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Banks offer new credit lines, expect defaults

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Despite State Bank of India, Bank of India, and Bank of Baroda announcing fresh credit lines for troubled companies on Wednesday, they are expecting a series of defaults by small and medium firms as the financial year draws to an end. Union Bank and Indian Bank also announced similar measures to increase working capital limits.

Banks are also asking the Reserve Bank of India (RBI) to delay non-performing asset (NPA) classification by three months (from the end of 90 days of non-servicing of loan). If a loan is not serviced for 90 days, it becomes a bad debt for the bank and provision is made. To ease pressure due to the coronavirus lockdown, corporates had asked banks and the government for a six-month liquidity line, so that they can pay off their suppliers and employees.

According to Prabal Banerjee, group finance director at Shishir Bajaj-led Bajaj Group, both bond and loan defaults will exponentially rise if the RBI doesn't allow two-year moratorium on principal payment and six- to one-year moratorium on interest payments. "The slowdown will have huge ramifications on bank NPAs," said Banerjee.

Bankers see it as a necessary step, even as it may give rise to concerns around q moral hazard.

Rating agencies are particularly in a fix. With the financial year ending on March 31, small- and mid-sized companies are likely to default en masse, while rating agencies will have to mark them in the 'default' grade. The rating agencies are guided by the principle of 'one day, one rupee', which says even if the default is for a day, or for a rupee, the issue has to be flagged as 'default'. Once the default happens, the 'default' rating cannot be withdrawn for at least six months.

"The issue now is that cash flows should be protected, and banks must give loans to companies to keep their cash flow intact, so that they can keep on giving salaries. If people don't get salaries, that would be double whammy for the economy," said a rating agency executive.

There has been no communication on this issue from the RBI or the capital markets regulator Securities Exchange Board of India, the rating agency executive said.

With deadline looming and faced with redemption pressure, some corporates are withdrawing their liquid funds parked with mutual funds (MF). According to industry sources, debt MF schemes saw about ₹1 trillion of investments pulled out at the end of last week.

"With daily operations disrupted, corporates are finding it challenging to access funding from banks and therefore, dipping into liquid investments to meet their working capital and debt obligations," said a fund manager.

The fear of run on industry assets has prompted MFs to write to the RBI to increase line of credit to ₹1 trillion through a repo window for corporate bond and commercial papers.

At the end of February, the average investor assets managed in liquid funds - which are largely used by corporates and institutional investors for short-term liquidity needs - stood at ₹4.9 trillion.

At a systemic level, liquidity has started to dry up, reflected in the spike in yields in domestic bond markets. Yields in shorter-tenure debt markets have moved up by 100-150 basis points in the current month.

The squeeze has been tightened by heavy selling by overseas investors, with over ₹54,000 crore worth of debt securities sold in March.