TIMELY WINDFALL: ON RBI'S FUND TRANSFER

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

The Reserve Bank of India’s decision to transfer 99,122 crore of surplus to the Centre comes as a windfall to the government, at a moment when the ferocious second wave of the COVID-19 pandemic has likely upended most projections for the economy including revenue assumptions. The payout is almost double the 53,511 crore that the Finance Minister had budgeted for by way of dividend receipts, including from nationalised banks and financial institutions. That the RBI has generated a surplus that is over 73% higher than what it posted for the previous 12-month period ended June 2020, is also noteworthy when one considers that the bank just changed its accounting calendar from July-June to an April-March format by truncating its last financial year to a nine-month period. The RBI’s annual report, released on Thursday, shows that a sharp 63% contraction in expenditure was a major factor in boosting the surplus, especially as income fell by 11%. However, the biggest contributor in real terms was the 50,629 crore of exchange gain realised by the central bank from its foreign exchange transactions. The central bank, which admits to intervening in the foreign exchange market to smoothe volatility, clearly had a very busy time mopping up the record foreign direct investment inflows that exceeded $81 billion (at a gross level) in the last financial year, as well as the sizeable portfolio investments from overseas. Still, a 69% increase in exchange gain, over the preceding 12-month period, prompts the question as to whether the RBI’s foreign exchange transactions were all entirely aimed only at stabilising the rupee’s value.

Given the magnitude of economic disruption caused by the ongoing pandemic and the lack of visibility on the costs that the economy is going to have to bear in the coming months, the RBI’s transfer surely provides a much-needed buffer to the government’s finances. However, both the Centre and the central bank need to be cognisant of the risks in making a habit of banking on these surpluses to cushion the government’s coffers. After all, just two years ago, the RBI had transferred a record 1.76-lakh crore to the exchequer. While the Reserve Bank has ensured that it maintains contingency reserves at exactly 5.5% of the overall size of its balance sheet, the level of its reserves provides little wiggle room to safeguard against a sudden, unexpected financial crisis and is at the lower end of the 5.5%-6.5% band recommended by the Bimal Jalan committee. With the government facing the likelihood of overshooting its budgeted borrowing, given the higher spending needed to bolster vaccinations, health care and direct fiscal support, the RBI’s balance sheet could swell in size this year too. It would behove policymakers to remember that the central bank is ultimately the lender of last resort to the nation as a whole and can ill-afford to be less than adequately funded to meet every conceivable contingency.

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