Case Study

Effect of Moratorium on RBI

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Moratorium is the process where borrowers are allowed to defer the payment of EMI (equated monthly instalment) without any penalty charge against the non-payment to banks. The RBI has been playing a pivotal role by giving relief to the borrowers facing liquidity crunch in this pandemic situation. On March 27th 2020, the RBI brought out a circular to provide three-month moratorium on all types of term loans like home loans, vehicle loans, personal loans, agricultural loans and crop loans as well as the dues on credit cards. Again, on May 22nd 2020, the moratorium time period got further extended by another three months. However, Piyush Gupta, CEO of DBS Bank said that "The Indian banking system could face serious asset quality and capital challenges in the next 12-18 months because of the pandemic."

Current position of Indian Banks

Mega merger of the banks have already taken place where ten large PSUs banks got amalgamated into four biggest banks in 2019. The reasons behind the merger were to reduce NPA suffered by weaker banks and also strengthen the financial position. Other benefits include increase in the lending capacity, risk management, operational efficiency and also creation of the capability of the banks to compete with foreign banks. But, Covid 19 has such a huge impact that it has overshadowed all these advantages and it has thrown new challenges before the financial institutions. The current scenario is as follows:-

Risk of underlying assets under moratorium

As per the Financial Stability Report of the RBI, capital to risk weighted assets of the banks decline to 14.8% in March 2020 compared to 15% in September 2019. At present, Rs 90 lakh crore stand due in the books of micro, small and medium enterprises (MSME) which is 20% of the total outstanding loans.

Inter-bank market

Interbank market refers to currency market of international banks' operation in financial centres around the world is at high risk because of which there is a possibility of the economic crisis spreading across the countries.

Problems of liquidity risk

Most of the non-banking financial companies (NBFCs)/Non-banking financial institutions (NBFIs) are the ultimate sufferers among the financial institutions. They are into the business of short term liquidity which is the result of substantial gap between the cash inflows and cash outflows. This funding gap leads to bank borrowing which further increases the total borrowing from 23.1% to 28.9%. NBFCs are currently standing with gross payables of Rs 8.84 lakh crores and gross receivables of Rs.89 lakh crores as per Financial Stability Report.

The second largest borrower in the financial system is housing finance companies (HFCs) with gross payables of Rs.5.91 lakh crores and gross receivables of Rs 0.45 lakh crores. These overleveraged non-financial sectors have to downsize their bank credit which forges high risk in terms of their solvency.

Decision taken by the RBI to counter the effect of Coronavirus on the economy

The RBI has constituted a team of 150 members who will face upcoming challenges and ensure the smooth functioning of the financial system. The following measures have been taken to combat the current scenario:-

Adjustment in LAF rates

Liquidity adjustment facility is one of the important tools used in the monetary policy by the RBI where banks can borrow money from the RBI and also make loans to RBI. The RBI has reduced the repo rate and reverse repo rate to help the private and public banks to overcome the financial crisis. The RBI is trying to reduce the pain and stress level bearing by non-financial institutions and housing finance institutions by reducing the repo and reverse repo rates.

Effective Date	Fix Range LAF Rates	
	Repo	Reverse
22-05-2020	4	3.35
17-04-2020	4.4	3.75
27-03-2020	4.4	4
04-10-2019	5.15	4.9

https://dbie.rbi.org.in/DBIE/dbie.rbi?site=home

As per the above data the RBI has frequently adjusted the repo and reverse repo rates to bring liquidity into the financial system. Currently the repo rate is 4% and the reverse repo rate is 3.35% which has opened the doors for liquidity of Rs.1, 37,000 crores in the banking system.

Relaxation of working capital interest

The RBI has allowed deferment in payment of interest on cash credit/ bank overdraft and permitted the banks to convert the accumulated interest into funded interest term loan (FITL) whose repayment will start after March 31st 2021.

Net Stable Funding Ratio

Net Stable Funding Ratio mainly promotes resilience of the banks in the long run. The formula used to calculate NSFR is the Total Available Stable Funding (ASF) by Total Required Stable Funding (RSF) which should always be greater than 100% as per the policy norms of the RBI but due to present outbreak of pandemic disease, the RBI decided to adjourn it till October 1st 2020.

Special financing facility

To inject more liquidity in the economy, the RBI announced special financing facility of Rs 50,000 crores for NABARD, SIDBI and National Housing Bank.

Changes in NPA classification

Announcement of 90 days relaxation in the loan repayment structure and further extension of the moratorium period outplayed the present NPA classification of the banks. These changes are providing the banking system a huge relief from the stressful situation occurring due to the pandemic.

Impact Analysis

Negative impact

- Where protecting the social harmony and health structure are the major concern, banks are taking measures to reduce the financial crisis and to increase the financial stability. The MSME sector, which is the key pillar of our economy, will find it difficult in getting loan as this sector is unable to meet the asset quality requirement of the banks.
- As per the report of *Fitch Rating* post-Covid 19, non-performing assets are expected to increase to Rs 10 lakh crore which with increase the stress level of the individual banks of India.
- Relaxation of the interest payment on working capital leads to the probability of increase in bad loans as well as non-performing assets for banks.

- Because of frequent changes in repo and reverse repo rate, the banks have decreased the rate of interest in savings account and in term deposits.

Positive impact

- Moratorium is a compulsory financial binding. But banks like the SBI, the largest bank of India, and Axis Bank, the third largest bank, have reported that only 10% to 12% of the borrowers have opted for temporary suspension of EMI. The HDFC Bank has reported that it is in single digit.
- Due to relaxation in LAF, banks can easily take the loans at low rate of interest.
- The financial institutions reduce their stress level due to deferment of net stable funding ratio norms which is mandatory for the banks to keep stability in relation to composition of assets quality and off balance sheet activities.
- Special financing facility assists the voluntary sector of the economy because this sector plays an essential role and contributes a major portion to our gross domestic product (GDP).

Decision Paradox

The case study reveals the present situation of the Reserve Bank of India and measures taken by it to combat the problems of the banking system. The banking system is one of the most vital parts of our economic system. The case study highlights the major impact of Covid 19 on the Indian financial system and its affairs. One of the key elements used by the RBI to tackle the current pandemic is moratorium which is a great relief given to the borrowers.

It also puts emphasis on the ongoing issues of the financial institutions and also spotlights the major effects on the Indian banking system. It has tried to describe the problems of the RBI while going through the path of uncertainty and risk exposure attached in every minute changes on the policy can provoke political or credit risk in the economy. In response to this, Amitabh Choudhury, Managing Director & CEO, Axis Bank, said, "Moratorium just pushes the problem or the recognition of the problem down the road for a certain period of time in the hope that when the economic activity revives, the cash flows will come back and things will be okay. So moratorium is a bit of a blunt instrument." RaghuramRajan, former Governor, RBI, further highlighted the macroeconomic policy of India and said, "Full economic recovery takes a very long time." The RBI needs to be more proactive in reinforcing the economy.

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