Waning Stimuli*

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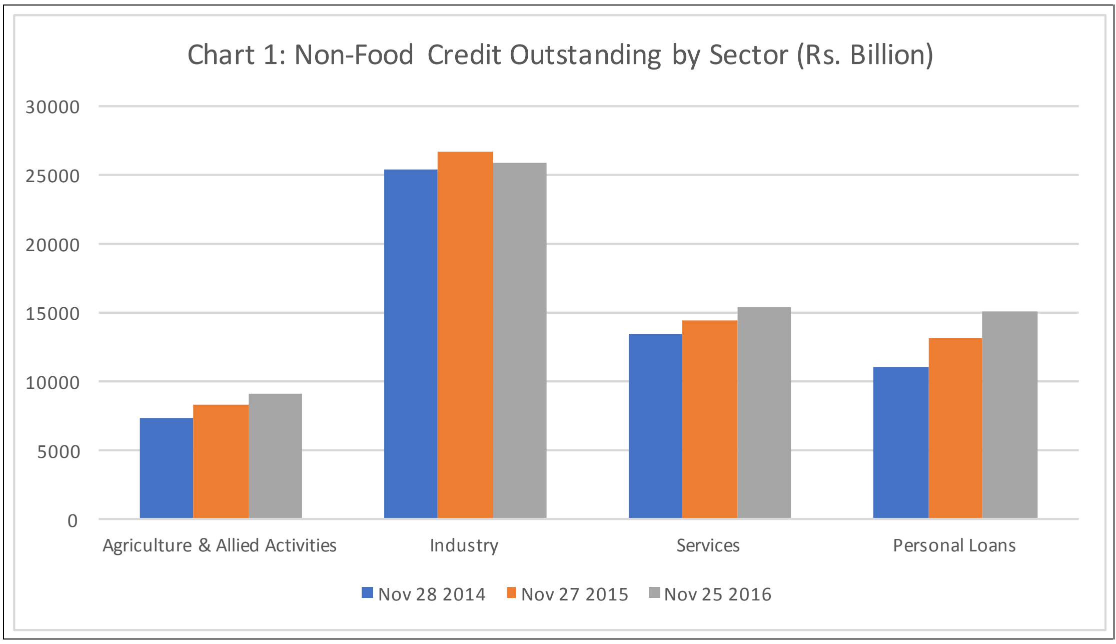
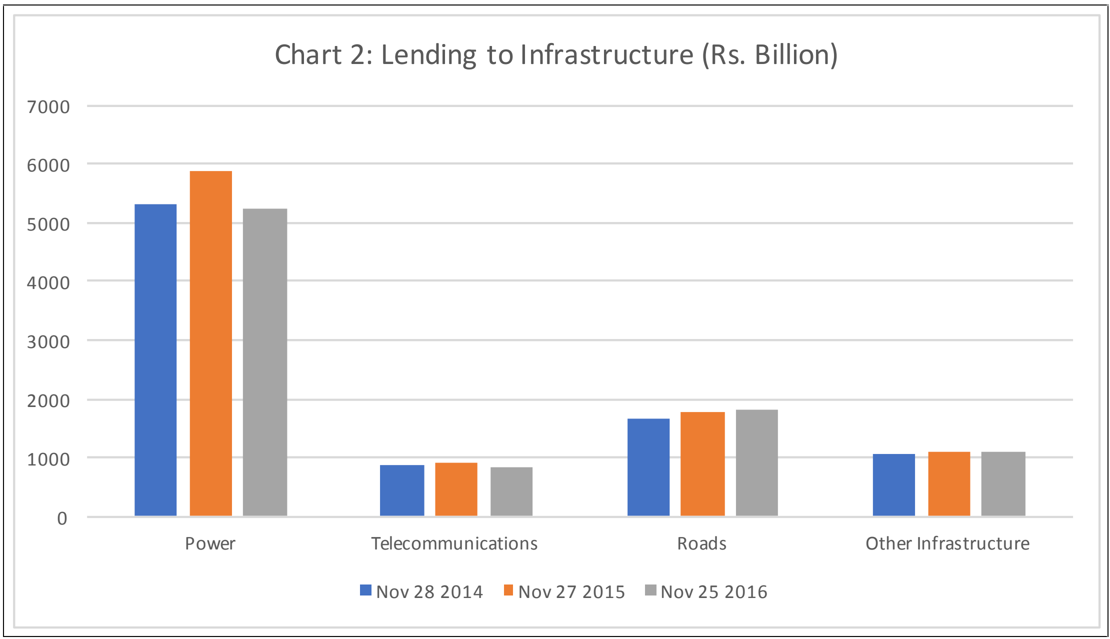
Indian banks have not experienced the kind of stress they now face in a long time. Even before they could think up strategies to deal with large non-performing assets, consisting in particular of large bad loans to the infrastructural sector, they were hit by the chaos created by demonetisation, which disrupted all normal operations. With the government failing on its promise to adequately recapitalise the public sector banks, because of its adherence to self-imposed fiscal deficit targets, this segment of the banking industry is experiencing much strain.

The Reserve Bank of India's Financial Stability Reportc released in December 2016 recognised this strain when it said: "The GNPA (gross non-performing advances) ratio of SCBs increased to 9.1 per cent in September 2016 from 7.8 per cent in March, pushing the overall stressed advances ratio to 12.3 per cent from 11.5 per cent." This, together with the danger that deteriorating macroeconomic conditions could worsen the problems faced by these banks, had made the banks "risk averse", the RBI argued, as they focused on "cleaning up their balance sheets".

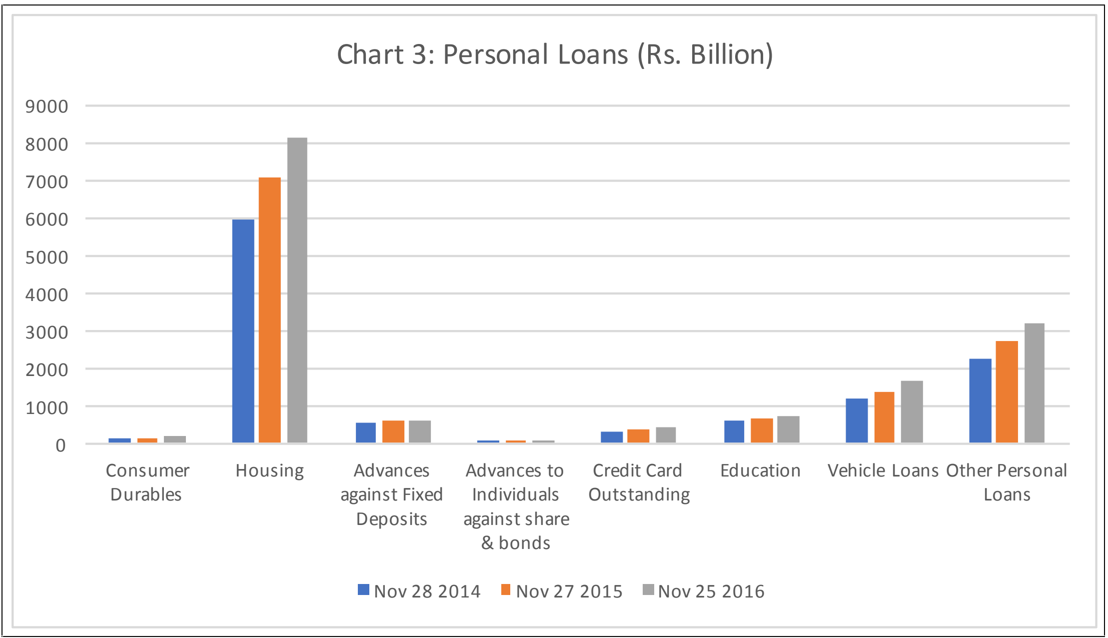
The effect of this is beginning to show. Outstanding non-food credit from the SCBs, which rose in all other major areas such as Agriculture, Services and Personal Loans, fell in the industry sector over the year ending November 2016 (Chart 1). Outstanding loans to industry which had risen from Rs. 25,419 billion on November 28, 2014 to Rs. 26,687 billion on November 27, 2015, fell to Rs. 25,793 billion on November 25, 2016.



The decline in lending to industry was focused on the infrastructural sector, with power and telecommunications setting the trend (Chart 2). Outstanding loans to power, which had risen from Rs. 5,311 billion in end November 2014 to Rs. 5,865 billion at the end of November 2015, fell significantly to Rs. 5,253 billion at the end of November 2016. The figures for telecommunications were Rs. 863 billion, Rs. 907 billion and Rs. 849 billion respectively on those three dates.



If despite this, non-food credit growth was pccositive during 2015-16 (November to November), though reflecting considerable deceleration in growth relative to the previous year, it was largely because of a sharp increase in retail lending, mainly for housing investments and vehicle purchases. Even in financial year 2015-16, retail lending registered double digit growth with housing loans that accounted for 54 per cent of the total increasing by more than 16 per cent. Outstanding housing loans also rose from Rs. 5,946 billion on November 28, 2014 to Rs. 7,052 billion on November 27, 2015, and to Rs. 8,153 billion on November 25, 2016 (Chart 3). The corresponding figures for vehicle loans were Rs. 1,194 billion, Rs. 1,379 billion and Rs. 1,673 billion respectively.



Thus, clearly, banks are cutting down on their overall lending and restructuring their portfolios to reduce exposure to the infrastructure sector in favour of the retail sector. Both these trends have implications for growth in the immediate future. For a decade and a half now, Indian growth has been fuelled by credit financed investment and consumption spending. So a deceleration in credit expansion implies that the principal stimulus to growth is being dampened, with obvious implications.

In addition, a major plank of the private sector driven growth strategy is that the government would facilitate the process by ensuring investments in infrastructure. Unable to do this with its own resources because of the fiscal crunch that results from a business-friendly taxation and tax collection regime, it has been using public sector banks as the vehicles for financing the infrastructure push. That strategy has clearly failed. While an expansion of retail lending can part compensate for this loss of growth stimulus, that cannot be sustained in the absence of other stimuli that ensure income growth of a kind that helps service rising household debt.

This is hardly good news when the available figures show that during April-November 2016 industrial growth virtually stagnated at 0.4 per cent, as compared with a 3.8 per cent rate of growth during April-November 2015. The corresponding figures for manufacturing at -0.3 per cent and 3.9 per cent reflect a trend that is worse.

This has made the Narendra Modi government desperate to find an alternative route to growth. One such route was determined by the fond hope that the demonetisation, by forcing the corrupt and the tax evaders to burn their money, would allow the Reserve Bank of India to “extinguish” a large chunk of its liabilities. Since it was claimed that this would allow the RBI to transfer the value of the corresponding assets to profits and pay out a dividend, the government hoped to have enough resources to both pay off the ordinary citizen who was penalised through demonetisation as well as make heavy investments in infrastructure to revive growth. Unfortunately, these misplaced expectations that currency would just disappear have been almost completely belied.

The other desperate move is the search for public assets like spectrum that can be sold and for public sector corporations that can be listed for strategic sale, to attract large investments by the private sector. Since this would give the government a substantial amount of “non-debt capital receipts”, it would allow it to invest in infrastructure without flouting fiscal deficit targets (since non-debt receipts are excluded when calculating that deficit). However, receipts from sale of spectrum through auction have been far short of expectations and finding public sector firms that can be hawked for a tidy sum through strategic sale that hands over management to the private bidder has been difficult. The government had identified and obtained in-principle cabinet approval for strategic sale of 20 public sector undertakings two months back. But the process has been so slow, and the environment created by demonetisation so damp, that the government is unlikely to achieve even the original Rs. 20,500 crore budgetary target for resource mobilisation through strategic disinvestment.

The final sign of desperation is the hype about making India the world’s next manufacturing hub. Unfortunately, although exports from India have registered increases over the last four months after a prolonged period of decline, the growth rate during April to December 2016 compared with the corresponding period of the previous year was a measly 0.75 per cent.

In the event, the government is left with nothing but rhetoric and hype when claiming that India will return to a high growth trajectory. Rendering the economy cashless is the next magic wand. Meanwhile, the CSO has obliged by providing advance estimates of national income in 2016-17 that ignore the impact of demonetisation and project a 7.1 per cent rate of growth, in the hope that the illusion can be prolonged.

* **This article was originally published in the Business Line on January 16, 2017**