Funding Challenges to Continue for India's Shadow Banks in H1FY20

Mumbai, March 19, 2018

Liquidity Crunch fueled by muted demand from capital market and low appetite from banks

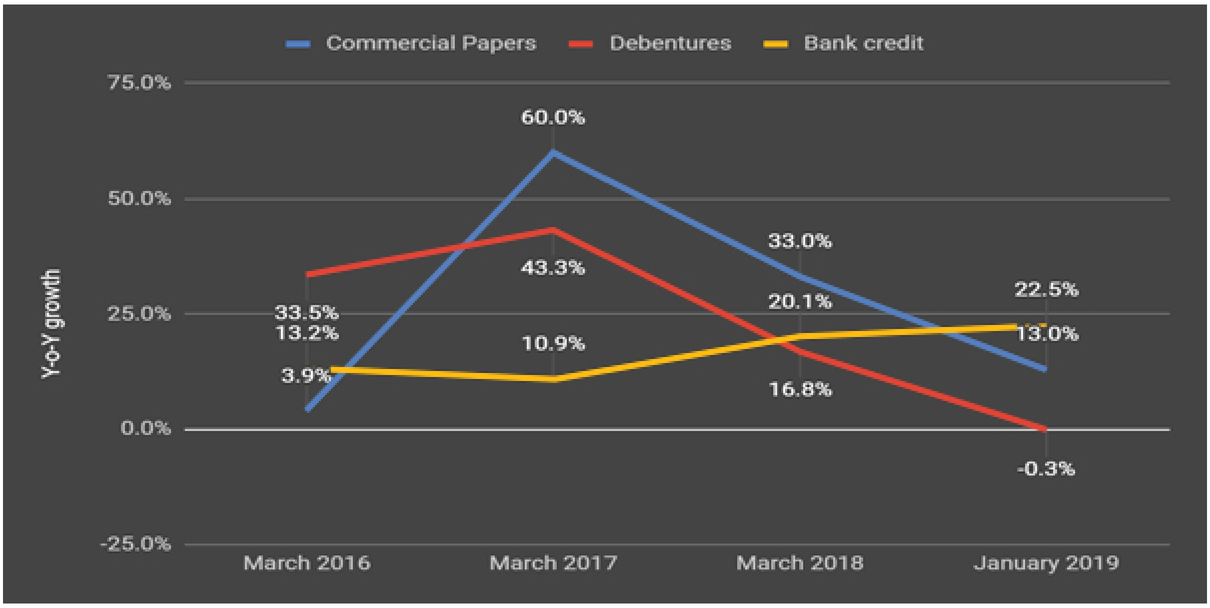
Brickwork Ratings, Mumbai, 18 March 2019: Brickwork Ratings sees prolonged liabilities mismatch for India's shadow banks – Non Banking Financial Companies (NBFCs). This will be partly due to drying up of market borrowings, as mutual funds turn wary of investing in financial instruments issued by NBFCs and partly due to challenges faced by banks internally like an elevated Credit-Deposit (CD) ratio.

NBFCs have seen a healthy growth over the years. During the period FY14 to FY18, this segment grew at a CAGR of 16 per cent, while bank credit grew by 10 per cent during the same period. However, unlike banks, which are struggling with asset quality issues, NBFCs have been facing challenges in managing their liability side, especially raising funds from the capital market.

The major source of funding for NBFCs have been market borrowings and bank borrowings, accounting for close to 80 per cent of the overall resource base, bank borrowings being the largest source of funding.

In terms of market borrowings, mutual funds (MFs) were the major subscribers of debentures and commercial papers (CPs) issued by NBFCs. This exposure became a source of concern for many investors after the IL&FS default thereby resulting in investors becoming reluctant towards lending to this segment. MFs continue to be vary of investing in long term liabilities of NBFCs, which has seen a degrowth of -0.3 per cent y-o-y as on January 2019. However, they have shown some interest in short term liabilities like CPs, albeit at a slower rate of 13 per cent y-o-y compared to previous year growth of 33 per cent.

Growth of MFs exposure to NBFCs (by instrument) & Growth of bank credit to NBFCs



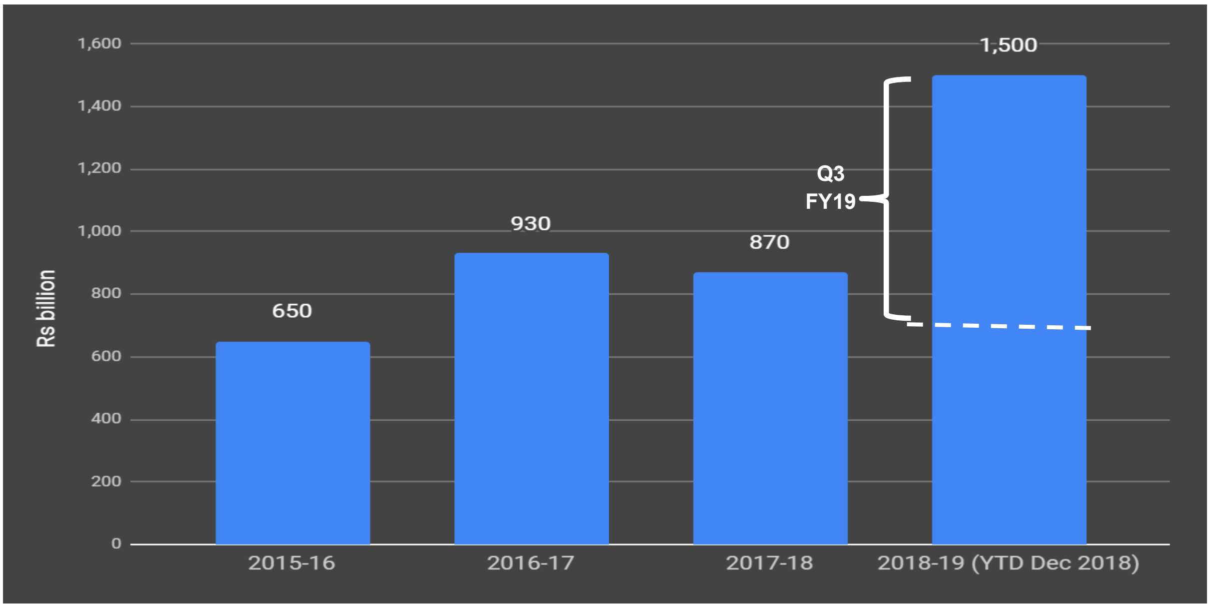
Source: SEBI, RBI, BWR Research

While on the other hand, bank credit to NBFCs has been steadily increasing. In the last couple of years i.e. FY18 and FY19, bank credit to NBFCs has grown by 20 per cent and 23 per cent respectively, which is much faster than 10 per cent and 13 per cent growth seen in FY16 and FY17, when market borrowings were still on the rise.

Reserve Bank of India (RBI) has also recently issued regulations to facilitate credit flow into the sector. One of them is related to risk weight calculation for banks exposure to NBFCs, wherein rated exposures of banks to all NBFCs, would be risk-weighted as per the ratings rather than assigning a risk weight of 100% earlier. This would help banks save capital, as they now have to assign less capital while lending to better rated NBFCs, thereby enhancing funding access to NBFCs.

Further, the relaxation of asset securitisation norms by RBI in November 2018 has helped ease the liquidity issues to some extent. The total securitisation volumes have almost doubled reaching close to Rs 1.4 trillion in 2018-19 (YTD Dec 2018). In Q3 2018-19, out of total assets securitised of Rs 78,000 crores around Rs 73,000 crores was raised by NBFCs and HFCs through sell-down of their retail and SME loan portfolio to various investors. BWR expects similar volumes for Q4 FY19 as well, taking the total volumes to around Rs 2 trillion.

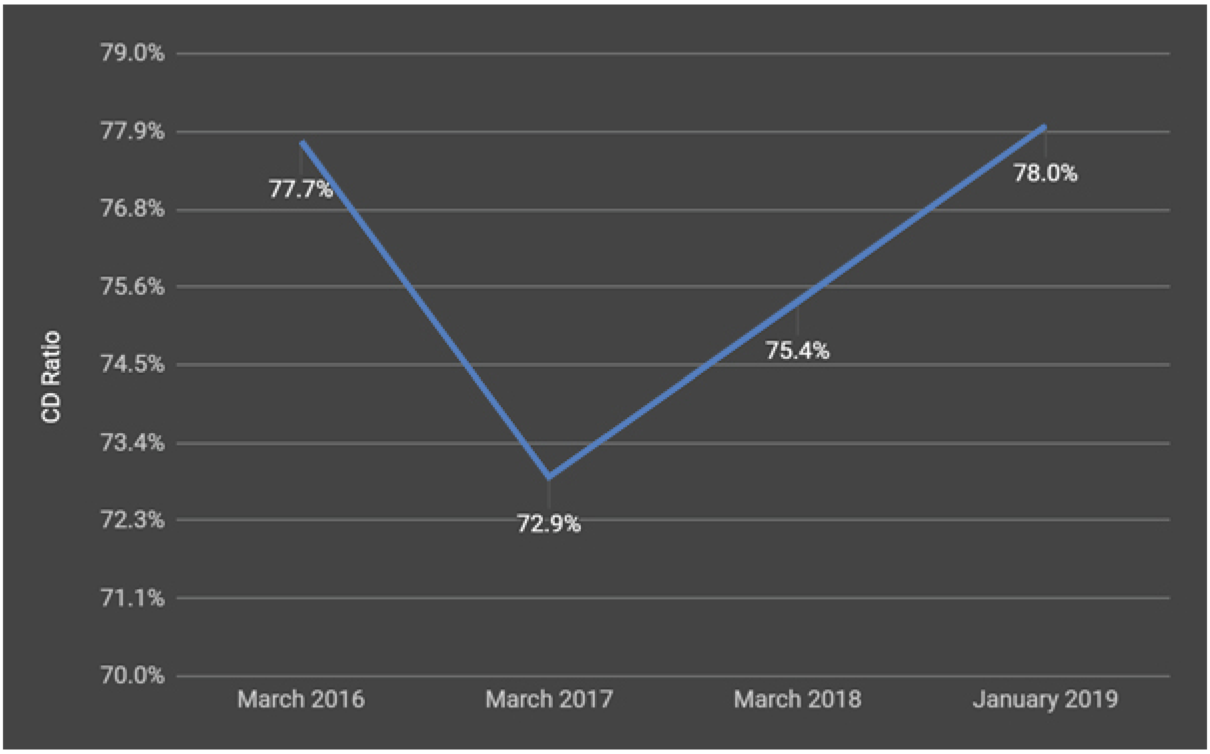
Securitisation volumes (Rs billion)



Source: BWR Research

While these measures have helped NBFCs to continue to borrow more from banks, the banks have other restrictions. The credit-deposit ratio of banks has reached around 78 per cent from a low of around 73 per cent seen 2 years back, which means banks are lending more out of their deposits. Banks are running out of space to continue lending, unless they can shore up their own deposits. During the first ten months of FY19 i.e. as of Jan 2019, the incremental CD ratio has been around 135 per cent. This has been due to faster credit growth and tepid growth in deposits. As on Jan 2019, bank credit has grown by 14.3 per cent y-o-y in contrast to just 9.1 per cent growth in deposits.

Credit-Deposit ratio of Banks



Source: RBI, BWR Research

If the lending growth continues to outpace deposit growth, the banks will be under pressure to raise more deposits. This leads to inability to transmit the effect of rate cut by RBI, on the contrary, banks might be forced to increase their deposit rates and thereby increase their lending rates as well. The changes in the regulations related to bulk deposits taken by banks and linking rates to external benchmarks should help ease the pain but that needs to be seen.

Though the RBI has been providing regular support through issuing regulations to ease the funding crunch faced by NBFCs, challenge still remains and might lead to the slowing down of the buoyant credit growth seen by NBFCs over the years. To be sure, the better run NBFCs continue to get funding for their growth needs, albeit at an elevated cost of funds. However, relatively better asset quality (challenge so far contained to some pockets of construction finance and loan against property), RBI support and strategic importance of the segment, may result in confidence returning thereby opening up funds from the capital market for this segment.

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