Shobhana edit

While a committee will examine issue of 'excess' reserves, govt would do well to not push on relaxing prudential norms

It certainly won't be business as usual at Monday's meeting of the Reserve Bank of India (RBI) board in Mumbai. But going by the buzz, it could be a far more cordial affair than one would have thought possible even a week back. Hopefully, stances will soften and the government will not need to invoke Section 7(2) of the RBI Act to force RBI to do its bidding. But if it does resort to strong–arm tactics, the already weak financial system will become weaker. Every issue on the table is contentious, but discussions on some like the transfer of RBI's reserves to the government's exchequer, for instance, might be harmonious rather than acrimonious. To be sure, the government remains convinced the capital needs to be transferred and both S Gurumurthy and Subhash Garg will reiterate the point, but the board will probably refer the matter to a special panel.

The point on which the government is unlikely to budge, however, is on easier capital norms for banks, from 9% to 8%. There is no real case for this, but if these are eased, they must be accompanied by tighter prudential norms which, right now, are not as robust in India as they are overseas. There are lenders here with provision coverage ratios of just 30-35%; our banks provide just 15% if a loan starts going bad as compared with 100% in other countries. The government nominees will also push hard to reduce the number of filters which trigger a PCA (Prompt Corrective Action). Rather than three metrics—capital, NPAs and profits—they want only capital be considered. Diluting these norms could be dangerous because, as we have seen, even after the clean-up of the past two years, some of the PCA banks continue to post large losses—IDBI Bank, for instance. The government also wants RBI to extend forbearance on the classification of loans to the small and medium enterprises (SME). This could be tricky, except for very small-ticket loans where a one-time restructuring of the debt might not hurt. One can understand the government's anxieties. Small businessmen have been badly bruised by demonetisation, GST and, now, rising interest rates and, ahead of a string of elections, it is a concern for the government. But, as a report in this paper showed Non Performing Assets (NPAs) to the sector are high; diluting discipline would not be desirable.

After all these years of ever-greening loans and misclassifying assets, state-owned lenders have finally cleaned up their balance sheets. At the end of it, 11 state-owned banks are in precarious shape. Muddying the loan books again, simply because the government wants more credit to flow to small borrowers, would be unfortunate. The way to get around these demands is for RBI to infuse more liquidity into the system, especially by stepping up Open Market Operations (OMO). While PSBs have upped their lending to NBFCs, and the worst of the liquidity crisis in the money markets seems to have blown over, the markets can do with more liquidity which will rein in yields. This is important because of the expected loss in GDP growth of 20-30 basis points due to the shortage of liquidity with NBFCs and Housing Finance Companies. Given inflation has been subdued, there is no excuse for RBI not to pump in more liquidity.