Farm Loan Waiver – Double Edged Sword

What is the issue?

\n\n

\n
- Farm loans waiver worth of Rs.850 million was announced by various state governments.
\n
- This can affect credit offtake and induce further stress for banks and amount to another agrarian crisis.
\n

\n\n

What is the causal relationship between credit growth and loan waivers?

\n\n

\n
- Usually, rural banks mobilise funds through deposits in specific regions and lend to agricultural activities (credit growth).
\n
- The increase in credit growth (lending to various sectors by banks) in rural banking has shown a declining trend.
\n
- This denotes that the rural banks are not in position to mobilise the required amounts of deposit to make proportionate lending.
\n
- This affects credit-deposit ratio and risk weighted capital adequacy ratio, return on assets and economic value of equity.
\n
- The trend of credit – deposit ratio owing to farm loan waivers can induce stress in rural banking and therefore, banks will be reluctant to lend further to the farm sector.
\n
- It can produce a trickle-down effect on credit offtake, deposit mobilisation, bank operation and performance.
\n

\n\n

What are the other effects?

\n\n

\n

- The formal institutional credit (by financial institutions) to farm sector has increased to 89% in 2016 from 76% in 2010.
  \n
- And the informal credit (by money lenders) has decreased from 22% in 2010 to 11% in 2016.
  \n
- Thus, the share of informal credit in total outstanding debt in farming sector has gone down with RBI and various state government initiatives.
  \n
- The farm loan waivers affect bank's lending capacity and credit-deposit ratio.
  \n
- The rural cooperatives and regional rural banks could not channelise investment credit to farm sector.
  \n
- This could push small/marginal farmers to the brink and compel them to depend on varying informal sources for credit.
  \n
- The magnitude of direct institutional credit will be reduced, and Indirect or informal credit will see a rising trend.
  \n
- Farmers have to then bear exorbitant rates of interest, ranging between 24-36% per annum.
  \n
- Eventually, credit lending rates and magnitude of NPAs will go up in the foreseeable future.
  \n
- This can downgrade the rating of banks and destabilise the functioning of the credit market in general.
  \n
- Thus, farm loan waivers worsen the plight of farmers in the long term and make it difficult to rejuvenate the credit culture between institutional lenders and farmers.
  \n

\n\n

\n\n

Source: Financial Express