RBI's announcement on 90% LTV on gold loans to heighten credit risk for banks: **Brickwork Ratings**

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The Reserve Bank of India (RBI), as part of its monetary policy announcements on Thursday, has allowed banks to increase the permissible loan to value (LTV) ratio for loans to borrowers, against the pledge of gold ornaments and jewellery for non-agricultural purposes from 75 per cent to 90% for all incremental lending up to 31 March 2021. This comes as a positive for individual borrowers as it provides an interim liquidity buffer to tide over the crisis related to the COVID-19 pandemic. It also increases collateralised retail lending avenues for banks that have been sitting on excess liquidity.

However, BWR believes that an increase in the LTV ratio to 90% increases the credit risk for banks as the collateral available in the form of gold ornaments or jewellery may not be sufficient to fully cover both principal and interest components on these loans. Says Vydianathan Ramaswamy, Director Ratings,"Gold loans with an LTV of 90% would result in a negative carry for banks as the total exposure will exceed the value of the pledged gold. It could adversely impact the recoverability and asset quality of banks in the case of a weakening in the borrower credit risk profile and/or sharp decline in gold prices, which have seen a strong rally over the last few months. However, the risk on the portfolio is for a limited period, given that the applicability of the scheme of a higher LTV is allowed only till 31 March 2021. Moreover, gold loans are mostly short-tenure loans of anywhere between 3 months to 24 months".

Given that the RBI's announcement today on higher LTV gold loans is limited to the banking sector, banks are bound to garner a larger market share vis-à-vis their non-bank peers in loans against the pledge of gold in fiscal 2021.