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Govt, RBI may tread a mid-path on NBFC liquidity, says DBS Bank

BY [ATMADIP RAY](#), ET BUREAU | NOV 09, 2018, 06.35 PM IST

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KOLKATA: The government and the [Reserve Bank of India](#) are likely to arrive at a common ground over easing of [liquidity](#) crunch for non-banking finance companies, while state-run banks cannot become a perfect substitute for funding medium and small enterprises, [DBS Bank](#) said.

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The government's concerns over liquidity has been one of the reasons for its differences with the monetary authority. The RBI did not agree to the government's call for a dedicated liquidity window to tide over the crisis and has instead opted for indirect liquidity support to NBFCs through banks and money markets.

Successful rollover of NBFCs' commercial papers is a reflection of easing liquidity, said a person close to the central bank. The government, on the other hand, upped the ante on the RBI to part with the reserve that it kept as a contingent buffer.

"The government and the RBI are likely to reach a common ground on support mechanism for NBFCs, which has been a contentious point of late," DBS Bank economist Radhika Rao said in a note. She expects more regulatory changes for NBFCs, particularly on the funding make-up for non-bank entities to limit pipeline systemic risks.

At present, the liquidity squeeze faced by India's NBFCs has eased somewhat in recent days with support from banks, Rao said. Data suggested that NBFCs have returned to banks and rupee-debt markets to raise funds, albeit at a higher cost, lowering the reliance on short-term borrowings.

But their liabilities are likely to get re-priced more often than assets (particularly shorter-tenor borrowings), posing refinancing challenges. One of the litmus tests will be the upcoming commercial paper maturities, in the region of Rs 1.0-1.5 lakh crore in in the fourth quarter of 2018, DBS Bank said.



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“For now, wider systemic risk has been contained with assurances of liquidity support from the RBI, securities regulator and the finance ministry,” Moody’s Investors Service said. “But the economy is now at risk of a credit squeeze from non-bank financial entities, following the Infrastructure Leasing & Financial Services Ltd default crisis.”

NBFCs made up 12-15% of the total credit generated in fiscal 2017. Eleven out of 19 government-owned banks, meanwhile, have been ring-fenced under the RBI’s Prompt Corrective Action (PCA) framework for deterioration of their asset quality and erosion of capital, with restrictions on fresh loans and dividend distribution.

“It will be a challenge for banks to meet all the displaced funding demand,” Rao said. The PCA rules have crippled credit availability with non-PCA banks going for higher due diligence, she said, while noting that banks did not have the reach to rural pockets where NBFCs enjoyed a competitive advantage.

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