

'WITHDRAW FORBEARANCE ONCE ECONOMY RECOVERS'

Relevant for: Indian Economy | Topic: Issues relating to Mobilization of resources incl. Savings, Borrowings & External Resources

The Economic Survey 2020-21 has prescribed an early withdrawal of the regulatory forbearance that was adopted in the wake of the pandemic to ward off the threat of financial sector failures impacting the real economy.

“Forbearance represents emergency medicine that should be discontinued at the first opportunity when the economy exhibits recovery, not a staple diet that gets continued for years,” the survey’s authors said, citing the lesson learnt from the prolonged continuance of the loosened regulations over the seven years following the Global Financial Crisis (GFC) of 2008.

During the GFC, the forbearance, which should have been discontinued in 2011 when GDP, exports, IIP and credit growth had all recovered significantly, continued for seven years resulting in unintended and detrimental consequences for banks, firms, and the economy, the survey asserted.

“Given relaxed provisioning requirements, banks exploited the forbearance window to restructure loans even for unviable entities, thereby window dressing their books,” it said.

The lesson for policymakers was “to treat emergency measures as such and not to extend them even after recovery: when an emergency medicine becomes a staple diet, it can be counterproductive.”

It recommends policymakers set thresholds of economic recovery at which such measures would be withdrawn. These thresholds ought to then be communicated to the banks in advance so that they could prepare for the same.

“Prolonged forbearance is likely to sow the seeds of a much deeper crisis... forbearance should be accompanied by restrictions on zombie lending to ensure a healthy borrowing culture.”

It said a clean-up of bank balance sheets was necessary when the forbearance was discontinued. “Note that while the 2016 AQR [Asset Quality Review] exacerbated the problems in the banking sector, the lesson from the same is not that an AQR should not be conducted,” the survey added.

AQR imperative

It said given the problem of asymmetric information between the regulator and the banks, which gets accentuated during the forbearance regime, an AQR exercise must be conducted immediately after the forbearance is withdrawn.

“The asset quality review must account for all the creative ways in which banks can evergreen their loans. The banking regulator needs to be more equipped in the early detection of fault lines and must expand the tool kit of ex-ante remedial measures.”

The Survey said a clean-up unaccompanied by mandatory capital infusion exacerbates bad lending practices. “Expecting banks to get recapitalised on their own on account of economic

recovery may not be prudent.”

Therefore, a clean-up exercise should be accompanied by mandatory recapitalisation based on a thorough evaluation of the capital requirements post an asset quality review, it added.

“Apart from recapitalising banks, it is important to enhance the quality of their governance. Ever-greening of loans by banks as well as zombie lending is symptomatic of poor governance, suggesting that bank boards are “asleep at the wheel” and auditors are not performing their required role as the first line of defence,” it said.

Subscribe to The Hindu digital to get unlimited access to Today's paper

Already have an account ? [Sign in](#)

Start your 14 days free trial. [Sign Up](#)

Find mobile-friendly version of articles from the day's newspaper in one easy-to-read list.

Enjoy reading as many articles as you wish without any limitations.

A select list of articles that match your interests and tastes.

Move smoothly between articles as our pages load instantly.

A one-stop-shop for seeing the latest updates, and managing your preferences.

We brief you on the latest and most important developments, three times a day.

*Our Digital Subscription plans do not currently include the e-paper, crossword and print.

You can support quality journalism by turning off ad blocker or purchase a subscription for unlimited access to The Hindu.

[Sign up for a 30 day free trial.](#)

END

Downloaded from **crackIAS.com**

© **Zuccess App** by crackIAS.com