INDIA'S ECONOMIC AMBITIONS: Can the Financial Sector Deliver?

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FICCI
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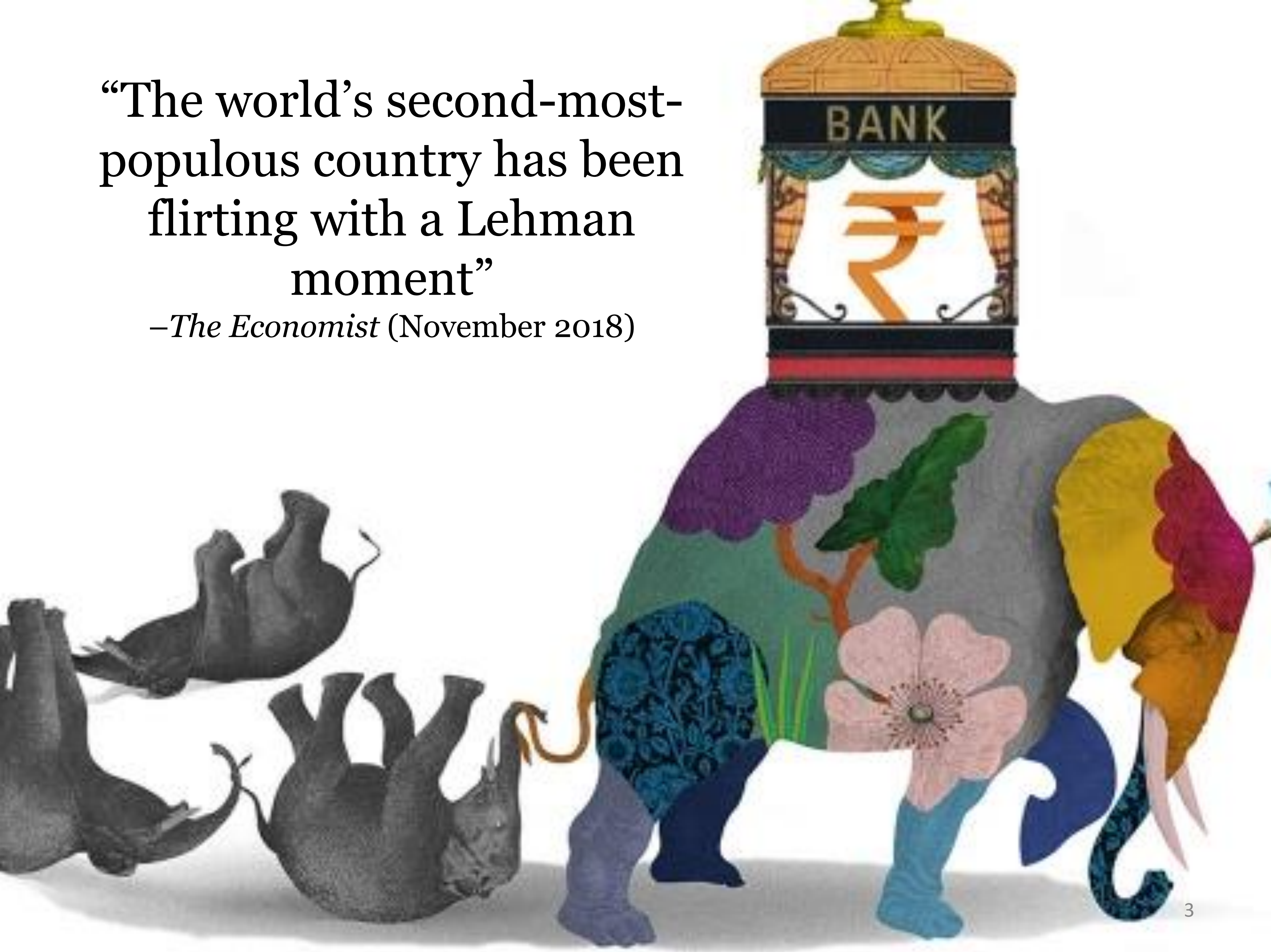
Outline

- **India's Financial System: Taking Stock**
- **Recent Reforms: What Has Been Done?**
- **Strengthening the Financial System: What Next?**

"The world's second-most-populous country has been flirting with a Lehman moment"

–*The Economist* (November 2018)

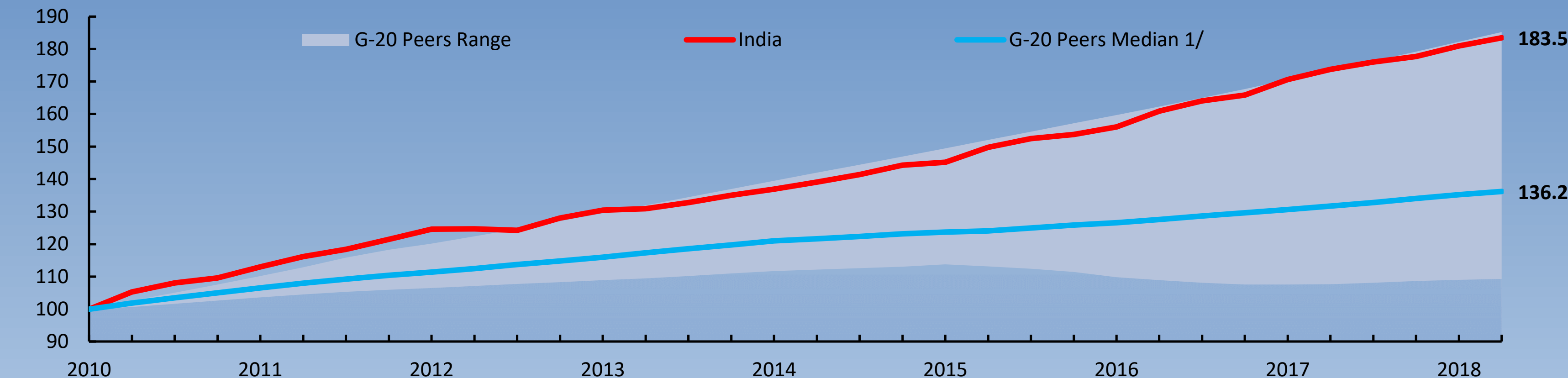


India's Financial System: Taking Stock

Economic Backdrop

Real Growth: India and G20 Peers

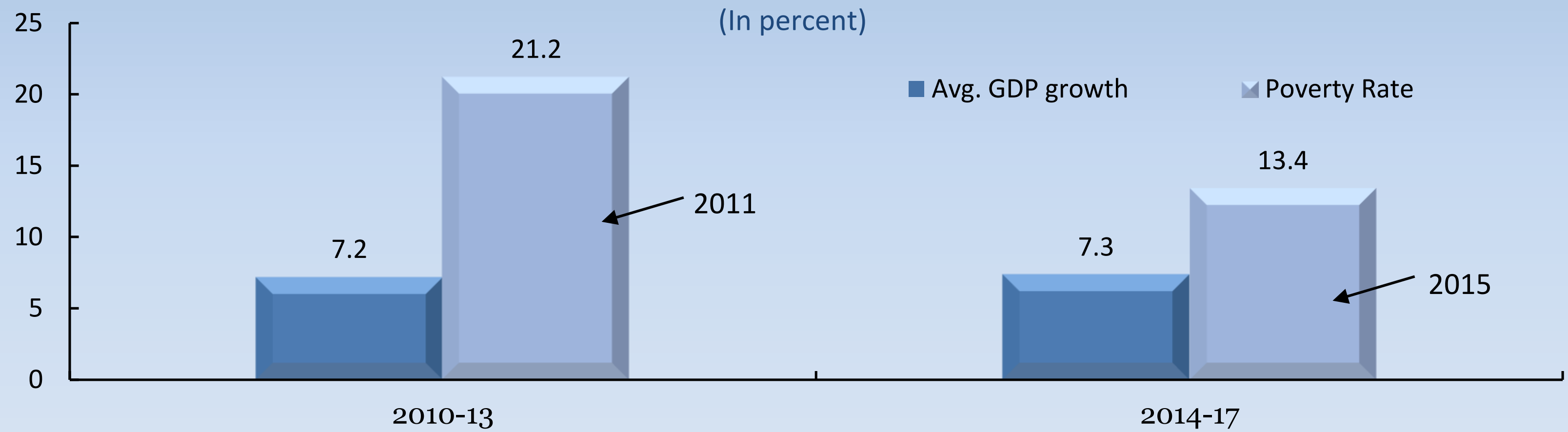
(Index, Seasonally Adjusted, 2010-Q1=100)



Sources: Haver Analytics and IMF Staff Calculations
India's G-20 peers are Brazil, Russia, China, South Africa, Indonesia and Turkey

India: GDP growth and poverty rate

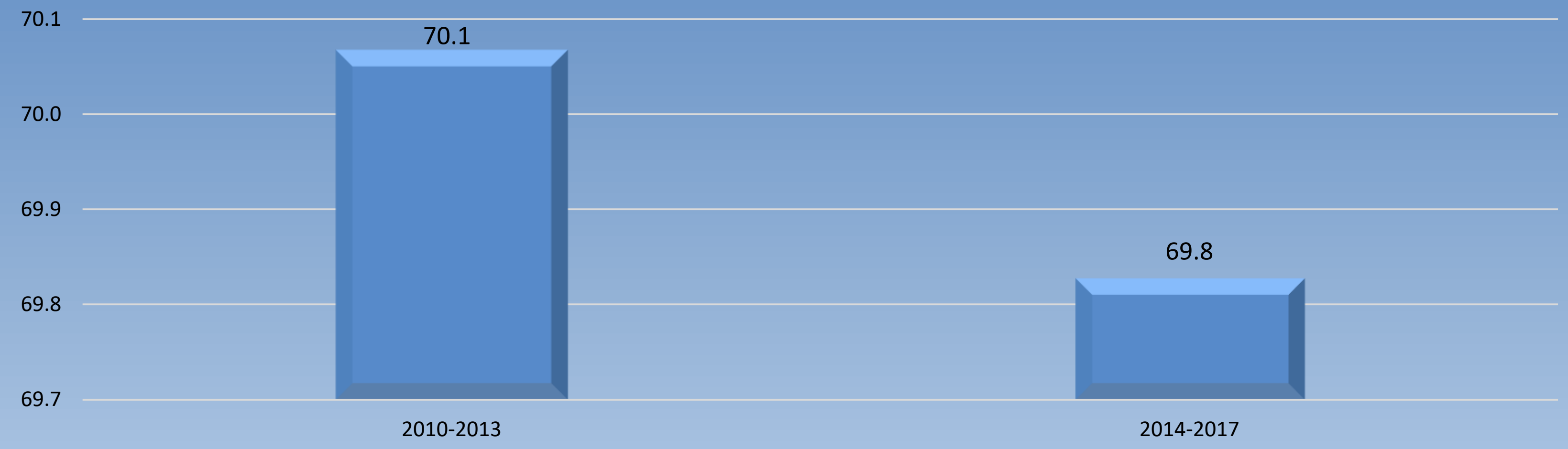
(In percent)



Sources: Haver Analytics and World Bank Group, *Poverty and Equity Data Portal*.
Note: Poverty rate is based on the international poverty line (2011 PPP, $1.9 per person per day).

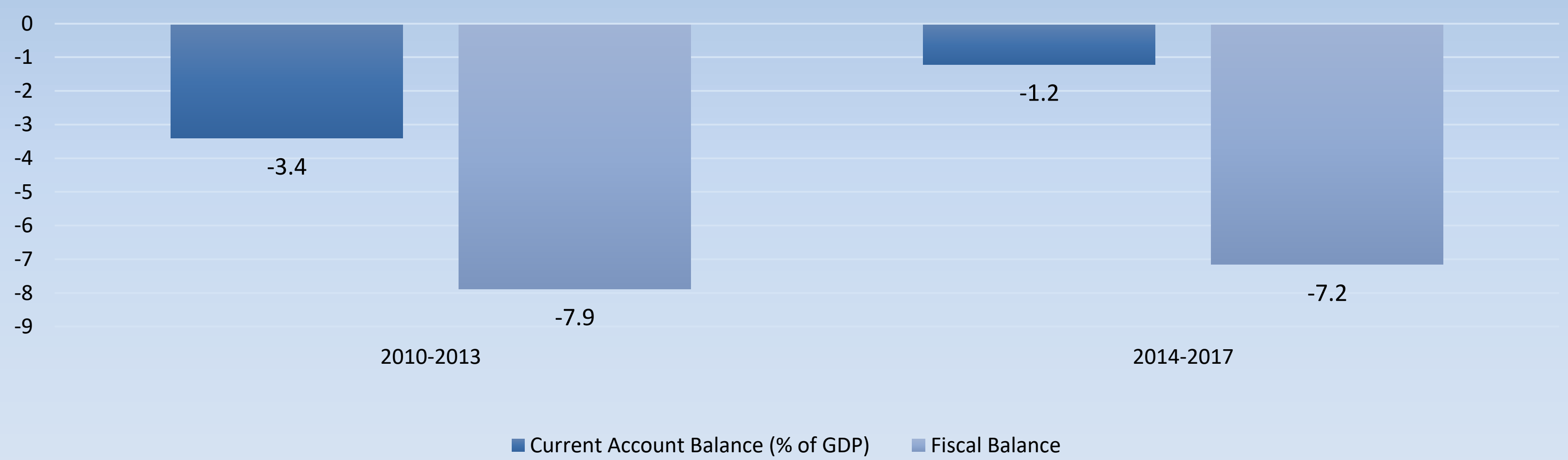
Economic Backdrop

Gross Debt (% of GDP)



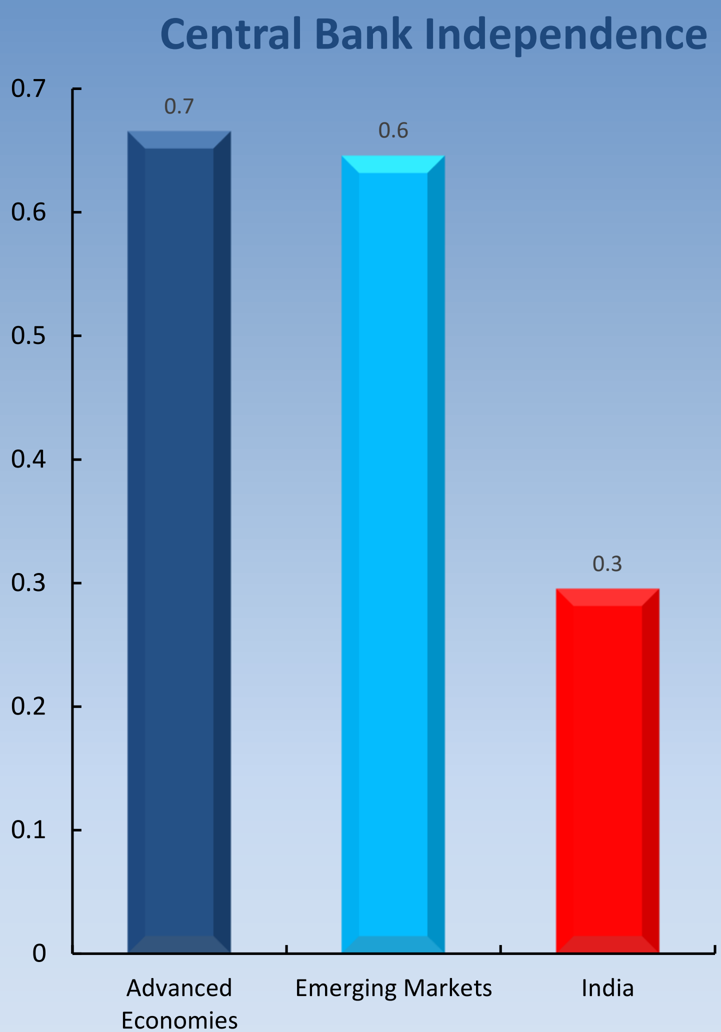
Source: Haver Analytics

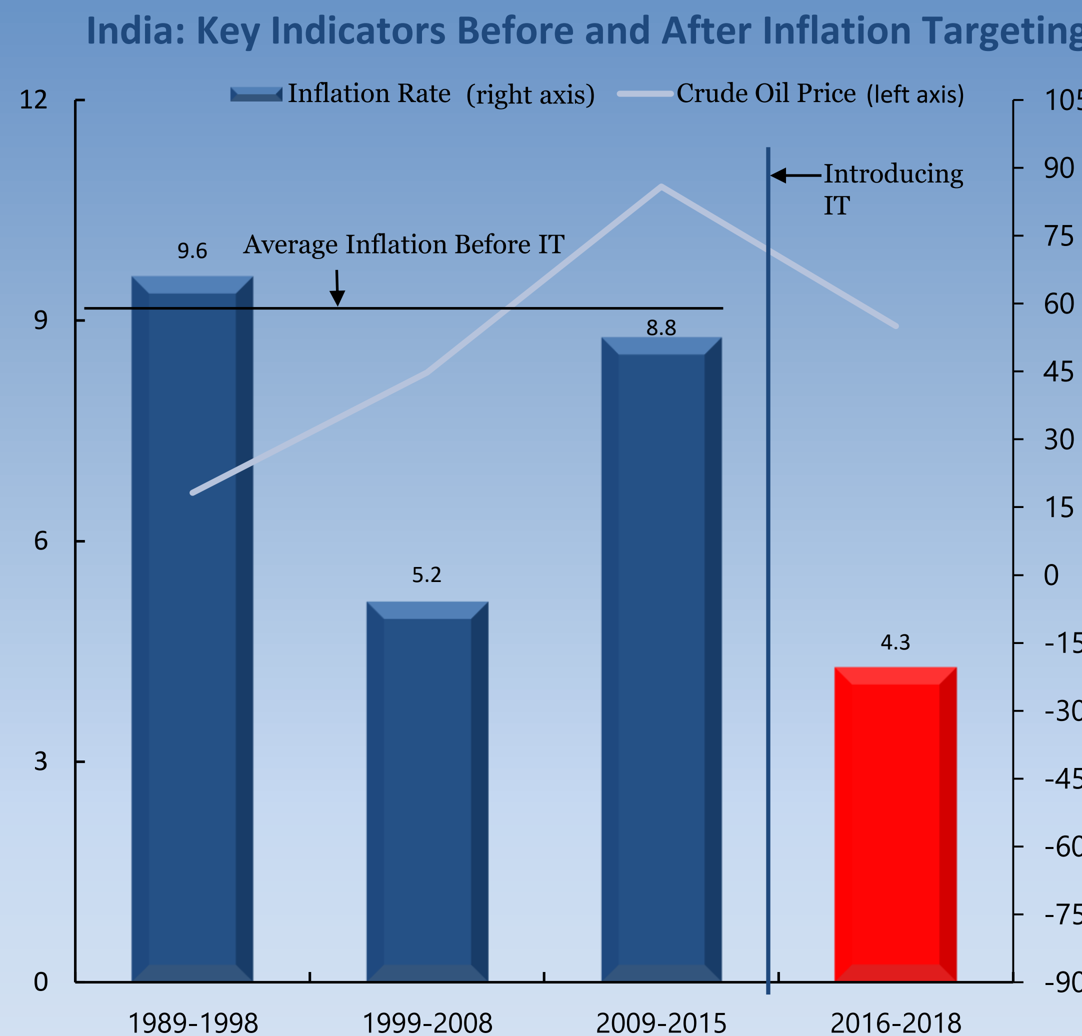
External Current Account and Fiscal Balance



Source: World Economic Outlook

How is the Central Bank Doing?

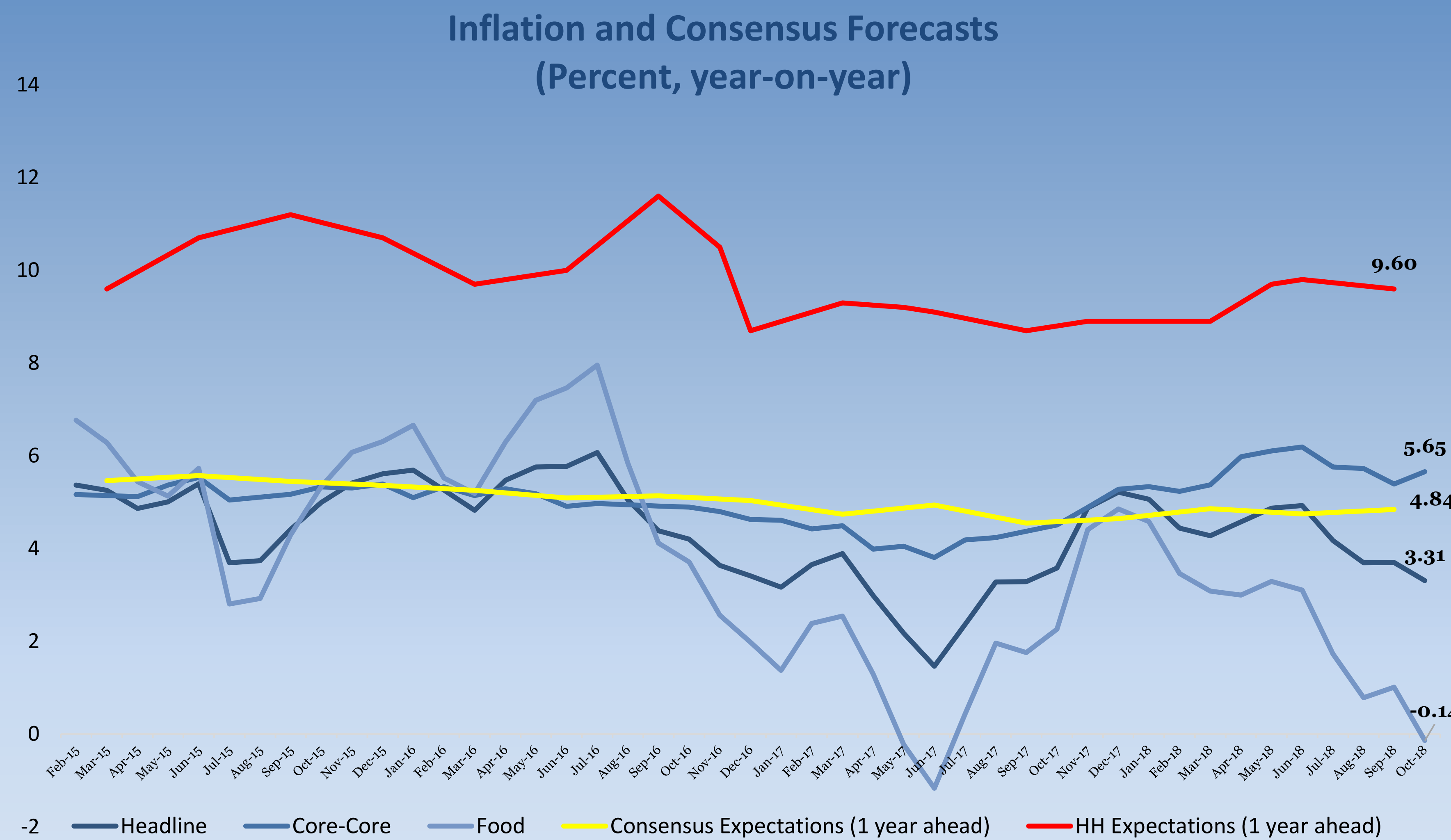




Source: Garriga, Ana Carolina 2016. Central Bank Independence in the World: A New Dataset.
Note: Advanced economy classification is from current IMF WEO classification; emerging market classification is from the IMF classification as of Oct. 2015

Source: World Economic Outlook

How is the Central Bank Doing?



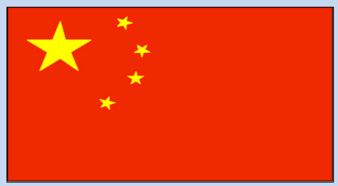
Source: India IMF Article IV Staff Report, 2018

Are Financial Markets Competitive?

Countries Dominated by State-Owned Banks

India

Turkmenistan



China

Bhutan

Belarus

Libya

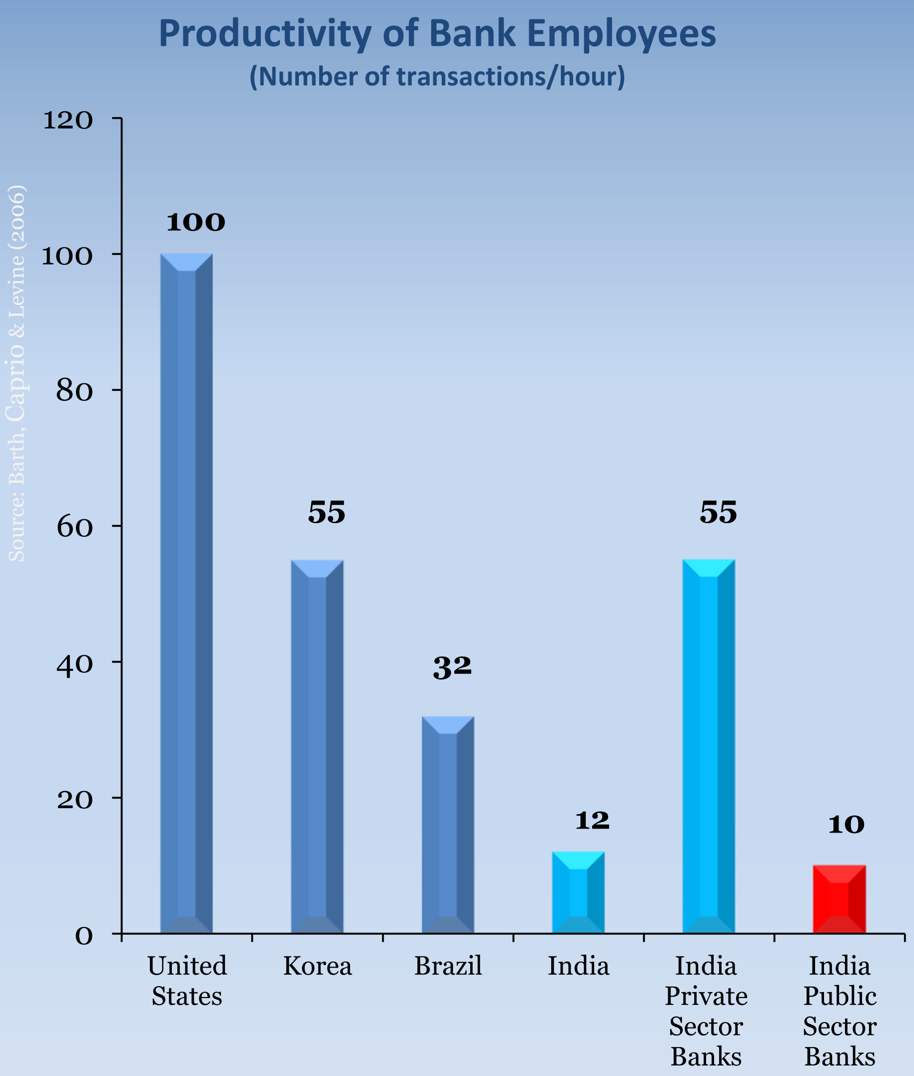
Egypt

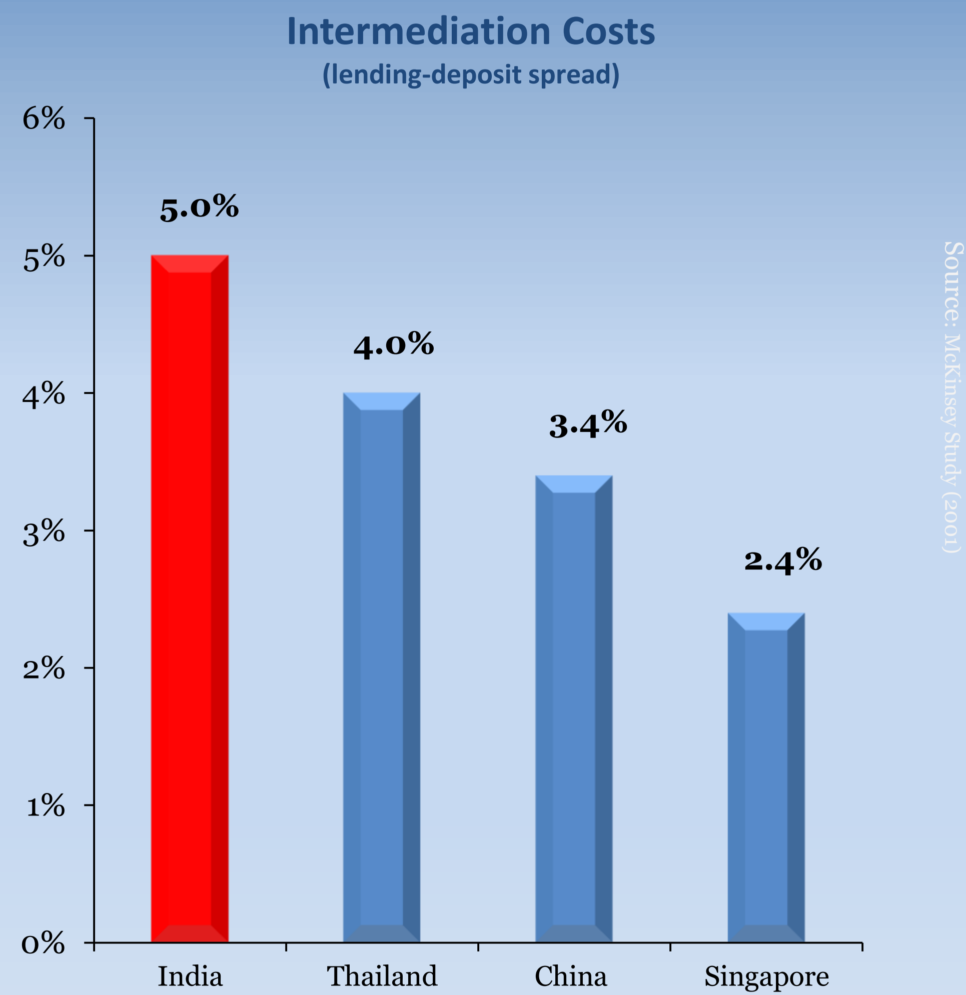
Algeria

Costa Rica

Source: Barth, Caprio & Levine (2006)

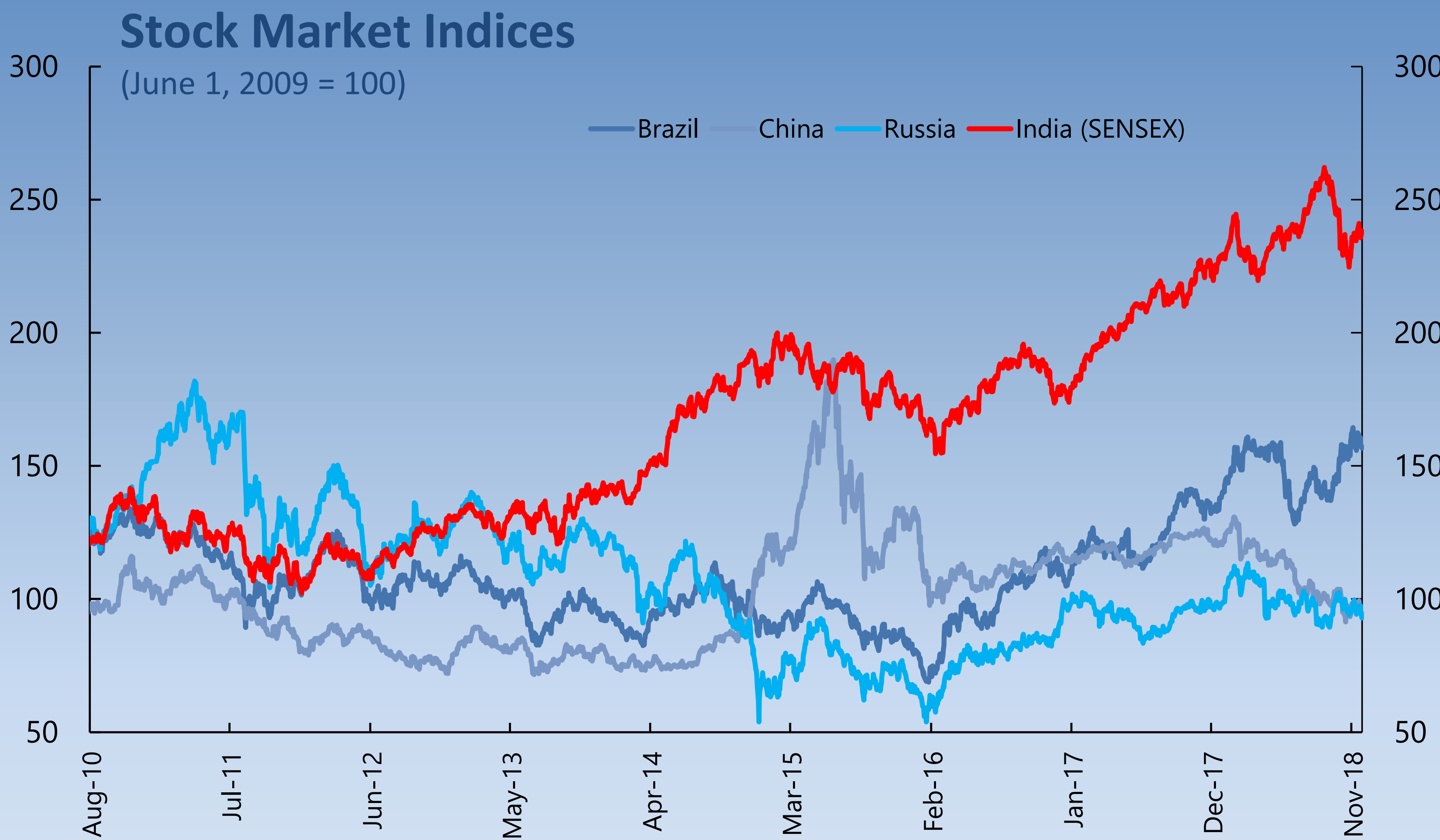
Are Financial Markets Competitive?





Source: Report of the Committee of Financial Sector Reforms, GOI (2008)

Are Financial Markets Deep?



Source: Bloomberg Financial Markets L.P.

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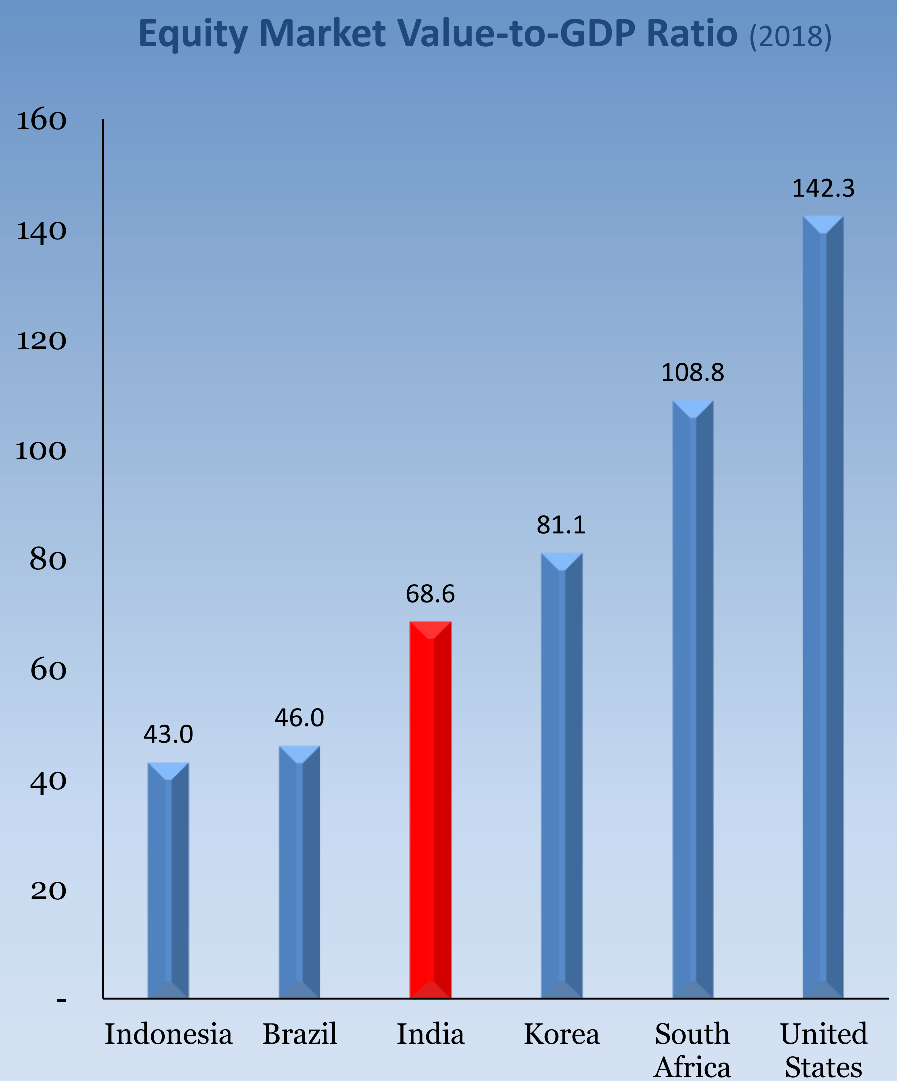
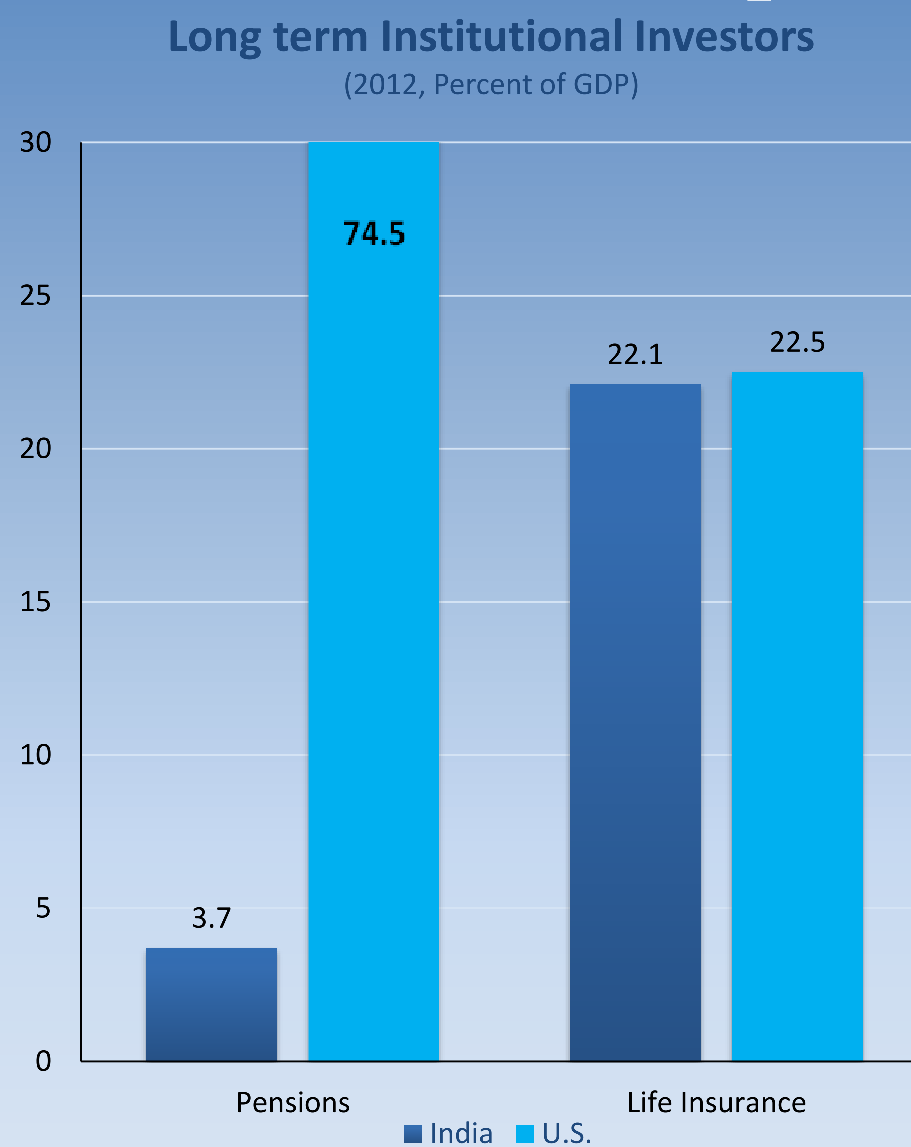
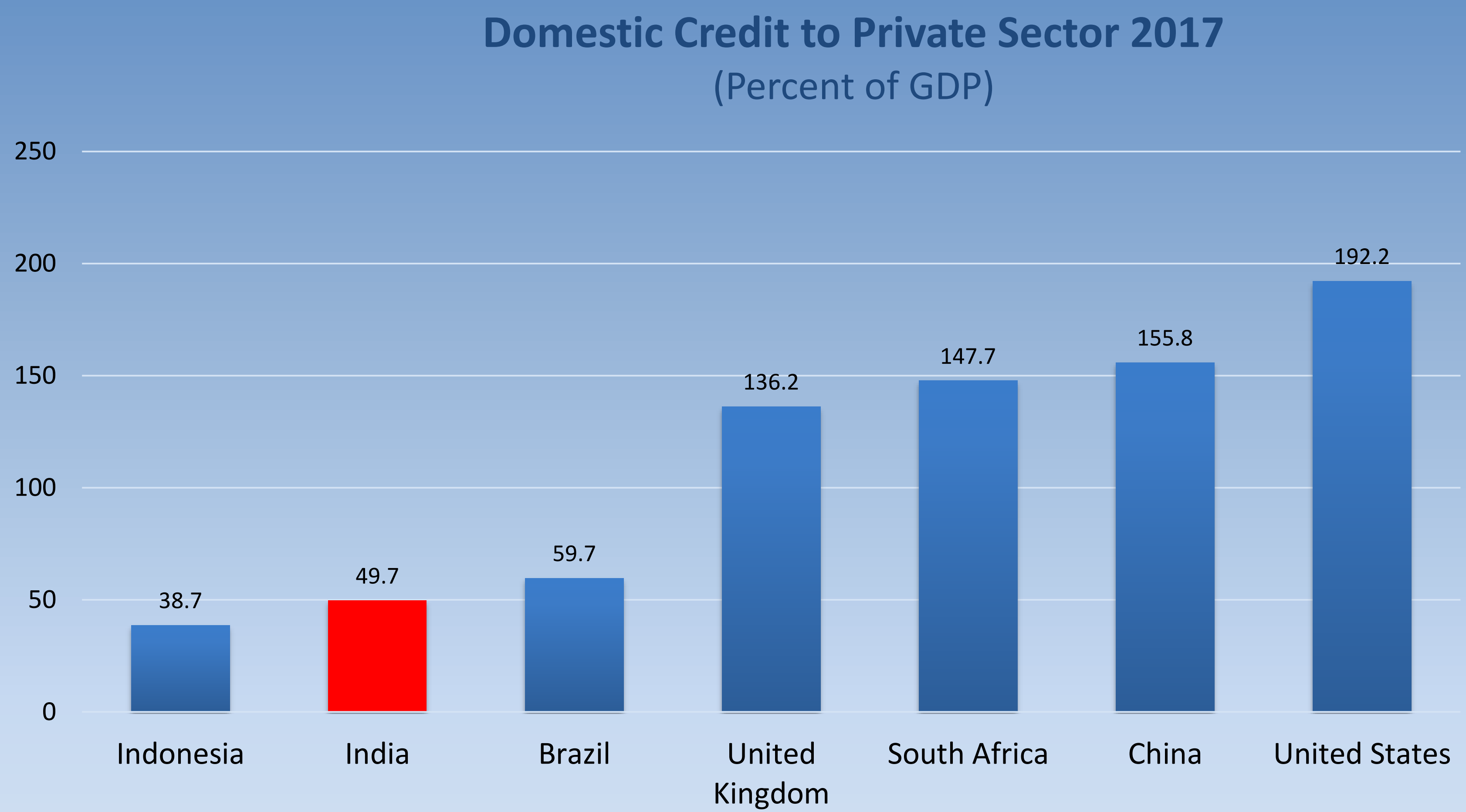


Source: Bloomberg, Haver Analytics



Source: Mercer, OECD, Allianz Global Investors, IMF Staff estimates

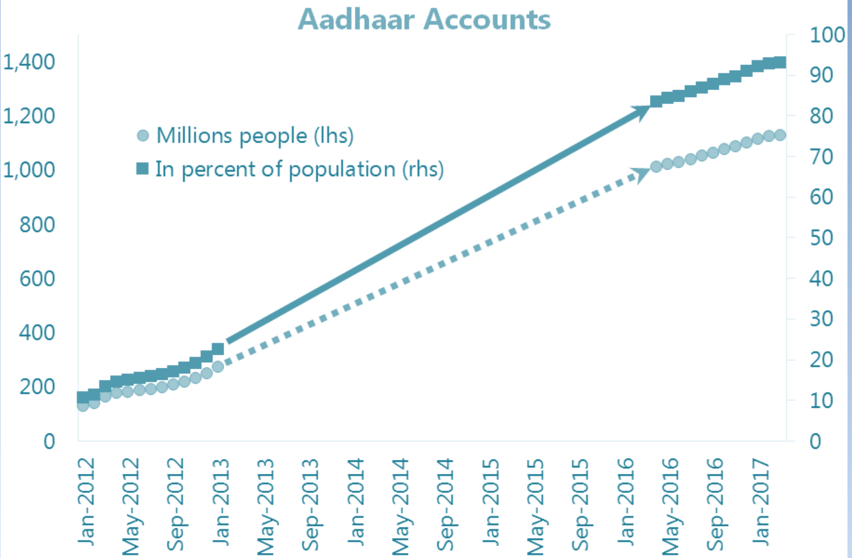
Are Financial Markets Deep?



Source: World Development Indicators

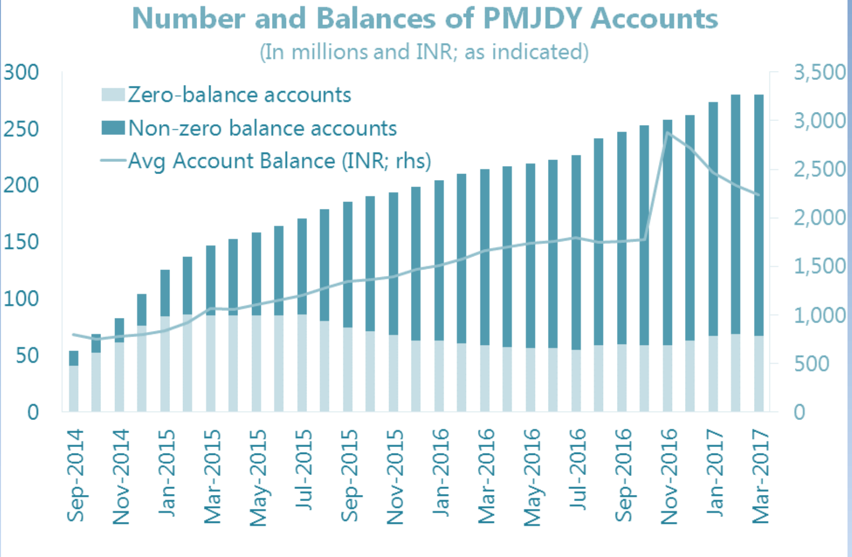
Does the Financial Sector Serve the Population?

Growth of Aadhaar Accounts, 2012-2017



Source: Unique Identification Authority of India (UIDAI).

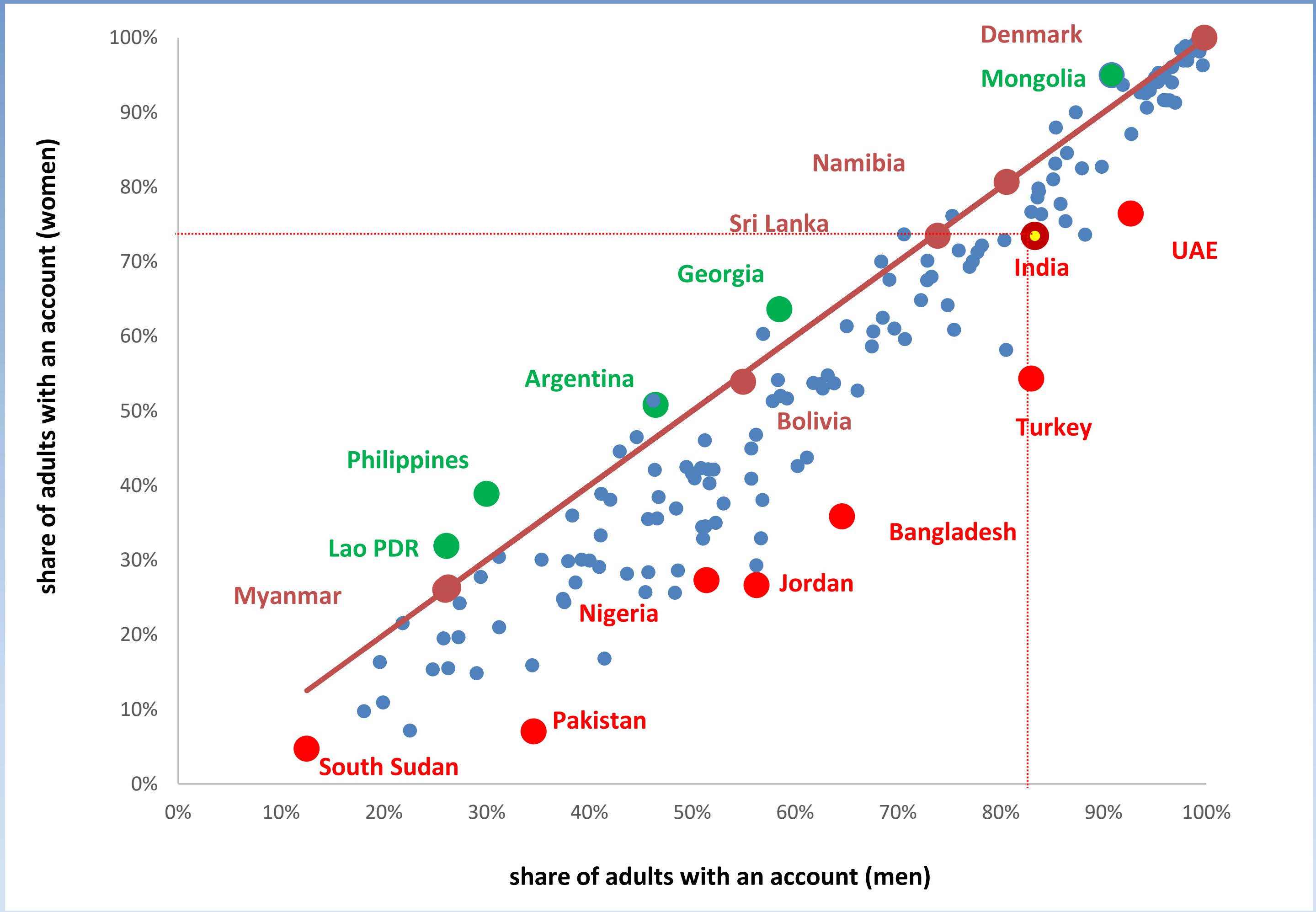
Growth of Bank Accounts, 2014-2017



Source: PMJDY

Does the Financial Sector Serve the Population?

Financial Inclusion and Gender Gap

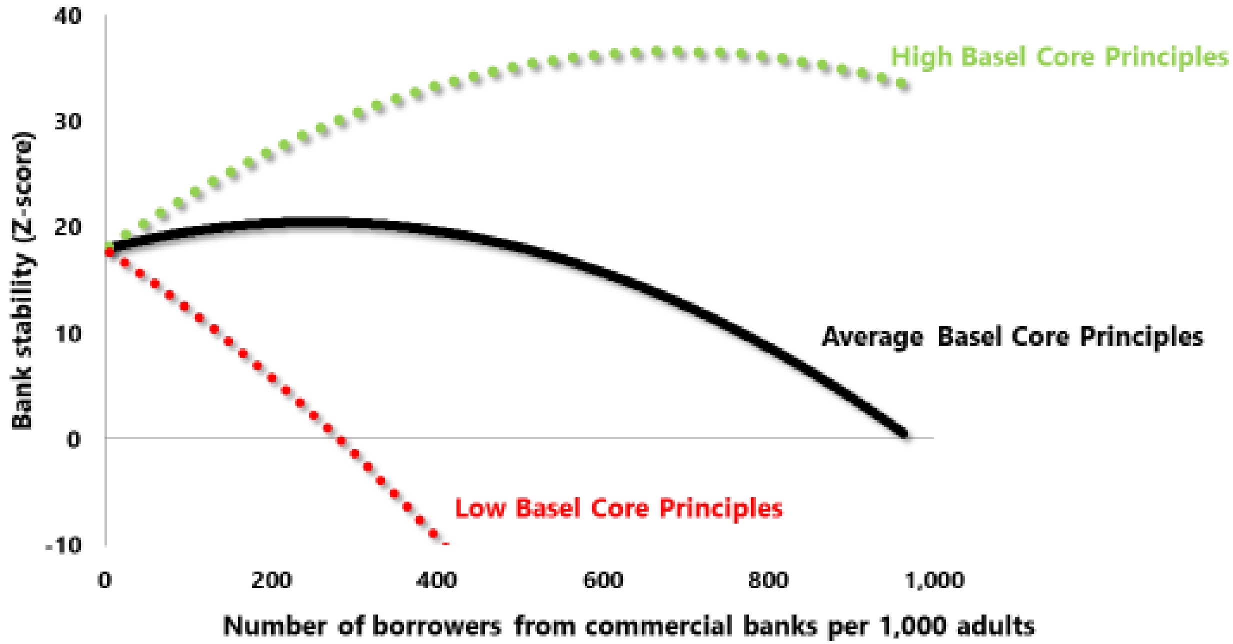


Source: IMF staff calculations based on the 2017 Global Findex.

Is There a Tradeoff Between Financial Inclusion and Financial Stability?

Financial Inclusion and Financial Stability

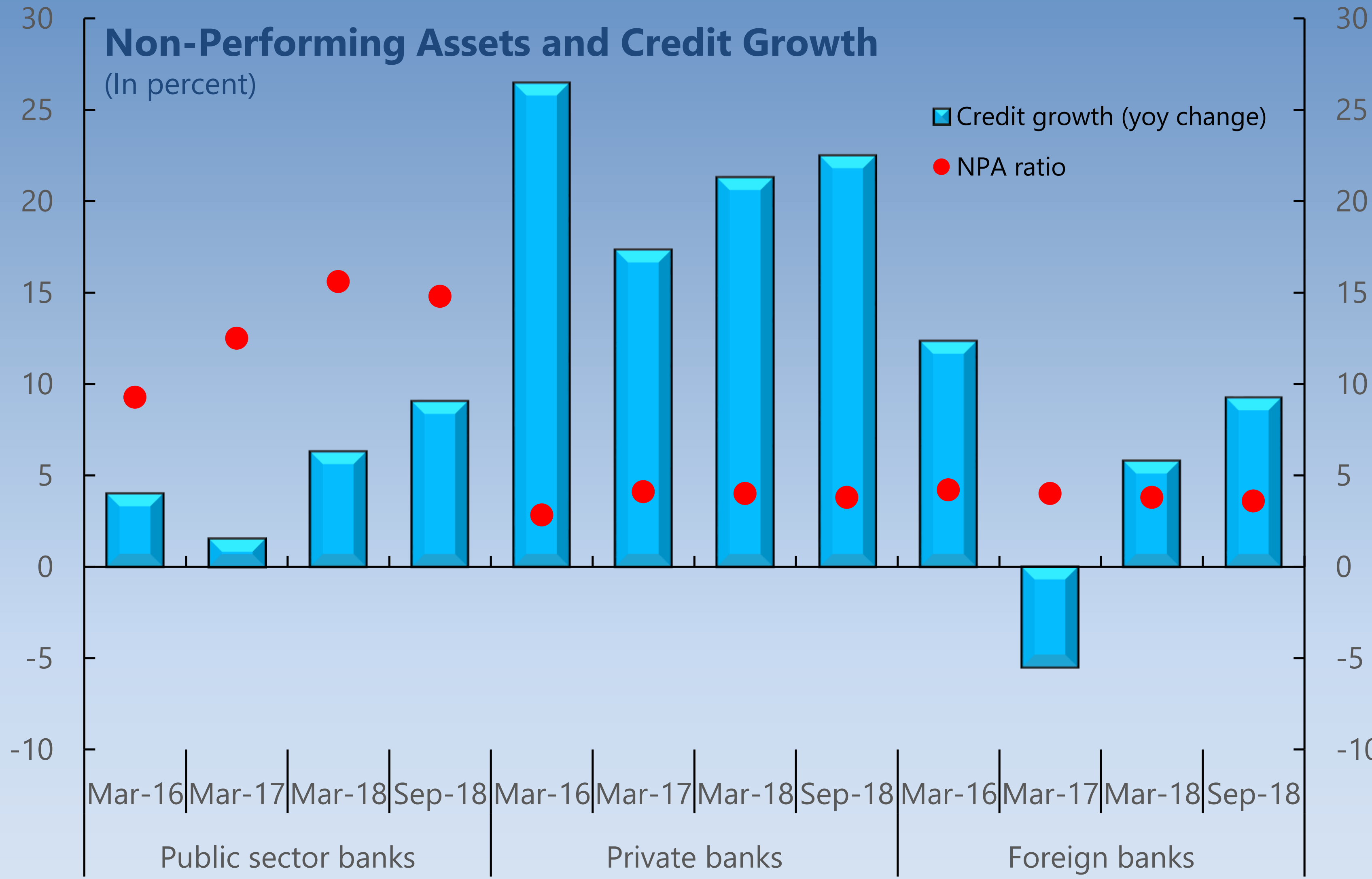
Financial stability: risks with broadening credit access rise as supervisory quality falls



... in contrast, increases in financial services other than credit do not seem to hurt stability

Source: "Financial Inclusion: Can It Meet Multiple Macroeconomic Goals?" Ratna Sahay et al. SDN 15/17 IMF September 2015

Are Banks Sound Enough to Finance the Real Economy?



Source: Reserve Bank of India, and IMF Staff estimates.

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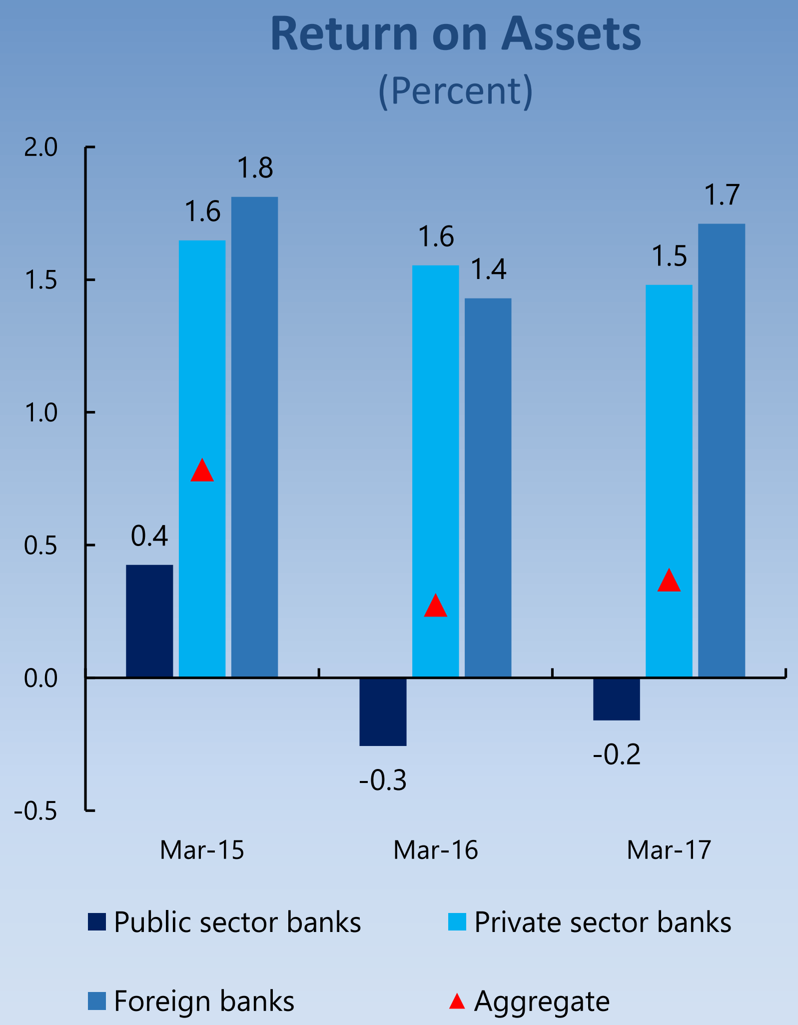
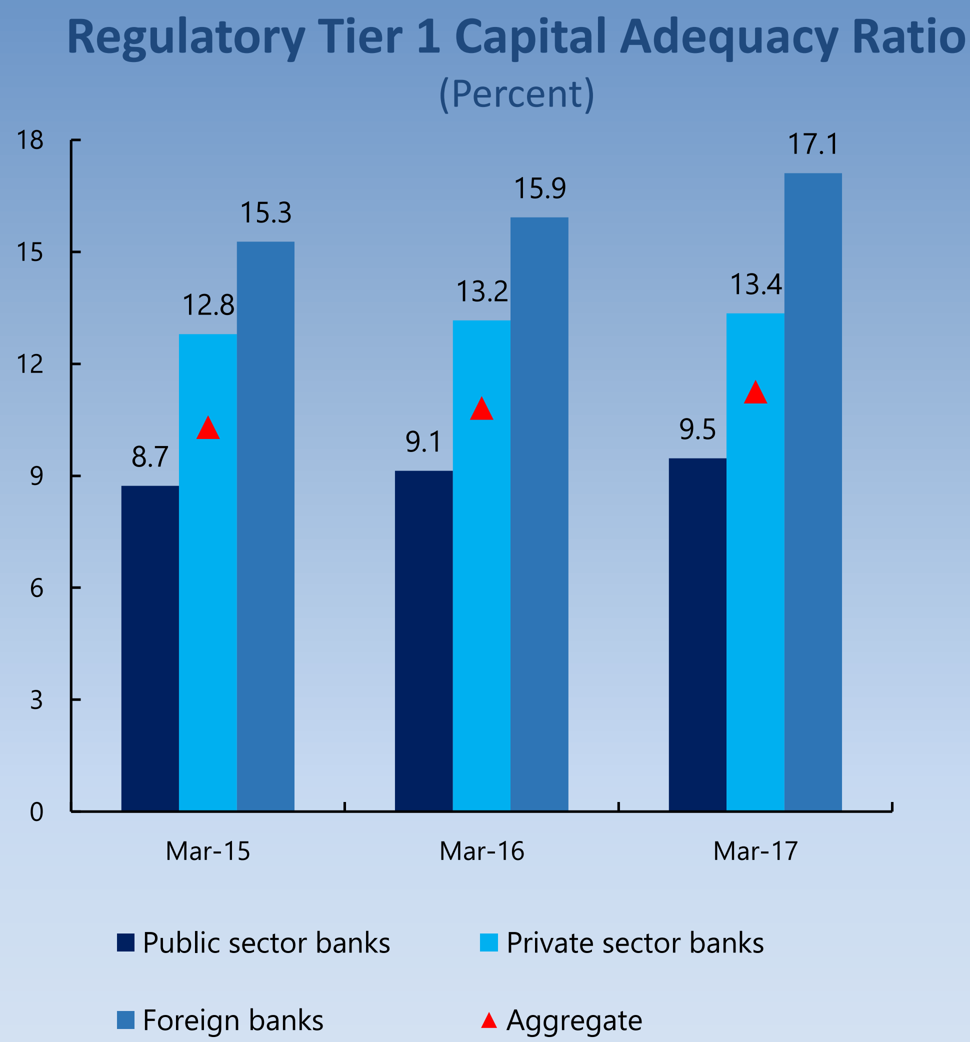


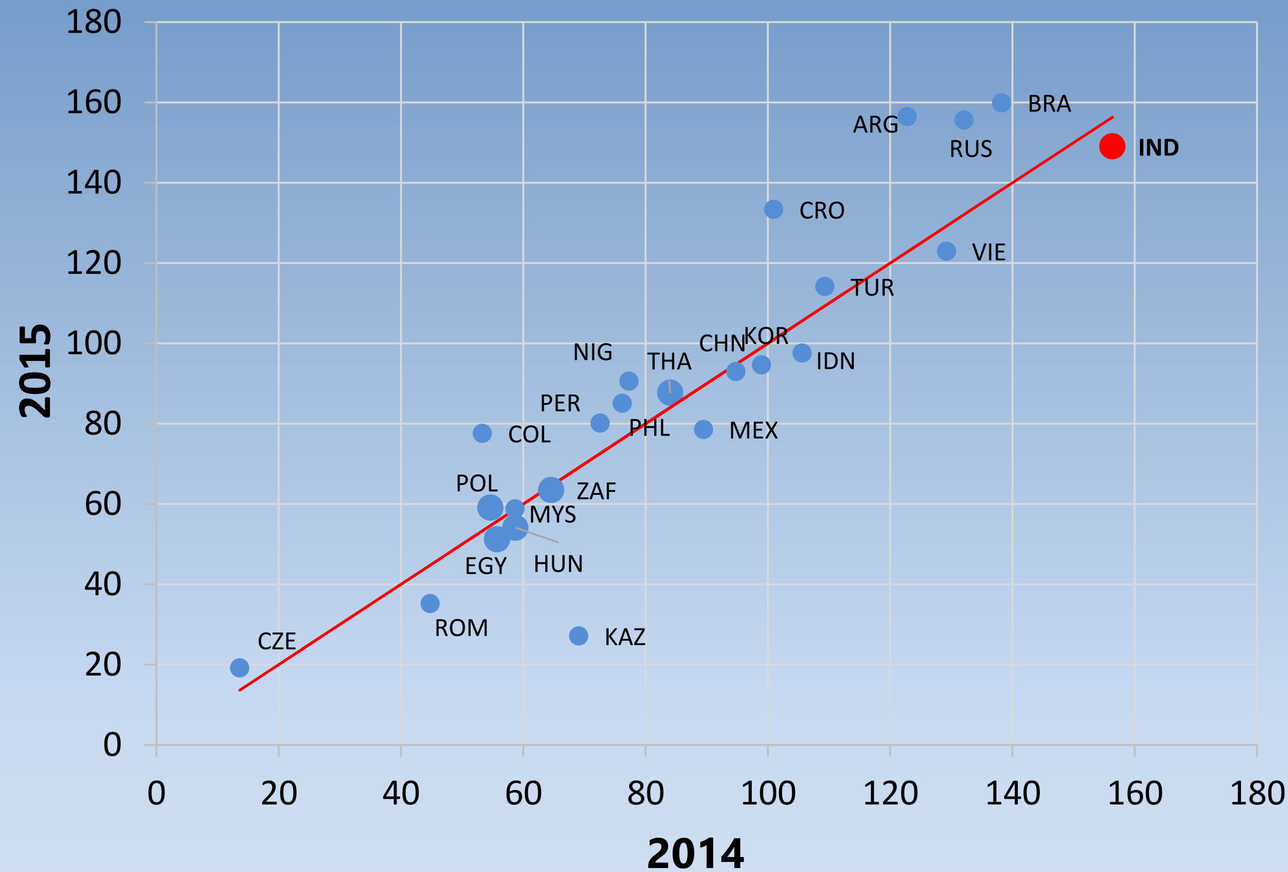


Source: Reserve Bank of India, and IMF Staff estimates.

Are Corporates Sound Enough to Contribute to Growth?

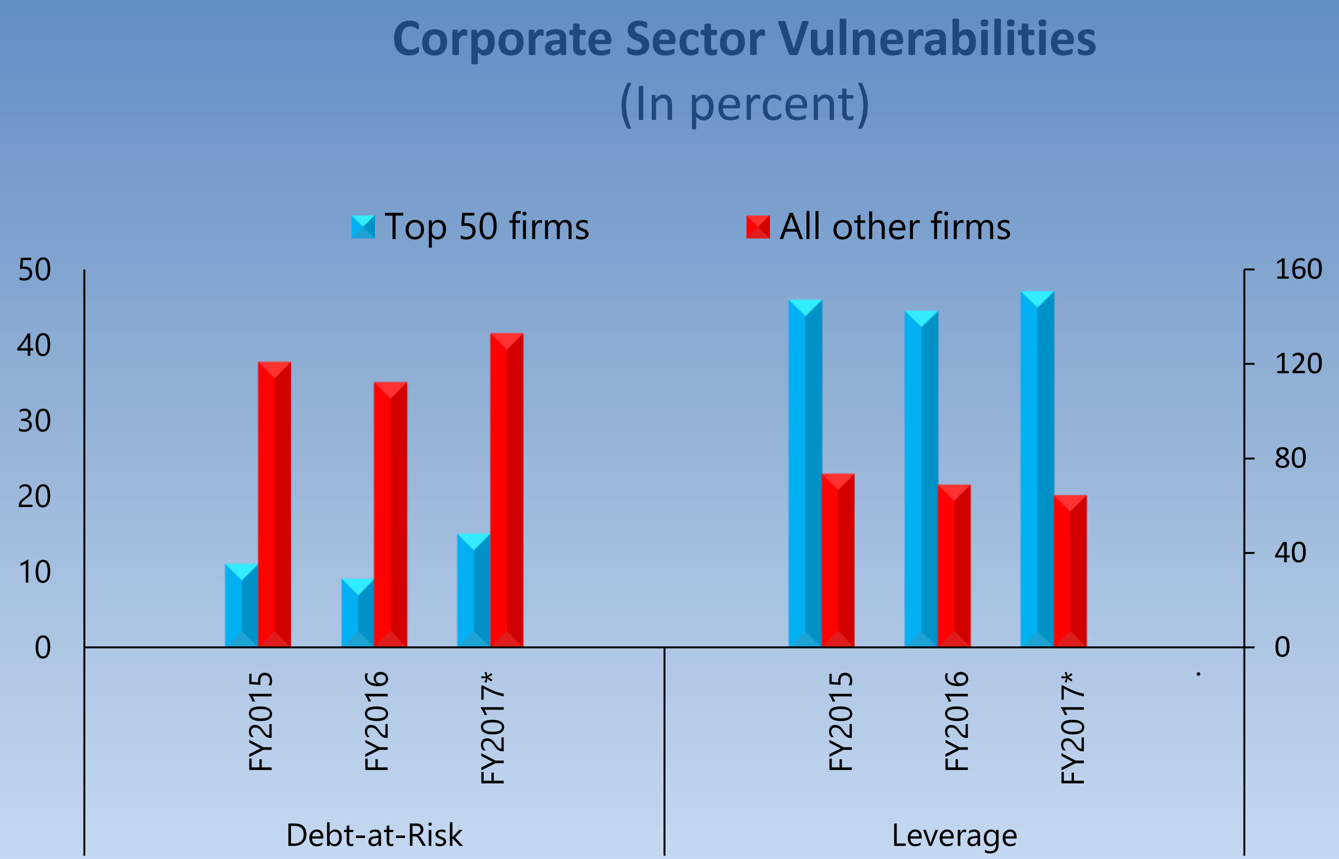
Indian corporate leverage is among the highest across emerging markets…

Corporate Leverage, Selected EMs
(Debt-to-Equity Ratio, top quartile)



Source: IMF, Corporate Vulnerability Utility.

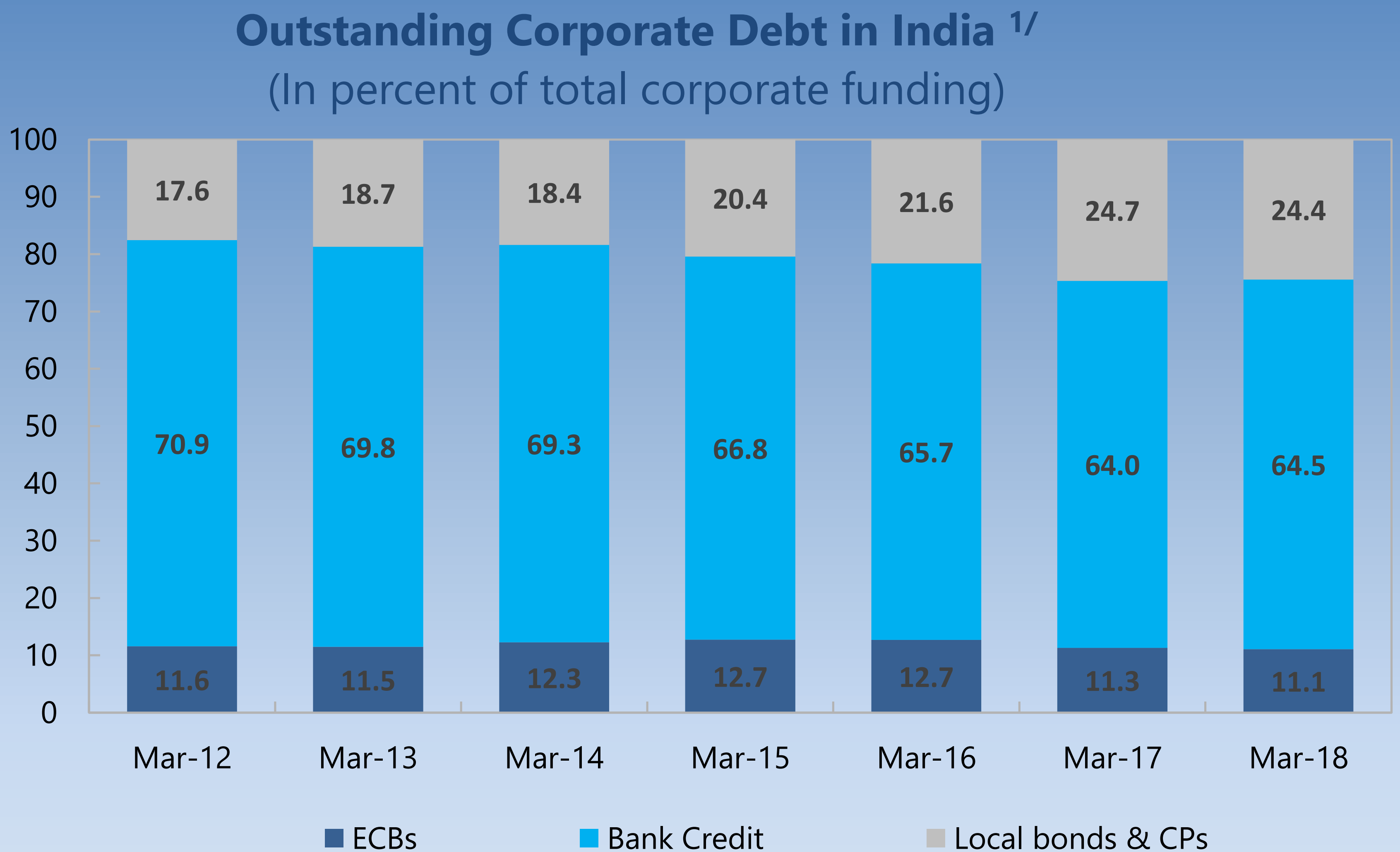
Are Corporates Sound Enough to Contribute to Growth?



… with leverage particularly high across the largest corporates, and debt-at-risk levels edging up.

Sources: CapitalIQ; and IMF staff estimates.
Note: Based on a sample of 1,826 firms. 2017 estimates reflect each firm's latest available quarter. Top firms determined based on latest total assets. Leverage is median debt-to-equity ratio in each group (no firms with negative equity). Debt-at-risk is the share of debt of firms with ICR less than 1.

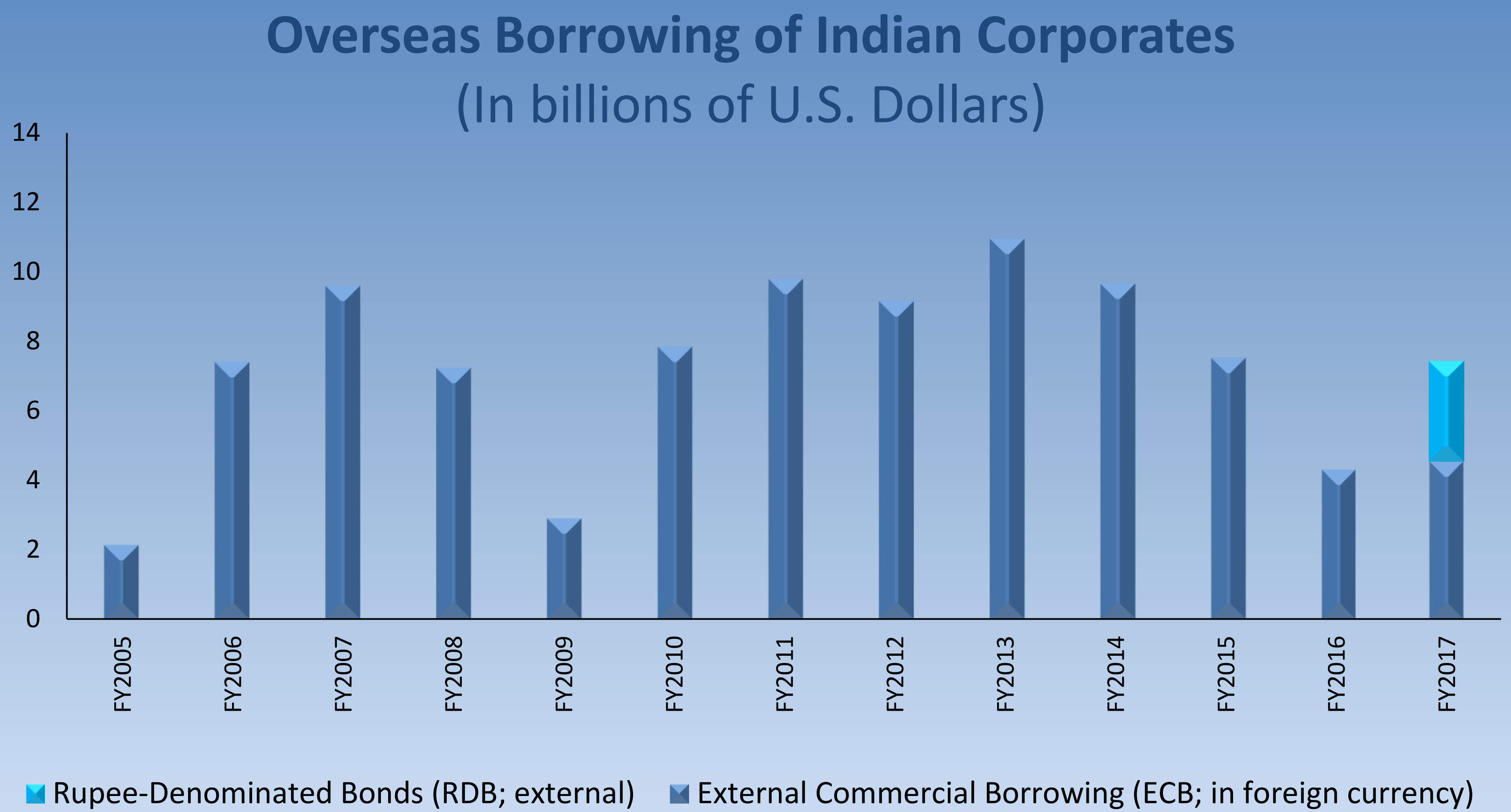
Are Corporates Sound Enough to Contribute to Growth?



Corporates are exposed to external shocks through external commercial borrowings...

1/ Other local securities include commercial paper (CP) and syndicated loans.

Are Corporates Sound Enough to Contribute to Growth?



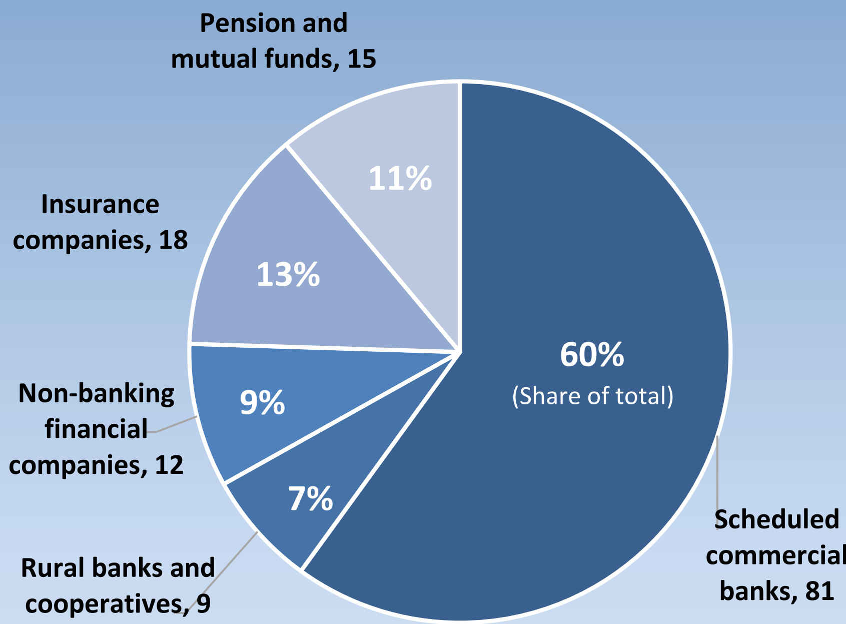
… but dependence on external foreign-currency funding has declined considerably

Sources: Reserve Bank of India; IMF, Financial Soundness Indicators; IMF, Corporate Vulnerability Utility; and IMF staff estimates

Can the Non-Bank Sector Pick Up the Slack?

Financial System Structure

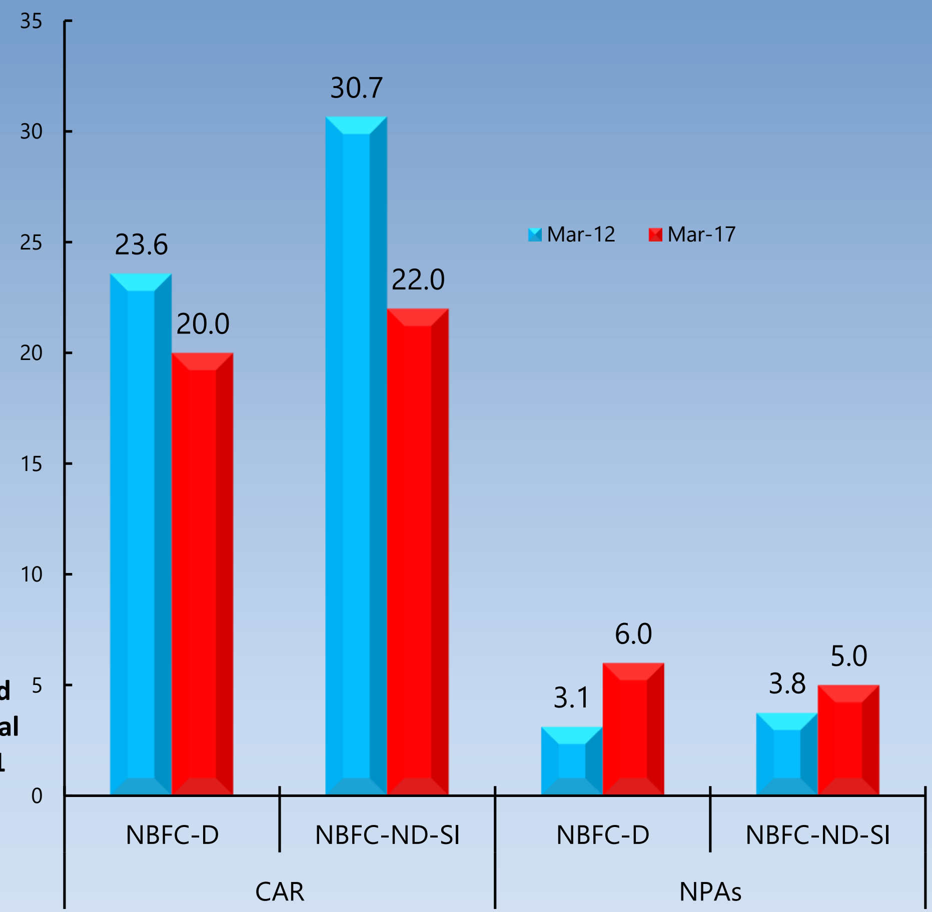
(In percent of GDP, March 2017)



Sources: India Article IV IMF Staff Report (2017)

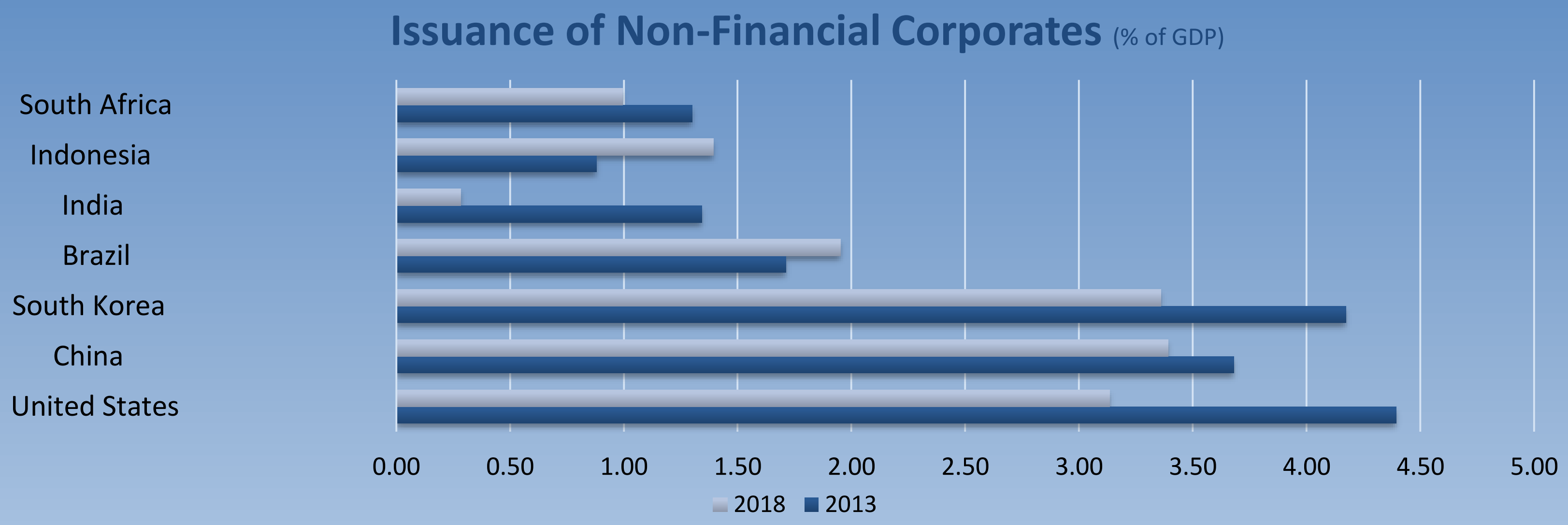
NBFCs Financial Soundness Indicators

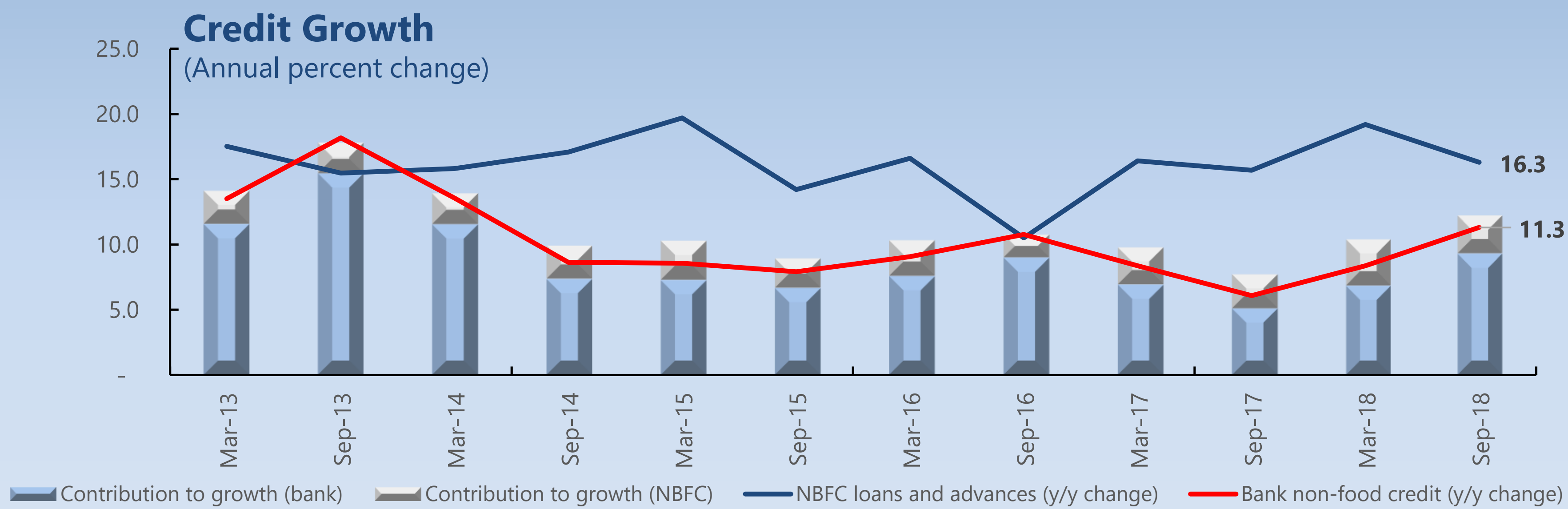
(Percent)



Sources: Bloomberg; Reserve Bank of India; Insurance Regulatory and Development Authority of India and Securities Exchange Board of India

Can the Non-Bank Sector Pick Up the Slack?



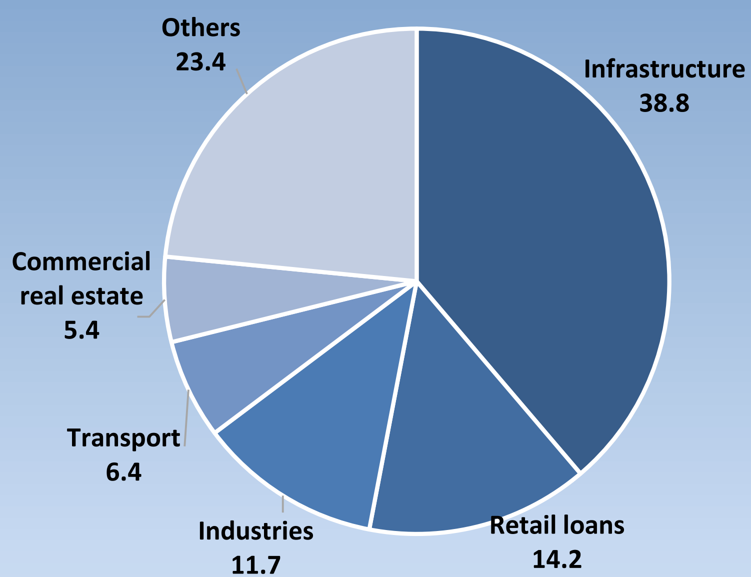


Sources: RBI and staff estimates.

Challenges in the Non-Bank Sector

NBFCs Loans by Sector

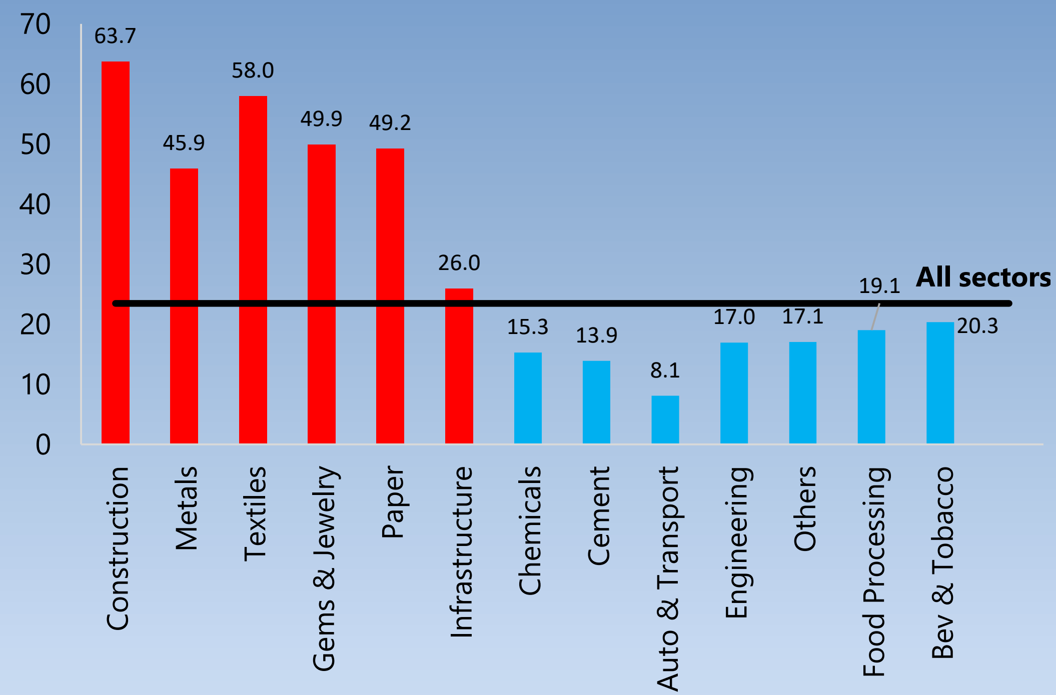
(Percent, March 2017)



Sources: Bloomberg; Reserve Bank of India; Insurance Regulatory and Development Authority of India and Securities Exchange Board of India

Corporate Sector Debt-at-Risk

(In percent of sectoral debt, 2016)

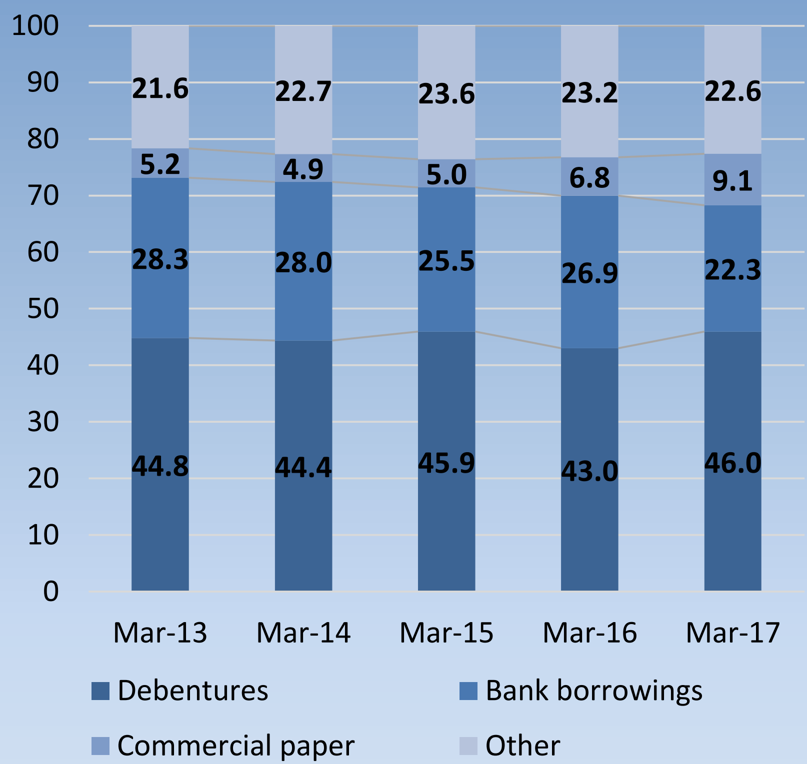


Sources: CapitalIQ; and IMF staff estimates.
Note: Debt-at-risk is debt of firms with interest coverage ratio—multiple of earnings before interest, taxes, depreciation and amortization (EBITDA) relative to interest expenses—below one.

Challenges in the Non-Bank Sector

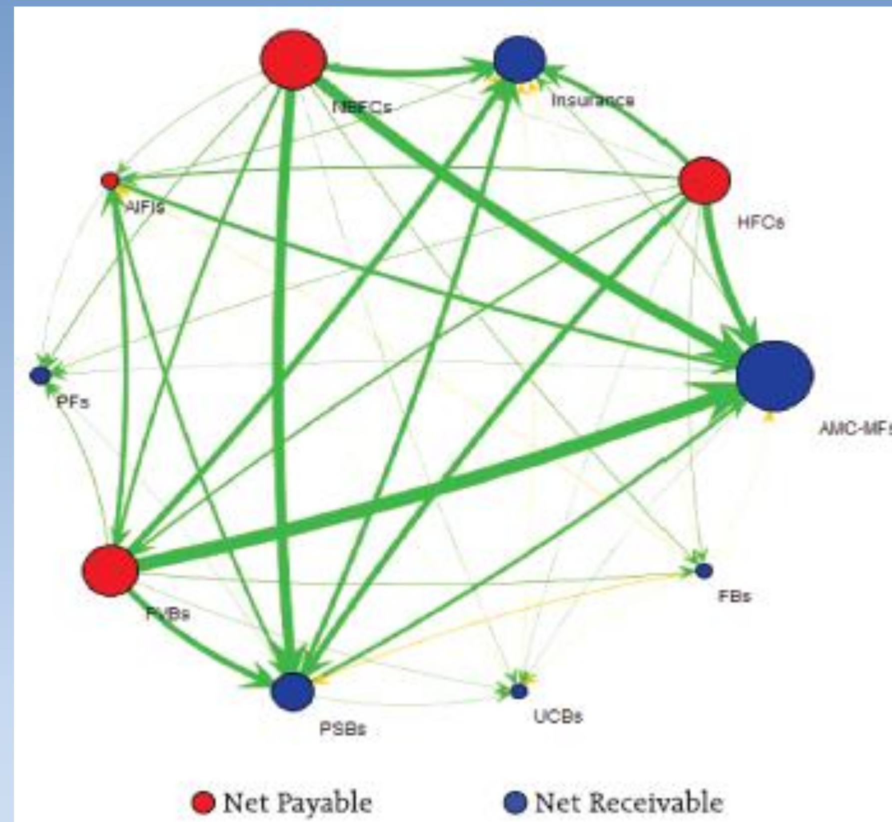
NBFC: Sources of Funding

(percent of total borrowing)



Sources: RBI and staff calculations.

Network plot of the financial system (March 2018)



Source: India FSSA IMF Report, 2017

Note: PSBs: Public sector banks, UCBs: Urban commercial banks, HFCs: Housing Finance companies, NBFCs: Non-bank financial corporations, AFIs: All India Financial Institutions, PFs: Private Pension Funds, AMC-MFS: Asset management companies and mutual funds, FBs: Foreign banks, PVBs: Private banks, Insurance cos: Insurance companies

India’s Financial System: Key Takeaways

- **Macroeconomic fundamentals improving slowly.**
- **Credibility of RBI has increased.**
- **Most banks are well capitalized, the insurance and security markets are well supervised.**
- **The PSBs dominate banking sector, are inefficient, NPAs are large, governance is poor. Sovereign-bank nexus is large.**
- **Financial markets are deepening. Pension sector is underdeveloped.**
- **Financial sector increasingly reaching the underserved, helped by technological innovations.**
- **Corporate sector is highly leveraged, high debt-at-risk, impacting banks’ and non-banks’ balance sheets.**
- **Interconnections amongst banks and between banks and non-banks are high. Non-bank sector, though small is rising rapidly, creating vulnerabilities for the financial system.**

Recent Reforms: What Has Been Done?

Recent Reforms: What Has Been Done?

2010
Creation of **Financial Stability and Development Committee** lead to better interagency cooperation.

2015
Introduction of Inflation Targeting Framework in the RBI.

2015
Started **Asset Quality Review** of 36 commercial banks (including all PSBs) covering 93% of all loans.

2016
Insolvency and Bankruptcy Code introduced to deal with insolvency of companies and individuals.

2016-18
Recognition of NPAs: NPAs increased from 9.6% to 11.6% in one year as restructured loans were moved to NPA category.

2017
The new **Prompt Corrective Action** framework became effective in **April 2017**. By December 2017, RBI instructed 11 PSBs (out of 21), representing 40% of NPAs, to put several large corporate accounts to time-bound resolution process's. Amendment of IBC in June 2018 prioritizes a speedy sale of assets under liquidation.

2017-18
Recapitalization plan for PSBs (1.3 percent of GDP): announced in October 2017, first tranche of recapitalizations Feb.-March 2018.

2018
Introduction of **Banking Reforms Roadmap**. **Indradhanush Plan and Banking Board Bureau (BBB)** to improve governance and operations in PSBs—quality of Board members, infuse new talent from private sector, etc. Recapitalization to be contingent on strengthening governance.

Strengthening the Financial System: What Next?

Strengthening the Financial System: What Next?

Amend RBI Act to provide full regulatory and supervisory powers over the PSBs.

In addition to IBC, enhance out of court restructuring of corporates, speedy/time limits, with penalties for non-cooperative creditors. Remove impediments to voluntary settlement processes and develop distressed debt markets.

Recapitalization of PSBs should attract fresh capital. Provision of fresh capital based on meaningful restructuring of PSBs. Exit of weak banks. Outright privatization?

In additional to stock problem (NPAs), address flow problem by enhancing risk-management of banks and financial strength of corporates.

BBB should be further empowered to appoint and remove senior management of PSBs.

Monitor risks migrating to non-bank sector. Improve prudential framework for balance sheet risk management of NBFCs. Enforce stricter standards of corporate governance.

Review Statutory Liquidity Ratio (SLR) and Priority Sector Lending (PSL).

Introduce Special Resolution Regime for financial institutions, per international standards.

Reform ELA (emergency liquidity assistance from the RBI) to clarify eligibility, collateral standards, penalty rates. Government to give guarantee if solvency in doubt.

Strengthen FSDC—systemic risk monitoring, crisis preparedness and response.

Thank You!