Recapitalisation not enough, PSU banks need Rs 1.64 lakh crore to deal with future losses

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The authorities' approach to the banking sector has been shifted towards spurring lending in recent months, said Fitch Ratings.

Government's latest capital infusion of Rs 48,239 crore in PSU banks announced on 21 February 2019 may not be sufficient to support significantly stronger lending growth, said Fitch Ratings in a report.

Since a large proportion of the government's latest round of recapitalisation would go towards meeting the regulatory shortfalls, there is a need for more infusion of funds as a cushion against future losses. "Overall, we estimate that banks will need an additional Rs 1.64 lakh crore in 2019, after these latest injections, to sufficiently meet minimum Basel III capital standards, achieve 65 per cent NPL cover, and leave surplus capital for growth," said Fitch Ratings in the report.

The authorities' approach to the banking sector has been shifted towards spurring lending in recent months, said Fitch Ratings. The Reserve Bank of India (RBI) has resorted to a three step strategy to tackle the challenges. In January, it deferred the implementation of the final tranche of the capital conservation buffer (CCB) of 0.625 per cent to end-March 2020.

It has also lowered risk weights for some lending to non-bank financial institutions, despite these companies facing increased liquidity stress in the past year. These steps, along with capital injections, have eased but not removed capital constraints on state banks' growth, said the Fitch Ratings.

The move to recapitalise PSU banks, which disproportionately share the burden of non-performing assets, was taken to strengthen the financial performance of these banks and help them deal with the central bank's prompt corrective action (PCA) plan. With this, the government has largely completed the final round of capital infusion under the Rs 2.11 lakh crore recapitalisation plan announced by Finance Minister Arun Jaitley in October 2017.

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The recapitalisation plan has helped some PSU banks such as Bank of India, Allahabad Bank and Corporation Bank, Bank of Maharashtra and Oriental Bank of Commerce to get out of RBI's prompt corrective action (PCA) framework. However, leaving the PCA framework will not remove the constraints on growth imposed by weak capitalisation, therefore the state is required to inject more capital into these banks.

Meanwhile, an recent report by Moody's Investor Service also pointed out towards the insufficiency of the current recapitalisation plan in solving the large volume of legacy loan problems in the PSU banks.

State-run banks would need about a further Rs 20,000-25,000 crore in external capital in FY20 to maintain Common Equity Tier 1 (CET1) ratios of about 8.5 per cent, which is above CET1 requirement of 8 per cent under Basel III, including a Capital Conservation Buffer (CCB), which will increase to 2.5 per cent, said Moody's in its report.