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Impact of INR Crunch on Banks in Bhutan

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Abstract: In early 2012, Indian National Rupee shortage in Bhutan had portents of being aggravated. Royal Monetary Authority resorted by stopping housing and vehicle loans, lowering CRR, prioritizing imports which affected lending, profitability and assets of commercial banks. The paper intends to study impact of government policies on three leading banks of Bhutan including Bank of Bhutan, Bhutan National Bank, and Druk Punjab National Bank of Rupee crunch and measures adopted by banks to overcome it. Primary data were collected through 100 questionnaires with 50 from BOB, 25 from BNB and 25 from DPNB, and supplemented by internet, blogs, journals, newspapers and annual reports of RMA, Phuntsholing being study area. Data collected were analyzed with MS-Excel and SPSS. The findings and analysis have been concluded with suitable recommendations to avoid recurrence of INR crunch.
Keywords: INR crunch, credit-deposit ratio, liquidity, banks assets, lending, profitability

INTRODUCTION

On 18th March 2012, INR crisis in Bhutan emerged as major issue due to surge in rupee demand for trade in goods and services, capital and financial transactions. 'With worsening rupee crisis in Bhutan and central bank taking various measures to redress it, it is clear that commercial banks don't have enough money to function but they claimed as being comfortable', Business Bhutan, 24thMarch 2012. Bhutan had, by and large, borrowed as a nation, prudently for investments that will bring income in future years. Two prime reasons of crisis were private consumption like car imports and private sector activities leading to credit expansion by banks and unsustainable rupee imports. Particularly, the crisis affected banks which could not provide rupee to customers in real need.

OBJECTIVE AND SCOPE

The paper intends to study impact of government policies on banks of Rupee crunch and measures adopted by banks to overcome it. Bank of Bhutan established by Royal Charter of 1968, presently incorporated under Kingdom of Bhutan's Companies Act, 2000 and Financial Institutions Act, 1992; with growing economy of Kingdom having only one bank in 1995, Royal Government converted Unit Trust of Bhutan into Bhutan National Bank which started operations on 6thJanuary 1997; and Druk Punjab National Bank, is a joint venture of India's PNB and local promoters, first FDI bank in Bhutan, started operations on 27thJanuary 2010 by opening first branch at Thimphu and, later, two more branches at Phuntsholing and Wangdue – have been studied to grasp how banks negotiated this crisis, and how far government policy was effective.

LITERATURE REVIEW

As per information in 'the Euro crisis for dummies' much of euro zone country government debts were owned by banks, Britain being at heart of world banking making nearly 15 percent of their economy if euro zone countries can't pay back all their debts, banks will struggle to get their money back as happened in 2009 [1].

RMA ensured, rupee was no more available as freely circulated currency, and it pinned down the cause to increasing dependence on imports from India to be paid in rupee [2]. Information on economy stated, iron and steel of Nu 3.8 billion in 2010; fuel, such as diesel, of Nu 2.8 billion in 2010 while petrol, including aviation fuel, of Nu 969 million; kerosene of Nu 53 million; around 3,047 light vehicles in 2010 of Nu 573 million; transport vehicles including dumpers, other heavy vehicles, engines and parts of Nu 2.9 billion were imported, more imports than exports forced RMA stopping rupee replenishment to commercial banks.

'Bhutanese government delegation visited New Delhi to request an increase in Rupee borrowing cap to Rs.10 billion, but were asked to provide more information to justify the hike'. As Rupee crisis raged on, only possible solution was to get help from Indian government. The key solutions were to increase rupee borrowings from Rs.3 to Rs 10 billion from Government of India, and to allow swap Ngultrum for Rupee or US$ from US$ 2billion SAARC currency swap arrangement with 2% interest [4].

Earlier banks issuedRs.10000 in cash to facilitate business, studies and medical travel, and transit cash requirement which had been stopped after RMA's notification(*Bhutan Today, April5, 2012*). Bhutan Chamber of Commerce and Industry, secretary general, Phub Tshering [11] said, 'Central bank figures showed banks had cash, but that cash was from short-term deposits which cannot be used for long-term loans'. As per BCCI study, 'central bank reduced Cash Reserve Ratio from 17 to 5 percent which increased cash in banks by Nu 5.8 billion, but cash shortage still existed with some banks'. While liquidity had been achieved through CRR reduction, still banks stuck to 17% to pay year end dividends. The study highlighted that of Nu.11 billion, liquidity was dominated by Bank of Bhutan being 80% with it, and little in other commercial banks. But bankers which joined market recently had no liquidity problem and provided maximum loans for growth [2].

Governor Daw Tenzin stated, 'Some banks have liquidity crunch and some don't' [3]. NK Arora, CEO of DPNB said, 'although figures indicated to no liquidity crisis, people were going from one bank to another seeking credit. It's the banks' liquidity position which disallowed loans', adding that if Nu 2-3 billion were infused in banks, the problem would be solved in next 5-6 months [5].

A Japanese consultant to Royal government of Bhutan said, Japan experienced a bubble economy in late 1980s when real estate prices were skyrocketing and banks lent recklessly believing that collateral values would never fall. The bubble burst in early 1990s and central bank and commercial banks mishandled massive non-performing loans leading to 20-year long stagnation. Seeing rapid construction boom in Bhutan, he says it signaled as bubble economy. Loans for construction and housing, personal, and transport (cars) grew 35%, 58%, and 48% respectively within just one year i.e. 2011. This pace was unsustainable and economy faced consequence as Rupee shortage [6].

Putting brakes on runaway Rupee

Banks were stopped from approving new housing loans. Task force constituted to study prioritized imports, and identified excessive lending as primary cause of rupee shortage. In 2011, credit from financial institutions was around Nu 47 billion, credit was concentrated in housing with Nu 10.29 billion (25.5%) followed by manufacturing and industrial Nu 7.09 billion(14.6%), and personal loan Nu 6.52 billion (16.5%), and tourism sector 11.2% as of March 2012.

'Banks did not have enough liquidity, therefore stopping loans was not a wise option', said deputy governor Pushpalal Chettri. Despite Indian currency shortage, foreign exchange reserves were sufficient for 13.5 months of essential imports. The crunch occurred owing to use of ineffective monetary instruments by RMA. 'The RMA didn't have proper monetary tools to reduce excessive lending and measures such as cash reserve ratio applied to hilt, hasn't been very useful', said finance minister, RGOB [7].

Money supply dips due to decline in domestic credit

Supply of money decreased due to fall in overall credit by banks in last one year, reported Phurba D Dorji. The money supply declined from 36.2% end of March, 2011 to 32.1% end of March, 2012 whereas growth of broad money decreased from 13.7% to 5.4%.The combined assets of financial sector which stood at Nu 68.5billion grew by 13.8% compared to March 2011. After a decade and half wait for fixing upmarket based competitive lending rates, the RMA concluded lending rates in the country were still sticky and financial institutions follow each other in fixing credit rates [8].

METHODOLOGY

Both primary and secondary data have been collected and personal interviews conducted with top management of these banks. Primary data are based on close and open-ended questions, distributing 124 questionnaires but only 100 could be collected and analyzed. Secondary data have been accessed from internet, blogs and journals, newspapers such as Bhutan Times, Kuensel, Bhutan Today, Business Bhutan, and annual reports of RMA. The sample size, for this study, is 100 out of which 50 respondents are from BOB, 25 from BNB and 25 from DPNB while Phuntsholing being area of study. MS-Excel and statistical tools like SPSS were used specially for closed-ended questions. Charts and cross tabulations were used to interpret. Some interpretation is based on annual reports of RMA and open-ended questionnaires.

DATA ANALYSIS AND DISCUSSION

Rupee crunch impact was experienced across Bhutanese economy. On the one hand, banks faced shortage of Indian currency causing stoppage of work transacted through INR, price of goods increased by 10 to 20%, on the other. RMA directed banks to close non-Bhutanese accounts losing most of their customers and deposits which affected profits. The other measures of RMA encouraged nationals to 'import less-export more' to achieve balance of trade equilibrium as well increasing rate of interest.

Impact of rupee crunch

Table-1shows, 65%of 100 respondents said rupee crisis affected whereas 35% saw no negative impact on their institution, being central bank agency. The banks could not control the crisis but RMA could take measures which included rate of interest hike to discourage borrowers and decrease money flow, temporary suspension of loans, providing INR who are in real need, limit for INR ATM withdrawals in India, limiting transactions to 10,000 rupees per transaction/day and to 15,000 per month, residents without bank account with Bhutanese work permit were permitted to be paid INR through employers' validation, all export proceeds must be brought in through banking channels within 91 days from export date.

Table 1: Impact of rupee crunch

Particular		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	65	64.4	65.0	65.0
	No	35	34.7	35.0	100.0
	Total	100	99.0	100.0	
Missing	System	1	1.0		
Total		101	100.0		

Most affected departments

Table-2 shows, all departments were affected but 48% think credit department while34% say operating department was most affected whereas other departments were not so affected by rupee crunch. Credit department is directly affected because lending is stopped.

Table 2: Departments affected the most by rupee crunch

Particular		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Credit Department	48	48.0	48.0	48.0
	Operation Department	34	34.0	34.0	82.0
	Finance Department	10	10.0	10.0	92.0
	Remittance	8	8.0	8.0	100.0
Total		100	100.0	100.0	

Since deposits gone down, there was limited INR, operations department handled huge crowds. Recovery department is affected as loans are suspended; clients face difficulties in clearing loans and bills on time, issuance of drafts. Accounts department is unable to maintain balance of credit-deposit ratio. Finance department, as per RMA's policies, closed non-Bhutanese accounts in banks hampering liquidity. TT department earns less commission from remittances for INR payment, decrease in loans decreases interest income, cannot transfer funds to India. Cost of human resource department is increased to avail training in India.

Changes in profitability, lending and bank assets

About BOB and BNB 48% respondents each and for DPNB 56%, felt lending had changed mostly due to closure of Indian accounts triggered deposit withdrawals in border towns after rupee crunch. Lending cannot happen without deposits and RMA stopped housing and vehicle loans to correct INR imbalances.Whereas34%, 32% and 28% respondents respectively thought profitability of banks had changed since loan freeze (Table 3). 10% respondents for BOB and 12% each for BNB and DPNB fel to wing to closure of non- Bhutanese accounts banks' assets had changed;520 non-Bhutanese BNB accounts with 538 million deposits and DPNB's 2244 accounts were paid lump sum in March, 2012 to be closed. Refund of these deposits left banks with no money to lend or invest outside.

Table 2: Change in profitability, lending and bank assets

Particulars	BOB				BNB				DPNB			
	Frequency	%	Valid %	Cumulative %	Frequency	%	Valid %	Cumulative %	Frequency	%	Valid %	Cumulative %
Valid Profitability	17	34	37	37	8	32	34.8	34.8	7	28		29.2
Lending	24	48	52.2	89.1	12	48	52.2	87	14	56		58.3
Bank assets	5	10	10.9	100	3	12	13	100	3	12		12.5
Total	46	92	100		23	92	100		24	96		100
Missing System	4	8			2	8			1	4		
Total	50	100			25	100			25	100		

The changes in profitability, lending, and banks' assets were consequence of RMA's policies which increased lending rate of interest, suspended loans and limited ATM withdrawals of INR in India; residents without accounts with valid Bhutanese work permit were permitted to receive INR after employers' validation. Payments related to government and PSUs; payments for import of capital goods, spare parts, raw materials and other inputs for industries where goods were to be received within 91 days after date of payment and invoice verified by banks with custom authority; payments for importing oil and fuel products as well medical supplies and equipments; importing construction materials for approved housing construction by Dzongkhag authorities and municipalities as of 8thMarch 2012, by individuals/business entities; payments for importing goods excluding transport/vehicle goods except for public transport buses by individuals/business entities; and payment for education/training and medical treatment expenses in India were permitted in INR denominated transactions subject to documents. Further, all export proceeds must be brought in by exporters through banking channels within 91 days from date of export.

Highest impact

Banks felt pinch of economic slowdown in the form of decrease in income, the major reason being restrictions on housing loans and ban on vehicle imports. BOB and DPNB saw marginal increase in profits while BNB and Tashi Bank registered decline in profits by 28 and 48 per cent. For BOB, BNB, and DPNB 90%, 88% and 76%respondents felt INR crunch impacted profitability, lending and bank assets. Deposits had increased due to increase in deposit rates (Table 4).While 10%, 12%, and 24% respondents felt that rupee is being provided by RMA so banks are unaffected. To de-motivate, borrowers who opted to buy luxuries rather than necessities, to meet credit-deposit ratio and to mitigate rupee problem, RMA increased lending rates.

Table 4: Highest Impact on profitability, lending and bank assets

Particulars	BOB				BNB				DPNB			
	Frequency	%	Valid%	Cumulative %	Frequency	%	Valid %	Cumulative %	Frequency	%	Valid %	Cumulative %
Valid Yes	45	90	90	90	22	88	88	88	19	76	76	76
No	5	10	10	100	3	12	12	100	6	24	24	100
Total	50	100	100		25	100	100		25	100	100	

International Reserves with RMA

In May, 2012 rupee reserves for BOB had decreased from Nu559.6 million to Nu506.2 million and BNB by Nu 94.30 million from May, 2011 level whereas for DPNBit increased by Nu.292.80 million (Table 5).There is increase in convertible currency (US$ millions) reserves as of May 2012 for BOB and DPNB compared to May 2011, whereas BNB decreased by Nu.2.5 million in May 2012.

Table 5: Rupee and convertible currency (US$)reserves (Millions)

Period	BOB		BNB		DPNB	
	INR	US$	INR	US$	INR	US$
May 2011	559.6	11.1	129.2	13.6	19.4	0.1
May 2012	506.2	11.4	34.9	11.1	312.2	3.9

Effect on banks' reserves with RMA

After rupee crunch, commercial banks' reserves with RMA plummeted from Nu. 8179.4 to 4802.8 million reducing Cash Reserve Ratio from 17 to 5 percent; increase in cash from Nu.829 to 853.4 million as of May 2012; RMA/Govt. Treasury Bills and other deposits increased by Nu. 287.5 and Nu.1309.10 million respectively (Table 6).

Table 6: Commercial Banks' Reserves with RMA (Millions)

Period	Total	Cash	CRR	RMA/Govt. T Bills	Other Deposits
May 2011	15067.2	829.0	8179.4	499.4	5559.4
May 2012	13311.6	853.4	4802.8	786.9	6868.5

Effect on foreign assets of commercial banks

As of May 2011, banks had Indian assets of Nu673.5millionwhich increased to 1377.5 million as of May, 2012. But convertible currency decreased by Nu.940.10million as of May, 2012. Foreign assets of commercial banks declined from Nu3122.9(673.5+2449.4) to Nu2886.8 m (1377.5+ 1509.3) as of May, 2012(Table 7).

Table 7: Changes in banks' foreign assets (Millions)

Period	Total	Rupee	Convertible Currency
May 2011	3122.9	673.5	2449.4
May 2012	2886.8	1377.5	1509.3

Changes in demand and time deposit liability

In a bid to improve liquidity of financial institutions, government issued a notification, requiring all corporations and trust funds to maintain idle funds as term deposits in banks meaning thereby that corporations were no longer allowed to keep their money in savings and current accounts. Prior to this, most corporations had parked funds in BOB's current and saving accounts (Dukpa, 2012).

Table 8: Demand and Time Deposit liability of Banks

Period	Demand Deposits			Time Deposits		
	Individuals	Govt. Corps	Others	Individuals	Govt. Corps	Others
May 2011	13196.4	3674.6	880.0	232	6682.5	7527.9
May 2012	16303.4	4354.1	7145.9	6617.1	5965.6	5827.2

Demand deposits of individuals, Government Corporations, and others increased sharply from Nu13196.4, 3674.6, 880Millionas of May 2011 to Nu16303.4, 4354.1, and 7145.9 Million as of May 2012 respectively. Time deposits of individuals witnessed drastic increase from Nu232to Nu6617.1 Million whereas of government corporations and others decreased from Nu6682.5, 7527.9 as of May 2011 to Nu5965.6, Nu5827.2Million respectively as of May 2012 after rupee crunch (Table 8).

The interest rates of term deposits ranged between 5 to 8.5 percent, depending on maturity, ranged from three months to seven years and above. For three months, most banks paid interest rate of 5.5% while BOB offered 6.5% for same duration. BOB enjoyed highest liquidity with credit-deposit ratio at around 74%. While all major banks recorded a credit to deposit ratio of 72 per cent and below, BNB's CD ratio stood at 94 per cent beyond which could aggravate asset liability mismatch, oncecrossedeven100 per cent. The higher the credit-deposit ratio, the less money a bank has to lend. According to central bank, a CD ratio of 75% was most optimal in Bhutanese context [9].

Change in deposit Rates

After rupee crunch, saving deposit rates were increased by BOB and BNB by 0.5% whereas decreased by DPNB. For fixed deposits of '3 months to less than one year'0.5 % and 1%, for '2 years to less than 3 years'1.50% and 2%, for '3 years to less than 5 years' by 1% and 1.50% and for '5 to7 years and above'1.25% interest rates had been increased by BOB and BNB respectively (Table 9). However, DPNB effected slight increase of 0.5% for deposit of'2 years to less than 3 years' keep in grates for other durations constant.

Table 9: Increase in deposit rates

Particulars	BOB		BNB		DPNB	
	2011	2012	2011	2012	2011	2012
Saving Deposits (%)	4.50	5.00	5.00	5.50	5.00	4.50
3 months to less than 1 year (%)	4.50	5.00	4.50	5.50	5.50	5.50
2 years to less than 3 years (%)	6.00	7.50	5.50	7.50	7.00	7.50
3 years to less than 5 years (%)	7.00	8.00	6.50	8.00	8.00	8.00
5-7 years and above (%)	7.00	8.75	7.50	8.75	8.00	8.00

BNB Corporate deposit rates

BNB upped interest rates for fresh corporate fixed deposits, in an obvious move to build up liquidity and lending capacity. The new interest rates ranged between 2 to 8.5 percent, depending on the period, the highest it has offered in recent years. Two new periods of 15 to 45 days with interest rate of 2% and of five years and above with an interest of 8.5% were added for corporate fixed deposits.

Table 10: BNB corporate deposit rates

Duration	Corporate FD rates before crunch (%)	Corporate FD rates after crunch (%)
15 days to 45 days	---	2.00
46 days to 90 days	1.50	2.50
91 days to 180 days	2.00	5.50
181 days to 364 days	2.50	5.50
1years to 2 years	3.00	7.00
2 years to 3 years	3.50	7.50
3 years and above	4.00	8.00

(Source: Kuensel, 2012)

FINDINGS

Impact of rupee crunch across the economy in general and banks in particular rattled the Himalayan Kingdom. The credit and operations departments were most affected. Since March 9, 2012 fixed deposit worth Nu. 2 billion of Indian merchants in Phuntsholing banks were refunded as central bank disallowed non-Bhutanese non-residents to hold account. DPNB has been, still, giving vehicle loans to customers in transportation business, travel agents in tourism, resorts and hotels. The bank CEO reasoned that tourism sector earns income by using vehicles. They use it in business and there is timely loan repayment [10]. The real challenge for banks presently is mobilizing deposits not lending [10].

BNB gave loans that had already been approved and need additional funds to complete constructions, depending on viability. 'The construction will be complete, they will repay us and it is good for the bank' (*Kipchu Tshering, 2012*). Karma Shacha said all banks are equally affected due to slowing down of loans means decreasing interest income. 'About 80-90% of revenue that banks generate is through loans. It is unlike international banks where revenue comes mostly from banking sector. Closing loans will obviously affect business,' he said. Druk PNB chief executive officer Mukesh Dave said, 'with economy on a standstill, Royal Monetary Authority restrictions such as freeze on loans in particular, still on and market struck with an acute shortage of cash, increase in loan defaults were only expected'.

Some banks experienced run on their liquidity or cash-in-hand, after 3,500 non-Bhutanese withdrew 1,352 million during March 9-15, 2012 keeping in view RMA circular to close all non-resident non-Bhutanese accounts as a means to rein in outflow of INR [6].

According to credit head, Tashi Bank was in the process of slowing down on giving housing and vehicle loans even before RMA directives. 'It is not healthy for the bank if housing loans suddenly shoot high. As housing loan period is 20 years with lowest interest rates, it won't be good for the bank,' Karma Shacha said, adding that retail loans are better with short term and higher interest rates [10].

Despite restrictions, imports from India increased by 11 per cent while exports decreased by 0.1 per cent. The upside of rupee crunch was that agriculture sector doubled vegetable exports to India. However, RMA restrictions since March 2012 failed to correct current account deficit.

CONCLUSIONS

Bhutan faced first ever INR crisis due to more Indian imports than exports affecting whole economy including banks. The crisis had impact on day-to-day working of banks. Rupee crunch affected every department, credit and operating departments were the most affected. Profitability, lending, bank assets and reserves were adversely affected. RMA monitored and initiated measures to control the crisis by implementing policies to be followed by banks which included temporary freezing of loans, limiting INR transactions to 10,000 per customer /day and hike of interest rate to discourage borrowers and decrease money flow to other country.

Bhutan's excessive borrowing without a clear policy and benchmark reveals symptoms of 'high indebtedness' which may severely restrict development, affect credit worthiness, and endanger national insolvency. The World Bank report on growth performance, also perceived economy under 'high risk of debt distress' and called for creating a savings stabilization fund to reduce risks related to hydropower debt repayment. The RGOB commissioned a study to find sustainability of total debt, to see how much loans would be sustainable for economy now and in future. By June 2014, government revenues also increased and export price of Chukha hydropower was revised which will add half a billion rupees every year. The rupee reserve with central bank reached around Rs. 7B, and is expected to increase further, with receipt of excise duty refund from India which amounts to almost Rs. 3B.

RECOMMENDATIONS

Banks have to ensure proper end use of loans to farmers and small industries and can lend for buying second hand vehicles. Agriculture credit can help grow more vegetables, rice etc to substitute imports. Banks can propose the government for external borrowings to bridge liquidity crunch. RMA can take steps to improve banks' liquidity position instead of suspending loans having adverse impact on economic development.

LIMITATIONS

INR crunch being recent issue there are limited secondary data and time constraint hindered in-depth study. The resource persons were prohibited to provide accurate information about policies implemented by RMA due to confidentiality of data.

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