1.Recapitalisation Bonds

1.1 Figures and Statistical Data

Table 1.1 Gross and Net Non Performing Assets of Public Sector Banks since 1992-93 to 2012-13 ***(Amounts in INR Billions)***

Year	Gross NPAs Amount	Gross NPAs as percentage of Gross Advances	Gross NPAs as percentage of Total Assets	Net NPAs Amount	Net NPAs as percentage of Net Advances	Net NPAs as percentage of Total Assets
1993	392.5	23.2	11.8	–	–	–
1994	410.4	24.8	10.8	–	–	–
1995	383.8	19.5	8.7	–	10.7	4.0
1996	416.6	18.0	8.2	–	8.9	3.6
1997	435.77	17.8	7.8	202.85	9.2	3.6
1998	456.53	16.0	7.0	212.32	8.2	3.3
1999	517.10	15.9	6.7	242.11	8.1	3.1
2000	530.33	14.0	6.0	261.87	7.4	2.9
2001	546.72	12.4	5.3	279.77	6.7	2.7
2002	564.73	11.1	4.9	279.58	5.8	2.4
2003	540.90	9.4	4.2	248.77	4.5	1.9
2004	515.37	7.8	3.5	193.35	3.1	1.3
2005	483.99	5.5	2.7	169.04	2.1	1.0
2006	413.58	3.6	2.1	145.66	1.3	0.7
2007	389.68	2.7	1.6	151.45	1.1	0.6
2008	404.52	2.2	1.3	178.36	1.0	0.6
2009	449.57	2.0	1.2	211.55	-0.9	0.6
2010	599.26	2.2	1.3	293.75	1.1	0.7
2011	746.00	2.4	1.4	360.00	1.2	0.7
2012	1124.89	3.2	1.9	593.00	1.5	1.0
2013	1644.62	3.6	2.4	900.00	2.0	1.3

Source: (i) RBI. Handbook of Statistics on the Indian Economy, 2005-06, 2013-14
http://dbie.rbi.org.in

1.1.1 Pre Issue of Bonds Period (1993)

In **1993**,the Gross NPA Amount is **INR 392 Billion**in Public Sector Banks.

Dr. Manmohan Singh as the Finance Minister takes the decision to issue recapitalisation bonds.

1.1.2 Post Issue of Bonds Period (2007)

In **2007**,the Gross NPA Amount is INR **389 Billion** in Public Sector Banks, **lower than what it was in 1993**, much lower after adjusting for inflation.

Hence time proving the ***success of the recapitalisation scheme.***

(Read: 1.2 Effects of 2001)

1.1.3 Post 2008 Crisis Period (2013)

In 2013, the Gross NPA Amount is **INR 1644 Billion** in Public Sector Banks, a whooping **~422% increase since 2007 signaling the increasing debt crisis in the country**.

(Read: 1.3 Reasons for rising NPAs and need for disinvestment in Banks)

1.2Effects of 2001

1.2.1 Fiscal Impacts

Since it was a **cash neutral transaction**, fiscal deficit was ***impacted only by the interest cost*** on the bonds that the government paid every year. The government's overall debt/GDP ratio though probably increased to the extent of the bond issued and so did its repayment obligations. **Rating agencies saw this as credit positive for banks but credit negative for the government** as the debt/GDP rose which was already very high for India as against similar BBB-rated countries.

1.2.2 Impact on Debt Market

There was **no major impact on the debt markets**.It was anyway unlikely that these bonds would have been traded in the open market. In fact, there were other global events such as the volatility in crude oil prices and minor widening of global trade, which would have affected the bond yields.

1.2.3 Net GDP Impact

According to a report which was prepared by State Bank of India, during 1986 till 2001, interest paid by the Government to the nationalised banks on the recap bonds works out to 0.07% of GDP per annum on average. However, during the period the banks have paid dividends to Government amounting to 0.06% of GDP on average. So, **ultimately the net impact was only 0.01% of GDP on fiscal deficit**,almost zero.

1.3Reasons for rising NPAs and need for disinvestment in Banks

1.3.1 Inefficiency

The popular way of looking at this is the **state-owned banks are inefficient**—they do not have the expertise in credit appraisal and monitoring of loans. In some cases such as infrastructure, there was subtle and not-so-subtle nudge by the government, the majority owner of these banks. Besides, most

of these banks also have a **herd mentality**. Once one bank gives a loan to one particular sector, others follow it almost blindly in search of balance sheet growth.

Key Elements for Bonds

According to an IMF research paper there are Key elements of a good bond design from the perspective of the recapitalized banks' financial performance are:
• market rates of interest to provide sufficient income;
• use of floating rates to deal with interest rate risk and minimize mark-to-market losses;
• short to medium maturities to avoid the likely lack of matching long term liabilities and to mitigate the volatility in valuation of long-dated bonds arising from interest rate fluctuations;
• no trading restrictions to facilitate liquidity management;
These would be necessary to get the most out of these recapitalised bonds and for proper functioning of the plan in 2017

Src: http://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/pdp/2003/_pdp04.

1.3.2 The 2008 Crisis

In the aftermath of the collapse of iconic US investment bank Lehman Brothers Holdings Inc. in September 2008, growth collapsed in the world, but **India was almost insulated from that** with the government unveiling massive economic stimulus programmes. RBI cut its policy rates to a historic low and flooded the market with liquidity and banks gave loans indiscriminately. ***The "boom" lasted for a few quarters but the "bust" that followed has been continuing for years***. Most banks misread the economic scenario.

1.3.3 Lesser Deposits

Also, post-Lehman collapse, the **deposit growth for private banks slowed** while the government-owned banks were flooded with money and that, in many cases, led to **misallocation of capital**.

1.4 Proposed Source of Capital

1. An estimated Rs 18,000 crore will come straight from the central exchequer by way of equity.
2. Another Rs 58,000 crore is expected to come from banks raising capital from the market.
3. The remaining Rs 1.35 lakh crore would be in the form of recapitalisation bonds, the details of which are yet to be made public.

1.5 Further Impact Of Recapitalization in 2017

1.5.1

Minor decrease in the fiscal consolidation plans for the provision of the capital required- Although these bonds are meant to be 'liquidity neutral' as previously stated, it would still certainly add to the government's borrowing.

1.5.2

To resolve the issue of a wide fiscal deficit A **balance between fiscal prudence** and and **the amount of capital spending** will be needed wherein some relaxation in the target for fiscal deficit reduction is possible to allow a higher amount capital expenditure to make higher growth possible.

1.5.3

Even after all the positive reactions to recapitalisation, studies show these packages **cannot in itself prevent the decrease in public sector bank assets.**

1.5.4

Nevertheless this approach will still allow for a way whereby banks that have still addressed their balance-sheet problems and are **in a position to use fresh capital injection** for immediate credit creation can be given priority while others shape up to be in a similar position and will at least address the **Twin balance sheet problems of the Indian economy** (indebted India Inc and rising bad loans of banks) however minorly.

1.5.5

Currently the stock markets are showing a positive reaction to this plan and estimates show that the**-** as well where there is an opportunity of a further jump in the Sensex and Nifty Bank index.