

FinMin to replace interest subvention with back-ended subsidies

Concerned at the slow transmission of policy rate changes by banks, the Centre plans to replace interest subvention schemes with interest subsidies that do not interfere with lenders' marginal lending rates. The government has also asked states to coordinate with one another in market borrowings so that there is no liquidity crunch.

“We need to revisit our interest subventions schemes and replace them with back-ended interest subsidies that do not interfere with the marginal lending rates, and yet have the same effect on the loan repayments as the interest subventions have,” Finance Secretary Ratan Watal said at a meeting with state finance secretaries here on Monday.

While the focus is on setting policy rates, equally important is the monetary policy transmission, said Watal. “This cannot be left entirely to the central bank. Our policy interventions can often interfere with the transmission of monetary policy actions.”

Noting that banks have moved to a new system of marginal setting of lending rates, he said, “This cannot succeed unless we remove the marginal distortions that have crept into our system over the years.”

He said the finance ministry's decision to rationalise small savings rates should be seen as a positive development in this light. “Small savers and ordinary households are also needy creditors who deserve a better deal than they have been getting.” While the Reserve Bank of India has announced a number of path-breaking measures to systemically improve liquidity conditions, management of liquidity in the financial markets has remained an area of concern, he noted.

According to Watal, one of the reasons for the tight liquidity conditions, especially since October 2015, was that a number of government securities were simultaneously off-loaded by state governments to meet their borrowing requirements.

Having learnt from this experience, the Centre has now proposed a better coordinated and more evenly spaced borrowing schedule for 2016-17.

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