RBI Repo Rate Cut - May 2020

Why in news?

The RBI recently cut the repo rate by 40 basis points as a lockdown measure.

What is the rationale?

- The RBI has cut 1.15 percentage points from the rate chart in the 58 days since the lockdown began.
- This has brought the repo rate down to 4% and the reverse repo rate to 3.35%.
- The move will reduce the cost of capital and ease the financial burden on businesses due to the extended lockdown.
- With a careful move on repo rate, the RBI also seems to reserve some leverage for the future if economic conditions deteriorate even further.

Will this be effective?

- Some believe that the latest rate cut may be no more than a sentiment booster as economic activity is at its all-time low.
- There are not many investment proposals on the anvil that may benefit from the lower interest rate.
- Existing borrowers may be the only beneficiaries of the rate cut at this point in time.

How beneficial are the other RBI moves?

- The RBI is appreciable for its listening to feedback over some of its moves initiated earlier during the lockdown.
- Thus, the extension of the repayment moratorium on loans is a welcome measure.
- A large proportion of commercial borrowers have availed themselves of the moratorium but retail borrowers have not taken to it in a big way.
- But, extended lockdown has left many businesses in a shambles, and salaries have either not been paid or are being disbursed with delays.
- So, going forward, there may be more opting for the moratorium.
- The RBI has also shown empathy by allowing accumulated interest on working capital loans to be converted into a term loan.
- This could be repaid by the end of this fiscal.

- Borrowers would otherwise have faced problems in paying up their interest dues in one shot at the end of the moratorium period.
- The increase in group exposure limit for banks to 30% from 25% will help large corporate borrowers.
- Notably, these have found themselves handicapped in raising funds from the markets now.

What are the concerns?

- The extended period may however still not be enough as it will offer borrowers only about 7 months from the end of the moratorium period.
- During this, they will have to speed up their businesses and service their loans.
- The RBI might well find itself in a situation where it is forced to offer another extension in the next few months.
- So, it could have instead put off accumulated interest repayment by one year.
- There was also some disappointment in the markets that the RBI did not relax norms for loan restructuring by lenders.
- The central bank has played its cards well here because there is no way of knowing the true extent of distress now.
- So, it will be difficult to propose the right restructuring norms.
- Chances are that this may well form part of the RBI's next announcement.

Source: The Hindu