MORE LIQUIDITY FOR LENDING

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

What are SLR, CRR, and LCR?

SLR, or statutory liquidity ratio, is a measure of the reserves that commercial banks are required to hold in the form of government bonds, gold, and similar liquid assets. CRR, or cash reserve ratio, is a measure of the reserves that banks need to hold in the form of cash. LCR, or liquidity coverage ratio, is a measure of highly liquid assets which can easily be converted into cash that banks are required to hold. All three are policy tools used by the Reserve Bank of India (RBI) to influence the total amount of reserves held by banks at any point in time. These reserve requirements, in turn, influence the amount of loans that banks can extend to borrowers. So when the RBI tightens reserve requirements, banks are forced to cut down lending and this causes money supply in the economy to shrink. Money supply rises when reserve requirements are eased by the RBI.

Why are they in the news?

The RBI last week allowed banks to classify an additional 2% of the value of their SLR investments in government bonds as high-quality liquid assets (HQLAs). The move, which could increase the overall amount of assets that can be classified as highly liquid reserves by banks, can increase bank lending and ease the availability of funds in the economy. It is estimated that the latest easing of SLR norms by the RBI can release 2.5 lakh crore into the economy. The decision to reclassify SLR assets is part of the RBI’s emergency measures to improve the availability liquidity in the economy. Borrowers like non-banking financial companies (NBFCs) have had to to borrow at higher rates after investors turned cautious after infrastructure lender IL&FS’s default. The RBI hopes that increased bank lending can help ease the crisis.

Can they solve the liquidity crisis?

The injection of fresh money through the banking system can help boost aggregate demand in the economy. It, however, remains to be seen whether banks are willing to risk lending money to NBFCs and other financial companies in the current environment. The move to ease reserve requirements is unlikely to have any effect until this happens. Money market rates, however, did witness an immediate drop after the RBI’s emergency measures suggesting that the RBI may be enjoying some success in calming the nerves of investors.

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