

'Bank funding will be liquidity-neutral'

Stepping stone: A well-capitalised banking system is a pre-requisite for stable economic growth, says Dr. Patel. Reuters

The Centre's move to infuse Rs. 2.11 lakh crore capital into public sector banks through recapitalisation bonds and budgetary support is a welcome step, according to Urjit Patel, Governor, Reserve Bank of India.

He added the recapitalisation bonds will be liquidity-neutral for the government except for interest payment.

"The recapitalisation bonds will be liquidity neutral for the government except for the interest expense that will contribute to the annual fiscal deficit numbers," Dr. Patel said.

The banks will be recapitalised over a period of two years through recapitalisation bonds and budgetary provision.

Dr. Patel said a well-capitalised banking system was a pre-requisite for stable economic growth and this package to restore the health of the banking system was a monumental step forward in safeguarding the country's economic future.

"The proposed recapitalisation package for the banking sector combines several desirable features," he said. "First, by deploying recapitalisation bonds, it will front-load capital injections while staggering the attendant fiscal implications over a period of time."

The move will involve participation of private shareholders of public sector banks by requiring that parts of the capital needs be met by market funding, he said. The Governor said healthier banks with could get the capital first which will prompt others to also address the balance sheet issues.

'Calibrated approach'

"Last, but not the least, it will allow for a calibrated approach whereby banks that have better addressed their balance sheet issues and are in a position to use fresh capital injection for immediate credit creation can be given priority while others shape up to be in a similar position," he said.

"This provides for a good way of bringing some market discipline into a public recapitalisation programme compared to the past recapitalisation programmes," Dr. Patel said.

The central bank Governor said for the first time in the last decade, there was a real chance that all the policy pieces of the jigsaw puzzle will be in place for a comprehensive and coherent, rather than piece-meal, strategy to address the banking sector challenges. "It bodes us well that this step has been taken in a time of sound macroeconomic conditions for the economy on other fronts," he said.

Commenting that financial sector policies should support growth while maintaining financial stability, Dr. Patel said RBI is looking forward to working with the government in ensuring these plans reached their natural completion for the benefit of the broader Indian economy.

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