

# Govt vs Reserve Bank: Why differences may surface again

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Despite a temporary easing in tension between the finance ministry and the central bank, differences could surface again when the Reserve Bank Of India's board meets next on November 19, as the ministry will likely take up the contentious issues again.



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Despite temporary easing in tension between the finance ministry and the central bank, differences could surface again when the Reserve Bank Of India's board meets next on November 19, as the ministry will likely take up the

contentious issues again. An official source told FE that key issues — including liquidity, prompt corrective action (PCA) framework for weak banks, surplus funds from [RBI](#) and higher credit to MSME — could be flagged again in the meeting.

For its part, though, the RBI will likely stick to its stance. Still, it will be an opportunity for both to de-escalate the tension that hit the peak last week when RBI deputy governor Viral Acharya last week warned against ‘potentially catastrophic’ consequences of any government incursion into the central bank’s autonomous regulatory space. Already, the finance ministry said on Wednesday that it respected the autonomy of the RBI.

The central bank and the finance ministry have differed in their assessment of the liquidity crunch being faced by non-banking financial companies (NBFCs). While the central bank is learnt to have asserted that there is no liquidity crunch, the finance ministry feels (based on its interactions with some NBFCs) that any such concern needs to be addressed.

In a meeting of the Financial Stability and Development Council (FSDC) on Tuesday, chaired by finance minister [Arun Jaitley](#), the finance ministry asked the RBI to ensure that the crisis at Infrastructure Leasing & Financial Services doesn’t spill over to the broader financial system. Both the department of financial services and the RBI also agreed to exchange inputs and data on liquidity crunch in the NBFC segment and ensure the situation doesn’t turn into a crisis.

While the government seeks more funds from the RBI, among experts there are divergent views on the RBI’s surplus and how much of that needs to be shared with the government. Former chief economic adviser Arvind Subramanian had

suggested that the central bank's 'excess capital' could be redeployed to bolster the capital base of state-owned banks. Others, including former RBI governor [Raghuram Rajan](#) had, however, denounced the proposal, saying if the proposal is implemented, it could get the banking regulator into the business of owning banks with resultant conflicts of interest.

Experts also reckon that the RBI needs to maintain a strong balance sheet to perform its functions effectively. They note that the perception that the RBI capital is in excess of what generally other central banks have is because of the amount held in the currency and gold revaluation account (which stood at `5.29 lakh crore on June 30, 2017). The gains arising out of revaluation of foreign currency assets, these experts point out, are notional and cannot be treated as free reserves that could be transferred to the government.

The finance ministry has also sought changes to the 'stringent' prompt corrective action (PCA) regime for stressed banks, suggesting that the framework be aligned with best global practices to allow banks some headroom for growth. But arguing against any dilution, Acharya recently said that without the PCA imposition, some banks would have witnessed even higher losses and required even higher taxpayer money for recapitalisation.

As many as 11 of the 21 public-sector banks are on the RBI's watchlist for battered financial position. Under the PCA guidelines, stressed banks operate under some tough conditions. The lenders are stopped from expanding their branch networks and need to maintain higher provisions. In certain cases, they are stopped from lending until they fix their finances. Recently, the RBI also made public its dissent note on certain recommendations of a government panel under the economic affairs secretary, opposing the idea of setting up an

independent regulator outside the central bank to deal with issues relating to payments.

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