1. 'India's Great Slowdown'

Context:

- Seemingly suddenly, India's economy has taken ill. The GDP numbers are worrying enough, but the disaggregated data are even more distressing. Production of consumer and investment goods is falling.
- Indicators of exports, imports, and real government revenues are in negative territory, or close to it. Clearly, this is not an ordinary slowdown. It is India's Great Slowdown.

Standard Remedies aren't Working:

- The government and the RBI have been trying vigorously to bring the economy back to health. But the standard remedies for getting out of the current predicament aren't working.
- Monetary policy is stymied by a broken transmission mechanism, which impedes the pass-through of cuts in policy rates to lending rates
- The scope for fiscal stimulus is limited since fiscal deficits are already close to double-digits (when properly measured) and larger bond issues will only further crowd out the private sector, by pushing up already-high interest rates.

Causes for the Great Slowdown:

- The Great Slowdown stems from a balance sheet crisis that arrived in two waves.
  1. The **Twin Balance Sheet crisis,** encompassing banks and infrastructure companies — arrived after the global financial crisis, when the world economy slowed and infrastructure projects started during India's investment boom of the mid-2000s began to go sour. These problems were not addressed adequately, causing investment and exports, the two engines propelling rapid growth, to sputter.
  2. The second wave came from **the collapse of a credit boom**, led by NBFCs, and centered on the real estate sector. The collapse owed to the recognition that the boom involved unsustainable financing of a rising inventory of unsold housing.
- As a result, the economy now confronts a Four Balance Sheet (FBS) problem — the original two sectors, plus NBFCs and real estate companies.

Way to address the Four Balance Sheets (FBS):

- The special mechanisms are needed because even a strengthened IBC will not be suitable for certain types of cases, notably those where social considerations are as important as commercial criteria, where public subsidies of one kind or another are inevitable, and

where coordination across government is critical. The real estate and power sectors fulfil these criteria.

- Two bad banks to resolve the Four Balance Sheet problem might be one critical element of the solution.

Bad Banks:

- It is an institution would be largely based on the principles of an asset restructuring company (ARC), which **buys bad loans from the commercial banks at a discount and tries to recover the money from the defaulter** by providing a systematic solution over a period of time.
- Since a bad bank specialises in loan recovery, it is expected to perform better than commercial banks, whose expertise lies in lending.

Why a bad bank is likely to succeed?

- A single government entity will be more competent to take decisions rather than individual PSBs.
- Capacity building for a complex workout can be better handled by the government which has regulatory control and has management skillsets in public sector enterprises.
- Foreign investors with both risk capital and risk appetite would be more in a government-led initiative, knowing that regulatory risks would stand considerably mitigated in various stages of resolution, including take outs.

Conclusion:

- Bad banks are not magical solutions. They will take some time to establish, and will require difficult political choices, in particular about how to allocate the costs amongst creditors, promoters, homeowners, and taxpayers.