Indian Economy: Some Contemporary Perspectives
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Lecture 25
Indian Economy-Indian Banking Crises 1

So, we are now going to start the lecture 25 of this course Indian Economy Some Contemporary Perspectives and now as I told that we will be talking about now the Indian banking crises. In 2016 we had a very adverse moment so it was somewhat unprecedented in India's banking history, India's financial history. And that we had to take some drastic measures to avoid the shock.

And this particular shock was quite unique because we were doing good our GDP growth was good. We had a strong fundamental not that weak unlike first world countries were in 2007-8 when we were talking about the global financial crises. At that time, we had very adverse situations and then it led to the contagion effect on all other countries even first world had very difficult time.

But then in India we had only the case of interdependence it was not very contagion because at that time we were safeguarded. But in 2016 we had our own banking system in trouble because of some reasons that we will be discussing. And the one of the characteristics of the Indian banking crises was that this was unique in many ways. It was not just that it was crises but it was also it or resonated due to some regulatory failures or also because of the Indian characteristic that we have to help and support.

So, banks and firms, so banks lend the money to firms and firms had investment in the risky activities and that time people and firms were not paying so much attention. So, when the bad time started these firms had to default on the loans of the banks. And banks were still giving or supporting these firms because these firms were investing in real economy activities basically infrastructure, power generation, then we had the telecommunications, and also in somewhat in the case of energy.

So, since these firms were investing in the real economy activities and it was also a designated plan of the government. So, these banks were still in support of these firms and they were undergoing restructuring process and giving certain loans advances still even in the case of do and link profit. They were giving support to these firms that if these firms will survive in future then they may repay back their whole amount.

So, there was some kind of under reporting of such type of losses by the banks. And these losses when it was unearthing, then it became quite unmanageable. And the result we had to face is very adverse situation in 2016. So, in February 2016 we had face, we had to face very adverse kind of shock not only on the real economic activities but in the stock market also. When most of the public sector banks had reported heavy losses.

And the loss was so huge that it was not easy to comprehend for the policy makers, even policy makers had very difficult time to convince the concerned authorities that it is not because of the failure of the bank certain events were not responsible and as a result these particular banking crises came up. So, at that time if you could remember 2016 February and post February if you have gone through newspapers then it was a quite bit very awkward moment that we had we were doing good in terms of GDP numbers but banking sector was not good.

And the certain measure we had to take we had to implement certain rules and regulations immediately to tackle this problem. And then it took some time and now we have still not recovered. So, this banking crises that we are going to talk about is called twin balance sheet crises so we will have that detail in a few seconds.

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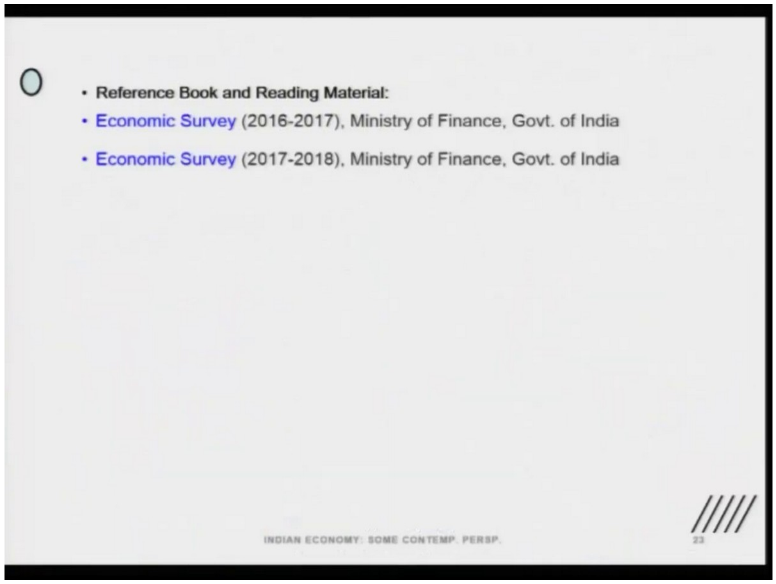

So, if you go through the economic survey 2016-17 volume 1 and mentions about the twin balance sheet crises. And that is why until 2017-18 economic survey in volume 2 they had very detail description of this that how many firms were tried under the bankruptcy clauses and how they were monitored. So, there was a whole lot of debate and discussion on this issue. So, I have referred only two important documents. So, one is Economic Survey 2016-17 Ministry of Finance government of India. Then we had Economic Survey 2017-18 Ministry of Finance government of India again.

So, if you as I have told in the beginning itself that economic survey is the most credible source of information to know about certain activities certain development, certain policy measures that government of India had undertaken in last one year and provides detailed account of that sometime you will also find the historical pictures mention over there, historical account of some event related to current development that the government is taking.

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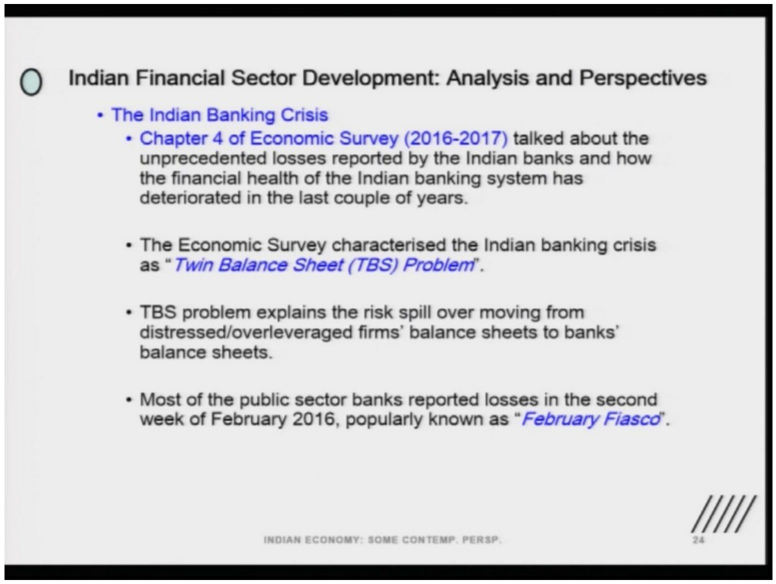

So, chapter 4 of economic survey 2016-17 talked about the unprecedented losses due reported by the Indian banks and how the financial health of this banking system has deteriorated in the last couple of years. The economic survey characterizes the Indian banking crises at twin balance sheet. Why it is twin balance sheet? Because these banks so because of the failure of the firms to repay the debt so this were the transfer of shock from the, so when the market was not doing good the firms had to pay those adverse situations.

And as a result, balance sheet has no better scenarios and these no better scenarios were transfer to the banks. And banks' balance sheet also came in trouble for instance suppose there is a bank and then you have the firm. And bank lends the money to the firms suppose it is 100 crore and this firm is supposed to invest this particular amount 100 crore to some other activities. And this particular firms are not able to invest and able to generate sufficient income so that it can repay the amount to the bank.

Then of course the first the firm is not doing good, so the balance sheet of the firm will not be good. And since it is not being able to repay 100 crores to the bank then bank balance sheet also be impaired, so it will not be also good. So, the transfer or this spill over or shock from the firms balance sheet to the bank sheet is called twin balance sheet problem. This called twin balance sheet syndrome also.

So economic adviser at that time he had mention about the twin balance sheet problem in India which later was called as the four-balance sheet. Which means that it has translated into the NBFC crises and then also the real estate firm. So that will be discussed in next two lectures. So, the TBS problem explains the risk spill over moving from distressed overleveraged firms balance sheet to the bank balance sheet.

Most of the public sector bank reported a loss in the second week of February. So, as I had already mention that the February Fiasco it is called February Fiasco because in the second week of February the most of the public sector bank had reported that the December quarter three results they had reported. And this quarter three result had all adverse scenarios for the banks. And as a result, the stock market is also had gone down by almost like 2000 points or so.

And it became so gloomy that it looks that the banking sector is now going to disappear and there was lot of apprehension uncertainties and that is why the second week of February it is called the February Fiasco. So, may be in your exam you may be asked about the February Fiasco.

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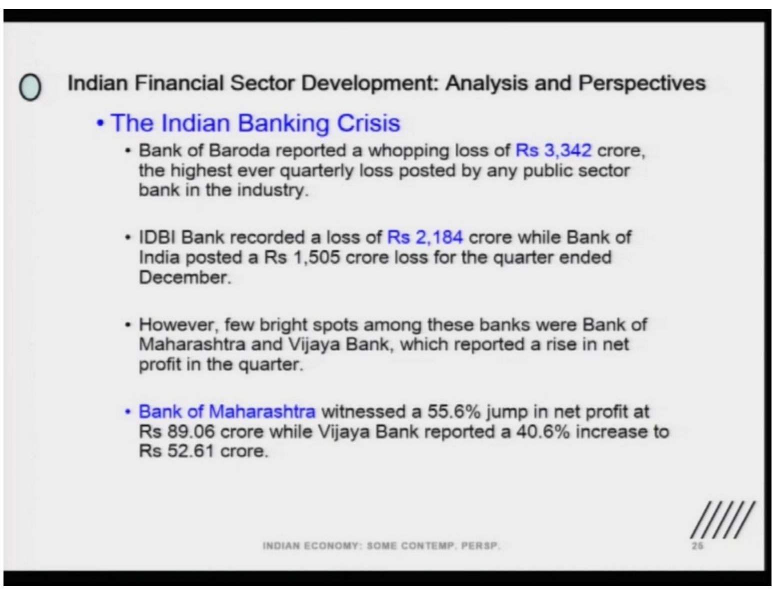

So, if you look at the numbers, then Bank of Baroda reported a loss of rupees 3342 crore, the highest ever quarterly loss posted by any public sector bank in the industry. IDBI Bank recorded a loss of 2184 crore while Bank of India posted a rupees 1505 crore loss for the quarter in

December. So, these numbers reveal that the magnitude of the shock that the Indian financial system had to absorb.

While these banks had reported huge losses there was some banks which were remain in a good financial position it was Bank of Maharashtra and Vijaya Bank. Bank of Maharashtra and Vijaya Bank for some reasons they had reported the jump in the profit of 55.6 percent and 40.6 percent respectively. So, this may be because the firms were having different exposures not to these sectors where bank were incurring higher NPA.

So that is why Bank of Baroda and IDBI Bank became one of the banks which absorbs the maximum shock of the NPA crises that we had.

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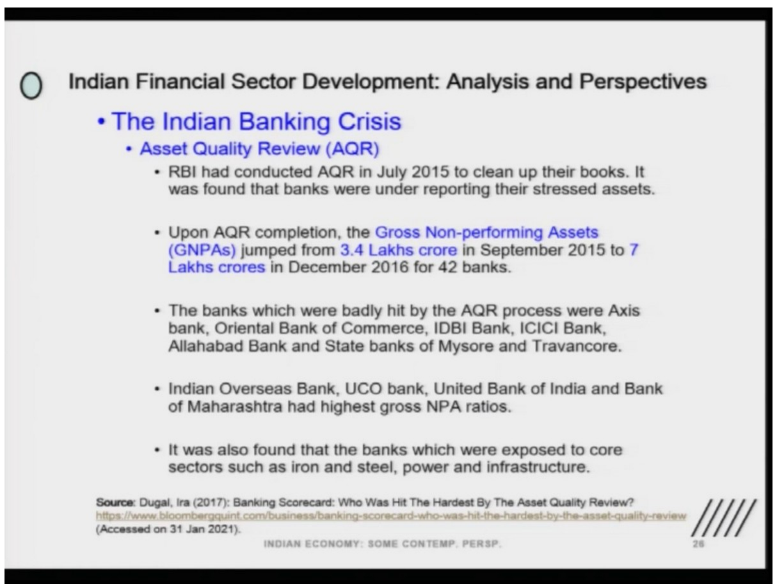

Now if we go through chapter 4 then you find that the economic advisor also mentions about what is called the asset quality review. So, for the first-time central bank had gone for such an extensive review of the balance accounts of the banks. So earlier it was, earlier it used to happen so this one is the regular process wherein each and every year, every bank had to declare or has to at least reveal the number of bad accounts.

Which means that accounts which have no earnings, no interest earnings for the bank and it is done by the inspector of RBI. But the individual those who are involved in such scrutiny they are from RBI. But for this year when Doctor Raghuram Rajan was the governor it this exercise was done. And this exercise was quite comprehension and it was done in July 2015. And this exercise was quite comprehensive and this comprehensive exercise gave rise to as huge amount of stressed asset.

Assets which means it led to the coverage of almost all the banks and all the banks had to force or were force to acknowledge these NPAs earlier it was a regular process. So most of the banks used to hide. Because there was a common apprehension among the investors those who had money invested in these banks that these banks are not reporting to their actual losses they are just hiding those debris.

It is important that central bank should look after and at least the central bank should force the banks to declare the asset called declare the bad assets. So, it was done in the July 2015 it is called asset quality review under AQR. So, after the completion of AQR suddenly there was jump of around 4 lakhs crore of NPAs from September 2015 to December 2016. And in the September 2014 the magnitude was 3.4 lakhs crore.

And it became by December 2016 it became 7 lakhs crore which means that this AQR process really helped the central bank to unearth the debris which was not reported by the banks and it included the sample of 42 banks. And 42 banks this particular exposure. The banks which were badly hit by the AQR process were Axis Bank, Oriental Bank of Commerce, IDBI Bank, ICICI Bank, Allahabad Bank, State bank of Mysore and Travancore.

Most of these a State Bank subsidiaries were merge to SBI and now SBI is consolidated authority consolidated bank and it is one of the largest by size. Because all these subsidiaries are being merge now. And then Oriental and Allahabad are also being merge and I think IDBI also. You will have a separate discussion on the merger of these banks that why we had to go through apart from this Indian overseas bank UCO Bank United Bank of India and Bank of Maharashtra had the highest gross NPA ratios.

So, despite being that these banks were not reporting losses the Bank of Maharashtra had the highest NPAs ratio which means that the account in which the bank has not received any amount which means that the interest payment that the bank are supposed to receive on their loans sanction to these firms. They were not receiving it and that is why gross NP net NPAs means when you include the interest or you adjust for the interest payment also.

It was also found that banks which were exposed to core sector such an RN and steel power and infrastructure had the highest NPAs. And there were reasons for this that I will be discussing in next two next slides. So, I found this global era 2017 article banking score card is quite useful and if some you are interested you may go through this it quite interesting to read about the asset quality review.

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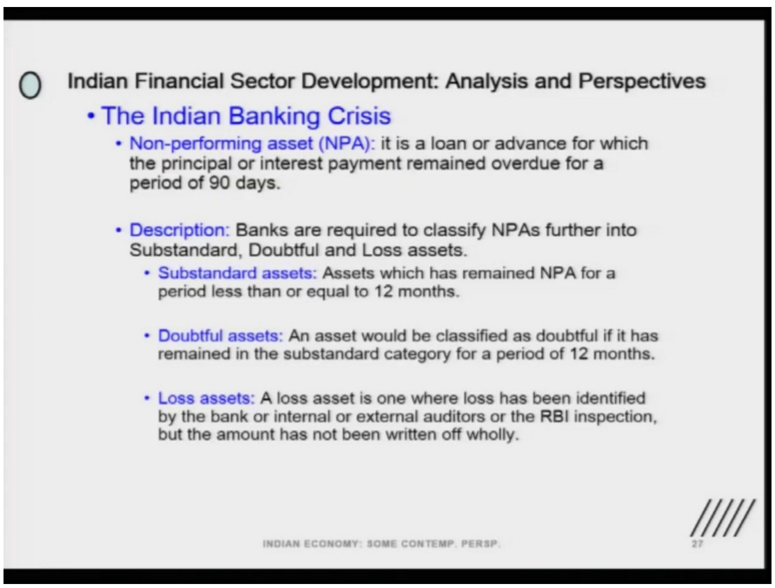

So just for the sake of this understanding if not only economics students but also for the non-economics audience, the non-performing assets that we read in the newspaper or anywhere it is said that it is a loan or advance for which principle interest payments are not materialized for at least 90 days and remains overdue. If this due for 90 days it means three months, if the banks are not receiving interest income from the firms, then it will become the NPAs non-performing assets.

It has further classification, it is call substandard assets, so assets which has remained NPAs for a period of less than or equal to 12 months so it becomes the substandard doubtful assets. If had remained in the substandard category for 12 months. So, these are the criteria but NPAs is wily reported. Loss assets is one where loss has been identified by the bank or external auditors or RBI inspection but the amount has not been written off wholly, fully.

So, which means that it not being no part of, so these are important to mentioned because in some cases we may not have the idea but the substandard once are available on the RBI website. If you want to go through further classification because there is a special mention account also under that these 90 days get reduced. So that if you have a semi 1, a semi 2 then a bank start caring about that before it reaches 90 days we should be taking some actions at the 60 days or before 60 days. So those are called a special mentioned account.

So, the moment you have a special mention account monitored then bank start looking after that you should not turn into NPAs. But once it has turned into NPAs then after that there are further classification which I just mention about substandard, doubtful assets, loss assets and everything.

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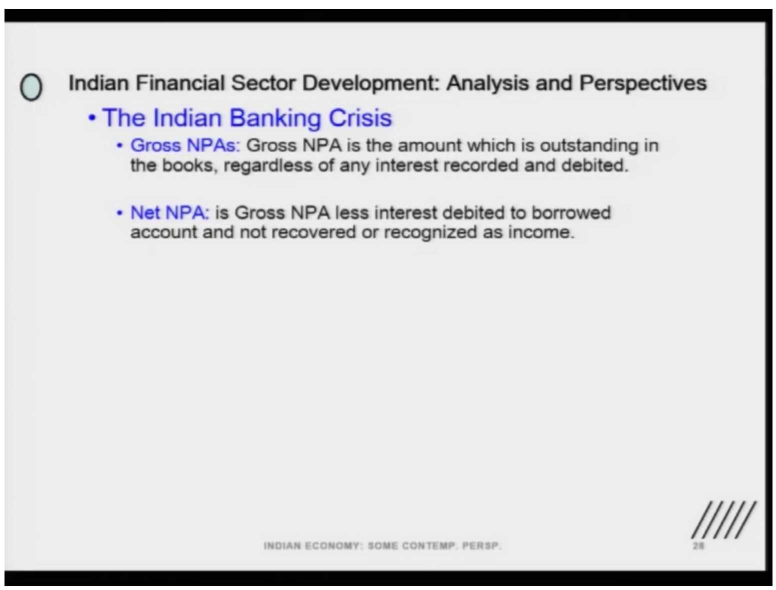

As I have already mentioned that gross NPAs is the amount by or it is outstanding in the books regardless of any interest recorded or debited. So, this is what it is call and if you just subtract the interest debited or borrowed account not covered or recognized as an income then this become what is called the net NPAs. So, these are just for the sake of your understanding.

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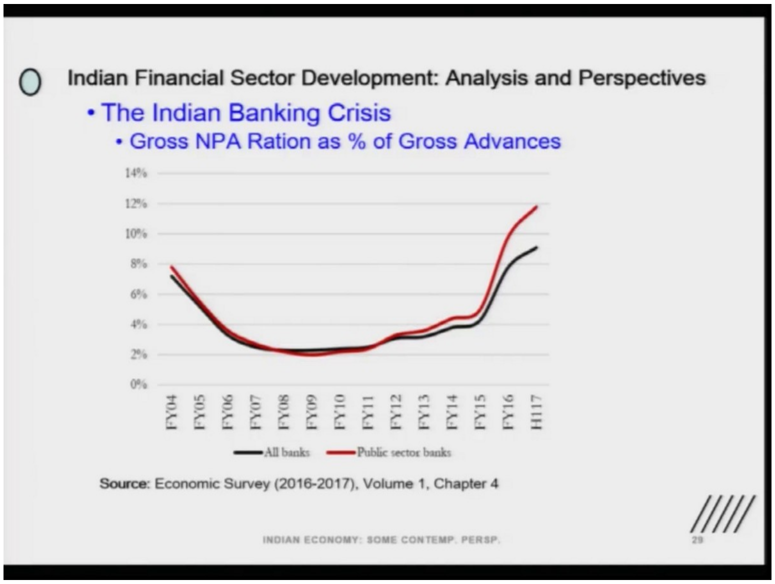

Because these will be coming and coming again so I thought it should better that we should be seeing it. In chapter 4 if you go through you will find that they have put a very nice chart in Indian economic survey volume 1 chapter 4. So, it mentions about gross NPA ratios it is ratio as percentage gross advances that how much you have given. And how much it has become NPA. So, lending of the banks which is called advances and the loans which are not occurring any interest to for the bank.

So that part so it is now you can see that from February 2007 onwards it was quite stable around 2 percent. But then after AQR so AQR effect it can see here fiscal year 2015 it has sudden upward moment which means that the acknowledgment of higher gross NPAs lead to this higher trajectory that we have. So, which means that this upward trajectory showing that the risk is increasing which means that this ratio is getting higher and higher.

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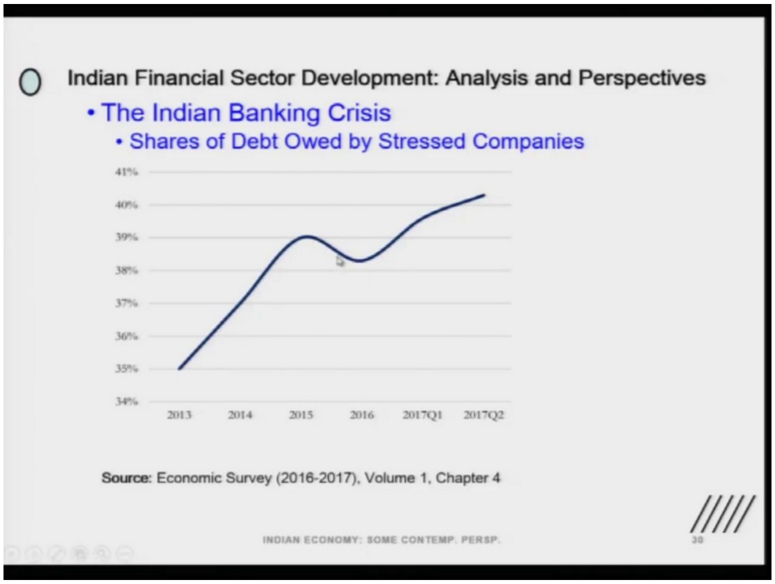

Share of debt owed by the stressed companies so in this you will find that after 2013 in 2015-16 there is a decline post 2016. There is a complete upward moment that also shows that it during this period we had a complete upward mobility which means that we had an insolvency and bankruptcy procedure in place and this resulted in the acknowledgment of higher NPAs. But here we have a decline, decline the sense that during this period there are still apprehension that what is the exact amount. How much it has been explored?

And those acknowledgments were also not completely fully materialized though in terms of number we had 3.4 to 7 lakh crores. But it was still going on in terms acknowledgment that how much is the actual NPA. So that period might be showing here but after that it has gone up.

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There was report publish by credit Suisse that has mentioned that it is also mention in the chapter 4 of the economic survey that mention that the interest coverage ratio offers about 40 percent of corporate date this particular firm monitored was owed by company which had the interest coverage were from the firms which had the interest coverage ratio of less than 1 percent. Which means that they most of this firms they were not the income was so low, earning were so low that they were not able to pay the rate of interest of even 1 percent.

So that also shows means they did not earn enough to pay interest obligation on their loan which means that their income was so low that they were not able to repay the loans. So far, we have covered the severity of the Indian banking crises. Now we look for the reasons that what were the reasons for this particular crisis. That what led to the Indian banking crises. So, the origin of the Indian banking crises is linked to the mid 2000 investment boom.

When the consortium of public sector banks financed the mega infrastructure, so mdi 2000 government of India had gone for a heavy investment infrastructure. And at that time the investments were made in the power generation, steel, infrastructure, telecoms and all. And at that time since the micro fundamentals were really good and we had a sufficient scope for an investment expansion.

I would say a largest investment plan in India history that had gone up to more than 2 lakhs crore. So, the investment ratio has gone reach from 11 percent to 38 percent or so 33 percent or so it was so huge that most of these banks were having some kind of access to these firms. And there was indication also from the government that you have to finance. So most of these infrastructure projects were finance by the banks and or the consortium of banks.

And some firms because of whatever we have the political reasons or whatever some firms had even gone for over leveraging which means that as per the balance sheet requirement they were supposed to get 1000 crore loan. But through rent seeking or other means they had the access to credit with that they had borrowed more than 2000 crore. And 1000 crore extra became extra burden on them. So, at that time it was not realize. But later it become extra burden when their earning started falling.

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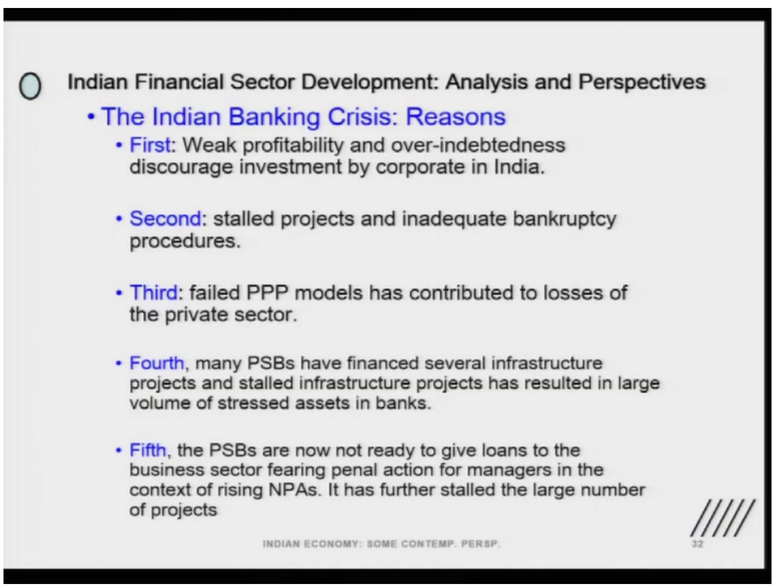

So weak profitability over in deftness discourage investment by the corporate in India. So that was also stalled project inadequate bankruptcy project. Stalled project means at that time many power generation companies were not able to operate and even infrastructure projects were stalled because at that time the regulations on an environment and other so we are not very conducive.

And the led to the investment fall for most of the project especially in power generation. So, companies even they had borrowed from the banks they will paying interest but because of these regulations they were not able to invest and as a result they were investing in some other activities and even risky activities which has not generated enough failed PPP models. So even public private partnerships when the government was supposed to go in one or two projects it had gone.

But after that they did not continue as a result these firms which were participating in triple P they were not able to manage the shock. So many PSB have financed several infrastructure projects stalled infrastructure project has resulted in large volume of stressed asset in banks. One more reason was that some of the firms had since the exchange rate was favorable at that time in mid-2000.

So, some of the firms had also gone outside and borrowed money, so they had gone for external commercial borrowing. And at that time since the interest rate was low so for instance suppose you are borrowing at 48 rupees. When the US dollar was at 48 rupees so you went outside in US you borrowed the money at 48 rupees exchange rate. But by 2009 or so by 2010 the exchange rate came down heavily.

And suppose the exchange rate was around 55 rupees or 56 rupees at that time which means that these firms were already having low earnings. And the extra burden was the exchange pressure that they had because they had borrowed outside. So, rate of interest that they had to pay apart from that they had to pay the interest exchange rate differences if it is not completely in the dollar terms.

So those were the cases most of the firms started facing then mid-2000 is a started then we had after 2-3 years again we had a 2007-8 global financial crises. And after that there were lot of approvals and then government had to come back again and support these firms. So, these firms did not learn anything. And after that 2008-9 it became quite unsustainable and that is why so it had a cumulative impact of these factors on the Indian banking sector crises.

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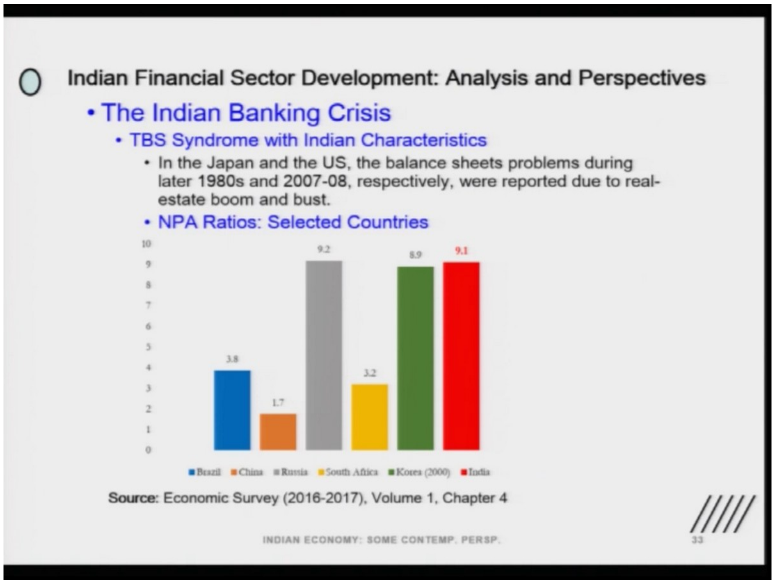

So, if you compare with the TBS syndrome Indian characteristic. So, it mentions that the economic advisor mentions that in case of 2007-8 crises. When banks were having losses or they had the losses reported in the balance sheet most of the banks they had cried and had asked the government for help. But in case of Indian it did not happen and most of the banks the steel supported those firms which were incurring losses thinking that if they go for restructuring of their loans.

Then it may happen that after sometime when they will recover then they will have a, then they will have the better scenarios and they may repay back the whole amount. So, in case of chapter 4 it mentions the NPA ratios if you see India comes out to be a quite high 9 point 1 then we have the Korea then we have Russia 9 point 2 but all other countries are quite low. So, if we compare the bricks then India the NPA ratio was quite high to 9 point 1. And that shows that who it become quite unbearable.

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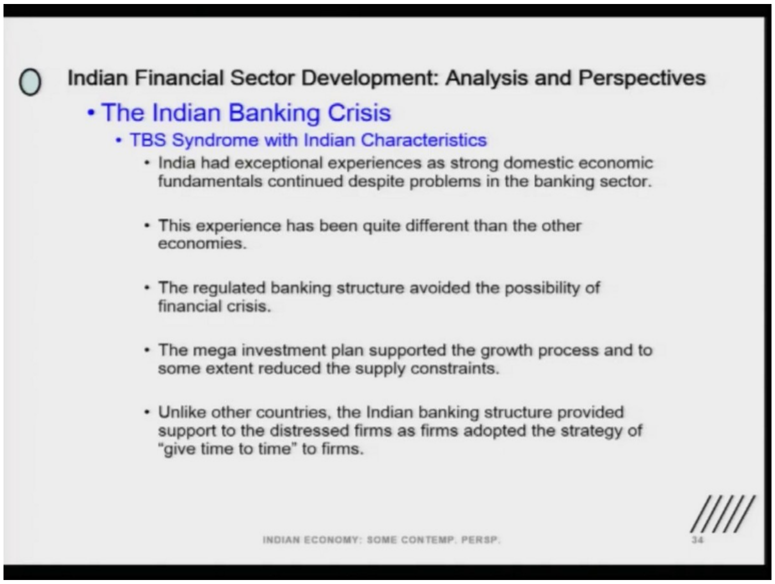

So, the TBS syndrome with Indian characteristic was it mention that this twin balance sheet, so syndrome had the Indian characteristic because it has the economy was recording a strong growth the fundamentals were really strong. So most of the firms which were reporting losses most of the banks also which were reporting losses the economy was going on the contrary to these shocks.

And it had almost better economic scenarios and the most of the cases India would have also faced the situation like limen brother. But because of the regulated banking structure it did not happen and the possibility of financial crises was avoided the mega investment plan supported the growth process into some extent deduce the supply constrained. Because most as I mentioned most of the investments were made in power generation infrastructure.

Then we had steel, then we had telecommunication, and this led to the expansion of capacities, and this capacity expansion had a positive impact on the overall I would say in terms of growth process of the economy. So, for example we had a Delhi airport then we had a, after that we had a Mumbai airport so the investment in airports. Then we had the excess power supply, power generation that also contributed a lot.

So no in most of the most regions of the country we do not have the power outreaches that used to be reported. Earlier it was also that most of the investments were also directed towards telecommunication. So, telecommunication sector also saw huge expansion as a result we are now completely self-relevant on the telecommunication front. Similarly, in case of steel also the capacity was expanded and this has resulted in this has, so this has resulted in excess supply of the steel and even in 2013 or 2015 when we had an adverse situation.

So, when Chinese economy had faced the 2015 shock at that time there was excess supply coming from China. It was a case of proper dumping in case of India at that time the government had taken measures to make sure that the domestic suppliers of a steel are not affected by the dumping and even in some cases in even Japanese firms were interested in dumping their cheap steel in India.

But government took measure so which means that even though we this banking crises can call as one of the most unprecedented shock that their economy had to absorb but at the same time these investments that the firms had given or the extension of credit to the firms which were investing in these activities. It has resulted in solving the supply constrained that the economy was facing earlier.

So now we can see that we are now looking to have a aatm nirbhar bharat or we are going for make in India scheme at that time we were not so much focused on the infrastructure. And thankfully mid 2000 investment boom led to the creation of excess capacity in that direction. Unlike other countries the Indian banking structure provided support to the distressed firms as firms adopted the strategy of give time to time.

So even if the firms were reporting losses and we are not able to repay the banks if they are asking for extra time or extra money there was a case of ever graining of account by some banks and give time to time in the sense that they were giving more times to the firms to invest in certain activities which were profitable or go for restructuring of the loans. So that the rate of interest will be much lower. So, it becomes quite easy to handle.

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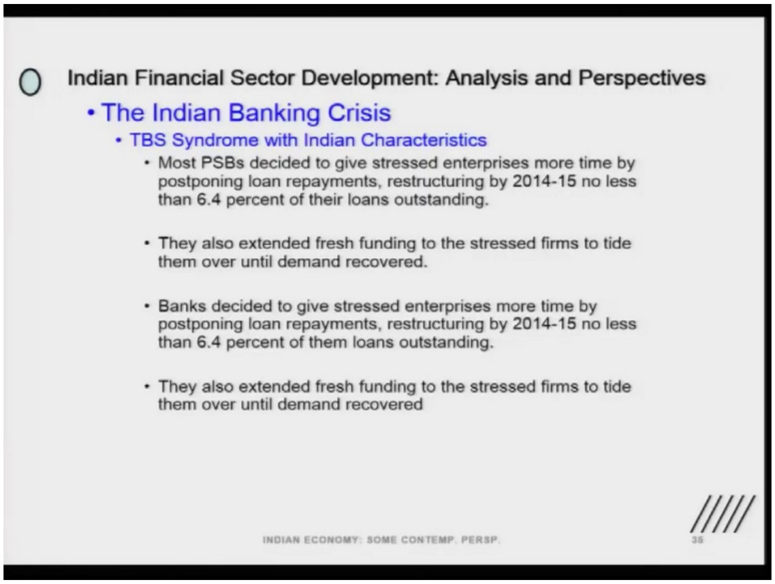

Most of the public sector banks decided to give a stressed enterprise more time by postponing loans repayments restructuring by 2015 no less than 6.4 percent of their loan outstanding. So, as I mentioned there was some kind of postponement of low payment. So now we will be continuing in the next session that how-to what extent we can cover up the in Indian twin balance sheet crises with Indian characteristic. Thank you, thank you so much.