18 February 2009

Dear Shri Sahoo,

This refers to our telecon on 16th instant. I got in touch with the concered members yesterday and got the following feedback on the impact of recent RBI measures.

As I have already explained, the economic meltdown is continuing and the growth prospects are clouded. Entrepreneurs are taking a very cautious view and all expansion and green field projects have been put on hold. Their focus is on keeping up the present level of activities and not expansion andcompetitiveness. In such a backdrop, demand for additional funds is naturally not picking up.

It has been reported that Banks also are not forthcoming to facilitate loan-disbursement, particularly to the SMEs. The procedural issues, especially for new projects, continue to be difficult. If they were cut down to the bare essentials, in terms of paper work, time taken, security needs, processing and pre-payment charges etc., we think that more and more SMEs could come forward to get the benefit of easier liquidity position of the banks. The 'risk aversion' attitude of the Banks is also a deterrent. Banks should find a reasonable and easier way of financing all rated-Projects of the SMEs who number around 12 million and contribute 7-8 p.c. of GDP. It is imperative that RBI's stimulus package reaches this sector also for a visible impact on the economic downturn.

High interest rate is another vital factor, responsible for poor demand for bank credit. The RBI has reduced CRR, Repo rate, and reverse repo rate, while inflation rate also has dropped below 5 p.c. But banks have not reduced their interest rates, except for housing loans. The PLR of banks is in the range of 12.50 p.c. – 13.25 p.c. and SMEs have to pay minimum 15-16 p.c. interest. This is unbearable, particularly in a melt-down climate. We think that the PLR could be reduced by 2-3 p.c.

and banks should play the developmental role. We have reports from a member that he took a home loan of Rs.50 lacs at 7.7 p.c. in 2006 but subsequently it has been raised to 12 p.c. in August 2008 on the plea of market condition.

In the current economic crisis, two important factors come into play – slowdown in growth and fall in inflation. Both these factors are conducive enough to scale down interest rates. Lower credit cost can be a powerful stimulus to get the economy back on the growth path. It will encourage consumer spending and boost up corporate investment. With the inflation expected to fall further below 3 p.c. within the next quarter, the RBI may like to cut their Repo rate and reverse repo rate further by 100 bps, to sent a strong signal to the banks to bring down their interest rates.

With regards,

Yours sincerely,

(R. K. Sen)

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