PP No-06/2023

EGROW Foundation

FOUNDATION FOR ECONOMIC GROWTH & WELFARE

EGROW POLICY PAPER

Financial Sector Stability in India: Responsible Policies during Covid-19

Charan Singh

May 2023

Financial Sector Stability in India: Responsible Policies during Covid-19

Dr. Charan Singh [1]

1. Introduction

The financial sector plays an important role in the economy by providing financial resources to the agents of production. In order to ensure that productive activities are able to function effectively financial sector has to ensure optimal use of resources.

This paper attempts to document the nature of various approaches taken by the RBI and the government with regard to financial sector during the COVID pandemic crisis. This paper has been divided into six sections. Section 2 documents the approach of the Reserve Bank of India (RBI) in dealing with the crisis. Section 3 examines the role of Central Government in maintaining financial sector accessibility and sustainability. Section 4 examines how the RBI and the Central Government closely coordinated and supported each other's policy measures. This was followed by a brief analysis of international comparison on various approaches towards the crisis by the monetary authorities. The last section provides a conclusion.

2. Measures taken by RBI

The RBI played an important role in its part, to support the economy, in the times of crisis. It undertook both conventional as well as unconventional measures. Conventional measures included reduction of repo rate to an unprecedented 115 bps in two phases. The interest rate on the fixed rate reverse repo rate under the liquidity adjustment facility (LAF), was reduced cumulatively by 155 bps, thus setting the ground work for infusion of cheap liquidity to support the economy. The decision to deregulate the interest rates on advances by Scheduled Commercial Banks (SCBs) by mandatory linking them with floating external benchmark rates ensured that reduction in policy rates be transferred to the borrowers.

---

[1] The author is the CEO of EGROW foundation. Views are personal. The author acknowledges the research assistance of Ms. Priyanshi Goel.

Unconventional measures, such is long-term repo operations (LTROs) and targeted long-term repo operations (TLTROs) were undertaken, in order to lower the cost of funding for banks. In the wake of heightened volatility in capital markets, liquidity support to mutual funds was announced on April 27, 2020, through a special liquidity facility for mutual funds (SLF-MF) of Rs 50000 crore. The SLF-MF was an on-tap and open-ended facility, under which, the RBI conducted repo operations of 90 days tenor at the fixed repo rate.

Sectoral support was provided to vulnerable segments through All India Financial Institutions (AIFI) in the early stages of the pandemic. A special refinance facilities were provided to NABARD, SIDBI and NHB for Rs 50000 crore in April, 2020. A line of credit of Rs 15000 crore to EXIM for 90 days was rolled out as early as May 2020, for it to meet its foreign currency resource requirements. Moreover, forward guidance was deployed to bring stability and trust in the central banks.

Solvency concerns of small businesses, especially MSMEs, were also allayed. RBI undertook a series of measures which included loan moratorium, asset classification standstill, restructuring of MSME loans, along with reduction in the liquidity coverage ratio (LCR) requirements. Many of these measures defied the traditional economic wisdom. Nevertheless, RBI held up its fair share in supporting the most vulnerable sections of the society. In this sense, the RBI has truly emerged as a people’s bank in the time of crisis.

3. Government and Financial Sector

The Central Government played its own part by facilitating access to financial system at a micro level, keeping in mind the restrictions and precautions in place. The Government, from initial stages itself, added banks, ATM (including IT vendors for banking operations), banking correspondents (BCs) and cash management services as essential services and exempted them from the lockdown. The Central Government advised the state governments to ensure that bank branches remained functional and if necessary, their working hours be extended especially on March 30 and 31 for their annual closure and that local authorities, police administration are in preparedness to coordinate with banks during disbursement of money to people under PM Garib Kalyan Yojana. Thus, government was alert, from the beginning of the lockdown, to the needs of common man and people operating in the unorganised sector mainly, the unemployed.

The Government announced Pradhan Mantri Garib Kalyan Yojana (PMGKY) under which approximately Rs. 27,500 crore were targeted to be dispersed through bank branches, ATMs and BCs. The Government, to ensure social distancing in a very unique pattern, staggered the arrival of account holders at branches, BC contact places and ATMs for withdrawal of money. Illustratively, for the month of April 2020 women account holders with account numbers ending with 0 or 1 were permitted to withdraw amount on April 3, 2020. Similarly, in continuation of the trend, women account holders with last digit 8 or 9 were scheduled to withdraw cash on April 9, 2020. After April 9, the beneficiaries could go to the branch or BC on any date as per normal working hours, assuming that crowd would thin out by then.

The coordinated approach between the Government and bankers was apparent and effectively deployed. The Government also advised the banks to similarly phase out the credit to account holders and extensively use technology to send text messages to beneficiaries. The Government also advised the banks to ensure local publicity through local channels, print media, and local radio and in any other way that is important to clearly let the public know that the amount has been credited to their accounts and is available for withdrawal when required. To ensure timely disbursement as well as social distancing, again a schedule of payment was drawn up and the task was assigned to State Level Bankers Committee (SLBC) for effective implementation.

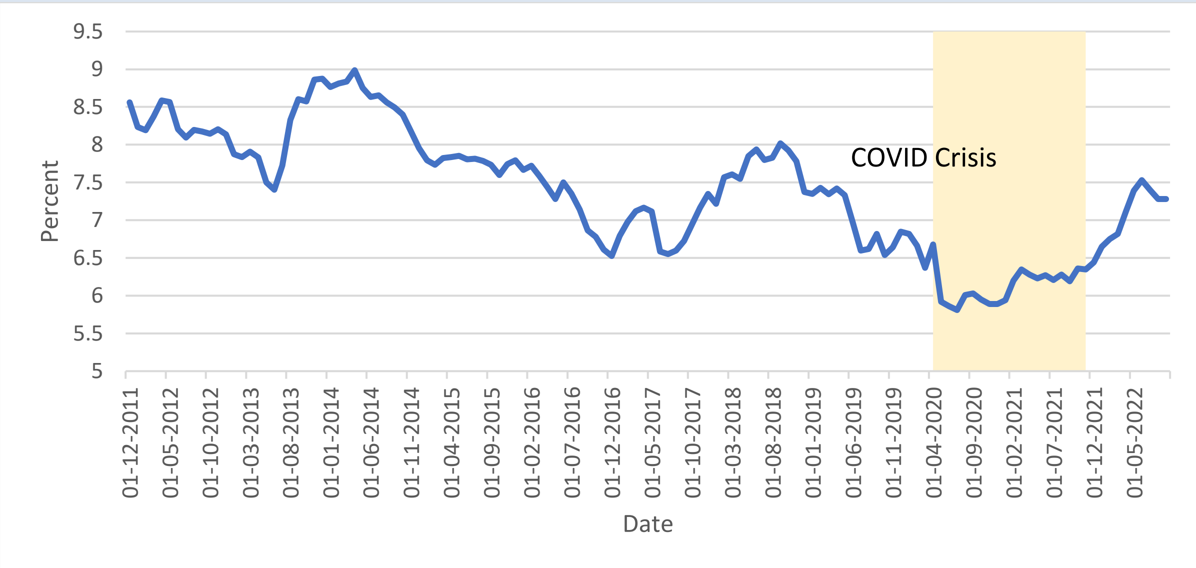
The Government also asked commercial banks to ensure adequate cash at bank branches, with business correspondents and in ATMs. The Government also recommended use of mobile ATMs to commercial banks. The technology, under JAM, was effectively tapped in sending SMS messages to the beneficiaries regarding time schedule of withdrawals and as well as urging them to use digital payment modes, considering that currency notes could be the carrier of COVID. Thus, meticulous planning was done at the level of the Government.

The banks realized the urgency and also assumed responsibility under COVID-19 to ensure safe practices and maintenance of hygiene at touch points of BCs. This initiative aimed to spread the message of protection and caution from COVID-19 to its customers, innocent members of public and bankers themselves. This safety measure was directly applicable for BCs because they go in hinterlands and interact with people at various places unlike bank branch where hygiene, social distance and cleanliness can be maintained in one location. The bank branches also attempted to ensure social distancing and introduce points for sanitization, disinfection and use of masks during working hours.

4. Fiscal-Monetary Coordination

The RBI played a crucial role in supporting fiscal measures provided by the government under the 'Aatmanirbhar Bharat' stimulus package.[2] In order to address liquidity constraints of Central Government in the wake of lockdown and the subsequent social security measures, the ways and means advances (WMA) limit of the Central Government was increased from Rs 1.2 lakh crore to Rs 2 lakh crore. These liquidity measures were effective as along with the G-Sec Acquisition Program (GSAP), which amounted to a Rs 2.2 lakh crore the yield curve remained moderated even in situation of economic uncertainty (Figure 1). Operation Twist, which involved simultaneous buying and selling government securities, was undertaken to lower long term borrowing cost. As a result, the weighted average cost of borrowing for the government stood at 5.82 percent in 2020, lowest in 16 years.[3]

Figure 1: India 10-year benchmark G-sec yield



Source: RBI

Beyond enabling accessibility to funding and moving towards financial stability, the RBI and Government of India worked closely during the pandemic to provide for institutional and

[2] The support under fiscal stimulus has been discussed in detail in paper titled "Fiscal Policy in Crisis in India: Lessons for the Global Economy", by the author
[3] Governor's Statement, Monetary Policy committee, RBI, December 4, 2020 https://www.rbi.org.in/commonman/English/Scripts/PressReleases.aspx?Id=3275

regulatory framework for smooth implementation of the relief measures. Illustratively, when the Government of India as part of its 'Atmanirbhar Bharat Abhiyan' extended the Emergency Credit Line Guarantee Scheme (ECLGS), the RBI permitted lending institutions to assign zero risk weight to the credit facilities extended under the scheme to the extent of guarantee coverage. Again, RBI and Government of India together set up a Special Purpose Vehicle (SPV) to purchase short-term papers from eligible NBFCs/HFCs to tackle the liquidity constraints faced by them. The special securities issued by the SPV were guaranteed by the Government of India and would be purchased by the Reserve Bank.[4]

5. International Comparison

Monetary policy as an instrument to support the economy as well as fiscal measures have been adopted by almost all economies. These have largely remained in tandem with the fiscal measures by the governments.

A preliminary analysis of major monetary policy announcements by central bank, however, reveals differing approach of various countries towards this crisis (Table 1). The RBI was most active central bank in announcing policy measures after the Federal Reserve. Majority of policy announcements, constituting 57.8 percent of total policy announcements, were in lending operations category, which largely constituted supporting liquidity measures of central and state governments and AIFIs. This was in contrast to other major Emerging Market Economies (EMEs), which used interest rate announcements as major policy tool.

Asset purchase program, though instrumental in keeping cost of borrowing lower for governments and corporates, constituted 9.4 percent of total announcements. This was relatively low, in comparison to Advanced Economies (AEs) like USA, United Kingdom and Canada, which had 26.6, 17.5 and 39.7 percent shares in their respective policy announcements. It is, however, important to note that several AE's[5] asset purchase programs includes the purchase of private bonds as well, a way that RBI had stayed clear off so far.

---

[4] Financial Stability Report, RBI (2021)
https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1169

[5] Among the G20 economies. These include the USA, Euro Area, Japan, UK, Canada and Republic of Korea.

Table 1: Monetary Policy Announcements: International Experience

Country	Total policy Announcements	Percentage of Total announcements					
		Asset purchases	Foreign exchange	Interest rate	Lending operations	Other	Reserve policy
India	64	9.4	4.7	20.3	57.8	4.7	3.1
Argentina	25	0.0	8.0	48.0	32.0	0.0	12.0
Australia	38	23.7	5.3	57.9	10.5	0.0	2.6
Brazil	33	0.0	12.1	48.5	24.2	3.0	12.1
Canada	58	39.7	3.4	31.0	25.9	0.0	0.0
China	35	0.0	22.9	34.3	25.7	2.9	14.3
Euro Area	59	22.0	33.9	25.4	16.9	1.7	0.0
United Kingdom	40	17.5	12.5	42.5	27.5	0.0	0.0
Indonesia	44	6.8	22.7	52.3	4.5	2.3	11.4
Japan	49	22.4	12.2	32.7	30.6	0.0	2.0
Republic of Korea	44	15.9	22.7	36.4	25.0	0.0	0.0
Mexico	46	4.3	10.9	37.0	39.1	6.5	2.2
Russia	41	0.0	4.9	39.0	53.7	0.0	2.4
Saudi Arabia	11	0.0	0.0	18.2	54.5	27.3	0.0
Turkey	56	3.6	23.2	41.1	12.5	1.8	17.9
USA	94	26.6	10.6	18.1	41.5	2.1	1.1
South Africa	24	4.2	4.2	66.7	25.0	0.0	0.0
Total	761	14.3	13.5	35.6	30.0	2.1	4.5

Source: Bank of International Settlements

The difference in the strategies deployed by central banks become crucial when it comes to rolling back these liquidity and credit support mechanisms, without causing turbulence in the economy. Most of the lending operations were performed to inject the required liquidity in the system, and thus, had a built-in sunset clause to unwind them. This alluded the risks of hard landing and promote stability. Moreover, as asset purchase program has been confined only to government securities, RBI maintains a healthy balance sheet and remains well equipped to control the impact of liquidity in the economy.

6: Conclusion

The biggest challenge for financial sector, during the crisis, was to remain afloat, accessible to public and supplement the implementation of other social security and fiscal measures by the Government. The RBI adopted a series of regulatory and monetary measures, to keep the financial sector solvent and to enable it to be a vehicle for economic sustainability and recovery. The government worked at micro level, issuing guidelines to equip the financial sector with a direction in times of disorder. One of the key lessons from the approach towards crisis was that, for recovery and support measures to be impactful, both fiscal and monetary authorities have to support each other.

While announcing the measures, RBI has been visionary to recognise that they are extraordinary in nature, and hence, will have to be rolled back smoothly and swiftly, as soon as the crisis subsides. This was unlike the AEs, that made liberal use of interest rate measures, which often lead to economic slowdowns when the withdrawal of liquidity begins. The fiscal and monetary policy of the AEs was too expansionary during the pandemic with high deficits and high debts rising to unprecedented levels as also the balance sheets of the central bank nearly doubling.

The financial sector of an economy is not only a sector in itself, but also a pivot to other sectors in the economy. Thus, in the times of economic crisis, the financial sector of a country has two-fold objectives, firstly sustain during the downturn and then enabling the economy in recovering quickly to normalcy. The above considerations were at the core of financial sector regulations in India during the COVID crisis.