Lenders scared, business more so: Bankers must be protected from action against bona fide decisions that go wrong

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Published: February 26, 2020 6:15:08 AM

The moderation in loan growth in Q3FY20 was especially visible in the case of state-owned lenders, where the growth was an anaemic 4% y-o-y.

If the state of credit markets is any indication, this slowdown is going to drag on for a long, long time. At the peak of what is typically India's busy season, the pace of loans given is hitting new lows; the growth in non-food credit in the second fortnight of January slipped to an over-three-year low of 7.08% year-on-year (y-o-y). Loan markets are languishing not because there is less liquidity—the surpluses are over Rs 2 lakh crore—but because there is no rush to borrow, and also because banks fear the money may not come back. That apprehension is not altogether unjustified because the environment is a highly risky one. But, there is also the big fear of being harassed by the authorities in the event that loans go bad.

The government must immediately amend the law to protect public sector bankers from the wrath of the investigation agencies; the harsh treatment meted to former chairpersons was uncalled for, especially since other former PSU bank heads, whose banks were in equally bad or worse shape, were not penalised at all. The action has, not surprisingly, scared bankers. The government must also quickly cut its stake to 33%, if not to 26%, and stop capitalising weak banks. If these can't survive, their customers can be handed over to stronger banks and the assets parked in an entity to be recovered over time.

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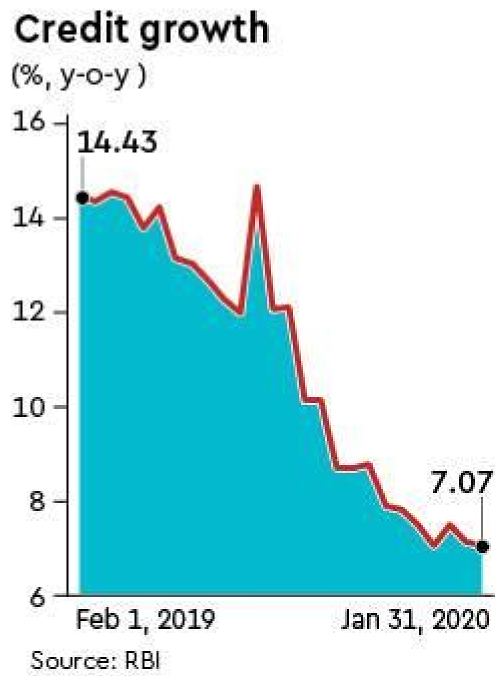
The bigger problem, as SBI chairman Rajnish Kumar had pointed out a couple of months back, is that companies have little or no appetite for loans. Sure enough, the lender's corporate loan portfolio barely grew in the December 2019 quarter. Incremental net corporate lending between April and December 2019 was about a fifth of what it was a year ago, and this has much to do with the changed environment.

A slowing economy in which companies are producing less has meant little additional demand—or a decreasing need—for working capital. This is also true for services where weak consumption demand has meant some scaling back. The government needs to act to make it easier to do business. So far, little has been done to make labour laws less intimidating for industry. Nor is India Inc confident that businesses will not be hurt by frequent changes in the rules, or an uneven playing field created after the investments have been made. The state of the telecom sector, where Vodafone-Idea—which has invested billions of dollars—is on the brink of a default, must have rattled businessmen both at home and abroad. Today, they are probably more scared than bankers. On the one hand, new technologies are disrupting their business models, whether it is in automobiles or retail. On the other hand, the regulatory environment is stifling progress. It has to be a tough environment if more than 1,000 companies have been downgraded in a year.



The need for better credit flows to small businesses cannot be overemphasised because these are the ones that create the jobs. The attempt to formalise the economy, via GST, is clearly hurting many small and micro businesses. While NBFCs were stepping in to disintermediate, that pool of money has shrunk, and is now much smaller than it was before IL&FS went bust in August 2018 and a couple of others followed.

The moderation in loan growth in Q3FY20 was especially visible in the case of state-owned lenders, where the growth was an anaemic 4% y-o-y. This is partly because some of them are in the midst of a merger while many lack growth capital.

How bad things are can be gauged by the 2.1% y-o-y rise in the outstanding value of non-financial corporate bonds in Q3FY20, the slowest increase in eight years and way below the average growth of about 30% seen in the four years to FY19. By one estimate, non-government non-financial(NGNF) debt, or corporate loans, grew by just 6.2% y-o-y in Q3FY20, the slowest in two decades. Over the April-December 2019 period, the total credit to NGNF sector crashed 70%, to Rs 3.5 lakh crore from Rs 12 lakh crore, from the comparable period of 2018. Local lending fell, but external borrowings trebled.

In a sense, India is exporting its credit markets. Because banks today have become so cautious and careful about who they are lending to; only the best get the loans. While it is early days, the long-term repo operations—LTRO—isn't likely to help too much. One way to give the economy a boost, and to prevent more loan losses for banks and NBFCs, is to get the real estate market going; solvent builders could be asked to complete stalled projects, with assistance through a line of credit and other benefits. It is a relatively simple thing to do, and can catalyse growth. Meanwhile, government must reassure India Inc that it will take some tough decisions and and will work towards improving the environment. Else, it cannot revive the confidence of either businessmen or consumers. And, even a 5% GDP growth number will be hard to come by.

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