A costly delay

In a combative speech in Parliament only days ago, Prime Minister Narendra Modi had pinned the blame for the bad loans mess on the Congress. The previous government was entirely responsible for the NPA crisis, he had said. The Prime Minister is right — the pile of bad loans is a legacy of the UPA government. But surely this government has to be blamed, too, for acting late on it even when it was clear at the start of its term in May 2014 that a clean-up of bank balance sheets was going to be one of its primary challenges. The government's own Economic Survey in 2015-16 had flagged this while making a strong case for 4 Rs — 'recognition' of assets close to their true value, 'recapitalisation' or infusion of equity for banks to protect their capital, 'resolution' in the form of selling underlying stressed assets. And 'reform', through the right future incentives for the private sector and corporates to ensure there is no repeat of the twin balance sheet syndrome.

Since then, the scale of the challenge has grown considerably with stressed assets now at well over 11 per cent of total loans and threatening to balloon further, with a growing number of banks, especially state-owned lenders, reporting losses in the past quarter, the SBI being the latest. And it is not just bad loans which are dragging down Indian banks. The recent secular rise in bond yields, reflected in a surge of over 100 basis points in the past year, has further compounded the woes of banks. According to India Ratings, the banking industry's profitability would be hit to the extent of Rs 30,500 crore in FY18 because of large mark-to-market losses on part of their investment holdings owing to the rise in bond yields, especially over the last six weeks. On top of this comes the regulatory filing by Punjab National Bank of having detected alleged fraudulent transactions worth over Rs 11,000 crore. Viewed against this backdrop, and considering the prospect of higher provisions in the wake of the new rules unveiled by the RBI on loan restructuring, the recent recapitalisation of Rs 2.11 lakh crore for state-owned banks may appear inadequate.

This government may take pride in the fact that it has not kicked the can down the road, like in the past, but equally it can be argued that if the clean-up of bank balance sheets had been undertaken in the first two years of this government's term, well before the slowdown, state-owned banks would perhaps have been better positioned to lend — especially with signs of a nascent recovery. Nurturing those green shoots may prove to be even more tough now — in the absence of any major governance reforms the economic recovery could take much longer. For the government, that can carry high costs — both economically and politically.

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