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Bank recap bonds: the positive impact on NBFCs and loan shopping

For your personal loan requirements, there are three segments of lenders in the market: public sector banks, private sector banks and non-banking finance companies (NBFCs). Over the past decade, the loan growth of all the three categories of lenders has been sagging. But there is a contrast. Of late, public sector banks' loan growth has stagnated at zero whereas that of NBFCs has seen a marginally upward curve. That is to say, over the past couple of years NBFCs have gained loan market share at the expense of banks. The reason is not far to seek: issues of non-performing assets (NPAs) have led to higher provisioning in public sector banks, and they are in need of capital infusion.

The bank recapitalisation bonds announced recently are going to revitalize the banking segment by equipping banks with adequate capital so that they can resume lending activities with vitality. This will help the cause of pick-up in loan growth and, as a consequence, growth of the economy. The impact of recapitalisation bonds will have positive spin-offs on other segments of the loan-provider market. It may take some time for all this to pan out—execution of the bonds; banks completing write-off of NPAs, and with enhanced capital, putting renewed thrust on lending. This may take anything between 6 months and 1 year. But whenever that happens, the lending ecosystem will be better for you.

In the future, public sector banks will re-emphasize lending and to gain market share, they will potentially lower interest rates, particularly in rate-sensitive sectors of the loan market. Increased competition will lead to pricing pressure, which may lead to NBFCs lowering their interest rates.

But there is another facet to this: for NBFCs, bank loans are one of the sources of funding. They have other sources also, such as issuance of bonds, accepting deposits, and others. Nonetheless, to the extent that they are sourcing their resources from banks, interest rates are likely to be lower as and when banks re-emphasize lending. With lower funding costs, NBFCs will have the leeway to be more competitive in rates, without putting pressure on their margins.

The various segments of lenders in the loan provider market have their own competitive strengths. Public sector banks have access to relatively cheaper funds, while NBFCs are more fleet-footed. Private sector banks are somewhere in between. NBFCs cannot match the kind of reach that public sector banks have in terms of number of branches, but more branches does not automatically translate into more loan business. The relative competitive strengths of lenders makes for more choice for you—the loan consumer.

Home loans have seen the biggest growth in quantum over the past 3 years: 30% of incremental system loans and half of incremental retail loans have been in the home segment, according to a report by Credit Suisse. In spite of this growth, the home segment remains under-penetrated; only 17 million families, or 6% of families in India, have a home loan, which is much lower than the global average, according to the report. If we look at the growth percentage in recent years, the fastest growing segments have been personal loans, consumer durable loans and home loans, in that order, followed by auto loans, commercial vehicle loans and others, but the share of these non-home sectors is relatively low. The competition among public sector banks and other lenders is likely to be more intense in the home loan segment. The reason for this is that companies source their loans from banks (and not NBFCs), and in the non-corporate segment, home loans form the bigger piece of the pie, and which all lenders will target. If rates become competitive in the ecosystem, the ripple effect will be felt by private sector banks as well.

Apart from this, credit demand being weak, particularly from the corporate sector, the initial thrust from public sector banks may take the shape of lower rates. There is scope for this. Over the past couple of years, banks have been emphasizing on their margins to compensate for asset quality problems—a case of good money making up for bad money. The losses being reported by some public sector banks is due to provisioning for NPAs. As and when this issue subsides, banks will be re-energized. Recapitalized and strengthened banks will have a positive ripple effect on the other constituents of the system, both as competition and as complement.

One must note here that it may not be a one-to-one correspondence between bank recapitalization bonds and lower interest rates. Interest rates are a function of rate signal from the Reserve Bank of India (RBI), through the overnight repo rate, which, in turn, is a function of many parameters such as inflation, GDP growth, fiscal deficit, and others. Apart from RBI signals, the liquidity surplus or deficit in the banking system also plays a role in determining interest rates. If and when the RBI talks of higher interest rates, lending rates would not come down per se, but the impact of competition can lead to a positive outcome for you.

Joydeep Sen is managing partner, Sen & Apte Consulting Services LLP

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