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Modi keeping state banks on fund diet puts weight on bond market

Growth in total lending is only starting to rebound from near the lowest since 2009

Banks in India need to find as much as Rs22,000 crore of common equity to cushion against future losses this financial year, Moody's Investors Service's local unit estimates. Photo: Bloomberg

Mumbai: India's smallest capital infusion for state banks since 2009 should boost corporate bond sales as lenders have less room to fund businesses, ratings companies say.

Companies have sold the equivalent of $28.1 billion of bonds denominated in either rupees, US dollars or euro this year, 11% more than a year earlier, data compiled by *Bloomberg* show. Similar syndicated corporate loans dropped 50% to $15.8 billion. Growth in total lending is only starting to rebound from near the lowest since 2009.

The government will inject `7,940 crore ($1.3 billion) into banks in the year started 1 April, finance minister Arun Jaitley said 28 February, about 40% less than Fitch Ratings Ltd.'s local unit reckons lenders need. Treasurers will struggle to boost capital buffers in the equity market as the CNX PSU Bank Index of 12 state-owned banks has fallen 17% since 31 December.

"Equity markets haven't been supportive and the low budgetary allocation means government banks will probably have to compromise on growth," said Ananda Bhoumik, a Mumbai-based senior director at Fitch's local affiliate India Ratings and Research Pvt. "That may starve the corporate sector of cash."

Reserve Bank of India (RBI) governor Raghuram Rajan has cut the repurchase rate by 50 basis points to 7.5% this year, helping spur demand for bonds. The yield on five-year AAA corporate notes declined 30 basis points to 8.37%, while 10-year government yields slid 7 basis points to 7.79%.

Loan growth

The lack of capital at state banks could put the brakes on total lending, which grew 12.6% in the 12 months ended 3 April, up from 9.5% in the period ending 20 March. Banks have been slow to pass on two interest rate cuts this year to consumers, with the pace of loan growth well off the average 16.85% in 2012, *Bloomberg*-compiled data show.

Banks in India need to find as much as `22,000 crore of common equity to cushion against future losses this financial year, Moody's Investors Service's local unit estimates. Considering rules state the gap can't be plugged with additional Tier 1 securities, they must either tap equity investors or conserve capital by reining in lending.

In the financial year ended 31 March, the government injected only `6,990 crore of capital into state banks as against its original target of `11,200 crore. It also began differentiating between lenders, allocating capital to more efficient banks in a departure from previous practice.

'Cracking the whip'

The shift should improve capital allocation and reduce the frequency and impact of future bad debt cycles, according to independent research firm CreditSights Llc. The move is also part of Prime Minister Narendra Modi's aim of helping banks meet tighter capital-reserve requirements amid forecasts by the International Monetary Fund that India will experience the world's fastest economic growth at 7.5% this year.

"The government is cracking the whip over the public sector banks in order to pressure them to improve their performance," CreditSights analysts Nicholas Yap and David Marshall wrote in a 4 March report. “We don’t think the government will allow them to default but their reduced size and role would eventually make it easier for the government to restructure the sector,” they said, referring more specifically to less well-managed public banks.

Slowing advances

India’s finance ministry estimates state lenders will need an additional `2.4 trillion as equity by 2018 to comply with tougher Basel III requirements. They need as much as `1 trillion of capital this fiscal year, up from `40,000 crore last year, according Moody’s local unit Icra Ltd.

“In the short term, banks will try to conserve capital by deferring dividend payments or slowing their advances to lower rated corporates,” Vibha Batra, the New Delhi-based head of financial industry ratings at ICRA, said by phone 23 April. “With monetary easing now started, banks can also aim to improve internal capital generation.”

The average cost of insuring the debt of five Indian banks with credit-default swaps has climbed to 163 basis points as of 23 April from a low this year of 156 basis points on 5 March, according to data provider CMA. The rupee has weakened 0.8% against the greenback since 31 December versus a 0.2% appreciation in the yuan.

“Bond markets are going to be the biggest source for corporates because banks are streamlining their business and their capital won’t be enough to meet the underlying credit demand,” said D.R. Dogra, a managing director at CARE Ratings Ltd. in Mumbai. “A 10 to 12% jump in overall issuance this year because of banks’ inability to meet demand wouldn’t be a surprise.” **Bloomberg**