THE PROBLEM WITH THE LIQUIDITY PUSH

Even if partially successful, it will culminate in eventual default; the crisis is only likely to intensify

The present government's much-hyped, post-COVID-19 relief and recovery package has disappointed many. It provides little by way of additional budgetary resources to halt and reverse the economic and social collapse that the pandemic and the response to it has triggered. Most estimates place the additional fiscal allocation implicit in the proposals at about a tenth of the size of the package, which the government claims amounts to around 10% of GDP.

In its effort to tote up a 10% of GDP relief-cum-stimulus figure, the government has relied heavily on measures aimed at pushing credit to banks, non-banking financial companies (NBFCs) and businesses big and small, which are expected to use borrowed funds to lend to others, make payments falling due, compensate employees even while under lockdown, and otherwise spend even while not earning. The thrust is to get the Reserve Bank of India (RBI) and other public financial institutions to infuse liquidity and increase lending by the financial system, by offering the latter capital for longer periods at a repo or policy interest rate that has been cut by more than a percentage point to 4%.

The fourth 'l'

There was a hint that this would be the thrust when the Prime Minister in his speech calling for a "self-reliant India" identified, besides land, labour and laws, "liquidity" as among the areas of focus of the package. In economic and business parlance, liquidity refers to ease of access to cash — a liquid asset is one that can be easily sold for or replaced with cash, and a liquid firm or agent is a holder of cash, a line providing access to cash, or assets that can be easily and quickly converted to cash without significant loss of value. In periods of crisis, individuals, small businesses, firms, financial institutions and even governments tend to experience a liquidity crunch. Relaxing that crunch is a focus of the government's crisis-response package. In keeping with that perspective, it gives a much larger role to enhancing liquidity than it does either to direct transfers to the poor and precariously employed workers devastated by the crisis, or to spending to ensure that micro- and small businesses would remain viable and along with medium and big businesses, would ride a demand revival when the lockdown ends.

Focus on NBFCs

The main intermediaries being enlisted for the task of transmitting liquidity are the banks, with NBFCs constituting a second tier. Among the first steps taken by the RBI was the launch of special and 'targeted' long term repo operations (TLTROs), which allowed banks to access liquidity at the repo rate to lend to specified clients. One round of such operations, which was relatively more successful, called for investment of the cheaper capital in higher quality investment grade corporate bonds, commercial paper, and non-convertible debentures. That funding allowed big business, varying from Reliance and L&T to financial major HDFC, to access cheap capital to substitute for past high-cost debt or finance ongoing projects. There is little evidence that this is triggering new investment decisions.

The second round was geared to saving NBFCs, whose balance sheets were under severe stress even before the COVID-19 strike, because they were finding it difficult to roll over the short-term debt they had incurred to finance longer term projects, including lending to small and medium businesses, housing and real estate. Banks were wary about lending to these NBFCs, because of fears that their clients could default in amounts that would bring the viability of these institutions into question. Those fears were confirmed when Franklin Templeton announced that it was shutting down six of its funds, setting off redemption requests across the NBFC sector, as investors rushed to take back their money, at a time when the ability of these institutions to mobilise funds to meet these demands had been impaired. Not surprisingly, banks were unwilling to respond when liquidity was infused to target lending to the NBFCs.

Building on these initial liquidity infusion efforts, the COVID-19 package identified more intermediaries (such as the Small Industries Development Bank of India, the National Bank for Agriculture and Rural Development, and the National Housing Bank) that could refinance lending by the banks to different sections, with targeted lending amounts providing figures to fatten the "stimulus". To persuade the banks and other intermediaries to take up these offers when the clients they must lend to (micro, small and medium enterprises, street vendors, marginal farmers, etc.) are themselves stressed, in some instances the government offered them partial or full credit guarantees in case their clients defaulted. The government also sought to persuade the RBI to lend directly to NBFCs against their paper.

These measures, which are only marginally effective even in the best of times, will not work during this crisis. Consider a bank or NBFC lending to small business. With economic activity either at a complete stop or at a fraction of the normal, those who can access credit would either not borrow or only do so to protect themselves and not use the funds either to pay their workers or buy and stock inputs. Even after the lockdown is lifted, the compression of demand resulting from the loss of employment and incomes would be considerable. It would be aggravated by the fact that spending by a fiscally conservative government would fall sharply because of a collapse in revenue collections. Faced with sluggish demand, firms are unlikely to meet past and current payments commitments and help the revival effort, just because they have access to credit. This would mean that credit flow would actually not revive. This danger is even greater because the government has been measly with its guarantees, not wanting to accumulate even contingent liabilities that do not immediately affect the fiscal deficit.

On disposable income

Another component of the "liquidity" push is the measures that temporarily increase the disposable income of different sections. Advance access to savings like provident fund contributions, lower tax deduction at source, reduced provident fund contributions and moratoriums on debt service payments for a few months, are expected to provide access to cash inflows and reduce cash outflows, to induce agents to meet overdue payments or just spend to enhance the incomes of others. These are marginal in scope, if relevant at all. They have been combined with non-measures like adding on pending payments such as income tax refunds to spike "liquidity provision".

Overall, the "transmission" of the supply side push from these monetary policy initiatives for relief and revival is bound to be weak. Given the circumstances, the liquidity push, even if partially successful, would only culminate in eventual default, as borrowers use the debt to just stay afloat in the absence of new revenues. The measures are only likely to intensify the crisis, rather than resolve it.

Think new transfers

What is needed now is government support in the form of new and additional transfers to people in cash and kind, and measures such as wage subsidies, equity support and spending on employment programmes. That, as many have acknowledged, would require debt financed spending by the government, with borrowing at low interest rates from the central bank or a "monetisation" of the deficit. Unfortunately, obsessed as it is with fiscal conservatism and tax forbearance, the Narendra Modi government is unwilling to take that route. Abjuring that option, the government's "self-reliance package" calls on citizens to rely only on themselves, aided by an uncertain offer of temporary access to credit. That path can only have devastating consequences for lives and livelihoods.

Meanings of Difficult Words :

- **liquidity** (noun) – the availability of liquid assets; liquidity means liquid assets; cash; (liquid asset is an asset which can be easily sold/converted into cash without losing its value); a measure of activity (i.e. the ability to buy or sell easily) in a market.
- **push** (noun) – thrust, drive, driving force, motivation, motive force.
- **culminate** (verb) – lead up to; end with, terminate with.
- **eventual** (adjective) – inevitable, resulting, ensuing.
- **default** (noun) – non-payment, failure to pay.
- **stimulus/relief package** (noun) – an attempt by the government to boost economic growth and save their country from a financial crisis by involving tax cuts, lowering interest rates and increasing government spending.
- **by way of** (phrase) – via, by means of, as a form of.
- **halt** (verb) – stop, end, cease, terminate.
- **reverse** (verb) – alter, change.
- **pandemic** (noun) – the worldwide spread of a new disease; The illness spreads around the world and typically affects a large number of people across a wide area.
- **fiscal/budgetary allocations** (noun) – fiscal (budgetary) allocations are integral components to an annual financial plan, or budget, of a government/ organization. They indicate the level of resources a government/organization is committing to a certain program.
- **implicit in** (adjective) – inbuilt in, incorporated in, connected with.
- **amount to** (verb) – add up to, come to, be equivalent/equal to.
- **tote (up)** (phrasal verb) – add up, sum, total, tally, calculate.
- **stimulus** (noun) – impetus, boost, incentive, fillip.
- **rely on** (phrasal verb) – depend on; resort to, bank on.
- **due** (adjective) – outstanding, overdue, unpaid, unsettled.
- **non-banking financial company (NBFC)** (noun) – a company incorporated under the Companies Act 2013 or 1956 which is engaged in the business of loans and advances, acquisition of stocks, equities, debt etc issued by the government or any local authority. The main objective of this type of a company is to accept deposits under any scheme or manner.
- **compensate** (verb) – recompense, repay, pay back, reimburse (for one's losses).
- **lockdown** (noun) – an emergency protocol implemented by the authorities that prevents people from leaving from a place; An extended state of confinement/encirclement/isolation of a person by the authority.
- **infuse** (verb) – add, impart, introduce.
- **repo rate** (noun) – it is the rate at which the central bank of a country (RBI in case of India) lends money to commercial banks in the event of any shortfall of funds.
- **self-reliant** (adjective) – self-sufficient, self-supporting, self-sustaining.
- **parlance** (noun) – expression, vocabulary, language.
- **liquidity crunch/crisis** (noun) – an acute shortage (or "drying up") of liquidity.
- **in keeping with** (phrase) – consistent with, in accordance with, in line with.
- **perspective** (noun) – outlook, viewpoint, approach.
- **precariously** (adverb) – insecurely, unsafely, dangerously, uncertainly.
- **devastate** (verb) – shock/shatter, traumatize, greatly upset, distress.
- **viable** (adjective) – manageable, feasible, effective.
- **ride** (verb) – to deal a difficult condition effectively and gain advantage from it; be supported by.
- **revival** (noun) – recovery, restoration.
- **intermediary** (noun) – middleman, broker, agent.
- **enlist** (verb) – enrol, join up.
- **constitute** (verb) – comprise, make up, account for.
- **tier** (noun) – row, rank, line.

- **Targeted Long Term Repo Operation (TLTRO)** (noun) – a tool introduced by the RBI on March 27th, to enhance liquidity in the system, particularly the corporate bond market, in the wake of the COVID-19 crisis. The central bank (RBI) wants banks opting for funds under this option to be specifically invested in investment-grade corporate debt.
- **Long Term Repo Operation (LTRO)** (noun) – a tool that lets banks borrow one to three-year funds from the central bank (RBI) at the repo rate, by providing government securities with similar or higher tenure as collateral.
- **relatively** (adverb) – comparatively, proportionately, by comparison; somewhat.
- **call for** (phrasal verb) – require, necessitate, demand.
- **non-convertible debenture (NCD)** (noun) – unsecured bonds that cannot be converted to company equity or stock.
- **debt** (noun) – liability, financial obligation, borrowed capital.
- **gear** (verb) – adjust/prepare something (e.g. a plan) for a particular purpose.
- **balance sheet** (noun) – a statement that shows the financial condition of a company at a particular point in time.
- **stress** (noun) – (financial) hardship, burden; trouble, difficulty.
- **strike** (verb) – affect, afflict, attack, hit.
- **roll over** (phrasal verb) – manage, extend (debt for a longer period).
- **incur** (verb) – suffer, sustain, experience.
- **wary** (adjective) – cautious, careful, circumspect.
- **default** (verb) – fail to pay, not pay, renege.
- **bring something into question** (phrase) – to raise/cause doubts about something.
- **viability** (noun) – ability, practicality, feasibility (to work successfully).
- **shut down** (phrasal verb) – discontinue, cease activity, close.
- **redemption** (noun) – it is a process of withdrawing units from a mutual fund scheme and getting the money back from your investment at the net asset value prevailing on that day; exchange, swapping, return/recovery.
- **set off** (phrasal verb) – give rise to, cause, invoke, trigger, bring about.
- **mobilise** (verb) – stimulate, galvanize, encourage, urge.
- **impair** (verb) – decrease, diminish, reduce.
- **unwilling** (adjective) – reluctant, disinclined, resistant.
- **build on** (phrasal verb) – develop, expand/enlarge on; enhance.
- **infusion** (noun) – the introduction/ instilling/imbuing of a new thing.
- **fatten** (verb) – feed up, build up, gain weight.
- **persuade** (verb) – convince, influence, press someone into, make certain.
- **take up** (phrasal verb) – engage in, participate in, start, undertake.
- **marginal** (adjective) – small, minor, insignificant.
- **stress** (verb) – pressurize, burden, overtax, strain.
- **credit guarantee (fund)** (noun) – a type of fund (by the government) which backs up the loan taken by the beneficiaries as a form of collateral (pledged as security/guarantee).
- **at/in the best of times** (phrase) – in the most advantageous situations.
- **compression** (noun) – reduction, contraction, cutting down.
- **considerable** (adjective) – sizeable, significant, substantial.
- **aggravate** (verb) – worsen, compound, exacerbate, increase, intensify.
- **conservative** (adjective) – cautious, understated/moderate, reasonable.
- **sluggish** (adjective) – inactive, dull, slow, unresponsive, lethargic.
- credit flow (noun) – availability of credit.
- **measly** (adjective) – very small.
- **accumulate** (verb) – gather, collect, pile up.
- **contingent liability** (noun) – a liability which may arise depending on the consequence of an unpredictable future event.
- **liability** (noun) – financial obligation, debt, indebtedness.
- **fiscal deficit** (noun) – the difference between total expenditure and total income of the government.

- **disposable income** (noun) – it means "total income minus taxes"; (i.e. income remaining after tax deductions).
- **provident fund** (noun) – a retirement savings scheme in which employees of an organisation contribute a small portion of their basic pay monthly. In the same line, the employer also contributes a similar amount on their behalf towards the scheme.
- **moratorium** (noun) – a temporary suspension of an activity; embargo, ban, prohibition.
- **(cash) inflow** (noun) – a flow of a large amount of money to a particular place.
- **(cash) outflow** (noun) – a flow of a large amount of money out of a particular place.
- **induce** (verb) – persuade, convince, urge.
- **at all** (phrase) – conceivably, in any way, by any means.
- **spike** (verb) – increase sharply.
- **liquidity provision** (noun) – the provision (providing) of liquidity by a central bank to the banking system to help mitigate a financial crisis.
- **bound to** (adjective) – certain/sure, very likely, guaranteed.
- **subsidy** (noun) – also called as subvention; a financial contribution granted to help an industry or business, mostly given by a government, in order to keep the price of service/goods at a low level.
- **circumstance** (noun) – situation, conditions, state of affairs.
- **afloat** (adjective) – out of burden, out of difficulty, out of debt.
- **monetisation** (noun) – in general, it is the process of converting something (e.g. an asset) into money.
- **deficit** (noun) – shortfall, deficiency, shortage.
- **obsess** (verb) – be fixated, be preoccupied, be dominated.
- **fiscal conservatism** (noun) – a political position that calls for lower levels of public spending, lower taxes and lower government debt.
- **tax forbearance** (noun) – temporary postponement of tax payments granted by the government. It is to give taxpayers extra time to make their tax payments.
- **abjure** (verb) – renounce, relinquish, reject/forgo.
- **call on** (phrasal verb) – appeal to, demand/ask, request.
- **aid** (verb) – help, assist, support.
- **uncertain** (adjective) – unsure, doubtful, dubious, unreliable.
- **devastating** (adjective) – destructive, ruinous, disastrous, catastrophic.
- **consequence** (noun) – outcome, ramification, repercussion.
- **livelihood** (noun) – means of making a living with the basic necessities (food, water, shelter and clothing); means of support, subsistence, source of income.