



RBI's Annual Report: 2020

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Why in News

Recently, the **Reserve Bank of India (RBI)** has released its annual report for 2019-2020.

Key Points

- **Financial Health of Banks:**

- **Moratoriums on loan instalments, deferment of interest payments and restructuring** may have implications for the financial health of banks, unless they are closely monitored and judiciously used.

These regulatory initiatives were taken by RBI **to reduce the economic impact of Covid-19 pandemic**. These measures have averted a big spike in **Non Performing Assets (NPAs)** till now.

- RBI in its **July 2020 Financial Stability Report** had warned that the NPAs of all Scheduled Commercial Banks (SCBs) may increase from 8.5% in March 2020 to 12.5% by March 2021. In the severe pandemic situation, the NPAs may also worsen to as high as 14.7%.

- **Risk Aversion by Banks:**

- **Indian banks need to shed high risk aversion** which is impeding the credit growth to productive sectors.

Banks have become extremely careful while giving fresh loans to borrowers due to the fear that loans could turn bad in future.

- Bank **credit growth has slowed significantly** in 2020 despite the RBI's efforts to infuse a significant amount of liquidity into the banking system.
 - Since March 2020, the RBI has infused around Rs. 8-9 lakh crore through various schemes into the banking system including multiple rounds of long-term **repo operations**.
 - The RBI also cut the **repo rate** or the key lending rate by a total 115 basis points since March 2020.

- **Bank Fraud:**

- Frauds reported by banks of Rs.1,00,000 and above value **have more than doubled in FY 2019-20**. The number of such frauds have increased by 28% in volume.

While there were 6,799 frauds involving Rs. 71,543 crore as of March 2019, the number of frauds jumped to 8,707 involving a whopping Rs 1,85,644 crore.

- **Majority of these frauds are in loan portfolios** of banks, both in terms of number and value. The **public sector banks accounted for most of these frauds (80%)**.

- However the average lag in detection of frauds remains long.

Weak implementation of **Early Warning Signals (EWS)** by banks, non-cooperation of borrowers during forensic audits, inconclusive audit reports and lack of decision making in joint lenders' meetings account for delay in detection of frauds.

- **Slow Economic Recovery:**

- The economic **contraction triggered by pandemic** will take longer time to regain the pre-Covid momentum, **as the shock to consumption is severe.**

- **The discretionary elements in private consumption has significantly reduced**, particularly in transport services, hospitality, recreation and cultural activities.

The **discretionary spending** includes spending on vacation and entertainment.

- **Urban consumption demand has suffered significant loss**, passenger vehicle sales and supply of consumer durables in the first quarter of 2020-21 have dropped to 1/5th and 1/3rd, respectively, of their level a year ago. Air passenger traffic has also ground to a halt.
- Citing the data of **e-way bills** for the month of July 2020, RBI said that the **consumer confidence fell to an all time low**, because of pessimism relating to the general economic situation, employment, inflation and income.

e-way bills are an indicator of domestic trading activity.

- However, **the rural demand fared better**, tractor sales picked up by 38.5% in July 2020, spurred by the robust pace of kharif sowing. There was also an increase in motorcycle sales in July.
- The pandemic has also exposed **new kinds of inequalities** e.g white collar employees can work from home while essential workers have to work on site, exposed to the risk of getting infected.

In some areas of work such as hospitality, hotels and restaurants, airlines and tourism, employment losses are more severe than in other areas.

- The **sharp cut in corporate tax rate** announced by the government in 2019 did not help in restarting the investment cycle as was intended. Instead it has been used by companies to reduce debt and build up cash balances.

- **Inflation:**

Headline inflation may remain elevated in the second quarter of 2020-21 but may moderate during the second half of 2020- 21.

Retail inflation was at 6.93% in July, above the upper tolerance limit of 6%.

Suggestions Made by RBI

- **Targeted public investment** funded by **asset monetisation** and **privatisation of major ports** is a viable way to revive the economy.
- **Goods and Services Tax (GST) Council type of apex authorities** can be set up in respect of land, labour and power to drive structural reforms and speedier implementation of infra projects.

- **Recapitalisation of public sector banks**, this assumes significance as the minimum capital requirements, which are calibrated on the basis of historical loss events, may no longer suffice to absorb post-pandemic losses.

Source: IE