

UPSC Syllabus Topic : GS Paper 3 –Indian economy- inflation.

Understanding Inflation and RBI's December Bulletin Insights

What is Inflation?

Inflation refers to the sustained increase in the general price level of goods and services in an economy over a period of time, leading to a decrease in the purchasing power of the currency. It is often expressed as an annual percentage.

Types of Inflation:

1. Demand-Pull Inflation:

- **Cause:** Excessive demand for goods and services surpassing their supply.
- **Effect:** Prices rise due to increased consumer spending.

2. Cost-Push Inflation:

- **Cause:** Increase in production costs, such as higher wages or the rising prices of raw materials.
- **Effect:** Producers pass on increased costs to consumers, leading to higher prices.

3. Built-In Inflation (Wage-Price Inflation):

- **Cause:** When employees demand higher wages, and employers, in turn, increase prices to cover the increased wage costs.
- **Effect:** A cycle where increased wages lead to higher prices, and vice versa.

4. Hyperinflation:

- **Characteristics:** Extremely high and typically accelerating inflation.
- **Cause:** Often linked to a collapse in the value of a nation's currency due to excessive money supply.

RBI's December Bulletin on Inflation:

1. Data Analysis:

- **Categorization:** Inflation is categorized based on price and quantity shifts.
- **Types:** Demand-driven inflation occurs when both prices and quantity rise, while supply-driven inflation occurs when they move oppositely.

2. Causes of Supply-Driven Inflation:

- **COVID-19 Restrictions:** Lockdowns caused production declines, leading to supply shortages.
- **Excess Rainfall (2019-2020):** Resulted in supply disruptions, especially for agricultural products.
- **Global Events (Russia-Ukraine Conflict):** Exacerbated supply chain issues, impacting global commodity prices.

3. Causes of Demand-Driven Inflation:

- **Post-Lockdown Recovery:** Release of pent-up demand outpaced supply recovery.
- **Vaccine Distribution:** Accelerated reopening of the economy, boosting consumer demand.
- **Russia-Ukraine Conflict:** Post-conflict, demand-side factors became more prominent, impacting prices.

4. Overall Inflation Trends (January 2019 to May 2023):

- **Supply Factors:** Contributed to about 55% of CPI headline inflation.
- **Demand Factors:** Dropped to 27.1% in 2020 from 41.5% in 2019 but rose again post-COVID-19 and during the Russia-Ukraine conflict.

5. Specific Categories (January 2019 to May 2023):

- **Supply Constraints Items:** Vegetables, oils, fats, milk, eggs, pulses, sugar.
- **Demand Influences Items:** Non-alcoholic beverages, personal care, health-related goods.

Conclusion:

The insights from the RBI's December Bulletin highlight the interplay of supply and demand factors in India's inflation trends. Understanding these dynamics is crucial for formulating effective monetary and fiscal policies to maintain price stability and support economic growth.

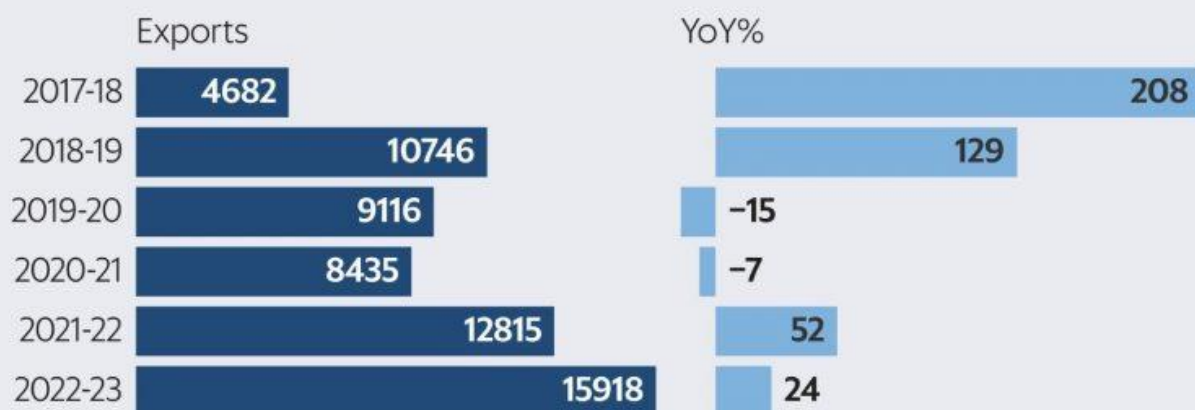
UPSC Syllabus Topic : S paper 3 -security- Security challenges & Science and technology-indigenization of technology.

Challenges faced by India's defense – India's defense budgeting and the point of deterrence

What is the current state of India's defense?

India's defence exports rose 24% in FY23, and tenfold in six years

India's defence exports (in Rs crore) and year-on-year change (%)



Includes only export by defence public sector undertakings.

Source: Ministry of Defence • [Get the data](#)

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Challenges:

1. Reduced Squadron Strength:

- *Issue:* Indian Air Force's (IAF) squadron strength is 32, below the desired number.
- *Concern:* Slow growth plan to reach 35 squadrons in ten years.

2. Budgetary Limitations:

- *Issue:* Defense budget under pressure due to electoral commitments.
- *Impact:* In 2023-24, defense capital acquisition budget fell short by ₹13,746 crore.

3. Low R&D Expenditure:

- *Issue:* India's defense R&D spending is 0.7% of GDP, much lower than China's 2.54%.
- *Global Standing:* India ranks 53rd in R&D spending globally.

4. Change in Military Strategy:

- *Shift:* Post the Russia-Ukraine war, a shift from short, intense conflicts to extended warfare scenarios.

Government Initiatives:

1. Innovations For Defense Excellence (iDEX):

- *Objective:* Foster innovation in defense, enhance self-reliance.

2. Service-Specific Competitions:

- *Example:* IAF's Baba Mehar Singh competition promotes unmanned aerial vehicle development.

3. Ordnance Factory Board Restructuring:

- *Aim:* Improve efficiency in defense manufacturing for sector reform.

4. Private Sector Participation:

- *Emphasis:* 25% of R&D funds dedicated to private companies.

5. Atmanirbhar Bharat Drive:

- *Objective:* Promote self-reliance, restrict imports, boost local manufacturing.
- *Result:* Defense exports reached a record high of approximately Rs 16,000 crore in 2022-23.

Way Forward:

• **Balance Affordability and Effectiveness:**

- Ensure a judicious increase in budget allocation.
- Address modernization needs of the Indian Air Force, Army, and naval strategies in the Indian Ocean.

• **Geopolitical Considerations:**

- Maintain strong deterrent against potential adversaries.
- Adapt to ongoing geopolitical shifts in the Asia-Pacific region.

• **Promote Self-Reliance:**

- Continue efforts under the Atmanirbhar Bharat Drive.
- Encourage indigenous defense production and innovation.

• **Strategic Modernization:**

- Prioritize modernization requirements for all defense forces.
- Align strategies with emerging security challenges.

India's defense preparedness is crucial for national security, and a holistic approach combining budgetary support, technological advancements, and strategic planning is essential to address the evolving threat landscape.

UPSC Syllabus Topic : GS paper 3-Indian economy (banking).

Evergreening of Loans: RBI Findings and Implications

Definition:

Evergreening of Loans: A practice where banks engage in creative methods to hide stressed loans, presenting them as performing assets.

RBI's Findings on Evergreening in India:

1. Banks' Innovative Methods:

- *Approach:* Creative strategies to conceal stressed loans.
- *Examples:*
 - Sale and buyback arrangements between banks to reset the history of stressed loans.
 - Extending loans to entities related to already stressed borrowers, masking the original loan's stressed nature.

2. Use of Alternate Investment Funds (AIF):

- *Observation:* Banks investing in AIFs, which, in turn, bail out stressed entities, perpetuating evergreening.

3. Use of Commercial Paper (CP):

- *Dynamic:* Mutual funds heavily investing in CPs issued by banks.
- *Cycle:* Banks utilizing CP proceeds for short-term funding, indirectly contributing to evergreening.

4. Rapid Growth of Unsecured Loans:

- *Concern:* Non-Bank Finance Companies (NBFCs) witnessing a 51% growth in unsecured loan assets by 2022-23.
- *Implication:* Raises worries about under-reporting stressed loans.

Implications of Evergreening Loans in India:

1. Misrepresentation of Loan Quality:

- *Issue:* Evergreening distorts the actual health of banks' loan portfolios.

2. Governance and Audit Failures:

- *Significance:* Indicates lapses in governance and audit mechanisms within banks.

3. Round-Tripping:

- *Challenge:* Increases correlation between bank and mutual fund performances, escalating market concentration risk.
- *Risk:* Mutual funds might be unable to redeem commercial papers during liquidity issues, triggering a crisis.

4. Regulatory Challenges:

- *Complexity:* Ever-evolving evergreening methods pose challenges for regulators like RBI.
- *Stability Concerns:* Ensuring financial stability in the face of such practices becomes a regulatory challenge.

Way Forward:

1. Enhanced Regulatory Oversight:

- *Recommendation:* RBI and SEBI should increase oversight and address regulatory gaps.

2. Transparency in Loan Reporting:

- *Essential:* Improve transparency in reporting, especially in fast-growing areas like non-bank financial companies.

3. Reinforcement of Governance and Audit Processes:

- *Crucial:* Strengthen governance and audit mechanisms within banks to prevent evergreening practices.

4. Dealing with Cross-Regulatory Financial Instruments:

- *Focus:* Address complexities related to cross-regulatory financial instruments to uphold financial system integrity.

Tackling evergreening requires concerted efforts from regulatory bodies, transparency improvements, and robust governance mechanisms to ensure the integrity and stability of the financial system.