

Transmission troubles: on inefficient banking system

The RBI continues to remain unable to influence the effective lending rates in the economy. In February, in its latest statement of intent to resolve poor monetary transmission, the RBI said it would instruct banks to switch base rate customers to the [marginal cost of funds-based lending rate](#) (MCLR) system from April 1, 2018. In April 2016, it had introduced the MCLR regime, scrapping the base rate regime, in place since 2010. "Since MCLR is more sensitive to policy rate signals, it has been decided to harmonise the methodology of determining benchmark rates by linking the Base Rate to the MCLR," it had said. This was supposed to push banks to lower lending rates. Currently, under the base rate system, the lending rate at State Bank of India is 8.7%. The one-year MCLR rate is just 8.25%. This difference of 45 basis points could make a significant difference in borrowing costs, especially for smaller firms and retail consumers relying on equated monthly instalments. In the RBI's assessment, a large proportion of outstanding loans and advances continues to be linked to the base rate system. This perhaps triggered the February statement.

A nudge to borrowers

Yet, the RBI is yet to operationalise that intent. One can understand the banks' reluctance to switch to the lower MCLR-based rates, given the multiple pressures they face, including record levels of non-performing assets and losses, and significant treasury losses. The RBI, which has often faced flak for poor monetary transmission, shouldn't be swayed by these concerns. An RBI study estimates that public sector banks could take a 40,000-crore hit on revenue if they allow all base rate borrowers to switch to the MCLR rate. The RBI, which has just allowed banks to spread the booking of losses on the treasury front over four quarters — after talking tough about such rollovers — may not want to hurt them more. But this creates an unfair situation as new borrowers get MCLR rates while the older ones continue on the higher base rate system. While a base rate customer can shift to the MCLR regime only by paying a fee, this outcome is not too different from the previous attempt by the RBI eight years ago to influence transmission by shifting to base rates from what was called a Benchmark Prime Lending Rate regime. There was no sunset clause included then. For troubled banks, this is an asset-liability mismatch issue. Given the need to revive the economy through consumption and fresh investment, this impasse needs to be broken.

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