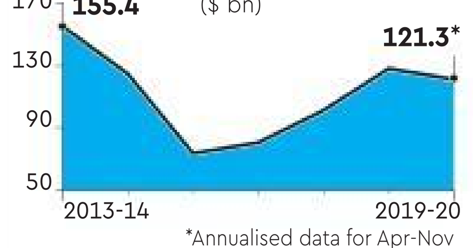
...so did local crude output...



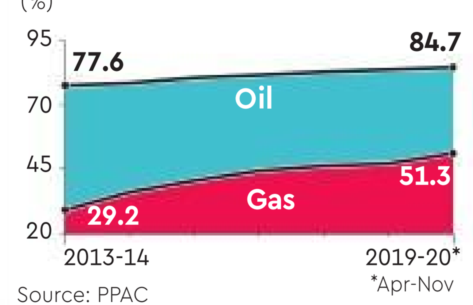
...imports rose as a result...



...keeping import bill high...



...and import-share is rising



Source: PPAC

DeepCHECK

Google's AI has gotten better at cancer detection, but that doesn't mean it can replace humans

WHEN GOOGLE, IN 2016, announced that its DeepMind technology was able to detect diseases from eye scans, many had heralded it as the age of AI replacing the doctors. While Google has deployed its systems across the world since, its recent results showcase a step taken forward for medical technology. The company, in a research published in *Nature*, highlighted that its technology has been outperforming radiologists in breast cancer detection using mammography scans. While the study is not a pioneering work—NYU research had already established similar results—what makes Google's work unique is the fact that it was conducted across two countries with a larger sample. More important, as against artificial lab comparison, this one compares performance with real-world diagnoses.

It was found that, for US and UK patients, AI reduced false negatives—test results wrongly categorised normal—by 9.4% and 2.7%, while for false positives, where cancer is erroneously detected, the reduction was 5.7% and 1.2%, respectively. Given that radiologists can't detect cancer in one in five cases, this is a marked improvement. While most tests were done using the same equipment, this facility may not be available in a developing economy, so the results still show promise. If combined with human intelligence, Google can bring down errors by even a 50%, it would save lot of lives. According to WHO, breast cancer impacts 2.1 million women each year.

ONION CRISIS

IMPROVED FORECASTING, CREATING A BUFFER STOCK, AND PROCESSING ONION WILL PROVE A BETTER RESPONSE THAN KNEE-JERK IMPORTS, EXPORT CURBS AND STOCKING LIMITS ON TRADERS

Plan better to avoid onion tears

SANDIP DAS

Senior consultant, ICRIER

Views are personal

AFTER A HUGE spike in onion prices few months ago, followed the familiar government response of banning exports, placing import orders and tinkering with stock holding limits of traders. Such reactions by successive governments, in the last two decades, have become the norm, especially during September-December period.

In November 2019, when retail prices of onion in several places touched ₹200 a kg, the central government took several measures such as fixing stock holding limits for the traders, ordering onion imports from Turkey and Egypt and selling subsidised stored onions through few retail channels. The government had stopped onion exports on September 30, 2019.

Now, a few months after the huge increase in onion prices, the government's own assessment says, there is expected to be a glut effect on the price by March 2020. "Significant decline in price is expected from February onwards when late kharif and early rabi arrivals start picking up pace. From mid-March onwards, a glut is likely to develop", an official assessment of the onion supply situation has stated.

The key cause behind the huge spike in onion prices is the close-to-a-million-tonne reduction in kharif and late-kharif output in Maharashtra, which produces around one-third of the country's output, because of prolonged monsoon last year resulting in crop damages. "Even Karnataka and Gujarat have witnessed significant rain-related crop damages. Rajasthan's Alwar district, which is an onion producing hub, was affected by dry conditions resulting in lower area and yield", the official note has stated.

Delayed monsoon (up to first week of November) has had an impact on the output. Overall kharif and late-kharif output is estimated to have declined by more than 27% to 4.83 million tonne (MT) in 2019-20 from 6.63 MT in previous year. Maharashtra reported a production of 2.43 MT in 2019-20 in kharif and late-kharif compared to 3.41 MT in 2018-19.

"The rains during September-October also affected transportation of the crop from these regions to consuming areas. This led to limited availability of kharif onion in the market and put pressure on its prices", Danve Raosaheb Dadarao, minister of state of consumer affairs, food and public distribution said in Lok Sabha last month.

However, the forthcoming rabi or winter crop is likely to be much better due to better water availability and increased sowing by farmers owing to high prevailing prices. According to an official assessment, 'rabi onion acreage is set to increase by 5% to 10% in key producing states, including Maharashtra, as the moisture level has been adequate post extended monsoon addition, the high prices will encourage more sowing'.

About 30% of the total onion output is during kharif and late kharif season, and rest is during rabi season. This ensures onion availability throughout the year. The harvesting of kharif and late-kharif is carried out during November-January while rabi crops arrives in the market during January-May. The rabi crops are stored, which takes care of supplies till the kharif harvests arrive in the market.

An official with the consumer affairs department said that while the stored rabi onion lasts till kharif crop arrivals in November, even a fortnight of delay creates supply constraints in the market, and leads to a spike in prices. The official said that a decline of 27% in kharif output could not have been replaced with imports from Egypt and Turkey.

We may recall that, a decade back, the government had asked the Competition Commission of India (CCI) to conduct an inquiry into unusual spike in onion prices in December 2010-January 2011. CCI had closed the inquiry due to absence of any evidence of collusion or cartelisation among the traders, or Commission agents or any other players in the supply chain.

Subsequently, a study in the competitiveness in the major onion markets—Maharashtra and Karnataka—titled *Competitive Assessment of Onion Markets in India* was conducted by the Agricultural Development and Rural Transformation Centre, Institute for Social and Economic Change, Bengaluru, for the CCI in 2011. The study stated that market structure of onion is unilaterally dictated by the traders, not farmers. The reason being the minimal role farmers play in price discovery due to the low size of average farm holdings—1.15 to 1.3 acres—and unfavourable weather conditions and price risk.

The study had suggested, among others things, having a better system for forecasting total production considering economic and meteorological events, at least in major onion producing area. This would help in taking appropriate decisions about onion export.

Meanwhile, the onion price in Lasalgaon, Nasik, the country's wholesale onion market, had dropped to ₹3,500 per quintal as against a record-high of ₹8,000 reported a month back. The consignment of onion stocks imported by MMTC from Egypt & Turkey have started to arrive in the country during the last two weeks, thus, increasing supplies in the domestic market.

As reported earlier (*bit.ly/2rZAh2I*) in 2015, the government will find it difficult to dispose off imported onion from Egypt and Turkey because of its lack of pungency which does not attract the consumers. In 2019 also, the government's customary knee-jerk reaction to go for imports will results in huge losses.

If the government really wants to deal with spike in onion prices next year, it must take up a couple of measures, promoting usage of dehydrated onions (flakes or powder) in the domestic market as well as the institutional buyers such as hotels, restaurants and army.

Instead of reacting to spike in prices, the government agencies must provide some advance information on the stock available and likely impact on the prices, besides building up a buffer from the rabi crops. The bottom-line is that agricultural commodities are often subject to price volatility, thus, instead of knee jerk reactions, the government must prepare itself in advance for spike in prices.

Onion production (million tonne)

Year	Production
2010-11	15.11
2019-20*	21.42

*Estimates, Source: Agriculture ministry

Wholesale modal prices at Nasik (₹/quintal)

Date	Price
Aug 2, 2019	1,200
Sept 3, 2019	2,100
Oct 3, 2019	2,900
Nov 4, 2019	4,800
Dec 2, 2019	5,396
Jan 1, 2020	3,500

Source: NHDRF

Why did socialism fail?

Capitalism has marginalised socialism by its capacity for innovation. Socialism as an ideology has to master the new forces of capitalism to fashion a credible response, or perish

MEGHNAD DESAI

Prominent economist and labour peer. *Views are personal*

IN THE LATEST election last December, the British Labour Party put forward the most radical manifesto with nationalisation of public utilities, strengthening trade union rights, generous increase in public expenditure and steep progressive taxation. The Labour leader Jeremy Corbyn was the most left-wing leader of the party since 1983. Even so, the party scored the lowest number of seats since 1935, losing 60 seats, and the Conservative Party, which had just a single theme manifesto—getting Brexit done—won a majority of sixty seats.

The Labour Party has now suffered four defeats since 2010. It was in power between 1997 to 2010; but those years of Tony Blair government are not thought to be socialist enough. Before then, the party was out of power for eighteen years. In the 64 years since 1945, it has been in power for 30 years, but even in those, it enjoyed a comfortable majority in only 22 years.

It is not just the UK. In France, the Socialist Party didn't make it to the final round of the presidential elections, and is now in a minority in third place. In Italy, the Socialist Party is in a precarious alliance with a populist party, and in Germany, though the party is in a coalition, it has steadily lost voter support.

Socialism was meant to improve upon, if not, replace capitalism. In the years since the Great Crash of 2008, socialist parties of Europe lost support rather than gaining it. Populist or just conservative, right-wing parties have gained ground round the world. In Latin America, Evo Morales lost in Bolivia though he tried to manipulate the result. In Brazil, the left lost to a right wing populist party. Only in Mexico can one say that there is a socialist government. Maduro in Venezuela has wrecked the economy, though he is still in power.

Why have socialist parties lost? In the century since 1917, and the Bolshevik Revolution, the contest was between the Leninist brand of socialism—communism and the democratic socialist parties, or in what are now long forgotten labels, the third international versus the second international. Except China, communism has lost support and has embraced capitalism with enthusiasm relative to its first-forty years. China has embraced many capitalist features and benefited.

It is difficult to believe now how strong the communist movement was in India during its first-fifty years after independence. Indian National Congress adopted socialist pattern of society as its ideal goal, and Indira Gandhi put the word socialist in the Preamble during her years of dictatorship. It is so vacuous, that no one even discusses it as they do the other adjective 'secular', which also was added by her in the Preamble. What passes as communism is naxalism, which is involved with tribal people engaged in a pre-capitalist mode of production in a backward part of the economy.

Why did socialism just become obsolete? The answer is that the varieties of socialism—Leninist or democratic, were built around a model of capitalism with manufacturing dominant with industrial workers forming the rank and file of the party. Capitalism in the rich countries began de-industrialising way back in the 1970's after the oil crisis. Now the dominant activity is services rather than manufacturing. Of the four biggest corporations listed on the Stock Exchange—Amazon, Facebook, Apple and Google, not one is in manufacturing. Most low- and medium-tech manufacturing has moved to East and South-East Asia, where governments are in symbiotic relation with domestic capitalists—Japan, South Korea, Malaysia, Singapore.

While capitalism has innovated and engaged in what Joseph Schumpeter called 'creative destruction', the political ideology of socialism is still stuck in the 1950's. Issues of public versus private ownership. Socialist ideology is still 'statist'. The doctrine is that the political movement will win power on behalf of the working masses and take over privately-owned industries.

Capitalism has in the meantime increased incomes despite cycles and crashes. Though there is income inequality, absolute incomes have gone up. The number of people living at under $1 has significantly declined thanks to 'capitalist' industrialisation in Asia, especially China. Now, poverty is reckoned in terms of $2 per day. So while the concern is of the gini coefficient, the rise in absolute incomes over the 75 years since 1945 across the world, has been unprecedented.

No doubt one can improve the quality of life in many ways. Climate change, health, water and other scarce resource preservation, lower inequality are all respectable ideals. But, no one believes you need a post capitalist economy for that. Capitalism has marginalised socialism by its capacity for innovation. Socialism as an ideology has to master the new forces of capitalism to fashion a credible response, or perish.

LETTERS TO THE EDITOR

Australia's wildfires

Not long ago, Amazon forest fires in Brazil, had caught the attention of international community for the extensive damage it inflicted on the flora and fauna inhabiting Amazon. Now, it is bush fires ravaging several parts of Australia since September 2019 evoking greater concern among people across the globe. That more than 25 people have lost their lives, 500 million animals have perished and more than 12 billion acres of land has turned in to cinders, bore a clear testimony to the horrific scale of havoc unleashed by bush fires on rich biodiversity of Australia. Termed as an unprecedented bush fires in the history of Australia, it had inflicted severe damage in its New South Wales state. While bushfires are an integral part of Australia's eco-system with plants depending on them to cycle nutrients and clear vegetation—for instance, the eucalyptus trees in Australia depend on fire to release their seeds—the prolonged blaze Australia had witnessed this time coincided with country's harshest summer. It should be noted here that Australia's climate has warmed by just over one degree celsius since 1910 leading to increase in the frequency of extreme heat events. As a home to more than 250 animal species including the rare species such as Koalas and Kangaroos, the present unabating bushfires was believed to have consumed larger parts of habitat and thus, putting them at the risk of extinction. What came to light from Australia's unprecedented bushfires is the complex ways in which climate variables interact.

— M Jeyaram, Sholavandan

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UNIVERSAL DECLARATION OF DIGITAL RIGHTS

For life, liberty and security in the digital realm

The right to privacy is a prime example of a digital right which would include the right to have secure encryption implemented and to private digital communications

TV MOHANDAS PAI & NISHA HOLLA

Pai is Chairman, Aarin Capital Partners. Holla is Technology Fellow, C-CAMP

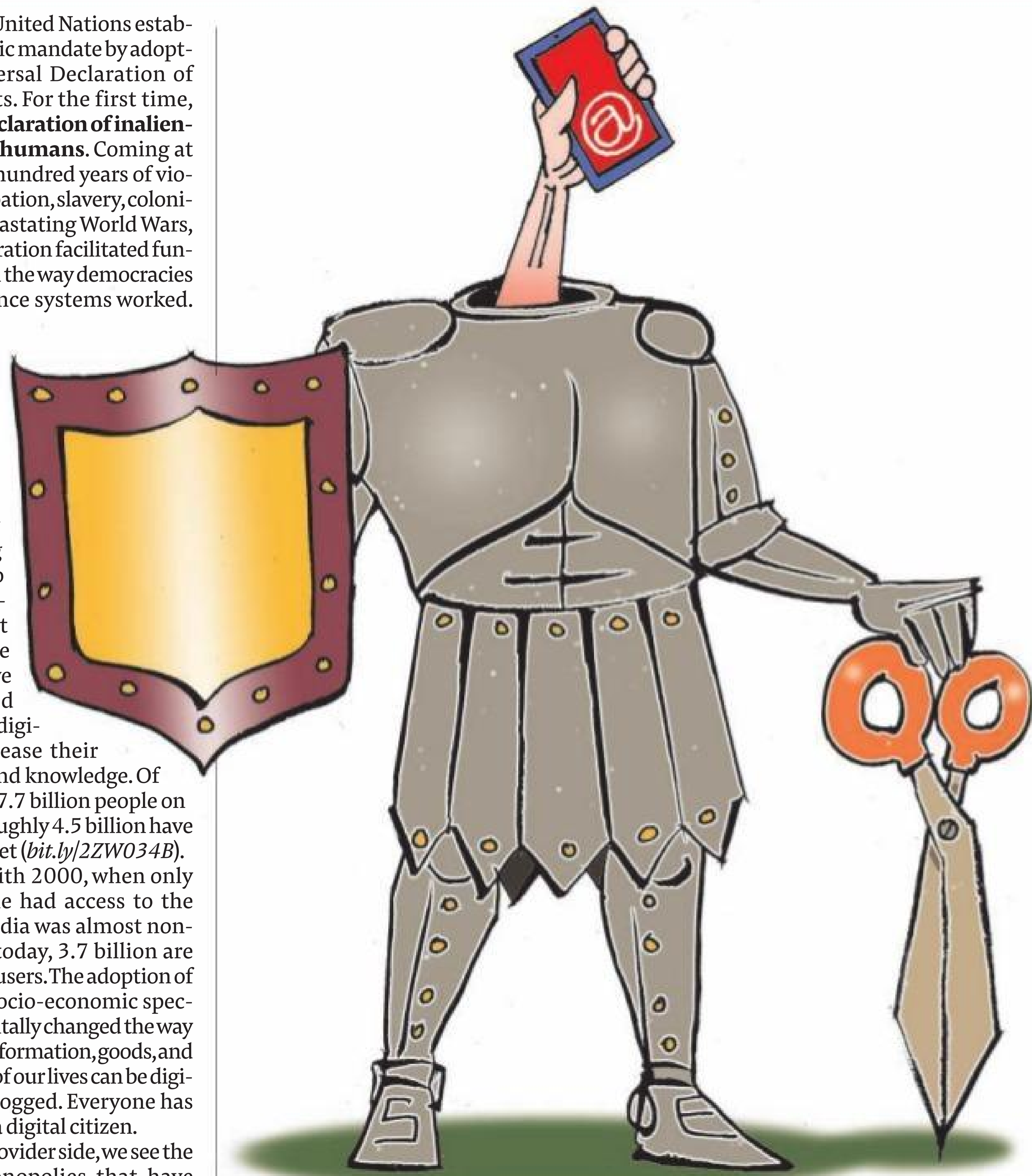


ILLUSTRATION: ROHNIT PHORE

IN 1948, THE United Nations established a historic mandate by adopting the Universal Declaration of Human Rights. For the first time, there was a **declaration of inalienable rights for all humans**. Coming at the tail end of five hundred years of violent invasion, occupation, slavery, colonisation, and two devastating World Wars, the Universal Declaration facilitated fundamental change in the way democracies and other governance systems worked. By and large, a wave of peace and respect for fellow humans across the world emanated from the Declaration.

As we head into 2020 and a new decade, looking back brings into sharp relief the digital revolution that has swept over the world. Societies have increasingly moved towards the use of digital devices to increase their communications and knowledge. Of the approximately 7.7 billion people on the planet today, roughly 4.5 billion have access to the internet (*bit.ly/2ZW034B*).

Contrast this with 2000, when only 738 million people had access to the internet. Social media was almost non-existent, whereas today, 3.7 billion are active social media users. The adoption of digital across the socio-economic spectrum has fundamentally changed the way we live and access information, goods, and services. Every part of our lives can be digitised, tracked and logged. Everyone has inevitably become a digital citizen.

On the digital provider side, we see the rise of digital monopolies that have grown so large in the last two decades; they effectively exercise control over most of the world. These monopolies started in different forms—Google as a search engine, Facebook as a social media network, Amazon as a digital shopping site, and so on. Today, these giants are akin to supermassive black holes slowly agglomerating a galaxy of services into their irresistible gravitational pull. They keep growing, they keep aggregating (like Facebook bought Instagram and Whatsapp), and they keep amassing data of the common global citizenry.

When one newly signs onto a digital platform, there is a long and oft-unread set of Terms and Conditions. These T&Cs effectively mean we have given away the rights to our data resulting from the usage of the platform to the managing company, such as Google or Facebook. The data now belongs to them and not to us. They can use it however they want, including in ways leading to monetisation. Most importantly, if there is a security breach, they cannot be held responsible. Moreover, since these companies are American, for example, Indians have no standing in US courts to take legal action against them for breach of private data.

On the one hand, in this knowledge-economy era, access to digital platforms and the internet is a necessity. On the other, there is effectively no protection of the data on the web with digital monopolies and data piracy. Loss of privacy has led to massive personal losses, financial and otherwise. Cambridge Analytica was one of the biggest eye-openers about the use of personal data harvested off Facebook without consent to try and influence elections. The inalienable rights mandated by the UDHR is openly in question because of the wild nature of the internet that was an unknown entity back in 1948.

It is time to formulate a Universal Declaration of Digital Rights, which upholds the spirit of the UDHR in the digital realm.

There are different principled positions across the globe on what constitutes stable digital security. On one extreme is China which has created a firewall around their network, effectively restricting the digital services and websites Chinese citizens can access. China is a surveillance state where all notion of privacy has been quashed. On the other extreme is a zero-censorship state where there are no restrictions, and every citizen will have to look out for themselves. No nation is at this extreme today because there are fundamental problems which cannot be handled with a zero-censorship policy like controlling child pornography, rampant sale of drugs on the internet, and so on. Most states have adopted censorship and data security policy that lies somewhere in between these two extremes of total control and zero-censorship.

Fundamental questions are being raised over individual protections in the digital age. Governments are waking up to the vast amounts of personal data companies store about their citizens and what it is being used for. The European Union recently formulated a significant boost to its data protection laws with the General Data Protection Regulation (GDPR). The GDPR lays out a framework to protect data that are personal identifiers like names, contact details, geo-location, and indicators like race and religion. It mandates that users or data subjects—who are providing their data to use a platform service—are accorded the rights to be informed about the usage of their data especially in automated decision-making and profiling, to access their data and port it, to rectify or erase their data from the platform, restrict processing, and raise objections.

GDPR places the burden on organisations to prove that they have a legitimate reason for holding onto personal data, to be much more upfront about data storage, why, and how it is being used, and use simple language while explaining data opt-in and opt-out. Moreover, if their database is hacked, they must notify users within three days, and immediately if they are at high risk like the cases when personal non-anonymised data is breached. Non-compliance warrants hefty fines and public outcry.

Today, organisations have a default opt-in procedure, with often no way of opting-out without getting off the platform altogether. With frameworks like GDPR making the fundamental assumption that people want control of their data, the right to opt-out, specific ways to opt-out, and demanding clarity on what to opt-out off is paramount. Moreover, since the GDPR mandates that not only EU-operational companies but any company with European users have to comply, this legislation now extends practically to the whole world. India is also active in the process of understanding how to protect its citizens' data so that we can pass legislation similar to GDPR.

The **right to privacy** is a prime example of a digital right which would include the right to have secure encryption implemented and to private digital communications. The **right not to be profiled** includes freedom from automated profiling and bulk surveillance, the right to get information about your data, to keep personal data protected, to opt-out of profiling, and anonymous access and participation. Another digital freedom worth putting on paper is the **right to personal safety and security**, which would include protections from the leak and abuse of your personal data. **Rights to digital self-determination** including control of our data, to object to the use of personal data, to challenge/opt-out of standard terms and conditions, to portability, and others are another example of sacrosanct rights.

These are but a sampling of some rights that a Universal Declaration of Digital Rights must formulate and mandate. Apart from affording personal protections, the UDDR will also form a basis for resolving digital conflicts like hacking, cyber-security and national security matters between nations.

While it is essential for every country to safeguard its citizens' interests, the time is ripe for a multilateral agreement—a Universal Declaration of Digital Rights—with an unambiguous and aligned view of the inalienable rights of the modern digital citizen. The principles of the UDHR where everyone has the right to life, liberty and security must now transcend to the virtual realm.

GOLD YIELDS

All that glitters is certainly gold

The killing of Qassem Suleimani sends gold to a seven-year high. But the yellow metal has already been on a long rally

"NOBODY REALLY UNDERSTANDS gold prices, and I don't pretend to understand them either," Ben Bernanke, then chairman of the Federal Reserve, told America's Senate Banking Committee in 2013, after a turbulent few months in the market for the metal (it hit its all-time peak in 2011, at the height of the euro-zone crisis and following a downgrade of America's credit rating). Yet it is not difficult to understand why the price of gold hit its highest level since early that year—$1,588 per ounce—on January 6th.

The jump to a near-seven-year high followed the drone strike that killed Qassem Suleimani, leader of the Quds Force of Iran's Islamic Revolutionary Guard Corps, three days earlier. Investors typically seek sanctuary in gold when geopolitical risk soars. The rise of 2.85% over two trading days is similar to those after other Middle Eastern flare-ups. (The killing of General Suleimani also caused oil prices to leap: Brent crude rose by 5%, briefly topping $70 a barrel for the first time since May.)

In fact, the price of gold has been rising for a while, climbing by more than 25% since November 2018. The effect of General Suleimani's death, at least so far, is just an additional upward tick. The underlying explanation seems to lie in the behaviour of real (ie, inflation-adjusted) interest rates. The most common measure is the yield on ten-year inflation-indexed American Treasury bonds, known as TIPS; this slid from around 1.1% in November 2018 to almost zero last August, after the Federal Reserve began cutting rates. That was the lowest since 2013, the last time gold was so dear.

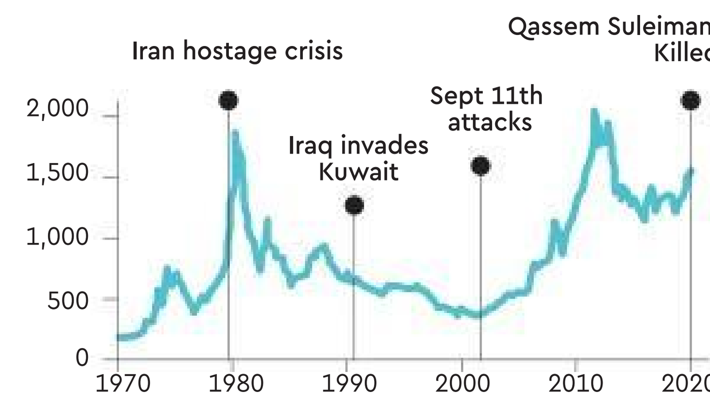
Analysts at PIMCO, a large fixed-income asset manager, think of gold as an asset with no default or inflation risk (in inflationary times, investors often regard it as a hedge against rising prices). That makes it pretty similar to TIPS, except that gold, unlike TIPS, never yields any interest. If real rates rise, the relative attractiveness of gold falls; if they fall, gold becomes more alluring. So a drop of a full percentage point in real interest rates over the past year helped push up the price of gold. Gold may pay no interest at all; but right now TIPS pay next to none.

Gold isn't for everyone. Warren Buffett, probably America's most celebrated investor, spurns it. Gold, he once said, "gets dug out of the ground in Africa, or someplace. Then we melt it down, dig another hole, bury it again and pay people to stand around guarding it. It has no utility." John Pierpont Morgan, eponymous founder of America's biggest investment bank, had a different opinion, quipping that "gold is money, everything else is credit". And when the return for providing credit is close to zero, it is little surprise that investors want their money in gold.

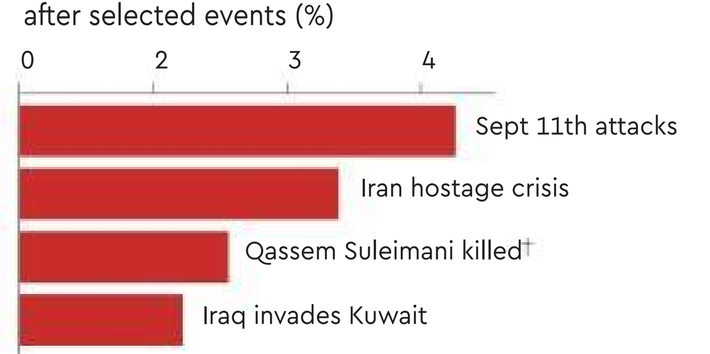
THE ECONOMIST

Volatile elements

Gold price, November 2019 prices*, $/ounce



Gold price, one week increase after selected events (%)



*Deflated by PEC Deflator
† January 1St-6th, intraday price
Source: Datastream from Refinitive/The Economist

With a twist

If RBI decides to follow up through twist operations further up the curve beyond 2020 maturities, the possibility of a bearish curve flattening cannot be ruled out

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The version of Operation Twist announced by the RBI last week is one among the many unconventional actions with respect to the conduct of Monetary Policy pursued by RBI in recent times. In the August 19 policy review, the MPC announced a non-standard reduction of 35bps in the repo rate which was followed by an explicit forward guidance in the October review on keeping accommodative stance 'as long as necessary' for reviving growth. Despite forceful policy actions and forward guidance the transmission of policy rates has been sub-optimal, mitigating against the very purpose of policy rate actions and forward guidance. In the time since RBI cut policy rates in August 19, the long end bond yields (9-14yr) had moved up by about 30 bps prior to the December Policy review. Worryingly, in an environment of easy liquidity, the term premiums in the sovereign bond markets have remained elevated. While credit market issues have kept credit spreads elevated, the lack of transmission in sovereign markets, in an environment where economic growth impulses remain muted warranted urgent attention. Subsequent to the policy review in December, where the MPC kept rates on hold, the sovereign curve had shifted upwards by about another 35-40 bps.

The decision to announce a twist operation, with simultaneous sales of shorter dated securities and purchase of the benchmark 10-yr bond clearly points to an attempt to arrest the unidirectional upward move in bond yields. Perhaps, RBI may also be mindful of the potential fiscal spillover in the current year and any additional fiscal measures that may be announced in the forthcoming Budget. Notwithstanding the immediate reasons, the significance of the announcement lies in the fact that given the current growth inflation dynamics and the policy stance, the current term structure of the sovereign curve is inconsistent with the stance and objectives of the policy stance. With the sovereign yields remaining elevated with an upwards bias, the transmission of rate cuts into the broader market segments get impeded as most credits are priced of the sovereign benchmarks. With the government owned PSU's being the larger borrowers in the market, even extra budgetary borrowings would feel the impact of rising yields. While market concerns with respect to the fiscal stance remain the proximate cause, in the current environment, unconventional and forceful actions were necessary. At the same time, the willingness of RBI to follow through would be watched as regards the durability of the down move in yields.

From a technical perspective, the stock of short-term bonds in the BI holdings would constrain larger interventions. At the same time, if RBI decides to follow up through twist operations further up the curve beyond 2020 maturities, the possibility of a bearish curve flattening cannot be ruled out. In the context of external benchmarking of bank loans, the impact of the same needs to be considered. Given that lack of policy rate transmission, especially in the loan markets have been one of the major addressable issues for RBI, it remains to be seen how RBI addresses the same. Impounding surplus liquidity generated through OMO purchases of long bonds through issuances of Market Stabilisation Scheme bonds could have been an option. However, given the present state of government finances, it remains unlikely that the same would be resorted to. In this context, creation of a Standing Deposit Facility (with auction determined rates) or the provision of central bank bills/bonds could be longer term options, especially as RBI seeks to arm itself with tools for potential similar unconventional measures.

While RBI has rightly stayed away from unconventional policy actions similar to those followed by global central banks, which have had a distortionary impact on asset markets, unconventional policy measures to the extent of targeted communication, explicit guidance as well as specific interventions in the markets were warranted in the current context. Over the longer term, the fundamental issue remains the demand supply mismatch evident in the government bond markets in the absence of RBI OMO purchases. Despite the net market borrowing of the centre remaining fairly stable over the last few years, the absorption of the net supply of SLR securities has remained challenging in the absence of RBI OMO's. While the improvement in general government balances would be revenue driven and likely to be achieved only over time, in the current context of existing and potential near term continuing challenges with respect to broad based revenue pick up, augmenting demand side remains the fairly obvious challenge as well as near term necessity with respect to government borrowings. The backtracking on the Budget announcement of considering overseas sovereign bond issuances may have been driven by the reticence to subject the sovereign balance sheet to currency vulnerabilities and its associated impact on FX and domestic rates. However, it is interesting to observe that the current calendar year has witnessed overseas borrowings by Indian corporates of more than $22 bn. This issuance list includes PSU's with covenants linked to the ownership, directly or indirectly. Given that external borrowings by the sovereign remains a much-debated issue within policy circles, with conservatism winning the argument for the time being, the alternate option would be to materially relax rules governing onshore rupee ownership of Indian bonds with the intent of being included in prominent indices. This may potentially open the route for additional external capital to enter the domestic sovereign markets.

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