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Goldman Drawing Negative Loops as SBI Risk Climbs: India Credit

By Anoop Agrawal and Anto Antony - Sep 18, 2013

Goldman Sachs Group Inc. warned that “negative feedback loops” triggered by waning investor confidence are threatening India’s finances, after state-owned lenders’ bond risk surged the most in Asia this quarter.

The investment bank said in a Sept. 16 report the rupee may drop to 72 per dollar in six months from 63.385 now as weaker capital inflows force the central bank to raise interest rates, hurting lenders and the economy. Rising bad loans then require more capital injections, further worsening perceptions of India’s finances.

“There might be a need to recapitalize banks above the budgeted amounts, but there is not much fiscal room available this year,” Tushar Poddar, Mumbai-based economist at Goldman Sachs, said in an interview yesterday.

Banking Secretary Rajiv Takru said last month authorities may delay cash infusions into government-controlled banks, as the International Monetary Fund forecasts the government’s deficit will reach 8.3 percent of the economy this year, the highest since 1987. Credit-default swap prices on State Bank of India, a sovereign proxy, surged 32 basis points to 307 this quarter, the worst in the Markit iTraxx Asia ex-Japan investment-grade index.

The next-worst performers were also state-owned lenders. Contracts on IDBI Bank Ltd. jumped 27 basis points to 342, while those on Bank of India leapt 25 basis points to 325. China Development Bank was the best performer, declining 43 basis points to 104.

‘Increasingly Tough’

Pacific Investment Management Co., which runs the world’s biggest bond fund, warned this week that India faces risks of ratings reductions. The chance of a downgrade by major credit agencies is “large” even as “outright default” is unlikely, Roland Mieth, Pimco Asia’s EM senior vice president, said in an interview.

“Compared to previous years, it’s increasingly tough now for the government to sustain the cost of capital infusion," said M. Narendra, chairman of Indian Overseas Bank (IOB), in a telephone interview from Chennai yesterday. "A sustained period of difficulties is inevitable."

India may delay injecting capital into state-run banks including IDBI and Indian Overseas Bank because it doesn't want to lose money on price declines when buying lenders' shares, Takru said in an Aug. 19 interview. The government, which usually infuses cash by buying lenders' shares, doesn't want to lose money on stock price declines, Takru said. While the S&P BSE Bankex index, a gauge for 13 banking stocks, has rebounded from a 20-month low marked on Sept. 3, it remains down 17 percent this year.

Slowing Economy

The government needs to provide 910 billion rupees ($14.3 billion) of equity capital to state-run lenders by March 2018 in order to maintain its current stakes, Duvvuri Subbarao, who was governor of the Reserve Bank of India at the time, said in October.

Prime Minister Manmohan Singh's economic advisory council said last week that containing the fiscal deficit within the budget estimate of 4.8 percent "could be a challenge." The ratio was 4.9 percent in the year through March 31.

Capital adequacy ratios at the state-run banks under the so-called Basel II rules averaged 12.4 percent as of March 31, data compiled by the central bank show. That exceeds India's minimum regulatory requirement of 9 percent. A higher figure shows lender's ability to absorb bad loans.

India's currency and bonds have dropped this year as Asia's third-largest economy expanded 4.4 percent last quarter from a year earlier, the least since the three months ended March 2009.

Positive Possibility

The yield on India's 7.16 percent rupee-denominated bond due May 2023 fell 7 basis points to 8.37 percent yesterday, according to central bank prices. It reached a five-year high of 9.23 percent on Aug. 19. The rupee was little changed yesterday after slumping as much as 13 percent this year, making it the worst performer in Asia.

"I think the commitment to banks on infusing capital will be met as it will strengthen the fundamentals of the economy," D. R. Dogra, managing director of CARE Ratings Ltd., said in a Sept. 17 telephone interview from Mumbai. "The central bank as a regulator will respond to the developing situation pro-actively."

Central bank governor Raghuram Rajan faces pressure to signal a reversal this week in his predecessor's tightening measures. Rajan will hold the repurchase rate at 7.25 percent tomorrow, his first meeting in charge of the central bank, according to all 34 economists in a Bloomberg survey.

Higher Costs

Goldman Sachs, whose report was meant "to illustrate the risk of feedback loops, not to predict them," wrote that there is also the possibility of a positive circle in which any improvement in the current account could lead to stability in the rupee. That in turn could encourage capital inflows.

Takru's retreat from earlier comments that India will inject as much as 140 billion rupees by September comes after the proportion of bad loans and restructured assets as a percentage of total lending rose to a 10-year high of 10.02 percent at the end of June, central bank data show.

Soured loans in the banking system rose to 3.92 percent of total lending as of June 30, the highest in at least five years, from 3.4 percent at the end of March, according to central bank data.

"Expectations that the bad loan situation will worsen are not out of place," Pratip Chaudhuri, chairman of State Bank of India (SBIN), said in a telephone interview yesterday. "It looks imminent the government will have to bear a higher cost for supporting the banks."

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