

# NBFC crisis keeps getting worse, wait-and-watch by govt isn't quite a solution

By: [Sunil Jain](#)

Published: June 17, 2019 3:32:23 AM

In the case of IL&FS, for instance, apart from the issue of how much of the group's debts are related to assets on the ground and how much of this was inflated, it is becoming clear that there aren't that many buyers of infrastructure assets who aren't themselves stretched for cash.

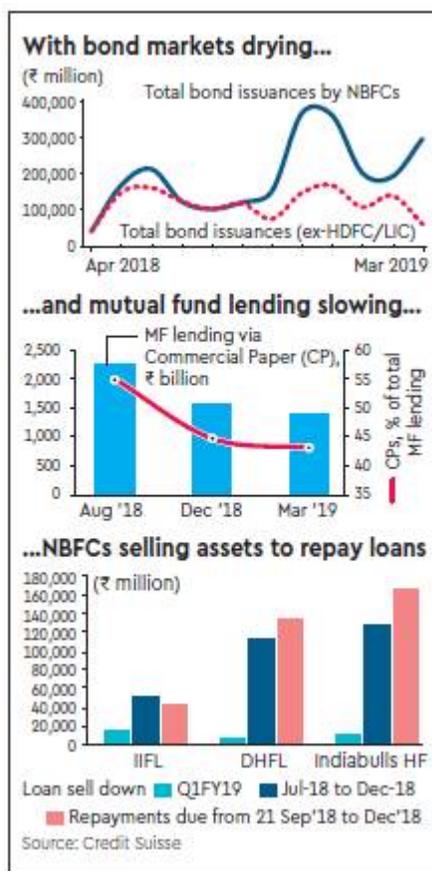


NBFCs can now raise funds at lowest cost as bond spread falls (Representative Image)

Even on its own, given its Rs 100,000+ crore loan book, the IL&FS meltdown was a big enough shock to the country's financial system, a [mini-Lehman](#) as many put it. If it didn't result in a contagion, that was due to the government approaching the courts for a freeze on bankruptcy proceedings as well as putting in place a management team led by Uday Kotak to sell IL&FS assets, in quite the same manner as was done when the Satyam scam unfolded. While this staved off the IL&FS crisis, a similar problem is being seen in other large NBFCs.

In the case of IL&FS, for instance, apart from the issue of how much of the group's debts are related to assets on the ground and how much of this was inflated, it is becoming clear that there aren't that many

buyers of infrastructure assets who aren't themselves stretched for cash. If that isn't worrying enough, with other NBFCs like Indiabulls, Dewan Housing (DHFL) and Reliance Capital in trouble, the country's financial sector is being buffeted by bad news in rapid succession and it is not clear how much more the economy can take.



There is, in all cases, the fundamental asset-liability mismatch since, in the absence of a deep bond market, the NBFCs are borrowing short and lending long. In such a case, market confidence is critical since that is what allows existing loans to be rolled over and fresh ones to be contracted. But with allegations of siphoning off dogging many NBFCs, apart from likely losses on loans to real estate developers with the realty market continuing to remain in the doldrums, the flow of fresh money has all but dried up. For a sector that saw lending skyrocket, especially after demonetization when there weren't too many investment avenues—between March 2012 and 2018, NBFC lending rose from Rs 7.2 lakh crore to Rs 17.6 lakh crore—this was the last straw; the inability to service loans resulted in these NBFCs being downgraded and that, in turn, further reduced their ability to borrow more so as to be able to service the loans.

### Read Also| [Why India should prefer the preferential trade agreement with Iran](#)

While the better-off NBFCs like HDFC, LIC Housing Finance (LICHF) and Bajaj Finance are still able to raise finance, as Credit Suisse points out, HDFC and LICHF accounted for around 60% of the bond

issuances in the first quarter of 2019. In Jan-March 2019, while HDFC raised Rs 24,715 crore from the market, LICHF raised Rs 13,704 crore and Bajaj Finance raised Rs 3,280 crore; Reliance Capital, DHFL, raised anything; while Indiabulls raised Rs 1,030 crore in January.

With large NBFCs in trouble, needless to say, this caused a huge problem in fixed income funds that had lent to NBFCs given how much value the funds lost. As a result, mutual funds have managed to reduce their exposure to the sector; while 30% of the AUMs of liquid funds were invested in the NBFC sector in August 2018, this was cut to 27% in March this year.

While the official stance so far has been that this is really an issue of solvency instead of inadequate liquidity since the better-off NBFCs have no problem raising money, and so the government will wait and watch, this is not good enough. It is not clear, for instance, whether the economy can take being buffeted by one NBFC meltdown or the other every other month. More important, since both banks and mutual funds have exposures to these NBFCs, there is always the fear of a spillover of some sort. Right now, with NBFCs not really growing their books, but trying to sell assets in order to retire existing debt (see graphic), the best option appears to be that of an orderly winding down.

While that leaves the vital question of who is going to be lending to the critical real estate/housing sector if NBFCs aren't going to be able to, this presupposes the existing assets of NBFCs will be able to cover the loans. That is unlikely to be the case, especially when it comes to loans given by NBFCs to realty developers; as in all other cases of companies in trouble, reasonable-to-large haircuts are almost certain. Indeed, for now, the assets being sold are the best ones; the haircuts will get larger as more assets need to be liquidated.

In other words, the government needs to look at an active solution, including taking over of some NBFCs or their assets—SBI announced a `45,000 crore plan to take over assets of NBFCs last October—and, if need be, making a budget provision for funding the gap between loans and assets; to the extent these NBFCs aren't going to be able to repay their loans from PSU banks, the government will have to, in any case, absorb this hit. Perhaps the budget will provide some clarity on the government's game plan; the economy cannot continue to grow at a reasonable pace if there is inadequate funding of a sector as vital as real estate or when so much of lending is in trouble.

Get live [Stock Prices](#) from BSE and NSE and latest NAV, portfolio of [Mutual Funds](#), calculate your tax by [Income Tax Calculator](#), know market's [Top Gainers](#), [Top Losers](#) & [Best Equity Funds](#). Like us on [Facebook](#) and follow us on [Twitter](#).