Reality check: On bank NPAs

The worst is far from over for Indian banks. The financial stability report released by the Reserve Bank of India on Tuesday has warned that the gross non-performing assets (GNPAs) of scheduled commercial banks in the country could rise from 11.6% in March 2018 to 12.2% in March 2019, which would be the highest level of bad debt in almost two decades. This puts at rest the hope of a bottoming out of the NPA crisis that has affected the banking system and impeded credit growth in the economy. The GNPA of banks under the prompt corrective action framework, in particular, is expected to rise to 22.3% in March 2019, from 21% this March. The RBI believes that this will increase the size of provisioning for losses and affect the capital position of banks. In fact, the capital to risk-weighted assets ratio of the banking system as a whole is expected to drop from 13.5% in March 2018 to 12.8% in March 2019. The deteriorating health of banks is in contrast to the economy, which is on the path to recovery, clocking a healthy growth rate of 7.7% during the last quarter. The RBI, however, has warned about the rising external risks that pose a significant threat to the economy and to the banks. The tightening of monetary policy by the United States Federal Reserve and increased borrowing by the U.S. government have already caused credit to flow out of emerging markets such as India. The increase in commodity prices is another risk on the horizon that could pose a significant threat to the rupee and the country’s fiscal and current account deficits. All these factors could well combine to increase the risk of an economic slowdown and exert pressure on the entire banking system.

A major highlight of the financial stability report is the central bank’s finding that public sector banks (PSBs) are far more prone to fraud than their private sector counterparts. This is significant in light of the huge scam unearthed at a Punjab National Bank branch earlier this year. The RBI notes that more than 85% of frauds could be linked to PSBs, even though their share of overall credit is only about 65%. This should come as no surprise given the serious corporate governance issues faced by public sector banks, which to a large extent also contributed to the lax lending practices that are at the core of the NPA crisis. In his foreword to the report, RBI Deputy Governor Viral Acharya has noted that governance reforms at PSBs, if implemented, can help improve their financial performance and also reduce their operational risks. For now, the RBI expects the government’s recapitalisation plan for banks and the implementation of the Insolvency and Bankruptcy Code to improve the capital position of banks. These reforms can definitely help. But unless the government can gather the courage to make drastic changes to aspects of operational autonomy and the ownership of PSBs, future crises will be hard to prevent.

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