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Banks' profitability under threat? IMF thinks so

By ET Bureau | Updated: Oct 12, 2016, 09.04 AM IST

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By **Devangi Gandhi**



ET Intelligence Group: The International Monetary Fund (IMF) last week named India among the emerging economies whose [banking systems](#) are vulnerable to further declines in growth or profits. In the October issue of its bi-annual global financial stability report (GFSR), the [IMF](#) said credit growth in the country is slowing and risks from elevated levels of non-performing loans are "most acute".

While the report highlights several data points that acknowledge the importance of de-leveraging for emerging economies, an ETIG compilation of bad debts from 13 of the 18 emerging economies covered by the GFSR confirms why the IMF made a special mention of India.

Of the 20 [banks](#) with the worst nonperforming asset (NPA) ratios from these countries, as many as 13 are from India.

The ETIG compilation is based on Bloomberg data and covers 200-odd banks from the mentioned emerging economies. It is further refined by excluding banks that are not listed or have stopped trading on bourses. Only those banks whose bad debt numbers were updated in the last six months were considered.

All of the Indian banks that feature in the list are public sector banks, which have seen their reported bad assets surge since the second half of FY16 after the Reserve Bank forced the lenders to recognise stressed assets on their balance sheets.

Indeed, the compilation points that high leverage among companies has caused such spike in the NPAs. Even the data base used in the GFSR report shows that the interest coverage ratio (ICR) — the measure of a company's ability to pay interest on outstanding debt — of Indian firms was the second lowest among a set of 18 emerging economies.

A break up of corporate debt by ICR for the last 12 months shows that over 20% of debt is with firms whose ICR is less than 1. Further, a comparison of debt-to-Ebitda ratios of emerging markets shows that India witnessed the fifth fastest deterioration on this parameter between 2012 and 2016. Its current ratio is only better than that of Brazil, [China](#) and Chile.

According to GFSR, since corporate debt service capacity is increasingly strained, especially in emerging Asia, the amount of debt at risk across emerging economics is estimated at \$430 billion — 11% of the total corporate debt. This risk measure considers debt of firms with operating earnings (Ebitda) lower than their interest expense.

For India, it says the loan-loss reserves with banks fall short of the expected loss on non-performing loans under the current level of debt at risk.

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