Opinion

SATURDAY, SEPTEMBER 14, 2019

DEALBREAKER?

Prime Minister of the UK, Boris Johnson

We are working incredibly hard to get a deal. There is the rough shape of the deal to be done. I have been to talk to various other EU leaders... I would say I'm cautiously optimistic

SHOBHANA SUBRAMANIAN

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PSB recap may not spur credit-growth

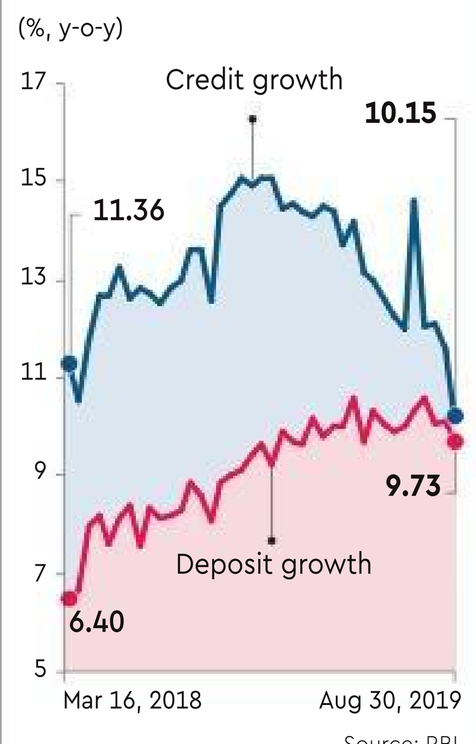
In the midst of an economic slump, banks are unlikely to find enough credit-worthy corporate or retail customers

AT 10.15% YEAR-on-year (y-o-y), the growth in non-food credit, in the fortnight to August 30, was the lowest in nearly two years. This, at a time when the banking system has an estimated liquidity surplus of over ₹1 lakh crore. While credit typically contracts in the period between April and August, the contraction this time around has been bigger than in the corresponding period of FY19. Most private sector banks have enough growth capital, though some state-owned banks may be a little short of it. Also, deposits, while not flooding banks, have been growing at an average of 10% y-o-y—though the latest reading has seen a fall to sub-10% y-o-y.

This, then, begs the question: Is it a problem of lack of demand, or are banks simply not lending? It is important to understand what exactly is happening because there is a lot of hope riding on the capitalisation of state-owned banks. On paper, the math looks encouraging, even exciting—₹70,000 crore of capital, leveraged at a conservative five times, can mean additional lending to the tune of ₹3.5 lakh crore; further leveraged, it could translate into loans of ₹4.2 lakh crore, or even ₹5 lakh crore.

That is a lot of money, but it must be lent prudently, to borrowers who give it back. The problem is that in the midst of an economic slump, banks are unlikely to find enough credit-worthy customers either in the corporate world or on the retail side. Demand for corporate credit is already down to a trickle. Or, more rightly put, there are probably thousands of companies that are longing for a line of credit, but simply don't have the credentials to get one. One can't blame banks for being far more careful about who they lend to; low-rated, over-leveraged businesses aren't exactly on top of their lists. It is even riskier to lend to the universe of small- and mid-sized firms; auto ancillaries and dealers will struggle more than OEMs. As for top-tier companies, they aren't in the market for loans anyway.

That, then, leaves the retail clientele. While, at an absolute level, the catchment may be large, the numbers that can form a reliable lending base for banks aren't. In a more sturdy economic environment, that universe would have grown, but in the midst of a sluggish economy, big job losses and no signs of a near-term recovery, it would stay stagnant or even shrink. Already, aggregate lending by NBFCs has decelerated sharply post the IL&FS and DHFL crises, and, therefore, the flow of credit to certain niche segments dominated by them is drying up. Banks, typically, haven't operated in segments such as consumer durables loans, which have been the domain of NBFCs. While there is a lot of talk of co-origination of loans, and banks teaming up with NBFCs to fill the gap, it is not clear whether banks really want to move into these spaces since they are clearly ill-equipped to do so.



A glance at the pattern of retail lending over the past year shows banks seem to prefer lending to individuals without collateral; this is reflected in the sharp jump in the unsecured loans portfolios of ₹1.45 lakh crore. Much of the credit has been put to work as loans against credit cards. The rationale seems to be that unsecured loans bring in much better yields, and can be worth it, if clients are screened properly. In contrast, an auto loan will fetch the bank a much lower yield, and the operational cost involved in repossessing the asset, in the event of a default, is high. Also, unsecured loans tend to be of a shorter duration than, say, an education loan, which could have a tenure of ten years; so, there is less of an asset-liability mismatch. Given this approach would necessitate a more thorough due diligence, it would throw up a smaller pool of eligible borrowers since not everyone would make the cut. Also, since the cost of an unsecured loan is much higher than that of a collateralised loan, not everyone would be able to afford one. That, too, would depress demand. The fresh capital infusion could have seen more auto and home loans being given, but the new rules that require banks to link the interest rate to an external benchmark could queer the pitch. As bankers have said, they will recover the entire interest, or much of it, in the early stages of the loan. That could make the new loan products more expensive than the older ones; this, in turn, will mean fewer eligible borrowers. To be sure, many of the state-run banks that have been starved for capital, will put their new-found resources to use since that is what the government expects of them. Hopefully, they will not fritter it away as they have in the past.

Live-in LIE

Rajasthan Human Rights Commission fans misogyny with comments on women in live-in relationships

A BENCH OF Rajasthan's State Human Rights Commission (SHRC) recently urged the state as well as the Centre to enact a law prohibiting live-in relationships on the grounds that cohabitation without marriage deprives women of their right to a dignified life. The bench making this recommendation comprised of retired justices Prakash Tatia and Mahesh Chandra Sharma. Their letter further stated that women in live-in arrangements are akin to "concubines", and that their situation prevents them from enjoying legal protections against domestic abuse. Not only do these assertions smack of rank misogyny, but they also lack any basis in actual fact.

The Protection of Women from Domestic Violence Act, 2005 extends protection from physical, emotional, and mental abuse to both, women who are married, and those who have a "relationship in the nature of marriage." Further, a 2015 Supreme Court judgement held that an unmarried couple cohabiting consensually would be presumed to be legally married, giving the woman, and progeny, if any, the same legal rights as a wife and a child. But, perhaps the SHRC can be excused from the burden of rooting its recommendations in facts, given that one of the bench members is recorded to have a passing relationship with them—in 2017, Justice Sharma had said that peacocks didn't have sex, but impregnated peahens through their tears. Perhaps greater moral outrage should be reserved for the fact that yet again, men who subscribe to a notion of women's "dignity" that belongs in the trash cans of the 20th century, are attempting, in the name of taking up the mantle of women's "protection", to crush their individual and sexual autonomy. In fact, the assumption underlying the SHRC's statements violates the very female dignity that it proposes to protect—implying that women are gullible creatures who are "kept", and treated as "concubines" already presumes that they are owned objects, serving the singular purpose of sex and procreation.

US ECONOMY

WHILE THE US ECONOMY IS SLOWING, NO DATA JUSTIFIES TRUMP'S DEMAND FOR RADICAL MONETARY STIMULUS. THE PRESIDENT APPARENTLY FEELS HE IS FACING A POLITICAL EMERGENCY

Trump hits the panic button

PAUL KRUGMAN

NYT

DONALD TRUMP MARKED the anniversary of 9/11 by repeating several lies about his own actions on that day. But that wasn't his only concern. He also spent part of the day writing a series of tweets excoriating Federal Reserve officials as "Boneheads" and demanding that they immediately put into effect emergency measures to stimulate the economy—emergency measures that are normally only implemented in the face of a severe crisis.

Trump's diatribe was revealing in two ways. First, it is now clear that he is in full-blown panic over the failure of his economic policies to deliver the promised results. Second, he is clueless about why his policies aren't working, or about anything else involving economic policy.

Before I get to the economics, let's talk about one indicator of Trump's cluelessness: his remarks about federal debt.

In addition to demanding that the Fed cut interest rates below zero, Trump declared that "we should then start to refinance our debt," because "the USA should always be paying the lowest rate." Observers were left scratching their heads, wondering what he was talking about.

Actually, however, it is fairly obvious. Trump thinks that federal debt is like a business loan, which you can pay down early to take advantage of lower interest rates. He is clearly unaware that federal debt actually consists of bonds, which can't be prepaid (which is one reason interest rates on federal debt are always lower than, say, rates on home mortgages). That is, he imagines that the government's finances can be managed as if the US were a casino or a golf course, and it never occurred to him to ask anyone at Treasury whether that's how it works.

But back to the economy. Why is Trump panicking?

After all, while the economy is slowing, we're not in a recession, and it is by no means clear that a recession is even on the horizon. There's nothing in the data that would justify radical monetary stimulus—stimulus, by the way, that Republicans, including Trump, denounced during the Obama years, when the economy really needed it.

Furthermore, despite Trump's claims that the Fed has somehow done something crazy, monetary policy has actually been looser than Trump's own economic team expected when making their rosy forecasts.

In the summer of 2018, the White House's economic projections envisioned that this year, three-month interest rates would average 2.7%, while 10-year rates would be 3.2%. The actual rates, as I write this, are 1.9% and 1.7%, respectively.

But, while there's no economic emergency, Trump apparently feels that he is facing a political emergency. He expected a booming economy to be his big winning issue next year. If, as now seems likely, economic performance is mediocre at best, he is in deep trouble.

Remember, Trump's two signature economic policies were his 2017 tax cut, and his rapidly escalating trade war with China. The first was supposed to lead to a decade or more of rapid economic growth, while the second was supposed to revive US manufacturing.

In reality, however, the tax cut delivered, at most, a couple of quarters of higher growth. More specifically, huge tax breaks for corporations haven't delivered the promised surge in wages and business investment; instead, corporations used the windfall to buy back stocks, and pay higher dividends.

> He expected a booming economy to be his big winning issue next year. If, as now seems likely, economic performance is mediocre at best, he is in deep trouble.

At the same time, the trade war has turned out to be a major drag on the economy—bigger than many people, myself included, expected. Until last fall, the general expectation was that Trump would deal with China the way he dealt with Mexico: make a few mainly cosmetic changes to existing arrangements, claim victory, and move on. Once it became clear that he was really serious about confrontation, however, business confidence began falling, dragging investment down with it.

And, voters have noticed: Trump's approval rating on the economy, while still higher than his overall approval, has started to decline. Hence, the panicky demands that the Fed pull out all the stops.

But, while Trump realises that he's in trouble, there's no indication that he understands why. He's not the kind of person who ever admits, even to himself, that he made mistakes; his instinct is always to blame someone else while doubling down on his failed policies.

Even actions that look like a slight policy softening, like his announcement of a two-week delay in implementing some China tariffs, betray a deep incomprehension of the problem—which has as much to do with his capriciousness as with the tariffs per se. Policy zigzags, even if they involve delaying tariffs, just add to the will-he-or-won't-he uncertainty that's causing companies to put investment on hold.

So, what happens next? Trump could reverse course, and do what most people expected a year ago, reaching a deal with China that more or less restores the status quo. But, that would be a de facto admission of defeat—and at this point, it is not clear why the Chinese would trust him to honour any such deal past Election Day. The fact is that when it comes to economic policy, Trump has trapped himself in a bad place.

Strong case for 50bps cut in October

RBI MPC may cut by 35bps on Oct 4 & 15bps by Dec, pause, and cut 40bps to 4.5% repo rate by Sept 2020, if global growth weakens

INDRANIL SEN GUPTA & AASTHA GUDWANI

Sen Gupta is Chief India economist, and Gudwani is India economist, BofA Merrill Lynch. *Views are personal*

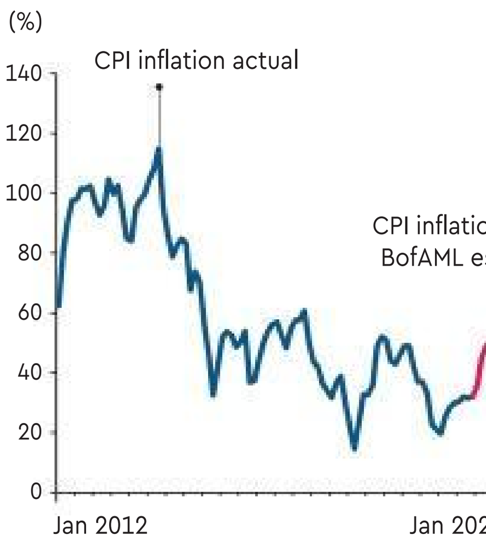
WE BELIEVE THERE is a rising case for a 50bps RBI rate cut on October 4, with August inflation coming in at a lower-than-expected 3.2% on September 13. Core inflation (except gold) is a reasonable 4%. We track September inflation at 3.6%—well within RBI's 4-6% mandate—on higher agflation. Our base has the RBI MPC following Governor Das into another 'out-of-box' 35bps cut (followed by 15bps in December, and if global growth weakens, 40bps by September). Why 50bps now? Lower yields/lending rates hold key to growth bottoming out by early 2020. The liquidity crunch is still hurting growth, with our India Activity Indicator pointing to weakness for another quarter. Further, time for lending rate cuts (50bps BofAMLe by March, 25bps FYTD) is running out with the October-March 'busy' industrial season around the corner. Transmission should be faster with banks linking 50% of their book to an external benchmark. Finally, we plan to review our RBI rate call after the September 18 FOMC meeting (25bps cut BofAMLe). It remains to be seen how banks re-price their lending rate on SME and retail loans on October 1.

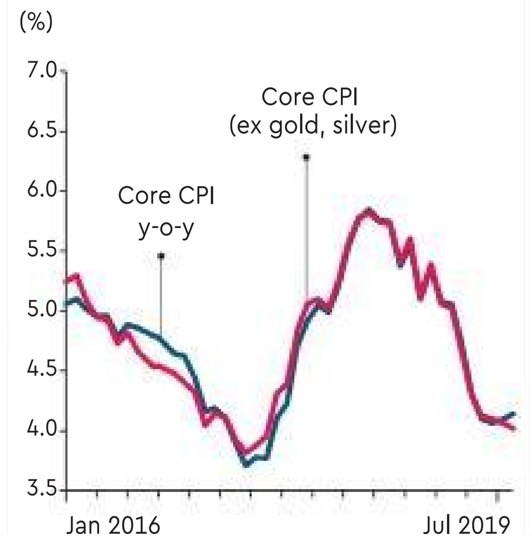
Incoming data support our standing call of a benign inflation outlook, though October-February may be higher on adverse base effects. August CPI inflation came in at a low 3.2% (3.3% consensus, 3.5% BofAMLe), up from 3.15% in July (see graphic). Adjusted for food, fuel and gold, core inflation moderated to 4.02% from 4.07% in July (see graphic). Looking forward, we track 3.6% for September on continued rise in food prices. A pick up in sowing on revival of rains should limit agflation ahead, in our view (see graphic). July industrial growth posted a higher-than-expected 4.3%, up from 1.2% in June (2.5% BofAMLe, consensus). This, in our view, is too volatile to call. Manufacturing did the heavy-lifting. While capital goods continued to contract, core IIP growth pushed headline up. FYTD IIP growth, at 3.3%, is running below FY19's 3.9%.

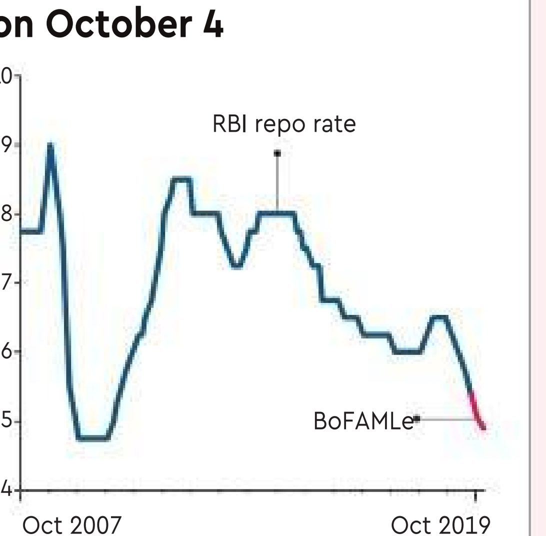
We see the RBI MPC cutting to a 4.5% RBI repo rate by September 2020, if global growth weakens. This will hold the real rate, 1.9% now, at 0-1% *ex post* and (-)1.5% *ex ante*. In the early 2000s recession, Governor Jalan had cut to 4.5%, 50bps below the 5% WPI average. As real lending rates are higher, a more negative real policy rate is surely justified, in CPI terms, especially as CPI inflation averages 100bps above WPI. Second, we assess that further RBI rate cuts are necessary to bring real lending rates down to our estimated 7% potential (in old GDP series) to incentivise investment. Finally, differential between the US federal funds rate target and RBI rate will still be a comfortable 300bps, even with our 75bps Fed cut.

How will the introduction of external benchmarks, effective October 1, impact the RBI MPC's rate policy? Our base case has banks pricing fresh retail/SME loans on a spread defined as the difference between the current retail/SME lending rate and the external benchmark. As the external benchmark falls on RBI rate cuts, banks will duly reduce lending rates. What if banks settle at a lower spread/lending rate to begin with? This would obviously reduce the need for deeper RBI rate cuts.

Edited excerpts from BofAML's 3.2% Aug CPI: Rising case for 50bp RBI rate cut, Oct 4 (September 13, 2019)







Source: BofA Merrill Lynch Global Research estimates, MOSPI, RBI

LETTERS TO THE EDITOR

Death by hoarding

Knocked down by a political hoarding illegally and precariously erected by an AIADMK functionary to welcome CM Edappadi Palaniswami and Deputy CM O Paneerselvam to his residence for the wedding of his son. It was a life sacrificed on the altar of Tamil Nadu's degenerate banner culture. The tragic incident has made the Madras HC to ask how much more blood need be spilled on the roads before sanity prevails and lash out at the state government and its employees—bureaucrats and police—for their indifference to the paramountcy of safety. Political parties in Tamil Nadu show scant regard for Madras HC's ban on banners, 'cut-outs', 'flex boards' and other publicity materials on roadsides to ensure the safety of road users and put them up to show their 'strength' and magnify the image of their leaders. Hoardings compound the problem of heavy congestion on city streets and cause accidents resulting in loss of limbs and lives. The party cadres are conditioned to massage the ego of their narcissistic leaders by providing them the pleasure of looking at their own 'larger-than-life' pictures while arriving at a place to attend a public rally or a private function. They put up the hoardings featuring the leaders as a sycophantic act and show no sense of shame for acting like minions. While there are innumerable sufferers from 'leader worship syndrome' in the so-called progressive state, the 'banner culture' is not separable from the motives of escaping the wrath of overweening leaders and winning favours from them. The state that seeks to pride itself on having greater political consciousness and upholding rationalism should shun the banner culture followed for 'hero-worship' and learn to pursue issue-based politics without expending time and energy on weaving 'personality cult'

— G David Milton, Maruthancode

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US-CHINA TRADE WAR

Stakes high for America, higher for China

IN THE 1970S, America normalised relations with China, sending ping-pong teams. Today, China and America are playing a brasher version of ping-pong, with a tit-for-tat trade war, reneging on the agreement made in June 2019 where they agreed not to levy tariffs. In early August, US President Donald Trump announced a planned tariff hike. This was met with China slamming tariffs on 5,000 American items. In retaliation, America announced tariff hikes on Chinese goods. The trade war has sent global investors, China's manufacturers, American automobile industry and American farmers into a tailspin. The trade war, while economic in intent, has strong political undertones, and while the stakes are high for America, they are much higher for China.

The trade war cannot be seen in isolation. In recent years, the South China Sea territorial dispute and militarisation of the seas has aggravated, as have boroughs of China's economic influence in Asia, Africa, Latin America and even Europe. And more recently, Hong Kong has descended into political chaos, where the Beijing-backed government is asking for a dialogue with the protesters, but clearly lacks the mechanism to facilitate it. China moving paramilitary forces to Shenzhen and sending fresh troops to Hong Kong as 'normal routine' does not help. A few protesters in Hong Kong have marched singing 'The Star-Spangled Banner', asking President Trump to 'liberate Hong Kong'. The ball is clearly in the American court.

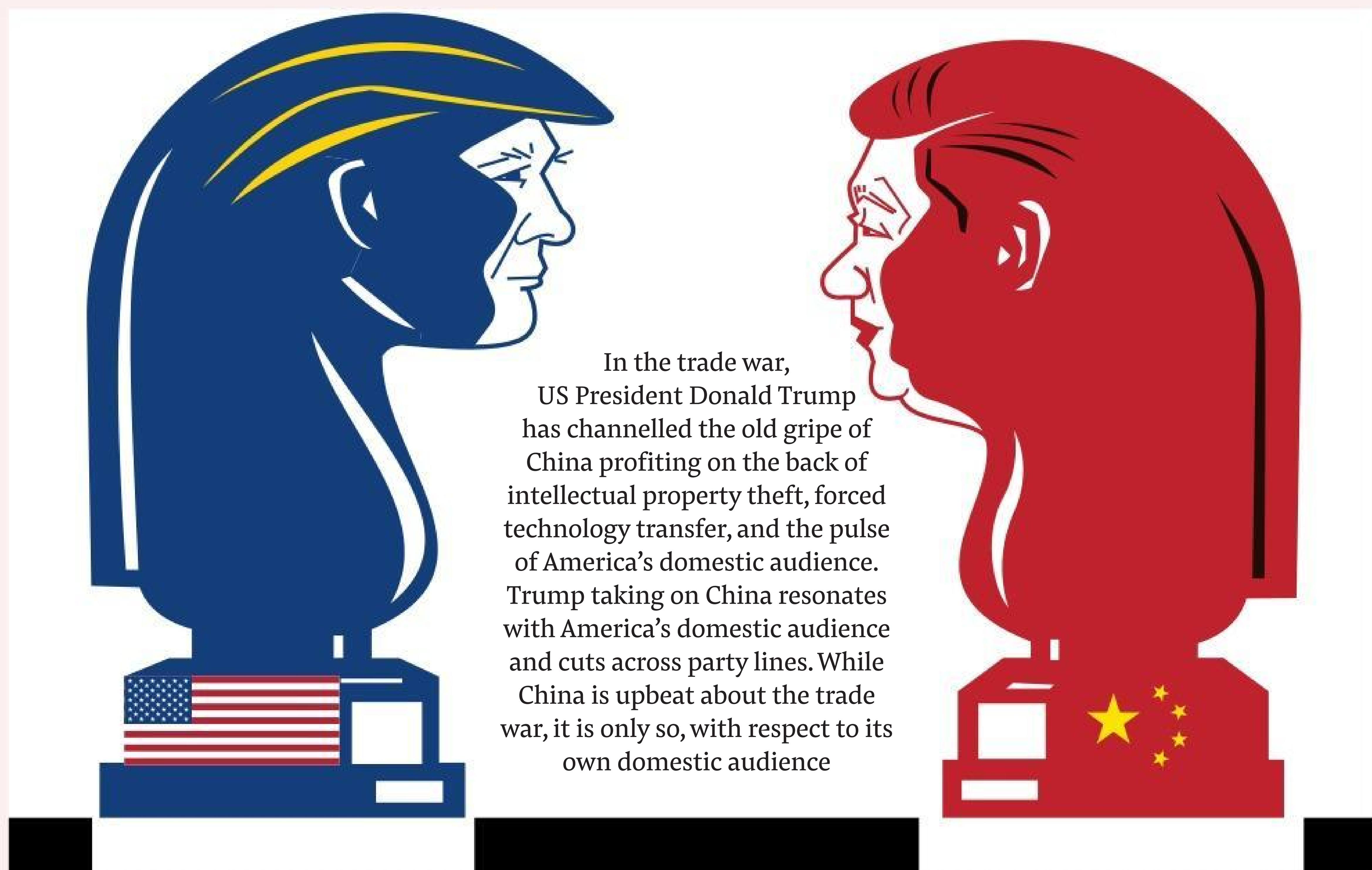

ILLUSTRATION: SHYAM KUMAR PRASAD

The American negotiating demands are transparency of an 'enforcement mechanism' backed by legislation in China and guarantees of farm purchases. China agreed to a 'regulatory mechanism' (not 'enforcement mechanism') and fell short of the American demand of reviewing the Chinese legislation prior to adoption. Months of trade talks failed to steer a deal. In response, President Trump indicated that tariffs on Chinese imports would be hiked.

In anticipation of the tariff hike, China announced counter-tariffs on $75 billion worth of goods, raising tariffs by 5-10%, in two tranches on September 1 and December 15. China also said that it would resume duties of 25% and 5% on vehicles and auto parts beginning December 15, and 5% tariff on crude oil from September 1.

The Chinese step led to America escalating the tempo of the trade war. American tariffs apply on $550 billion worth of Chinese imports, including a 15% tariff to $300 billion worth of Chinese imports beginning October 1 and raising the rate on $250 billion of Chinese imports from (existing) 25% to 30% beginning September 1.

ANURAG VISWANATH
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So, how will Chinese tariffs impact America? The *People's Daily* (China) reported that Beijing's tariffs were aimed at "inflicting pain on the US manufacturing sector." An analysis by Brookings Institution (2018) indicated that the 'hit list' of American industries was calculated to scare both 'red and blue' America. The items that China proposes to raise taxes include agricultural products (nuts, pork, soybean), textiles, toys, clothing and automobiles.

The *Wall Street Journal* has reported that major car companies, including Tesla and Ford Motor, which build their vehicles in America for export to China, will be hit hard. As for America's Midwest, G William Hoagland, senior vice-president at the Bipartisan Policy Center, a think tank, has thrown the spotlight on 240 Midwestern farms filing for bankruptcy due to the trade dispute and bad harvests. In fact, the agricultural sector has been recently granted $28 billion in subsidies.

Now, how will American tariffs impact China? These will impact Chinese companies and manufacturers who are facing slowdown. Job losses from the trade war are estimated at 2 million, or even 3 million. For China, this is bad news, with its incessant factories cutting production and jobs leading to unemployment and the circle of social problems. Goods such as clothing, footwear, toys and cellphones imported from China will cost more—a cost that the American consumer would bear. This would affect China's manufacturers, American consumers, importers, retail sales, disrupting the supply chain.

President Trump has been upbeat and optimistic that American companies would leave China and come home. But as it unfolds, American companies cannot ignore the massive Chinese market, nor the advantages of shifting base to Vietnam, Indonesia and Cambodia.

It is true that China's paternalistic state has ways to support Chinese businesses with cheaper credit and tax cuts. In fact, the American administration has labelled China a 'currency manipulator' with the yuan going past 7 against a dollar, making China's exports cheaper for the developing world. But this, too, is a double-edged sword as foreign/domestic investors could pull their investments out. China's Belt and Road Initiative indirectly facilitates exporting/dumping of products in the developing world.

But China has a lot to worry about. In the trade war, President Trump has channelled the old gripe of China profiting on the back of intellectual property theft, forced technology transfer, and the pulse of America's domestic audience.

Presidential elections are round the corner. America, despite not in decline, is perceived by a large section of the American public as a power in decline. Only a narrow majority (56%) are optimistic about America's future (Pew Research Center, 2019). According to the Pew Research Center, seven in 10 Americans (January 2019) are dissatisfied with the current state of affairs. A quarter of them (24%) view China and Russia as a threat to America, with 60% Americans having an unfavourable opinion of China (up from 47% in 2018), including a quarter who have a *very* unfavourable opinion (italics and data, Pew Research Center, 2019).

President Trump taking on China resonates with the domestic audience and cuts across party lines. This has reverberated in bipartisan support for Hong Kong, be it Kevin McCarthy's (Republican leader, US House of Representatives) opinion that America must help Hong Kong, to Nancy Pelosi's (Speaker, US House of Representatives) backing of the Hong Kong Human Rights and Democracy Act.

The truth is, as economist Eswar Prasad has noted, "...the U.S. economy is about 50 percent larger than China's, and is less dependent on trade, so its prospects look better." Clearly, with the Chinese economy slowing down, China has a lot at stake. While it is upbeat about the trade war, it is only so, with respect to its own domestic audience. China is cognisant of the downside of the trade war and hence makes conciliatory noises now and then. This explains Vice-Premier Liu He's call for "calm negotiations." This also explains why China has softened its stand with a tariff waiver on 16 US goods as a goodwill gesture ahead of the trade meet. China cannot ignore that America may not lose out too much economically and that the 'China card' is a trump card in the coming elections.

DATA DRIVE

Building a mortgage market

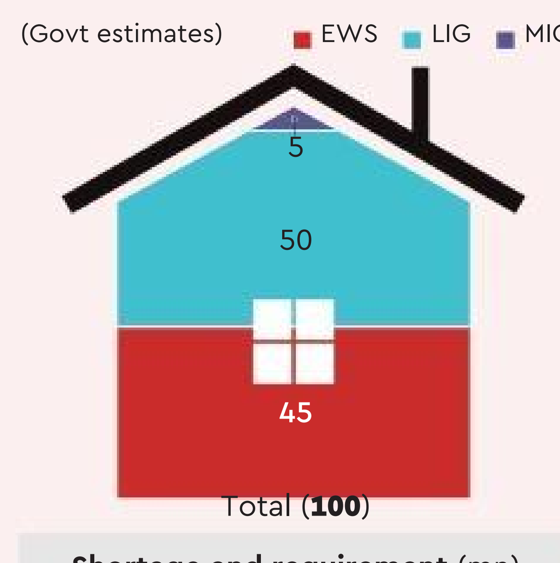
INDIA NEEDS AROUND 10 crore additional housing units by 2022, which calls for an investment of ₹115 lakh crore. A committee set up by the Reserve Bank of India has recommended setting up of a government-sponsored intermediary under the National Housing Bank (NHB) for the development of the home loan securitisation market.

The panel has suggested exemption of stamp duty for mortgage-backed securitisation. It has also suggested that loan documentation must be standardised for housing loan and NHB should establish the loan origination standards on a priority basis.

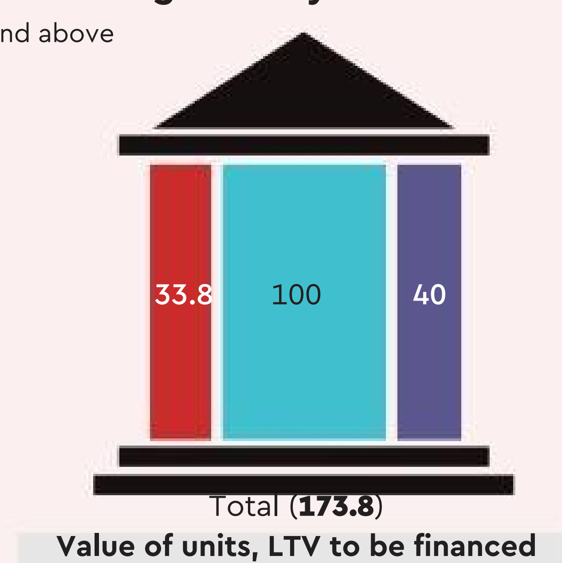
Securitisation involves pooling of loans and selling them to a special purpose vehicle. It is a mechanism to convert illiquid loans on the lenders balance sheet into tradeable securities. A well-developed securitisation market can emerge as source of funding for home loan lenders. The total volume of securitisation has grown from ₹23,545 crore in 2006 to ₹2,66,264 crore in 2019.

By the end of FY2022, the report estimates that outstanding home loans would reach ₹35 lakh crore, a compounded annual growth rate of 20% since FY19. Banks account for 58% of the outstanding home loans and the rest is from housing finance companies. India has a very low mortgage-to-GDP ratio compared to other countries and the ratio is expected to grow significantly over the years.

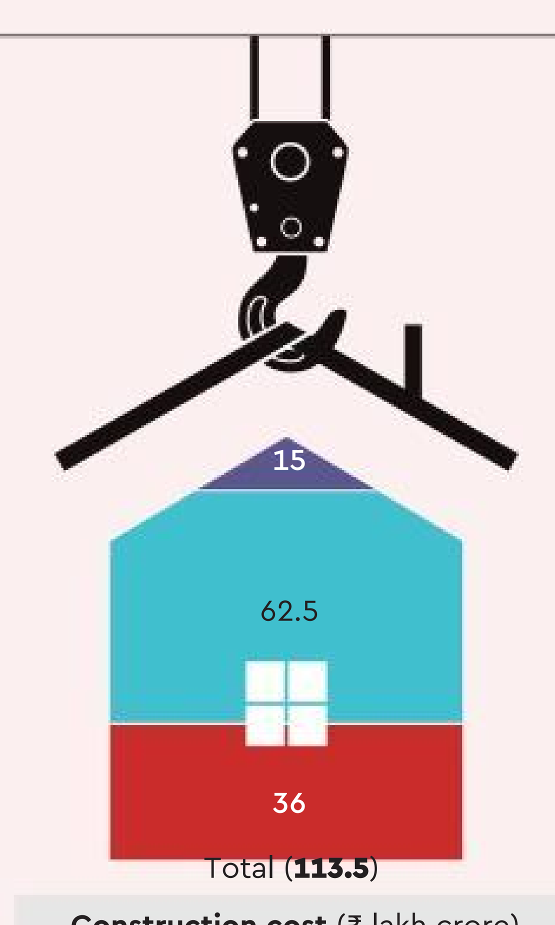
India needs additional 100 million housing units by 2022
(Govt estimates) EWS LIG MIG and above



Shortage and requirement (mn)



Value of units, LTV to be financed by HFCs, SCBs (₹ lakh crore)

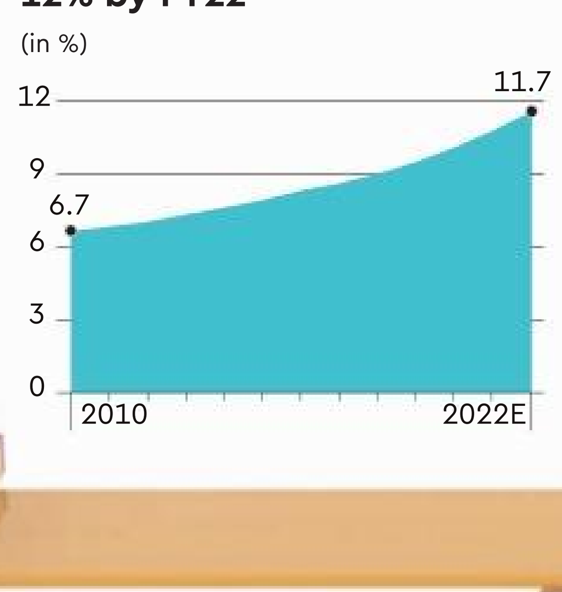


Construction cost (₹ lakh crore)

Aggregate home loan demand could be between ₹49 to 57 lakh cr

	Analyst estimates		Govt estimtes	
Units required (mn)				
EWS	36	Total 79	45	Total 100
LIG	38		50	
MIG and above	5		5	
Value of units (₹ lakh crore)				
EWS	27	Total 123	34	Total 149
LIG	56		75	
MIG and above	40		40	
Credit penetration (%)				
EWS	40		40	
LIG	80		80	
MIG and above	85		85	
Aggregate loan demand (₹ lakh crore)				
EWS	4	Total 49	5	Total 57
LIG	23		30	
MIG and above	22		22	

Mortgage-to-GDP ratio is expected to increase to 12% by FY22
(in %)



India has low mortgage-to-GDP ratio
(in %)

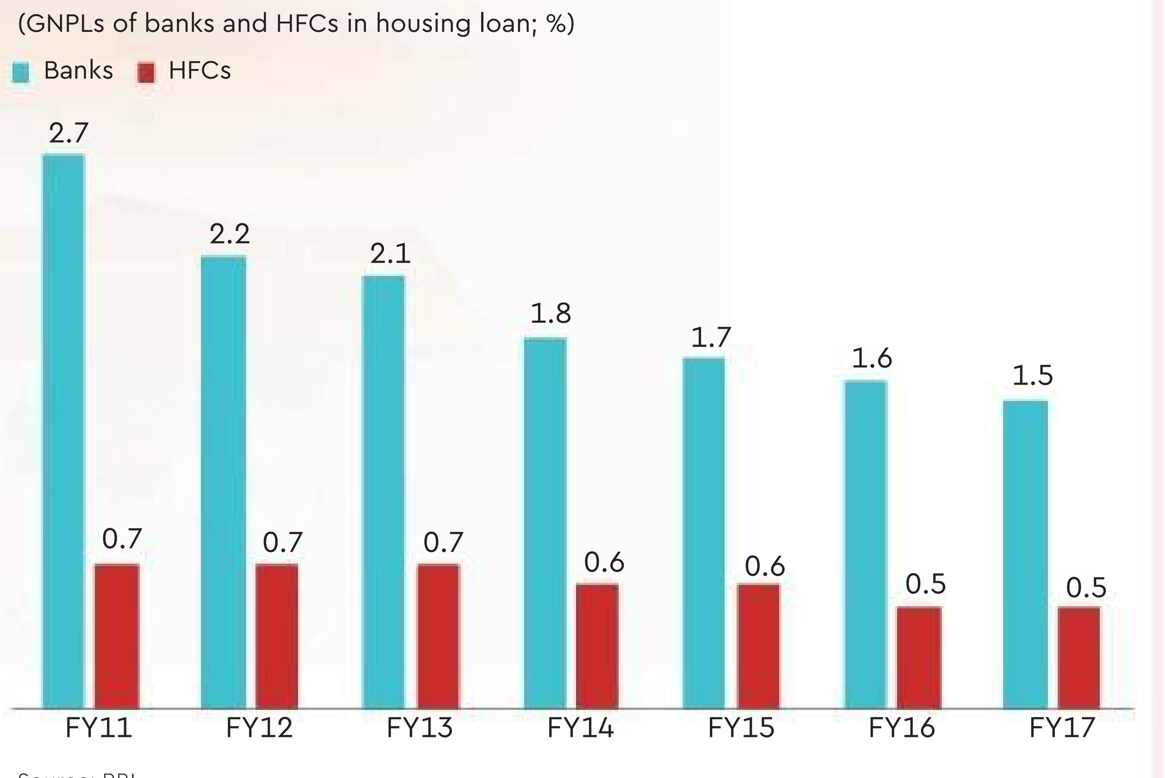
Higher finance penetration in urban India; rural catching up
(in %) Urban Rural

50, 40, 30, 20, 10, 0
34.3 → 47.5 (Urban)
7.6 → 10.3 (Rural)
FY11 FY20(E)

Market share of banks and HFCs in home loan
Banks HFCs (in %)

Home loan in India could grow to ₹35 lakh crore by FY22
(Outstanding home loan book; ₹ lakh crore)

NPA levels are still modest in home loans
(GNPLs of banks and HFCs in housing loan; %)
Banks HFCs



Source: RBI