Banks already flush with money; RBI move to make funds cheaper may not help, and may be misused

By: FE Online

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Even as the measures by the RBI 's aim at boosting liquidity, it's not clear how these measures may revive the economy, a domestic brokerage said. The RBI on Thursday announced measures to boost credit to the auto, residential housing, and MSME sectors by removing the obligation of maintaining CRR on incremental loans to these sectors. The RBI also announced long-term operation for up to Rs 1 lakh crore making credit cheaper for banks. However, it comes when the inter-bank market is already sitting on Rs 3 lakh crore of surplus liquidity. "It is still unclear as to how all these measures will lead to better transmission in the real economy. Since the banking system has been in massive surplus for the past 8 months or so, further boost to supply (or liquidity) is unlikely to revive economic activity", Motilal Oswal said in a report.

"Worryingly though, some lenders may be tempted to fund sub-prime projects or even evergreen loans, thus creating further concerns over the medium-term. With inflation expected to remain high in CY20, we do not expect any rate cuts during the next 3-4 meetings", the brokerage also said. In four straight reductions since the beginning of last February, the RBI has cumulatively cut the repo rate by 135 bps to a nine-year low of 5.15 per cent.

Meanwhile, in the last bi-monthly policy for FY20, the policy rates were left unchanged, the RBI announced long-term repurchase agreements (repos) of one-year and three-year tenors of appropriate sizes, totaling Rs 1 lakh crore at the policy repo rate, from the fortnight beginning on February 15. The monetary policy committee unanimously left the repo rate unchanged at 5.15 per cent but maintained an accommodative policy stance at the sixth meeting of the year. It can be noted that given the very tepid demand for fresh loans, the banking system is flushed with over Rs 2.5 lakh in surplus liquidity. Average credit growth until the last fortnight of January was a low 7.21 per cent.

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