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India’s shadow banking crisis raises spectre of contagion

Financial groups such as Indiabulls see shares fall as crisis grows

Workers at an Indiabulls Real Estate project in Mumbai. A liquidity crunch in India’s non-bank financial sector could also threaten the country’s banks and real-estate sector © Bloomberg

Benjamin Parkin in Mumbai OCTOBER 29 2019

At the turn of the millennium, a group of entrepreneurs in their twenties banded together in a cramped office near a New Delhi bus terminal to start what they hoped would be India’s answer to Charles Schwab.

Almost two decades later, founder Sameer Gehlaut — the son of a politician and army officer, once dubbed India’s youngest billionaire — and longtime executive Gagan Banga have more than achieved their dream, turning their company Indiabulls into one of the country’s most prominent financial groups.
Today, Indiabulls comprises a non-bank financial company, or shadow bank, with $17bn in assets and a real-estate developer. It has thrown its weight behind eye-catching projects such as the construction of India’s tallest building and the Mandarin Hotel in Mayfair. “They came out of nowhere,” said one Mumbai-based executive.

But the group’s success has been overshadowed in recent months by a growing crisis in India’s shadow banks, whose problems investors and analysts increasingly fear could spark contagion among conventional banks and real-estate companies and cause a broader financial crisis.

Shares of Indiabulls Housing Finance have fallen about 50 per cent since late September after the central bank blocked an attempted merger with a local bank, cutting off an important source of financing. A court, meanwhile, also agreed to hear a lawsuit alleging that Indiabulls misused funds — claims the company strenuously denies.

“We took on the big daddies of that time,” Mr Banga said, referring to the company’s rise. “It’s not the first time that we’ve been hurt.”
The woes at Indiabulls come only a year after the collapse of another shadow bank, IL&FS, sparked panic known as India’s “Lehman moment”. With the funding crunch since spreading to many of India’s 10,000-odd NBFCs — which are broadly less regulated than conventional banks — analysts say last year’s scare may not be a one-off.

A Reserve Bank of India report estimated that the failure of the largest NBFCs or housing finance companies could cause defaults in up to two banks. Nervousness about the financial sector rose this month after the RBI, responding to troubles at a small co-operative bank, issued a statement that the “Indian banking system is safe and stable and there is no need to panic”.

“It’s only a matter of time, if things are not resolved, that we’ll start to see bigger defaults in the sector,” said Saswata Guha, Fitch’s head of financial institutions in India. “There’s a risk of contagion which may flow through [NBFCs] and also banks. It’s very hard to say how this will unravel.”

Some say the problems in India’s financial companies, many of which lent heavily to real estate, echo the collapse of the housing bubble that contributed to the 2008 US financial crisis.

“You could almost take the Big Short, change the American names to Indian names, change Wall Street to Dalal Street, and you have got the best description of the NBFC crisis in our country,” said Saurabh Mukherjea, founder of Marcellus Investment Managers.

Start-up shadow banks such as Indiabulls grew to play a crucial role in India’s fast-growing economy over the past decade, coming to account for a fifth of new credit for everything from car purchases to education and luxury real-estate development.
Many borrowed cheaply from traditional banks and booming mutual funds on a short-term basis while financing long-term projects. But the scare following AAA-rated IL&FS’s defaults in September 2018 prompted the traditional institutions that fuelled the NBFCs’ rise to curtail funding sharply.

Between August 2018 to September this year mutual funds cut their exposure to the sector by around 30 per cent to Rs2.9tn ($41bn), according to Credit Suisse, and exposure to Indiabulls fell 86 per cent over the same period.

Another big shadow bank, Dewan Housing Finance, meanwhile, is negotiating with creditors after its rating was downgraded to default in June because it missed interest payments. Its stock has lost 97 per cent since its pre-IL&FS peak.

As a result, shadow banks have slashed their own lending by about a third, according to the Finance Industry Development Council, prompting a severe credit crunch that has hurt everything from car to housing sales. Authorities have announced a $10bn recapitalisation of public-sector banks designed to get liquidity flowing again.
Moody’s, which downgraded its outlook on Indiabulls’ rating to negative, cited concerns about its ability to continue accessing funding and its governance standards.

Indiabulls said the Moody’s downgrade was due to a “difference in opinion” and that it had built up a cash pool of about $2.5bn, which would cover its debt repayments for the next year. It said the lawsuit, filed by the Citizens Whistle Blower Forum, contained “distorted and fabricated facts”.

Mr Banga, who like Mr Gehlaut is from a military family, said the accusations of wrongdoing were simply a backlash towards outsiders who had broken into a corporate oligopoly of dynastic business families.

“Unless you’re part of a large conglomerate today you’re being hammered for no rhyme or reason,” he said. “It is very easy to target someone whose parents or grandparents have not been around for hundreds of years.”