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Govt to unveil bank consolidation plan soon: Arun Jaitley

Finance minister Arun Jaitley pledged to support banks' efforts to tackle bad loans

Malavika Joshi, Alekh Archana, LIVE MINT , Mumbai: 22 9 17

Finance minister Arun Jaitley said on Friday that the government is working on a strategy for the consolidation of the banking industry to create bigger and stronger banks.

"The **consolidation of banks will have to move parallel to the objective of strengthening the banks**," Jaitley said at an event organized by Bloomberg. "We are in advanced stages of coming out with a strategy for consolidation. The objective of consolidation is to create a bigger and stronger bank. **I would prefer a strong bank merging with a strong bank** than a weak bank merging with a weak bank."

Banks in India are weighed down by Rs 10 trillion of stressed assets, limiting their ability to advance fresh loans. Lack of demand for corporate credit, meanwhile, has led to loan growth declining to multi-year lows of around 5%. The government has in the past favoured bank mergers as a way out of the mess, but Jaitley's remarks are the strongest indication of the seriousness of intent with which it is proceeding.

"Bad loans is a legacy that we have inherited," said Jaitley.

It was a reference to the economic boom years when corporate entities borrowed heavily to invest in big-ticket projects that were stalled by an eventual slowdown, which squeezed their cash flows and hurt their ability to repay debt.

The country is now saddled with a so-called twin balance sheet problem—bank bad loans and corporate debt.

Fitch Ratings said in a report on 12 September that the government will have to pump additional capital into public sector banks to aid effective bad loan resolution and revive loan growth.

According to the rating agency, Indian banks need additional capital of $65 billion to meet Basel III capital norms, which will be fully implemented from the end of March 2019. The government has budgeted $3 billion in fresh equity for 21 state-owned banks over the current and next fiscal years.

"India and the world must rest assured that policymakers and the government of India are conscious of this responsibility... to support our banking system, to support the necessary policy changes required to respond to these challenges so that the position we gathered as the fastest growing major economy in the world for three years in a row can be maintained," Jaitley said.

In a speech to the Indian Banks' Association earlier on Friday, Jaitley pledged to support banks' efforts to tackle bad loans.

"…the government certainly stands one with the banking system," Jaitley said at the annual general meeting of the association. "Whatever steps that are required to be taken to find a resolution to this problem, we will expeditiously work with India's banking system in order to strengthen it."

The government is also seeking to lift economic growth that decelerated to 5.7% in the quarter ended June—the slowest pace in three years. Jaitley said this week that the government was working on a package of economic measures to boost growth. That has prompted concern among some economists that fiscal prudence may be compromised.

"How do you maintain the balancing act between continuing to spend in an economy, continuing to support your banks and at the same time maintain the best standards of fiscal prudence," Jaitley said on Friday. "I think the last part is the current challenge that we are facing. This seems to be the logical course in order to get back (economic growth). I don't think there is need for panic. There's a need for analysis and for responsive action to this and we are fully prepared for this."

Jaitley also spoke about Air India's privatization, which he said was on course.

"Always remember, privatisation is the art of the possible," he said. "And therefore, it's an exercise which has to be transparent, acceptable to a cross-section of the public and political opinion...The prospective buyer or the universe of buyers must be such that their identity itself inspires confidence."

Banks need a stiff dose of competition

JAIDEEP IYER in BUSINESSLINE 25 9 2017

Break free: Introduce innovative products

Public sector banks lack the flexibility to respond to challenges posed by NBFCs, CPs and bonds. Divestment could act as a tonic

Recent discussions on the banking sector have centred broadly around three themes: monetary transmission, asset quality in the banking system and consolidation of PSU banks.

Quixotic approach

In some ways, the three are inter-related. Let's start with monetary transmission. Before talking about effective/ineffective transmission, let's try and understand the RBI's, and possibly the Government's, concerns. Simply put, less than satisfactory monetary transmission means that reduction in policy rates have apparently not percolated down to the ultimate borrowers in full measure. Now, it is reasonably evident that the

RBI, over the last couple of years, has been extremely cautious on inflation and therefore, arguably has been reticent in aggressively cutting rates. At the same, the RBI has been vocally uncomfortable with the pace of monetary transmission.

One can safely argue that what matters for inflation and inflation expectations is not the policy rate/repo rate, but the rate at which borrowers and lenders transact. Assuming that the RBI's concerns on ineffective monetary transmission are true, they should ironically be rather pleased from an inflation impact standpoint. Why should the RBI then be concerned with poor transmission when their monetary stance itself is at best neutral?

Let us now look at monetary transmission. It is clear that transmission is far more effective in capital markets. CP rates and fresh bond issuances reflect new the interest environment instantaneously. Base rates and to some extent MCLRs are stickier.

A typical bank illustratively would have, on the liabilities side of the balance sheet, approximately 10 per cent as equity (non-interest rate sensitive), 5 per cent tier I / II (non-interest rate sensitive, given long-term fixed rate bonds), 5 per cent medium/long-term borrowings including infrastructure bonds (non-interest rate sensitive, given long term fixed rate bonds), 25 per cent CASA (arguably non-interest rate sensitive, other than the recent savings account rate cut by a few banks), and 55 per cent term deposits (interest rate sensitive with average tenor of say, 1 year). Effectively therefore a reduction in interest rates impacts approximately 55 per cent of the bank's liabilities and, more importantly, over a one-year period. The rest of the liabilities re-price over much longer tenor.

On the other hand, on the asset side, floating rate loans contribute approximately 50-60 per cent of the assets, the other 40-50 per cent being investments (including mandatory SLR and CRR), corporate bonds/other fixed rate investments and some proportion of fixed rate loan book (largely non-mortgage retail). While, at macro level, the balance sheet appears broadly matched — 50-60 per cent being floating on either

side of the balance sheet, the challenge is that fixed deposits take a year to re-price, whereas a cut in benchmark rate (MCLR/base rate) is instantaneous on the entire floating rate loan book, resulting in margin compression for the bank in the short term.

Understanding MCLR

Ironically, given that capital market instruments are not subject to base rate/MCLR regulations, the issuances of CP/ bonds reflect the current interest rates as banks are able to buy/subscribe new deposits reflecting extant interest rates, making transmission instantaneous.

The fundamental challenge here is that there is no true floating rate liability structure for banks. One can argue that banks themselves will have to develop the floating rate deposit product, but customer response, given the complexity and uncertainty for the depositor, has been at best lukewarm. In an environment where the banking system is fighting multiple battles — asset quality, weak growth, challenges on transition to Ind AS accounting practice, rapid digitisation leading to new competition from non-bank players, vulnerabilities in the legacy IT systems — creating a mindset for floating rate deposits hardly appears to be a priority.

In this context, it is clear that MCLRs have largely come down in line with policy rates. Some data indicate that while MCLR has indeed tracked policy rates (especially post demonetisation), as liquidity has been abundant, average lending rates have not yet reflected the fall in MCLR rates. This is simply because MCLR reset happens over a period of time depending on the benchmark MCLR used for sanctioning the loans.

Before jumping to the conclusion that this is a flaw in the structure as the benefit of lower interest rates is significantly lagging, the benefit will be to the borrower when the interest cycle turns. In fact, given that MCLR benchmarks vary from one month to one year, unlike base rate, banks are in a better situation to cut MCLRs, as not the entire book resets immediately. The stakeholders must therefore wait for few more months before concluding on the effectiveness of transmission on eventual lending rates.

Banks’ compulsions

Further, common sense would tell us that the best way to ensure competitive lending rates would be through competitive dynamics. One can easily argue that the Indian banking space is already crowded with many public, private and foreign banks. In an environment of single digit credit growth, ideally competition should play its role to bring down interest rates to the end borrowers; then what is at play here?

Clearly, lending rates in general will reflect the lender’s perceived risk profile of the borrower. It is reasonable to argue that the risk perception from a lender’s standpoint has been higher over the last couple of years. This also impacts the lending rate at a macro level though not necessarily at a product level/customer level.

Further, at a time when reported asset quality has sharply deteriorated, banks naturally don’t seem to be in a hurry to cut lending rates. Ideally, cut in lending rates should be driven by competitive dynamics and not through regulatory pressure. How does one then explain then, that when banking sector credit growth in the system is down to single digits amidst tough competition from NBFCs, and disintermediation through capital market issuances, banks don’t seem to be in a hurry to cut rates and grab market share? Most PSBs have significantly elevated asset quality challenges. Given the lack of capital support, undifferentiated business models and inflexible labour practices, ability and intent to grow are absent.

The Government’s strategy of starving inefficient PSBs for capital is laudable, but political courage is required to hasten the process, possibly reduce the shareholding below 26 per cent in select banks, unshackling them from the rigidities of government ownership and, most importantly, recognising that these are independent entities answerable to broader stakeholders, and not only to the Government. Consolidation of state-owned banks with no attempt to address the root issues is possibly just kicking the can down the road.

The writer is an ex-banker

SBI has provisioned for stressed telecom sector, says Chairperson Arundhati Bhattacharya

KOLKATA, SEPTEMBER 24: BUSINESSLINE

The telecom sector continues to be under stress and the State Bank of India is making extra provisions for this, according to the bank's Chairperson Arundhati Bhattacharya.

"Telecom has already been earmarked as a sector going through stress and provisioning has been done," Bhattacharya said while responding to queries on whether the Telecom Regulatory Authority of India's (TRAI) decision to reduce interconnect usage charges (IUC) will impact the finances of operators such as Idea, Vodafone and Bharti Airtel.

TRAI has reduced IUC — paid by telecom companies for calls originating from their network and terminating in other networks — to 6 paise per minute from 14 paise, effective October 1.

India Ratings and Research, in a recent report, said the reduction in IUC will have a 4-5 per cent impact on the EBITDA levels of incumbents such as Bharti Airtel, Idea and Vodafone India. However, this could help newcomer Reliance Jio to save ☐35-40 billion in IUC annually.

Leadership training

"We do not know how their (incumbent telcos') finances will be impacted," said Bhattacharya, who was here on Saturday to inaugurate the State Bank Institute of Management. The institute, which will impart leadership training to middle-level banking professionals, will have an initial capacity of 240 students.

According to Bhattacharya, NPAs (non performing assets) have almost bottomed out and slippages have come down.

"NPAs have probably reached the end of the cycles and slippages are down. However, there are new sectors like telecom that are showing stress. But even then it is not the same as it was, say, two years back," she said.

While the Centre and State governments have to do some more "heavy lifting" and push infra spends, several projects across sectors like roads, railways, petroleum, fertilisers and so on are coming up, pointed out Bhattacharya.

"We will see demand coming up and that will spur investment. The results will come over a period of time," she added.

Calling GST a deep-rooted structural reform, Bhattacharya said its positive impacts will be felt over the long term. Short-term pain is a given when such reforms are rolled out, she added.

"GST is a deep rooted structural change. It can cause short-term pain. But you need to see the outcome over the long term. You cannot see everything in order in 90 days," she said, adding that the "economy needs to formalise" for better results.

WHAT AILS BANKS – HOW TO REMEDY
EXPERTS WILL DISCUSS IN
AIBEA's NATIONAL BANKING CONCLAVE
" BANKS KI UNNATHI - DESH KI UNNATHI"
At Mumbai – 19th and 20th November, 2017

AIBEA THIS DAY – 25 SEPTEMBER	
1975	Banks taken out of purview of Bonus Act.
2001	Banaras state Bank comes under moratorium – AIBEA ,AIBOA demands takeover by any nationalized bank
2004	4th Conference of AICBEF at Vijayawada. A P chief minister Dr. Y S R Reddy inaugurates – Com. C H Madhav Rao & Com. P Bhalakrishnan elected President & General

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