Brickworks flags gold loan easing risks

NEW DELHI: The increase in loan-to-value (LTV) ratio for gold loans, or the quantum of borrowing against a given quantity of the precious metal, will heighten credit risks for banks, a ratings agency said on Friday.

The RBI had on Thursday increased the LTV ratio for gold loans by banks to 90 per cent from the earlier 75 per cent, in a bid to make money available to people affected by the coronavirus pandemic. "...an increase in the LTV ratio to 90 per cent increases the credit risk for banks as the collateral available in the form of gold ornaments or jewellery may not be sufficient to fully cover both principal and interest components on these loans," Brickworks Ratings said.

Its Director for Ratings, Vydianathan Ramaswamy, said the increase in LTV will result in a "negative carry" for banks as the total exposure will exceed the value of the pledged gold.

"It could adversely impact the recoverability and asset quality of banks in the case of a weakening in the borrower credit risk profile and/or sharp decline in gold prices, which have seen a strong rally over the last few months," he added.

However, given that the higher LTV is only till March 31 next year, the risk on the portfolio is for a limited period, the agency said in a note.

Also, gold loans are mostly short-tenure loans of anywhere between 3 to 24 months, it said.

The agency said given that the RBI's announcement on higher LTV gold loans is limited to the banking sector, banks are bound to garner a larger market share vis-a-vis their non-bank peers in loans against the pledge of gold in fiscal 2021.

At present, non-bank financiers and unorganised lenders like local pawn brokers with a wider network enjoy a large market share in loans against gold ornaments and jewellery.

They also charge high rates on these loans, which can range anywhere between 20 per cent to 50 per cent, whereas banks charge much lower interest rates, it said.