Syllabus subtopic: Effects of liberalization on the economy, changes in industrial policy and their effects on industrial growth.

Prelims focus: difference between NBFCs and regular banks

Mains focus: about the NBFC crisis and its implications; efforts of RBI to check further downfall in growth

News: The Reserve Bank of India (RBI) is looking to steadily tighten regulation of non-banking financial companies (NBFCs) without causing any disruption to the current recovery of the sector, RBI governor Shaktikanta Das said.

What changes are on the anvil?

- RBI has mandated that there should be a chief risk officer.
- It has also mandated that NBFCs should have liquidity coverage ratio (LCR) requirement to take care of asset-liability (ALM) mismatches.
- There are a few other regulatory measures, which are under consideration and will be brought in steadily. These new regulations have to be brought in a non-disruptive manner.

Green shoots

- There are signs that bank credit to NBFCs is slowly reviving and the better-performing ones are able to access funds from the market at rates that prevailed before the collapse of Infrastructure Leasing and Financial Services (IL&FS).
- Overall, non-bank credit growth is, however, yet to return to pre-IL&FS levels. According to RBI data, assets of deposit and non-deposit-taking systemically important NBFCs, excluding housing finance companies, have grown from Rs. 28.3 trillion in September 2018 to Rs. 31.95 trillion in September 2019, a growth of 12.9%.
- There are some indications of investment taking place. However, it’s too early to rush to a conclusion. It is to be seen if this gets entrenched and sustained over or one or two quarters.

RBI’s efforts in regulating NBFCs
In the October policy, the RBI governor had said that RBI was regularly monitoring the top 50 NBFCs much more closely and intensively than anyone could expect.

He had also said the central bank was aware of vulnerabilities in the NBFC sector. Non-banks are yet to completely absorb the systemic shock following defaults by IL&FS in September 2018, and a consequent liquidity crunch.

Besides, considering that most NBFCs have borrowed short-term money to fund long-term assets, they were able to continually refinance their borrowings as long as liquidity conditions were easy. As liquidity tightened, they were left facing debt repayment challenges and prospects of rating downgrades.

To ensure greater credit flow from banks to NBFCs, in August 2019 RBI also increased exposure limits to a single NBFC from 15% to 20% and allowed banks to lend to NBFCs for on-lending to customers.

Challenges and way ahead

- Referring to the recent measures taken by the finance ministry, Das said the government could find it challenging to find the fiscal space to provide further boost to the ailing economy.
- He said revenue maximization, therefore, assumes greater importance in the current context.
- In the October monetary policy, Das had said that the Reserve Bank decided to go for a “temporary pause” in the interest rate-cutting cycle and wait for the government to announce further measures in the Union budget for fiscal 2020-21.
- Spike in food inflation appears to be transient. With inflation at around 4%, nominal GDP growth will come down compared to what it was 7-8 years ago. With current nominal GDP down to 7%, it’ll be a challenge for the government to find space.
- Therefore, the government will have to focus on accretion of additional revenue, goods and services tax streamlining and plugging loopholes, if any, disinvestment programme and other revenue mobilization measures.