Our Views

Monitory policy announcements

Away from Moratorium, towards One-time Restructuring

Accommodating the differing views on moratorium, the central bank has introduced a well-structured resolution framework (aka one-time restructuring or OTS) even as it puts an end to the moratorium scheme. A similar approach of OTS was adopted post the Global Financial Crisis to provide relief to the stressed sectors. Unfortunately, this approach had snow-balled into a larger asset quality issue for the banking industry. To evaluate the magnitude of the problem, an Asset Quality Review (AQR) was later undertaken by the Central Bank.

In the current situation, it is a welcome move to see Mr. K V Kamath at the helm of the Expert Committee which will recommend the required financial parameters, along with the sector specific benchmark ranges for such parameters, to be factored into each resolution plan. Mr. Kamath, with his years of experience in banking will appreciate the challenges that businesses are presently facing and at the same time will follow reasonable prudence. Many sectors such as aviation, hospitality, real estate, etc which are significantly under stress in the current circumstances would require support at this stage to get over this crisis.

So far as banks are concerned, while OTS is good and required for the borrower, based on previous experiences it could become a moving target for banks. And to some extent it would be like playing blind for the capital markets and investors, who usually prefer clarity on assets quality and adequate provisioning. In my opinion, many banks who have raised or are raising surplus capital in recent times will therefore prefer to take a onetime charge on the balance sheet and provide for the stressed loan.

The Macros

Inflation targeting is back on the agenda, given the recent data and uncertain outlook. While focusing on growth and fixing stress in the financial markets and in the real economy are important, I think one primary objective of the monitory policy is also price stability. In that context, a pause on the policy rate was in line with the market expectations. However, with recognition of short-term inflation pressures in the Governor's statement, any future policy rate reduction will have to be viewed based on real outcome of the inflation numbers.

The borrowing cost in financial markets have dropped to their lowest in a decade due to abundant liquidity. The 3-month Treasury Bills (t bills), Commercial Paper (CPs) and certificate of deposits (CDs) are trading below the policy rate. Spreads on corporate bonds across maturities have compressed sharply.

Growth rate While the central bank refrained from making any forecast on growth, it noted that the real GDP growth is likely to be negative for FY2021.

Increasing the Loan to Value (LTV) on gold

Most of Indian household wealth is locked up in jewelry and gold, and in current circumstances one may need to borrow for liquidity reasons. Increasing the LTV on Gold to 90% will provide a good borrowing option to individuals, and at the same time would be a secure book for lenders. Of course, this could also be an indication of RBI's expectation of an upward trend for gold price even at present high levels.

Priority Sector lending (PSL) Guidelines

These guidelines are applicable to commercial banks to provide credit to required sectors/ section of the society. These guidelines were last reviewed in 2015. While we await the detailed guidelines, the announcement of inclusion of Startups, a segment which has been severely impacted in the current crisis, in priority sector is a positive. Additionally, an increased weightage for renewable energy including solar is an interesting move - I assume this is meant to push solar panel manufacturing in India to avoid dependency on the import which is a stated agenda under the Atmanirbhar Bharat program.

Creation of Reserve bank innovation hub

To innovate, imagination should be given a free flight to go well beyond boundaries. While RBI had made a beginning towards this by adopting the Regulatory Sandbox approach, setting up of an Innovation Hub by RBI to promote innovation across the financial sector is a significant move. The Hub will be leveraged to create innovative and viable financial services for deepening financial inclusion, efficient banking services, business continuity in times of emergency, strengthening consumer protection, etc. It will support, promote and hand-hold cross-thinking spanning regulatory remits and national boundaries.