

The global financial crisis and Indian banks: Survival of the fittest?

B. Eichengreen and P. Gupta

discussion by Giovanni Veronese
(Bank of Italy, usual disclaimer applies)

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The paper: questions and findings

- ▶ Surprise when some banks experienced a deposit flight,
- ▶ Depositors shifted toward government-owned banks (SBI)
- ▶ Tendency for depositors to favour *healthier* banks, but ... reallocation of deposits toward SBI *cannot be explained by these factors alone*
- ▶ Nor can it be explained by the impact of *explicit capital injections* by the government into some public-sector banks
- ▶ Rather the *implicit guarantee* of the liabilities of the country's largest public bank
- ▶ Superior performance of public-sector banks did not last (after 2011)

The regulator view at the time

From RBI Financial Stability Review (2010): *“This was largely attributable to **the higher interest rates** offered by public sector banks for wholesale and large-ticket deposits and **possibly due** to customers’ perception that in troubled times, the public sector banks act as safe havens.”*

*“Contrary to the belief that public ownership weakens the allocative efficiency, the **analytical exercises by the Reserve Bank** indicate that allocative, technical and cost efficiency of the public sector banks has been much higher than the private and foreign banks in India in the recent years.”*

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Discussion: I agree but

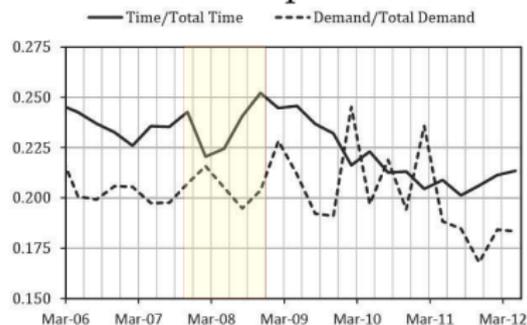
In 2010 I discussed a paper by Acharya, Agarwal, Kulkarni on same puzzle,

- ▶ They argued that implicit *and* explicit guarantees by Government of India for public sector banks helped them weather the financial crisis
- ▶ performance assessed looking at
 - ▶ deposits growth, and documenting the fall for private sector
 - ▶ market reaction (CDS spreads spike) was less acute for PSB than private banks
 - ▶ this despite marginal expected shortfall being higher ex ante for PSB (systemic risk measure)

Then I read the Acharya and Oncu paper and discovered more interesting results,

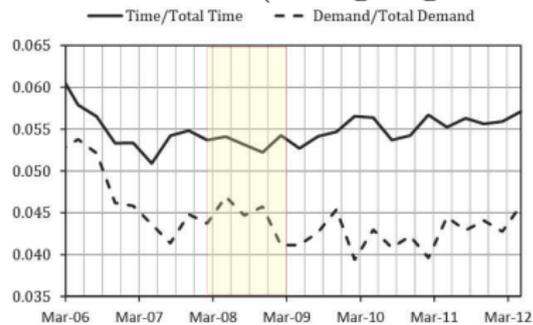
From Acharya-Oncu: group deposits / Total deposits

Public banks deposit shares

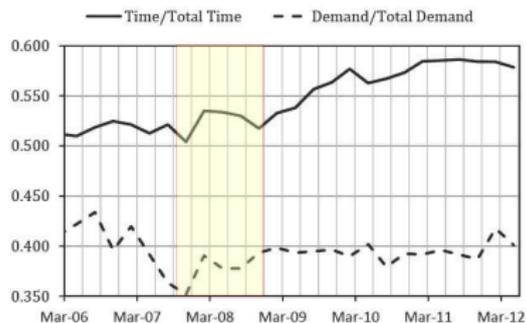


6.a) SBI Group

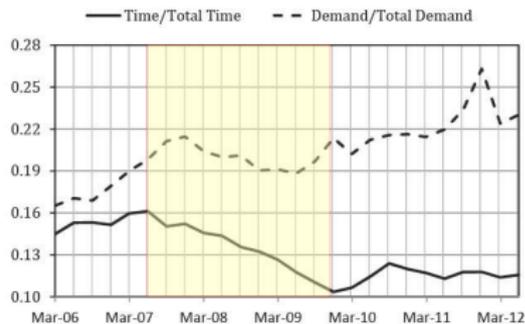
Private sector (foreign ignored)



6.d) Old Private Banks

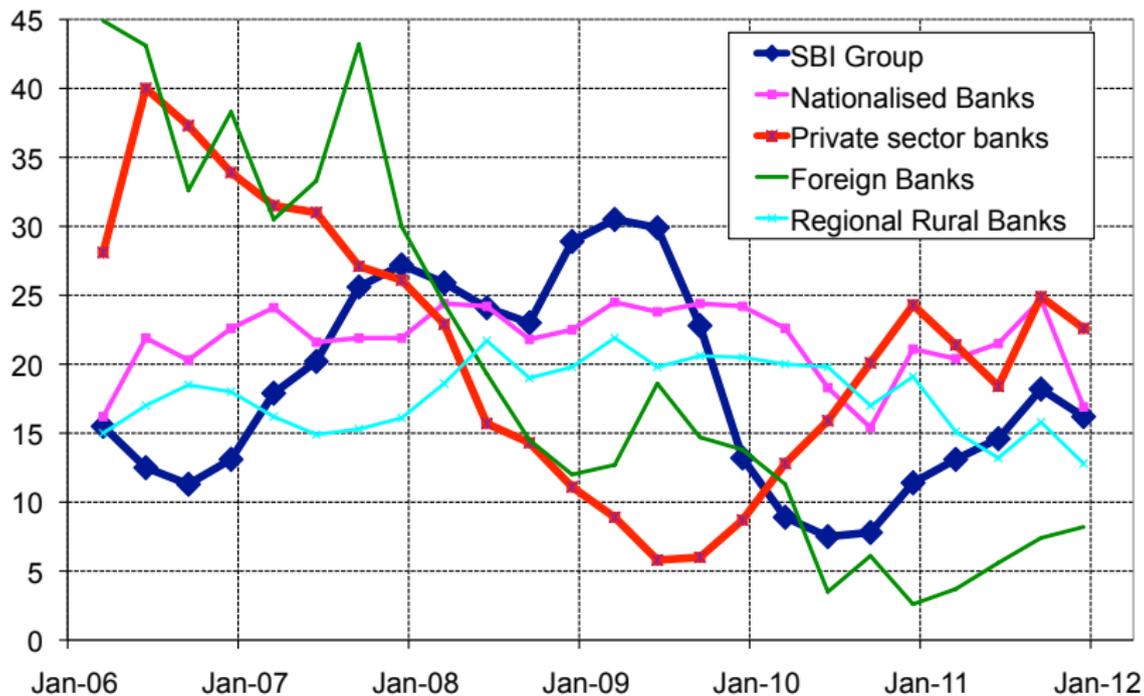


6.b) Nationalized Banks



6.c) New Private Banks

A higher frequency story: y-o-y growth, quarterly data



Questions I would like to see addressed:

- ▶ Why SBI, and not other peers in the PSB club?
- ▶ More details on deposits affected (term, time, by size)
- ▶ Which depositors: supply side
- ▶ How distributed geographically: in few metropolitan centres, or widespread across the country
- ▶ What if we looked at other sources of funding to see if also there private banks took a relatively greater hit (not liquid in general but mostly dominated by issuances of large banks)

What about prices?

We have only seen quantities,

but maybe banks pricing pattern drastically changed (predatory pricing to undercut competitors in funding trouble?)

leads me to the role of the state in banks:

What role are PSB playing in India, and elsewhere?

In Europe

Iannotta, Nocera e Sironi (2012) look at big banks between 2000 and 2010. Resort to “issuer ratings” and “individual ratings” differences to find that

- ▶ Govt-owned banks have lower **default risk** (reflecting the govt protection mechanism)
- ▶ but have higher **operating risk** than private ones
- ▶ potential distortion to competition, but not socially suboptimal if risk taking is to pursue social goals and address market failures, unviable projects etc.

However, they find that the evolution of GOBs operating risk over the electoral cycle is significantly different from the one of private banks, consistent with the political role of the govt as shareholder (rather than social role).

[Cole 2005, Dinc 2005 offer similar perspective for India and Emes in general]

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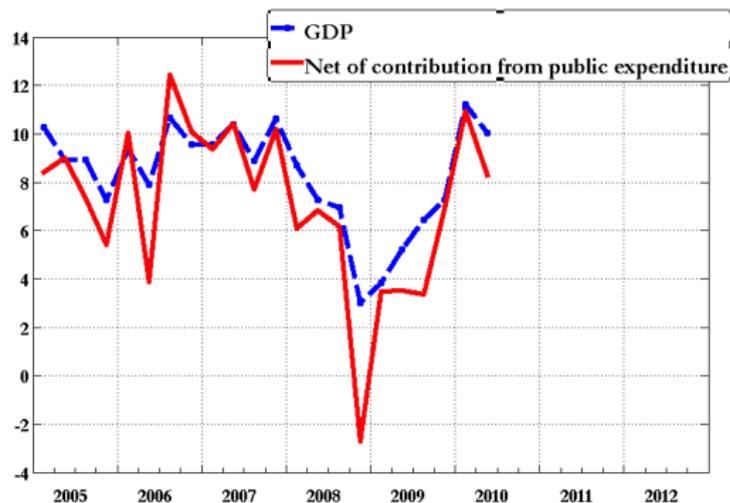
3 ideas

- ▶ Can we quantify this distortion? Various avenues possible
- ▶ Who is better at discriminating good banks from bad banks: govt or private depositors, firms?
- ▶ But more data needed from the Regulator (if Pakistan did, why not India: Khwaja and Mian QJE 2005)

3 ideas

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The explicit stimulus from GOI to GDP growth



Finally, on the “cost of implicit guarantee”: the direct outlay by GOI was massive during the 2008/09 year. Boost to GDP growth was roughly 5 pp% .

What we don't know is the contribution of this contingent liability to credit expansion that occurred thanks to PSB policies

Whose problem is it?

- ▶ Financial stability issues: deposit flight poses systemic risks (NBFCs link shows one dimension)
- ▶ The observed deposit flight and market share reallocation could be of interest to a Competition authority

Financial Sector Legislative Reforms Commission work:

“ 117. All over the world, there are complex interconnections between competition authorities and financial regulation. The Commission will re-evaluate the mechanisms embedded in the *present competition law and recommend certain areas of reform.*

In the eurozone

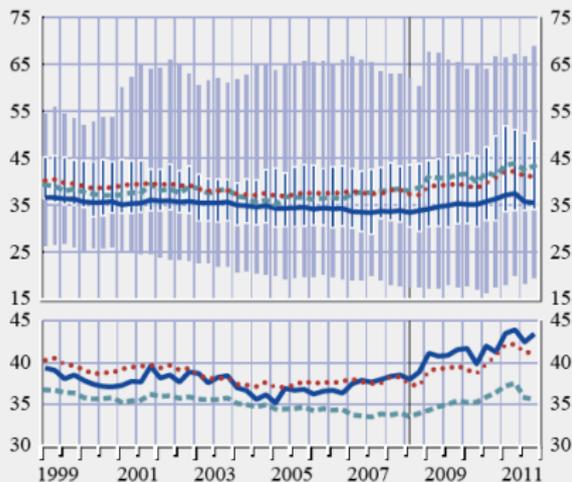
Higher uncertainty in wholesale funding markets, particularly in unsecured funding, resulted in further shifts in banks' funding strategies towards retail deposits, and *competition* to attract them.

- ▶ growing reliance on customer deposits (various factors at play)
- ▶ more so where sovereign tensions increase bank funding difficulties
- ▶ pressure on net interest margins and profitability

Chart 9 Non-bank deposit liabilities in total assets

(Q1 1999 – Q4 2011; percentages; maximum, minimum and interquartile distribution across euro area countries)

- median
- unweighted average
- - - weighted average

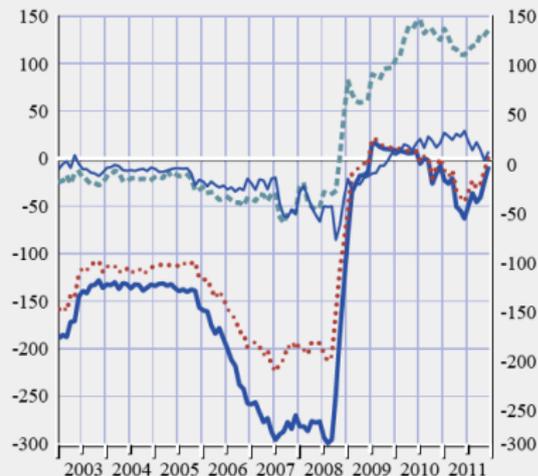


Source: ECB.

Chart 13 Spread of deposits held at banks over money market rates

(January 2003 – December 2011; basis points)

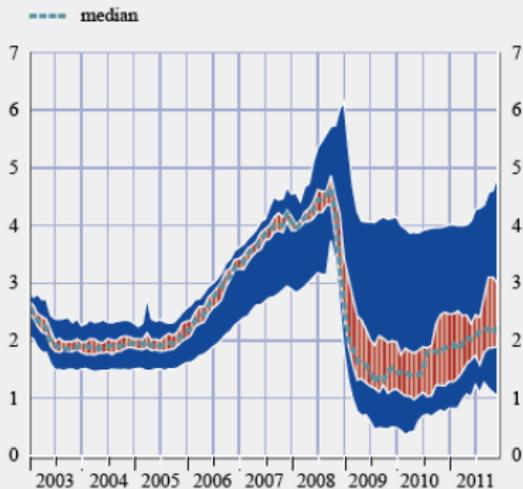
- overnight deposits from households – EONIA
- overnight deposits from non-financial corporations – EONIA
- - - up to one-year deposits from households – 3M EURIBOR
- up to one-year deposits from non-financial corporations – 3M EURIBOR



Source: ECB.

Chart 15 Rates of term deposits up to one year from households across countries in the euro area

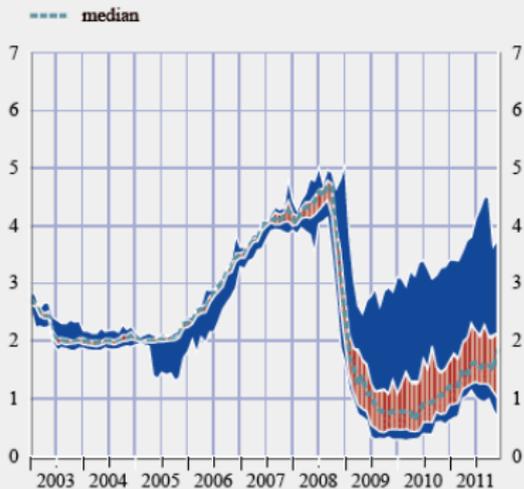
(January 2003 – December 2011; maximum, minimum and interquartile distribution across euro area countries)



Source: ECB.

Chart 16 Rates of term deposits up to one year from non-financial corporations across countries in the euro area

(January 2003 – December 2011; maximum, minimum and interquartile distribution across euro area countries)



Source: ECB.