SECTOR RESEARCH

BANKING

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Bank credit to witness healthy growth led by revival in economic activities, well-capitalised PSBs and under control NPAs to aid growth

Financial Sector Analysis

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Executive Summary

The banking sector plays a crucial role in the development of a country's economy. The Indian banking system has been successfully able to withstand the adverse impact of the pandemic mainly due to support from the RBI. A favourable regulatory framework and high capital infusion have helped cushion the shocks, and banks have responded positively to the increased demand for credit.

While deposit growth increased during the pandemic years from 8% in FY20 to 11% in FY21, the rural economy was relatively less impacted by the pandemic, which led to an increase in credit growth in the agriculture sector from 4% as on March 2020 to 10% as on March 2021. Going forward, in FY22 and FY23, BWR expects banks' credit outstanding to increase by 7.5-8.5% and 8-9% respectively, backed by a revival and growth in services and industries. The services sector, which was the worst affected during the pandemic, is expected to witness a turnaround as restrictions ease and economic activities improve.

Asset quality, which has posed a major challenge for Indian banks in the past, has started to ease out, courtesy strict regulations and high capitalisation by the government. The gross Non-Performing Asset (NPA) levels came down from 14% in March 2018 to around 8% in March 2021. BWR expects the gross NPA levels to stabilise in FY22, but to possibly rise in FY23 on the back of increasing stress in restructured loans, as well as the agriculture and retail portfolio. It can be noted that at present, there is no bank under the PCA mechanism. The lone bank that was there, has also reportedly met the requirements for moving out of PCA.

The government, in the last 5-6 years, has infused huge amounts of capital in Public Sector Banks (PSBs) to help them weather the NPA crisis, as well as maintain the minimum capital requirements under the Basel III framework. This has, in turn, ensured that the banks are now in a better position to achieve higher credit growth. Hence, PSBs are well capitalised, and BWR, assuming the pandemic remains in check, expects very little to no fresh capital infusion happening in PSBs in FY23 from the government.

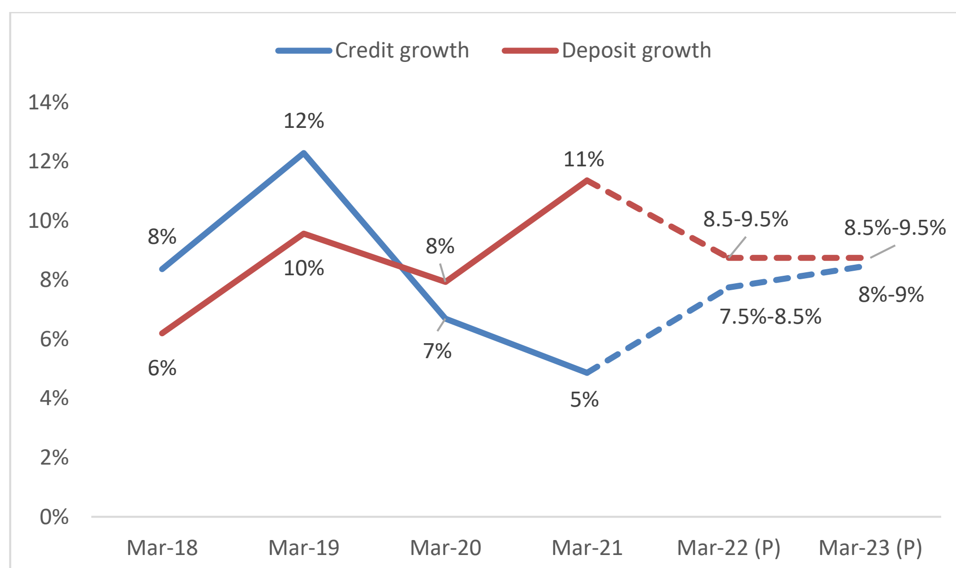
Bank credit growth revived in FY22, to witness healthy uptake in FY23

Bank credit growth has been anaemic over the past few years due to the economic slowdown, as well as the stressed balance sheets of banks in India. The Covid-19 pandemic proved to be another setback as credit growth slipped on account of huge business disruptions. However, with economic revival being faster than expected, credit growth for banks is expected to be around 7.5-8.5% in FY22 and to further improve to 8-9% in FY23.

In FY21, decelerated growth in the lending amount was mostly due to the pandemic, wherein companies had accepted the slowdown in revenue generation, thereby postponing their fresh capital expenditure. However, with the economy recovering from the effects of the prolonged pandemic and schemes such as Emergency Credit Line Guarantee Scheme (ECLGS), which have been beneficial, especially for small businesses, recovery for the banking sector is likely. BWR expects the scenario to take a positive turn in FY22 and FY23 and witness robust growth in bank credit.

The bank credit is expected to revamp in the near future backed by demand for fresh capital requirement from industrial partners.

Trend in Credit & Deposit Growth (y-o-y)



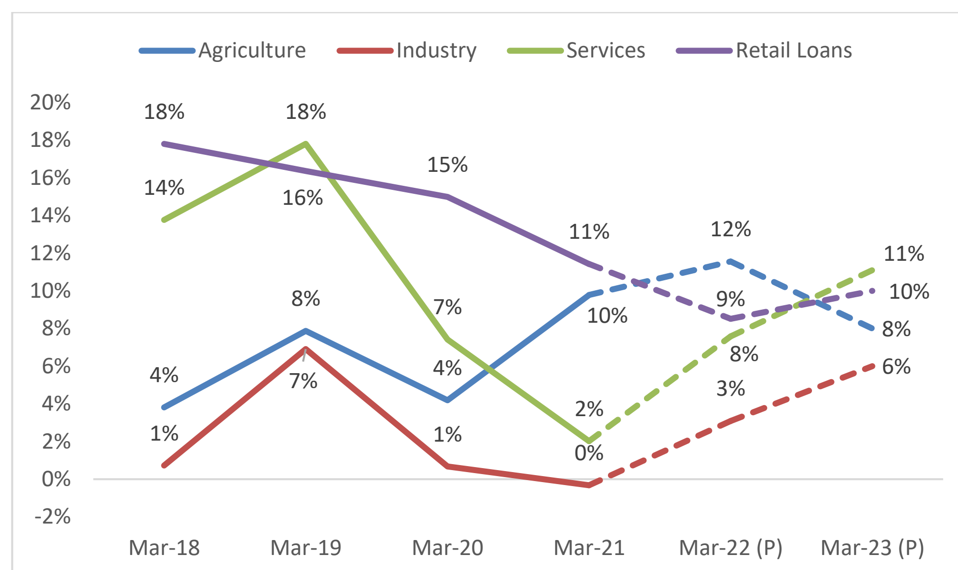
P-Projected

Source: RBI, BWR Research

While demand for credit decreased overall, the agricultural sector saw a strong increase in lending activity, mainly on account of a well-distributed monsoon and the minimal impact of the pandemic. On the other hand, bank credit in the retail segment had also shown good growth. This rise has been supported with rate cuts by banks to push retail credit as several banks offered home loans at record low-interest rates. In the last two years, banks have aggressively increased their share of retail lending as it

was a safer bet in terms of asset quality and required less capital preservation compared to corporate (wholesale) loans.

Trend in Sectoral Credit Growth



P-Projected
Source: RBI, BWR Research

While demand for credit is reduced in the industry and service sector, banks redirect their funds to the agriculture and retail segment during the pandemic. With the economy recovering banks are expected to reshuffle their funds.

In FY22, while the major industries have witnessed an increase in credit growth, a significant contraction has been witnessed in industries such as basic metal and metal products, cement and cement products, and glass and glassware. As these industries were already under stress in FY21, their capacity utilisation remained low, thereby not requiring any capital expenditure.

In FY22, BWR expects the agricultural and retail segments to be the driving force for credit growth. However, in FY23, positions may change, with the service sector being the leader and having a growth rate of 11-11.5%. The service sector has been under stress during the pandemic as it is a contact-intensive sector. With restrictions being eased and higher vaccination coverage, revival in this sector is expected to be much faster due to pent up demand being created. Hence, BWR expects the service sector to be one of the most benefited sectors in the post-pandemic scenario.

Trend in Industry Wise Credit Growth

	Mar-2018	Mar-2019	Mar-2020	Mar-2021	Dec-2021
Infrastructure	-1.71%	18.52%	-0.19%	3.67%	3.93%
Basic Metal and Metal Product	-1.17%	-10.69%	-5.72%	-6.07%	-12.96%
Textiles	6.93%	-3.03%	-5.47%	4.36%	6.01%
Chemicals and Chemical Products	-5.47%	17.48%	5.99%	-5.18%	3.04%
Food Processing	6.76%	1.09%	-1.85%	-0.50%	7.11%
All Engineering	3.81%	8.56%	-6.74%	-5.79%	5.21%
Construction	9.54%	10.43%	4.84%	-9.32%	1.14%
Vehicles, Vehicle Parts and Transport Equipment	7.03%	1.42%	3.44%	0.70%	2.04%
Petroleum, Coal Products and Nuclear Fuels	9.38%	-3.06%	20.11%	-11.77%	29.32%
Gems and Jewellery	5.26%	-0.90%	-17.36%	6.61%	6.99%

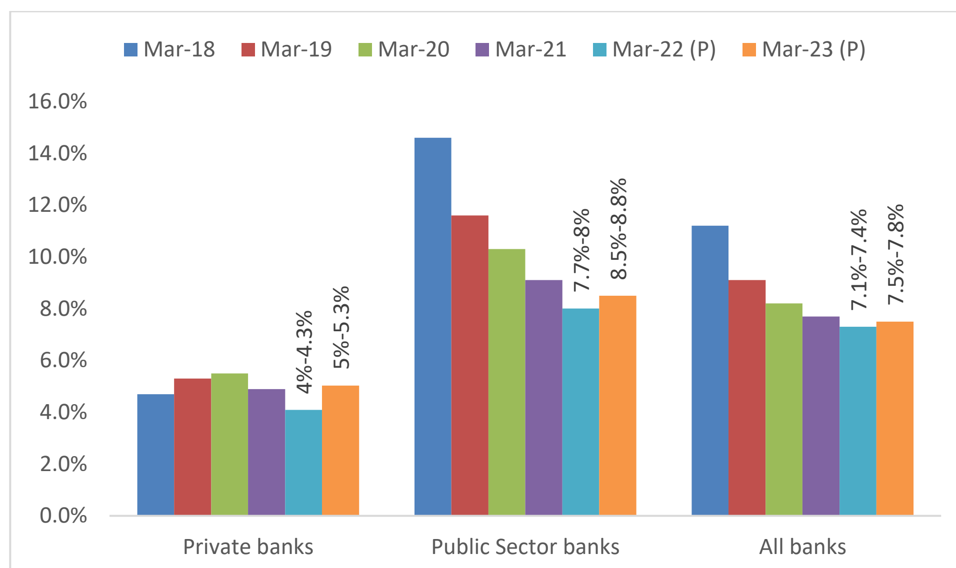
Source: RBI, BWR Research

Asset quality expected to improve in FY22, but restructured advances may pose risk in FY23

The asset quality of banks has witnessed steady improvements over the past few years. The asset quality improved with an increase in the recovery rate and fresh slippages declining. Decline in SMA overdue and restructured portfolio also helped improve asset quality, thereby reducing credit costs during this period.

In FY21, bank credit growth had been sluggish due to the pandemic impacting aggregate demand. During this period, the ECLGS led to an increase in lending to small businesses in comparison to their larger counter parties. This, in turn, led to the better asset quality of the medium-size enterprises in comparison to larger companies. While overall the major sectors saw a decrease in the gross NPA level as on September 2021, food processing, chemical and infrastructure (excluding electricity) witnessed an increase in the NPA in comparison to March 2021.

Trend in Gross NPAs - Bank Group wise

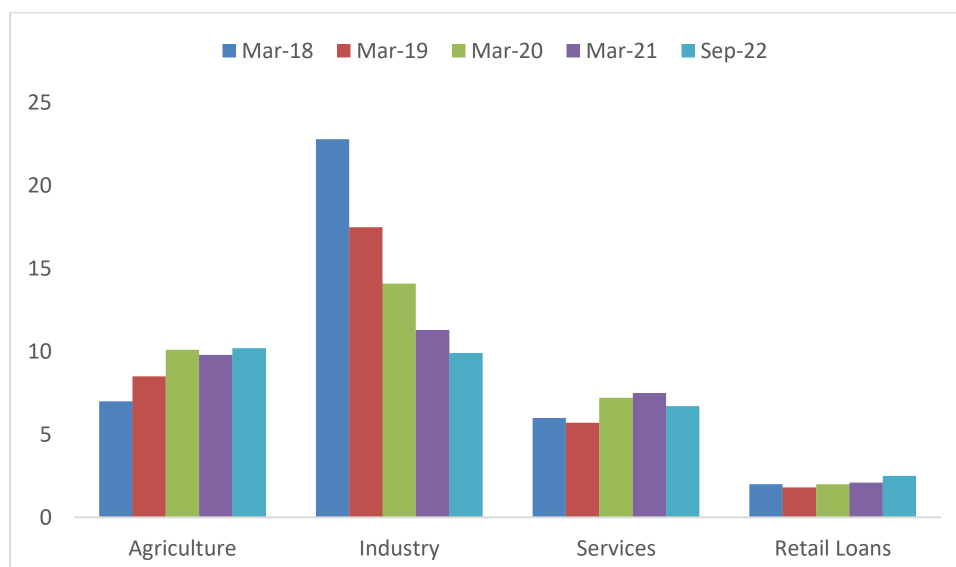


P-Projected

Source: RBI, BWR Research

BWR expects that in FY22, the gross NPA of banks will further improve, backed by a reduction in fresh slippages. In FY22, banks have been re-risking their portfolio, but the stress level is under control, which is expected to help reduce slippages. However, restructured advances may pose a risk in FY23 as banks have already started to witness some stress in these portfolios.

Trend in Sectoral Gross NPA levels



Source: RBI, BWR Research

Additionally, banks in the last couple of years have increased lending towards agriculture and retail in order to compensate for the loss of business from corporates.

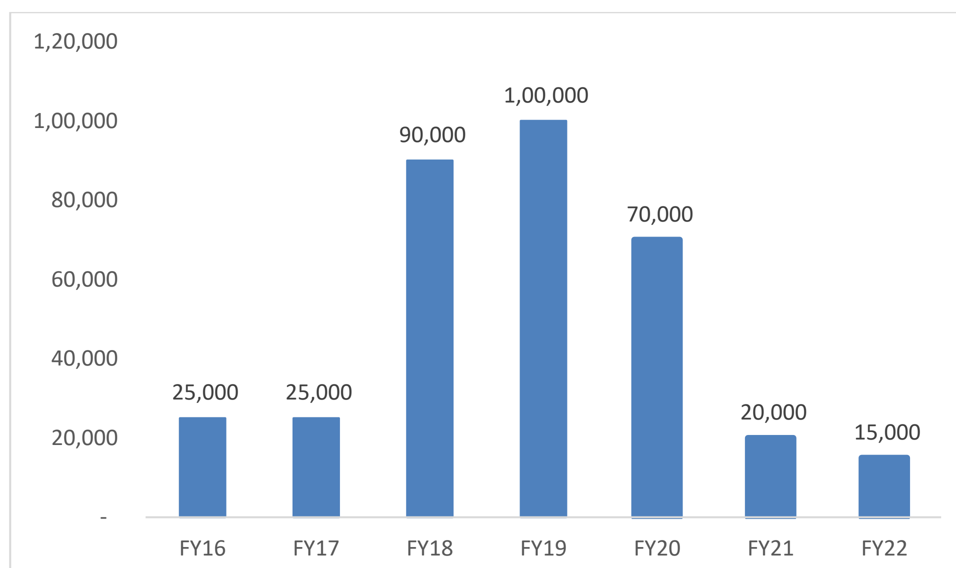
Some of the loans in these portfolios have started to show stress and are expected to contribute to fresh slippages in FY23.

PSBs are well-capitalised, would not require major infusion in FY23

The Indian banking system has been able to withstand the shock of the pandemic and maintain the capital adequacy ratio above the minimum regulatory requirements under the Basel III framework. Between FY17-FY20, the government injected ~Rs 3,000 billion in PSBs in order to help the banks maintain the minimum capital requirement, as well as manage huge amounts of bad assets in their books. The funds not only improved the Capital to Risk weighted Assets Ratio (CRAR) of PSBs from 11.7% in FY18 to 14% in FY21, but also acted as a cushion for the banks against the potential shocks of the pandemic.

The past capital infusion by GOI has proven to be fruitful in stabilising the banking system presently thereby reducing the need for any further dosage of capital from the government.

Capital infusion by government in PSBs (in Rs crore)



Source: Budget Documents

While the government has further infused Rs 200 billion and Rs 150 billion in FY21 and FY22, respectively, there has been no further announcement of capital infusion in FY23 as per Union Budget FY23. The government, as part of the restructuring of the banking sector of India, has merged 10 PSBs into 4 banks in 2021. This has provided a larger capital base for the banks and has reduced the need for capital infusion from the government. BWR expects that in FY23, banks will be able to achieve credit growth of 8-9% and adhere to the minimum capital requirements without any fresh capital infusion from the government.

Annexure

Digitisation in banking gaining momentum, digital currency a major step forward

Over the past years, the Indian digital banking platform market has witnessed robust growth, backed by faster digitisation and the adoption of advanced technologies. Technology advancement in the banking sector enables banks to provide a customised product mix to customers and will not be restricted by place boundaries. The pandemic has accelerated the process and made the public more adaptable to retail digital payments.

Bank lending through digital platforms is still at a nascent stage, and the RBI has been trying to encourage the digital banking system with innovative ideas. The recent launch of the account aggregator system will ease the lending process and documentation. It has been useful in creating a proper financial system, wherein user data security is ensured and personal financial data can be managed conveniently as data is stored in an encrypted form in a location.

While the public is becoming more accustomed to digital payment methods, the RBI has been working on shielding the digital lending ecosystem from illegal activities. Over the years, the RBI has proposed the following ideas, among others, to build a safer digital banking system:

- Setting-up a Self-Regulatory Organisation (SRO)
- Verification process for digital lending apps by a nodal agency
- The enactment of a separate legislation to prevent illegal digital lending activities
- The development of certain baseline technology standards and compliance with those standards as a pre-condition for offering digital lending solutions
- Consent-based data collection with verifiable audit trails

Another major step has been the announcement of a digital currency in this year's union budget. It will give a major boost to the digital economy and may also lead to a more efficient and cheaper currency management system.

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