Global Financial Stability Report

What is the issue?

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The ways to rejuvenate the banking sector has been discussed in the light of **Global Financial Stability Report (GFSR)**

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What did the GFSR says?

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The recently released Global Financial Stability Report by the **International Monetary Fund** brings out the following salient facts:

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- The Indian industrial sector is now among the most heavily indebted in the world in terms of the ability of its cash flows to meet its bank loan repayments.
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- The Indian banking sector comes out as worse-off compared to other emerging economies in terms of how little bank capital it has set aside to provision for losses on its assets.
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- When banks are in poor health, it does affect the potential borrowers.
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- Once a bank's asset quality is adequately impaired, the bank does not grow its lending book much with fresh loans.
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- Faced with such borrowing prospects, healthy borrowers who have access to alternative forms of finance may be able to switch out of bank borrowing.
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- Financial intermediation, however, is likely to grow at an anaemic pace, and **many deserving borrowers likely to remain starved of credit.**
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What are the available options for the banks?

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- **Private capital rising:** The healthier PSBs could have raised private capital by issuing deep discount rights in 2013, and some can still do so now.
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- They must be required to do this to share the government's burden of recapitalising banks.
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- **Asset sales:** Some banks will have assets or loan portfolios that are in good enough shape to be sold in the market.
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- Modern banks no longer just make bank loans but also hold non-core assets such as insurance subsidiaries, market-making divisions and foreign branches. Such non-core assets can be readily sold.
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- Such asset sales can generate some of the needed recapitalisation.
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- **Mergers:** The system will be better off if the banks are consolidated into fewer but healthier banks.
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- Synergies in lending activity and branch locations could be identified to economise on intermediation costs, allowing sales of real estate where branches are redundant.
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- **Tough prompt corrective action:** Undercapitalised banks could be shown some tough love and be subjected to corrective action, such as the **revised Prompt Corrective Action (PCA) guidelines** recently released by the RBI.
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- Such action should entail no further growth in deposit base and lending for the worst-capitalised banks.
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- **Divestments:** Undertaking these measures would improve overall banking sector health, creating an opportune time for the government to divest some of its ownership of the restructured banks, as it has over time in many other sectors of the economy.
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What is the way ahead?

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- Perhaps **re-privatising some of the nationalised banks** is an idea.
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- All this would reduce the overall amount the government needs to inject as bank capital and help preserve its hard-earned fiscal discipline, which along with a stable inflation outlook and the diverse nature of our growth engine, appears to have made India attractive for foreign investors at the present moment.
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Source: Business Standard

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