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Rising bad loans of banks

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IN developing countries, commercial banks play a prominent role in financing private sector investment.

The reason is obvious. Their capital markets are not fully developed. In developed countries, the private sector taps savings through issuing shares and floats bonds.

In all economies, during the expansionary phase, there are always optimistic expectations. They trigger a rise in borrowing from banks.

In Fiji, which is not usually much affected by external happenings as experienced during the great recession consequent to the US 2008 financial crisis, disruptions in economic activities are caused by manmade disasters.

They include periodical military coups and illegal civilian takeover as witnessed in 2000.

Fiji's coup and credit boom cycles

Immediate impact of a coup is fall in investor confidence. There is dramatic decrease in borrowings.

Only return to stability ushers in a period of credit boom, reflecting a "catch- up" from the past depressed levels of investment and consumer confidence.

Fiji's credit boom of 2002-2006 is a case in point. Following the December 2006 coup, Fiji had another phase of instability.

It was reversed by a steady period from 2008 of uninterrupted stable, political and economic conditions.

A working paper covering Fiji's banking during 1999-2015 by Jayaraman and Ajeshni Sharma of FNU and Baljeet Singh of USP reveals a credit boom began from 2002 after the civilian coup of 2000.

As per cent of GDP, credit during the credit boom which lasted until 2006, which was interrupted by military coup of December coup in 2006.

Credit to private sector rose from 39.8 per cent in 2002 to 62.0 per cent in 2006

Two years after the military coup of December 2006, which witnessed another phase of optimistic expectations, which is still continuing, private sector borrowings soared.

They reached a new high in 2016 at nearly 70 per cent of GDP**.**

"Too much of a good thing?"

There is a negative side too. During expansionary phase, banks become more aggressive.

More eager to capture a bigger share of business, they tend to relax loan appraisal standards. If banks were inefficient and the loan recovery process became weaker, their failure would be imminent, imposing heavy costs on the economy.

Remember the NBF saga?

In 2002, Fiji's bad loans, dubbed as non-performing loans (NPL), was 6.6 per cent of gross loans of banks; and the proportion fell to 5.7 per cent in 2007.

Though bad loans decreased in 2014 to 2.16 per cent of gross loans, the ratio in two years went up to 2.2 per cent in 2016.

Fiji is a much smaller economy than many among developing economies.

The bigger economies have much higher ratio of NPL to gross loans in 2016: India: 9.1 per cent, and Brazil 3.8 per cent.

Indian situation

A working paper of FNU this month by Jayaraman, Keshmeer Makun and Ajeshni Sharma, on India's bad loans says Indian banking is under stress.

The official economic survey presented to the Indian Parliament prior to its budget in January 2017 for financial year 2017-18 rang the alarm bells.

The public sector banks (PSB), which dominate the banking scene to the extent of 70 per cent in terms of share of business, have more than 80 per cent of NPL of the entire banking system.

Their share is at a record level of 12 per cent.

This is higher than in any emerging market and with the sole exception of Russia in the developed world. The latest estimates are still worse.

A former deputy governor of Reserve Bank of India, Rakesh Mohan, now at Yale and Partha Ray of Indian Institute of Management at Kolkata adopted a wider definition known as stressed assets, in their 2017 IMF Working Paper.

Defined as gross NPL plus restructured standard assets plus written off accounts, the stressed assets for the entire banking system stand at 14.5 per cent; the public sector banks take the largest piece of the unpalatable cake: it is 17.7 per cent of gross loans.

India has just last month decided to recapitalise the public sector banks with 1.35 trillion rupees ($F42 billion).

Similar recapitalisation of the public sector banks in 1990 did not achieve much. The NPL episode has repeated.

Only remedy: privatisation.

Can India undo what the socialistic policies of 1947 to 1990 did to the economy?

In a politically, ever highly charged Indian conditions, with 2019 elections around the corner, no one wants to talk about it.

Mohan and Ray correctly observed the past Indian governments suffer from "from the imperatives of societal concerns and thus were torn between the dilemma of equity versus efficiency".

Until a hard decision is taken, as Nobel Laureate Paul Krugman wrote on another occasion, flushing the toilet does not get rid of the cockroaches; and they only come back after a while.

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* The views expressed in this article are of the writers.