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COVID-19 impact | Sustenance of banking institutions at risk

With the COVID-19 pandemic adversely affecting countries, both in terms of healthcare and economic activity, banking regulators worldwide have announced monetary measures to increase liquidity in the market.

One such monetary measure announced by the Reserve Bank of India (RBI) was that of availability of moratorium on repayment of debt for businesses and individuals. This loan moratorium facility would help businesses sustain in times of financial stress caused by disruption in economic activity due to the coronavirus pandemic.

Initially, the moratorium facility was applicable from March 1, 2020, for a period of three months. Subsequently, keeping in mind the grave situation existing still, the same was extended for another three months upto August 31, 2020.

However, in its Monetary Policy Committee (MPC) meeting on August 4-6, 2020, the RBI announced that the moratorium facility would not be extended beyond August 31, 2020, and banks would be allowed for a one-time restructuring of loans of corporates and micro, small, and medium enterprises (MSMEs).

While appreciating the monetary measures announced by the regulatory authority in the light of the pandemic, it is also imperative that the RBI keeps the best interest of depositors in mind and comes up with an appropriate policy response. On the flip side, the million-dollar question is: Has the RBI studied the implications that these measures could have on the financial health and well-being of depositors?

The pandemic has forced countries across the world to rethink, re-strategise and thereby ease the financial burden on businesses and livelihoods. The objective of the moratorium was to offer temporary respite to the borrowers. With a viewpoint of not impacting credit scores, alongwith the moratorium facility a freeze in customer ratings of people benefitting from the loan was also proposed.

Interestingly, people of reckoning from the financial world such as Rajnish Kumar (SBI chairman) and Deepak Parekh (HDFC chairman) were of the view that the RBI should not extend the interest moratorium beyond August 2020 and that banks be permitted for a one-time restructuring on loans.

It is important to bear in mind that any extension in the moratorium beyond the period of six months could negatively impact credit behaviour of the borrowers and result in rising delinquency situations.

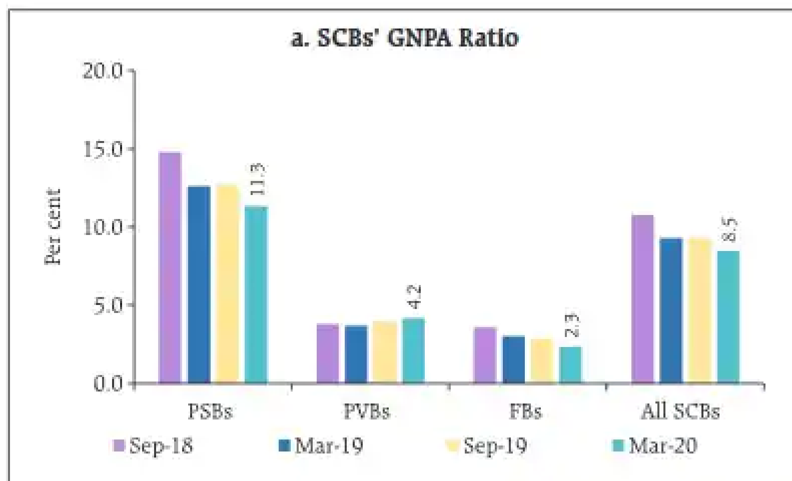
With economic activity gathering pace after the announcement of Unlock guidelines, temporary measures would not be a viable solution to address the cashflow issues of borrowers. A more durable solution was required to take care of the financial stress of viable borrowers who were unduly affected by the "Black Swan" event. One time restructuring of loans will allow banks to provide respite to the debtors by giving them tailor-made solutions that can take cognizance of specific issues based on their needs.

The Financial Stability Report (FSR) of the central bank released in July 2020 stated that the implications of monetary relief measures on the financial health of commercial banks was yet to be ascertained. The aim of the report was to gauge the degree and nature of financial risk and its implications which can have a bearing on financial institutions, financial markets and macroeconomic environment of the country.

The report based on stress tests assessed the resilience of the financial sector.

According to the FSR, the pandemic has led to deterioration in the macroeconomic and financial environment of the country and negatively impacted asset quality, demand for credit, capital adequacy and profitability of banks.

The FSR presented a grim picture of the status of non-performing assets (NPAs) in India. The challenging situation posed by COVID-19 as per the RBI could result in the gross non-performing assets (GNPA) increasing to 12.5 percent by March 2021 as against 8.5 percent in March 2020. GNPAs could even worsen to 14.7 percent by March 2021 if proper checks and balances are not put in place.

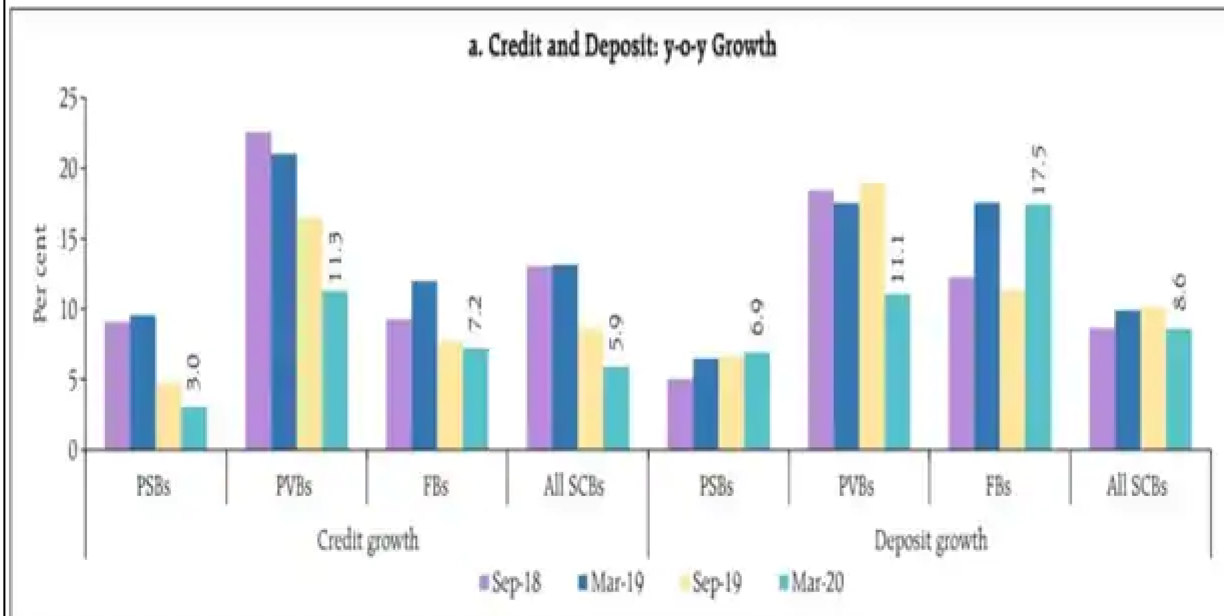


To add to the already prevalent worrisome scenario of GNPAs, the picture painted by credit and deposit growth numbers in the financial sector of the Indian economy was also not bright. The weakened credit growth prior to the pandemic due to the demand slowdown in the Indian economy dropped to 5.9 percent in March 2020 and had remained muted up to June 2020.

Decline in credit growth numbers are reflective of the fact that borrowings by individuals and corporates were on the decline even prior to the pandemic, and the situation has not improved even with a decline in lending rates and fall in cost of borrowings from banks. This shows the absence of financial deepening and normal cyclical upturns.

Also, on further investigating the credit and deposit growth numbers it can be seen that deposit growth (8.6 percent in March 2020) clearly outweighs credit growth (5.9 percent in March 2020) in the Indian economy. This brings to light that against the backdrop of a weak macroeconomic environment there is a risk aversion by banks and a growing preference for them to park the excess money in safer and less risky instruments. The inability to lend has become so dominant that banks have huge amounts of cash parked with them.

Data shows a dramatic rise in deposits with the RBI by banks under the reverse repo route from a few thousand crores in January and February (Rs 41,214 crore as on January 1, 2020) to over Rs 6.3 lakh crore on May 28, 2020. This situation is highly detrimental to the bank's profitability. Would the lack of credit-offtake result in banks easing lending rules? In such a scenario, wouldn't banks be less stringent in terms of evaluation of project viabilities of loans applied for resulting in weak loans being sanctioned at the outset itself is a thought worth contemplating.



On the flip side, deposit growth numbers y-o-y on account of private commercial banks showed a moderated growth in 2019-20, which subsequently improved slightly in the first few months of 2020. The same is reflective of a weakened savings capacity on account of the pandemic as many have lost their means of living due to the lockdown whilst a large number of people were forced to accept a pay cut by employers.

The situation has not improved despite unlocking on account of the pandemic. Thus, it is worth considering that in a continuous scenario of declining interest rates and increasing GNPAs would banks be able to attract depositors. Rather, would depositors want to keep their hard-earned money in financial institutions which they know are not able to give them an adequate return in terms of interest. For majority of investors, declining interest rates on deposits have made them an unattractive investment option. To worsen it, would these depositors want to invest their money with banks which are reporting higher NPAs?

Understandably any unprecedented situation requires out of the box thinking and out of line strategies, but it is worth rationalising if the fallout of the loan moratorium and increasing NPAs is just to depositors?

In light of the loan moratorium and one-time loan restructuring, NPA risks of banks are sky-high, and to further add to the woes, monetary measures such as collateral free credit availability scheme for MSMEs continue to exert pressure. Thus, would it not be right to say that while the RBI is providing monetary stimulus and ease of borrowing facilities to borrowers, they also need to focus on the impact that this would have on depositors and existing lending rules and regulations. In fact, attracting deposits is crucial for the very sustenance of banking business.

It is worth recollecting, here, how modern banks learnt the practice of banking from goldsmiths. Initially people used to deposit surplus money with goldsmiths at a fee due to safety provided by the latter.

However, once the goldsmiths saw a business opportunity and started lending to the needy, they felt the importance of attracting deposits by paying interest to the latter.

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