Bank Book 2016

World Economy

Federal Reserve's dovish stance on interest rates and the repercussions of the U.K. Referendum in favour of leaving the European Union (Brexit) triggered uncertainty in global financial markets. World trade remained sluggish in the first half of 2016 and the global outlook for 2016-17 has worsened post Brexit as per the projections.

Prospects remained varied across emerging markets and developing economies (EMDE's) with development financial institutions projecting downside risk to economic growth. Most of the advanced economies continue to confront significant economic slack coupled with a low inflation outlook. This is in addition to uncertainty over UK's future economic relations with the European Union post Brexit.

According to IMF, advanced economies are estimated to grow at 1.8% in 2016 as against 1.9% in 2015. Japan, continues to be in deflation and their domestic demand remains weak. Moreover, its Debt to GDP Ratio has remained one of the highest amongst the advanced economies.

On the other hand, EMDE's are expected to post better growth in 2016 (4.1%) compared to 2015 (4%) with some improvement for emerging markets like Brazil and Russia. China's GDP growth is likely to decelerate in 2016 (6.6%) compared to last year (6.9%) on account of slowdown in its trade. But, China's economy stabilised in the first half of the year on the back of strong government stimulus.

Overall, it is observed that the commodity-exporting emerging and developing economies, notably their energy exports are laggards, while commodity importing countries have reported steady growth. Gradual slowdown in non-OPEC production and some supply disruptions have helped oil prices to cross $50 barrel in early June. After reporting some moderation in July, the oil prices have remained range-bound since August.

Based on the projections in advanced economies combined with low commodity prices, weak global trade and diminishing capital flows prompted the World Bank to downgrade 2016 global growth forecast to 2.4% from 2.9% projected earlier.

Indian Economy

Despite sluggishness of the global economy, many analysts feel India have the right environment to be on the growth path. GDP growth is projected at around 7.6% for 2016-17.

Thanks to improved monetary and fiscal policies as well as lower oil prices, the Indian economy has stabilised. Moreover, the economic growth is expected to remain strong on the back of well-dispersed rainfall this year, which is likely to increase farm income and help rein in food inflation.

The passage of the Goods and Services Tax (GST) Bill augurs well with broad political consensus on economic reforms. Other initiatives by the government like Bankruptcy Code, SARFAESI Act, FDI measures and Real Estate Bill will be game changers for the economy. Series of developmental initiatives and measures have been taken by the financial sector regulators to boost the corporate bonds market. The success of Rupee Denominated Bonds has given avenue to the corporates to raise funds without currency risks.

Despite India's economic strength and potential, it is not immune to a global economic slowdown. Slow growth in bank credit, uneven performance of industrial sector, weak exports and demand presents a few challenges to be overcome in the coming period to sustain the growth momentum. However, implementation of the Seventh Pay Commission is expected to propel upturn in demand.

Prospects of a prolonged period of low policy rates across advanced economies are driving portfolio inflows into the country. But, any reversal could lead to capital flight from India may undermine economic performance.

Amid low domestic demand and fragile global economic recovery, RBI has opted for status-quo in its policy action. The stance of monetary policy is expected to remain accommodative with adequate provision of liquidity. According to RBI, easy liquidity conditions are already prompting banks to modestly transmit past policy rate cuts through their MCLRs and pro-active liquidity management should facilitate more pass-through.

India has jumped 16 ranks to settle at the 39th spot on the Global Competitiveness Index as per the World Economic Forum. This reflects improved competitiveness in the global arena with factors like basic requirements, efficiency enhancers, innovation and sophistication. With current account deficit broadly in line with earlier forecasts, coupled with government's focus on important economic reforms and other proactive reforms have facilitated India to be one of the fastest expanding economy.

Indian Banking

2015 – 16 was a water-shed year in Indian Banking, with the Public Sector Banking putting up their worst show ever, with extremely low growth in business, steep decline in their asset quality, high provisioning costs, huge losses and consequent drop in capital adequacy ratios. While compiling Bank Book 2015, we had noted that the clean-up of Banks' books – particularly in respect of asset quality – will happen by March 2017, but the scale of accretion to NPAs in the second half year of 2015 – 16, took everyone by surprise. Even the larger banks, which are considered the 'anchor banks' for future consolidation of the PSBs, showed very poor results; for another 5 – 6 banks which have been faring badly for nearly 2 years, there was no respite. Some banks were tottering at reaching the Point of Non-Viability (PONV) as per Basel III guidelines, and but for two reliefs granted by RBI, viz., allowing past profits to service coupons of Basel III instruments (Jan 2016) and capitalising by revaluation of fixed assets and foreign currency translations (Mar 2016), the situation would have been worse. While this deterioration was laid squarely at the feet of RBI saying the so called 'Asset Quality Review' done at their initiative pushed more accounts to NPA category, there was denying the fact that the situation for PSBs was quite bad. Morale of the banks was down, managements doing only fire-fighting every quarter; business started shrinking, and all players concerned, viz., the bank managements, Finance Ministry and even the RBI itself, seemed to run out of ideas as to how to deal with the problem. So, the only thing that is happening is shoring up the capital base of banks by infusion from the Government, and rising of Tier II capital.

The Private Sector Banks, on the other hand, have continued to perform well, as they had avoided lending to all the problematic sectors, viz., Steel, Power, Roads & Highways, other Infrastructure Companies, EPC Contractors, etc. They have consolidated their position in Retail Lending (mainly Home Loans & Automobile Loans), attracted better collateralised MSMEs from the Public Sector Banks, and even some of their good mid-corporate or large-corporate borrowers. Though their asset quality also declined to some extent, it was far below their Public Sector counter-parts. They continued to post good profits and healthy capital adequacy ratio. The stock markets have rewarded many of them with a significant increase in their share price, and higher P/BV ratios.

Amidst all this gloom, the two newly licenced full service banks, viz., Bandhan Bank and IDFC Bank started functioning. Two Small Business Banks, viz., Capital Small Finance Bank and Equitas Small Finance Bank also opened their doors, and the Payment Banks are working over-time to launch their business soon. India Post is in an advanced stage for taking up their place in the Sun.

It is in this context that we should discuss future road-map for the Indian Banking Industry. A couple of ideas that are being discussed at Government level are: (a) Consolidation of Public Sector Banks; merger process of SBI and its subsidiaries is already in progress, and expected to be completed before 31st March 2017; (b) Strengthening top management of PSBs by bringing in fresh blood from private sector; (c) Providing comfort to the Management of PSBs in taking decisions relating to OTS, waivers, etc., by making them go through a small Committee set up by GOI.

Bank Book 2016 discusses these issues in detail, in its complete version.