SIGNS OF A TURNAROUND: ON RBI'S FINANCIAL STABILITY REPORT

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

The fog of bad loans shrouding the banking sector appears to be lifting after a long period of sustained stress. The Reserve Bank of India’s Financial Stability Report reveals the first half-yearly decline in the ratio of gross non-performing assets (GNPA) to advances since September 2015. The ratio across all scheduled commercial banks has eased to 10.8% as of end-September 2018, from 11.5% in March, with both public sector and private sector lenders posting drops in the key indicator of bad loans. A stress test for credit risk at banks that models varying levels of macro-economic performance shows that for the baseline assumption, the GNPA ratio would narrow to 10.3% by March 2019. This prompted RBI Governor Shaktikanta Das to prognosticate that the sector “appears to be on course to recovery”. Still, state-owned banks continue to have higher levels of bad loans than their private sector peers and are projected to show slower improvements over the second half of the fiscal. The GNPA ratio for public sector banks (PSBs) is posited to only inch lower to 14.6% by March, from 14.8% in September. One reason is that PSBs have a disproportionately higher share of bad loans from among large borrowers, who accounted for almost 55% of loans advanced by all banks as of September. The GNPA ratio for this category at PSBs was 21.6%, compared with just 7% at private banks.

Interestingly, the RBI’s Prompt Corrective Action (PCA) framework, which attracted criticism including from a government appointee on the central bank’s board, has significantly helped lower contagion risk to the banking system. A contagion analysis that assumes there would be no sovereign guarantee provided for the 11 PSBs placed under the PCA curbs, in the event of a simultaneous failure, projects that solvency losses due to such failure have more than halved over the four quarters ended September: to 34,200 crore (3.1% of total Tier-1 capital) from 73,500 crore (6.8% of total Tier-1 capital). Data on banking frauds are also a cause for concern. Close to 95% of the frauds reported in the six months ended September were credit-related, with PSBs again bearing the brunt of *mala fide* intent on the part of borrowers. The RBI’s report has justifiably spotlighted the urgent need to tighten the oversight framework for financial conglomerates in the wake of the IL&FS meltdown, which continues to ripple across the financial system, including at mutual funds and non-banking financial companies. As Mr. Das said in his foreword, “...the recent developments in NBFCs have underscored the need for greater prudence in risk-taking.” Regulators and policymakers need to work together to insulate the economy from the risks of similar fiascos.

Nitish Kumar’s manoeuvres have been forcing other parties in Bihar into realignments

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