Is the loan restructuring narrative credible?

Zahid Hussain

The Bangladesh Bank (BB) has caved in to pressure for extending the loan restructuring facility to large borrowers once again, albeit on a case to case basis. Large loans restructured in 2015 can be rescheduled on lenient terms – low down payments, low interest rates and longer tenure.

When lenders keep postponing repayments, they effectively increase the grant element of loans by reducing the present value of interests and amortisation. This is elementary financial arithmetic. Such privileges to a few large borrowers are provided based on their perceived criticality in the economy.

Production, employment and income will take a hit if these businesses go under. And they will go under if their loans are not rescheduled. In other words, the finances of these businesses are so weak currently that they cannot withstand the burden of servicing their loans even on the previously rescheduled concessional terms.

This is very puzzling. It is incongruent with the narrative on Bangladesh's recent performance. Economic growth has accelerated with increase in exports, remittances, public investments and consumption expenditures in both public and private sectors.

In turn, these are attributed to political stability, prudent macroeconomic management, easing of the electricity constraints, increased stock of Bangladeshis working abroad, stable international commodity prices, oil in particular, and the beneficial effects of trade diversion resulting from the US-China tariff escalation.

In 2015, the narrative supporting the case for restructuring relied on political instability, past political based discrimination of certain business groups and global tailwinds which severely constrained the financial solvency of these businesses. How the narrative can be the same now is hard to figure. Why were they not able to benefit financially from the economic stability and progress since 2015?

Yes, it is possible for some to do badly even when the economy is doing well. Just as it is also possible for some to do well when the economy is doing badly. That is the name of the capitalistic game. You gain some, you lose some. You also want to pass on some to sleep better. Corporate risk management practices exist to hedge against idiosyncratic shocks. Any macroeconomic externality argument to bail them out when their risk management fails has to be based on solid evidence.

This is where the puzzle deepens. After all, the economy moved forward at an amazing pace despite their businesses not doing well. Nor is their evidence of downturn in the sectors they are in because the balance sheets of these entities were in red. This makes their criticality argument for bailing out weak and its veracity questionable.

If a business is not doing well under general economic adversities, as was argued in 2015, and alleged to have not done well when those adversities are gone, as was the case since 2015, then how can that business be considered too important to fail from a macroeconomic point of view?

Of course, there may be noneconomic externalities. The question then is how best to accommodate these interests? Policy concessions of the kind provided to the delinquent borrowers bring with them many moral hazards. When a policy stance responds to pressure groups, the signal transmitted to the market is to invest in ways to build the capacity to exert pressure. No matter what terms and conditions the new policy has to ensure orderly repayments, the game is unlikely to change.

STAR/FILE
The Bangladesh Bank office in the capital. There is a need for a permanent solution to protect the financial system from the contagion of chronic loan delinquency.

Having been captured, the regulator is no longer seen as working for the general interest, but for the pressure group. Client politics replaces prudential regulation where most or all of the benefits of a regulatory regime go to some, often small, interest while most or all of the costs are borne by many, say, the taxpayers. Regulatory capture conflicts greatly with the notion of "independent" regulatory agencies.

It often evokes a visceral reaction and a fair bit of denialism. Lobbying leading to regulatory capture have real consequences. It weakens the confidence in prudential rules and their non-discriminatory enforcement. This in turn fosters riskier practices and inefficient economic outcomes.

It is therefore important to relieve the regulator from external pressure and find more transparent ways of bailing them out without distorting financial market behaviour. The government has done such bailouts in the past and continues to do so at present.

State-owned enterprises such as Biman, Bangladesh Petroleum Corporation, Bangladesh Power Development Board etc. and the state-owned banks have been provided recapitalisation and loan redemption support through the budget. More recently, we have seen bailing out of a private bank through capital infusions provided by the state-owned banks and non-bank financial institutions.

The government can take over the loans by, say, asking businesses seeking rescheduling to issue equivalent amount of bonds at the same price as the rescheduled loans. The money received from the bond sales can be used to repay the bank loans. That way their accountability will shift to the government through servicing of the bonds. The public will know exactly how much of their money is used for which businesses and for how long.

There is need for a permanent solution to protect the financial system from the contagion of chronic loan delinquency. The problem of time-inconsistency and credibility of promises made is important to keep in mind here. The challenge emerges from a dynamic game between the regulator and the pressure group where the pressure group is the dominant player and the regulator is the follower.

The pressure group promises to the regulator what it considers to be optimal to get the loan rescheduled. If this promise is believed then, in the next periods, delivery of the promise may not remain optimal because the pressure group knows reneging brings no biting penalty. Simply stated, making the promise is optimal but delivering the promise is not.

Since the pressure group has no significant pre-commitment to the promised behaviour, such as a large down payment in cash, and usually makes use of its discretionary powers to create pressure, the incentive to renege is operative, making their promise non-credible. It will therefore be unreasonable on the part of the regulator to expect that the promised behaviour will be carried out.

If an organisation unable to meet its obligations to its creditors does not face potentially higher costs for additional credit and/or enhanced social sanctions, it will not lose sleep over reputation risk. We have had our share of naming and shaming and Wikileaks moments. What difference did they make? Hence the need for changing the bailout model from rescheduling/restructuring to transparent budgetary support conditional on credible corporate management reforms. This of course is an interim solution until a comprehensive resolution to the NPL problem is found.

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Trade war dents Chinese company profits, portfolio inflows

Reuters, *Shanghai*

Some Chinese business sectors reported solid first half earnings, though a substantial fall in industrial profits and in tepid overseas investment inflows into China's stock markets show fallout from the protracted trade war with the United States.

Foreign portfolio inflows into stocks in the world's second largest economy have slowed dramatically. Stocks exposed to overseas markets and a weaker yuan have seen sustained selling while companies in the consumer and technology sectors have seen share prices rise as Beijing boosts domestic consumption and seeks technological independence.

Inflows in January-August via the Stock Connect scheme with Hong Kong were about 120 billion yuan ($16.92 billion). That topped the year-earlier number, but was a fraction of the 600 billion yuan of 2019 inflows the China Securities Regulatory Commission (CSRC) expressed hope for at beginning of the year.

Global index provider MSCI is quadrupling the weighting of Chinese mainland shares in its global benchmarks this year, while FTSE Russell began adding China A-shares to its main emerging markets index in June.

But industrial profits have slowed since 2018's second half as economic growth slipped to a near 30-year low.

Shares in machinery, electronics and home appliances firms, seen as vulnerable to trade tensions given their reliance on overseas markets, have been under selling pressure.

BOE Technology is an example. The OLED display panel maker, which saw first-half profits plunge 44 percent, said it faced extremely severe challenges due to trade frictions and an industry downturn.

As the trade war pushed the yuan to an 11-year low, it hurt companies sensitive to currency moves, including real estate firms and airlines. The CSI300 real estate dropped 7.1 percent in August as a weakening yuan made the property market less desirable for foreign investors.

Major airlines posted losses in the first half, as a softer yuan ate into their profits, given their large amounts of dollar-denominated debt.

Consumer firms were among China's better performing sectors as Beijing rolled out measures to stimulate China's domestic consumption. Market bellwether Kweichow Moutai (600519.SS), a famous liquor maker, reported 27 percent profit growth.

To offset effects of the trade war, Chinese policymakers rolled out measures including tax cuts and lower reserve requirements for banks, which were pushed to lend to smaller companies.

Tech firms, in focus after the United States imposed restrictions on major Chinese tech giants including Huawei Technologies, got a boost from China's continued push for technological independence, in particular the newly launched STAR Market board which is modeled after Nasdaq.

Leading tech firms, in particular those in the 5G industry chain, posted robust first half profit growth.

REUTERS/FILE
Containers are seen at the Yangshan Deep Water Port in Shanghai, China.

India manufacturing growth at 15-month low in August

Reuters, *Bengaluru*

Expansion in India's manufacturing sector hit its slowest in 15 months in August as demand and output grew at their weakest pace in a year and cost pressures increased, a private sector survey showed on Monday.

The survey comes after official figures showed India's economy grew at an annual rate of 5.0 percent last quarter, its slowest in more than six years and significantly weaker than 5.7 percent in a Reuters poll.

The Nikkei Manufacturing Purchasing Managers' Index INPMI=ECI, compiled by IHS Markit, declined to 51.4 in August from July's 52.5, its weakest since May 2018. However, it has remained above the 50-mark separating growth from contraction for more than two years.

"August saw an undesirable combination of slowing economic growth and greater cost inflationary pressures in the Indian manufacturing industry," Pollyanna De Lima, principal economist at IHS Markit, said in a release.

A sub-index tracking overall demand hit its weakest in more than a year and foreign orders increased at their slowest pace in 16 months.

Input costs rose at their quickest pace in nine months while the rate of increase in output prices was slower than in July, suggesting firms' profit margins were squeezed.

With inflation predicted to remain below the Reserve Bank of India's medium-term target of 4 percent for the rest of this year, the central bank is expected to ease further in October to boost a slowing economy.

REUTERS/FILE
A worker pours molten iron from a ladle to make automobile spare parts inside an iron casting factory in Ahmedabad.

"Another worrying sign was the first drop in input buying for 15 months, which reflected a mixture of intentional reductions in stocks and shortages of available finance," De Lima said.

"Until manufacturers are willing to loosen the purse strings, it's difficult to foresee a meaningful rebound in production growth on the horizon."

Adding to the gloomy picture, tighter margins and demand growth easing meant firms barely increased headcount.

However, firms remained upbeat about the coming 12 months. Expectations of future output rose to their highest level in more a year, the survey showed.

Sanctions choke Iran's crude sales, but oil product exports booming

Reuters, *London*

While US sanctions on Iran's oil industry have slashed the OPEC member's crude exports by more than 80 percent, oil product sales from the Islamic Republic remain strong at nearly $500 million a month, shipping data and Reuters calculations show.

Sanctions have barely affected Iran's exports of oil products, primarily fuel oil used for power generation and shipping as well as liquefied petroleum gas (LPG) used as cooking gas and petrochemical feed.

Iran's product exports reached their highest level in August, oil minister Bijan Zanganeh was quoted as saying by a lawmaker after a parliamentary meeting on Aug. 27. "In exports of products we have no problem," Zanganeh was cited as saying.

Consultancy FGE estimates Iran's product exports at 400,000-500,000 barrels per day, exceeding the top end of crude export estimates by other analysts of some 400,000 bpd for July.

Refinitiv Eikon data shows Iran exported more than 230,000 bpd of fuel oil in August, all to the United Arab Emirates, slightly above July's figure of 220,000 bpd. At current prices, and assuming Iran is not selling at a big discount, such sales generate over $300 million a month.

Data intelligence firm Kpler says Iran exported 514,000 tonnes of LPG in July, or nearly 200,000 bpd, worth over $180 million at market prices. This compares with 579,000 tonnes in June. China accounted for more than 95 percent of Iranian LPG exports in June, according to Kpler.

Samantha Hartke, head of natural gas liquids and LPG at consultancy Energy Aspects, said her firm did not expect Chinese imports of Iranian LPG to abate given China's new petrochemical capacity is creating significant demand for the feedstock.

"The irony is: if not for the US-China trade war, the US would have greatly benefited from this uptick in Chinese demand as a means of mopping up its overabundance of LPG supplies, thanks to shale," she added.

Unlike crude oil, where the ultimate buyer is a refinery, fuel oil and LPG can find their way to potentially thousands of small-scale industrial or residential buyers, Iman Nasseri, managing director for the Middle East with FGE, told Reuters.

"The market for these two products is so vast that finding and targeting those individuals is not easy," he said.

In July, Grace 1, a jumbo tanker laden with Iranian crude, became the most-watched ship in the world after the British navy seized it off the coast of Gibraltar on suspicion of carrying oil to Syria.

The tanker has changed its name to the Adrian Daria since being released by Gibraltar and is in the eastern Mediterranean.

Oil products, like crude, fall under US sanctions.

"Non-US persons engaged in this sanctionable conduct could be sanctioned themselves and be subject to blocking by the US," Erich Ferrari, a Washington-based attorney who specializes in sanctions law, told Reuters.