



# drishti

## Domestic Demand and Economy's Animal Spirits

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The **Reserve Bank of India's (RBI)** annual report for the year 2018-19 has stated that the low domestic demand is holding back the animal spirits of the economy.

**The 'animal spirit'** is a term coined by the famous British economist, **John Maynard Keynes**, to describe how people arrive at financial decisions, including buying and selling securities, in times of economic stress or uncertainty.

### Insights from the Report

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- The report emphasized the need for the **revival of consumption and investment** pattern in the economy during 2019-20.
- It claimed that the slowdown could be **cyclical** in nature rather than a deep structural one. But there are some crucial **structural issues in land, labour, & agricultural marketing** that require urgent reforms.
- Banks are recovering, but **Non-banking financial companies (NBFCs)** have irrational exuberance and considerable overleveraging.
- Cases of frauds reported by banks saw a 15% jump in 2018-19 on a year-on-year basis.

### State of the Economy

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- There is a broad-based **cyclical downturn** in several sectors of the economy like, manufacturing, hotels, trade, transport, communication and broadcasting, construction, and agriculture, which **need urgent structural reforms**.
- **Farm sector** also requires crucial intense reforms such as reforms in cold storage facilities and the market mechanism, in order to **double the farmer's income by 2022**.
- The **investment rate** (measured by the ratio of gross capital formation to GDP) had **fallen** to 32.3% in 2017-18, which is a cause of worry and needs grave attention.

- The **Gross Non-Performing Assets (GNPA)** ratio of the banking system declined to 9.1% in March this year from 11.2% in the previous year, which is a healthy sign for the financial system.

## Gross Non-Performing Assets

- An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. A Non-Performing Asset (NPA) is a loan for which the principal or interest payment remained overdue for a period of 90 days.
- Gross NPA is the **summation of all loan assets that are classified as NPA** as per RBI guidelines. When the NPA occurs, it is not just an interest income loss to the bank, but a principal loss as well.
- Banks are required to classify NPAs further into **Substandard, Doubtful and Loss assets**.
  - **Substandard Assets:** A substandard asset would be one, which has remained NPA for a **period less than or equal to 12 months**. Such an asset will have well-defined credit weaknesses that jeopardize the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss if deficiencies are not corrected.
  - **Doubtful Asset:** An asset would be classified as doubtful if it has remained in the **substandard category for a period of 12 months**. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, - on the basis of currently known facts, conditions and values - **highly questionable and improbable**.
  - **Loss Asset:** A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of **such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value**.
- Banks are **staging recovery** because of several reforms initiated in the past such as, **Recapitalization, & Insolvency and Bankruptcy Code (IBC)**.
- In 2018-19, retail electronic payment transactions increased by 59% to Rs 23.3 billion from Rs 14.6 billion in the previous year, resulting in an **increase in the share of electronic transactions** in the volume of retail payments.

## Required Reforms

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- Reviving **consumption demand** and **private investment** is the need of the hour. It may involve:
- Strengthening the banking and non-banking sectors,

- Increased spending on infrastructure,
- Implementation of much **needed structural reforms** in the areas of labour laws & taxation.
- Other legal reforms, which will enhance the **Ease of Doing Business** in India.
- Faster implementation of capital expenditures by public authorities and **similar other measures as announced by the Finance Ministry** recently in this regard have the potential to inject growth impulses into the economy.

**Source: TH**