

**BANKING AND FINANCIAL SERVICES**

**Sector Impact:**

Banks - PSU - Highly Positive  
 Private Banks - Positive  
 NBFC – Infrastructure - Positive  
 NBFC – Others- Positive  
 HFC - Neutral

**Background**

The Banking & Financial Services Institutions (BFSI) sector continued to witness a moderation in credit growth during H1FY10 following the global credit crisis in H2FY09. High deposit growth coupled with low credit offtake led to a build-up of surplus liquidity in the banking system. Credit offtake remained low as most companies tapped into alternative sources of funding such as QIPs, FCCBs etc. Profitability for most banks during H1FY10 was driven mainly by treasury gains and lower provisioning on investments. Although the decelerating trend in credit demand has shown a reversal during Q3FY10, it continues to be on the lower side. Non-food credit growth of Scheduled Commercial Banks (SCBs) stood at 14.4% as on January 15, 2010 vis-à-vis the 21.9% growth seen in the corresponding period of last year. In view of this, the Reserve Bank of India (RBI), has successively lowered its FY10 projections for SCBs - adjusted non-food credit growth to 16%<sup>1</sup> and aggregate deposit growth to 17%<sup>2</sup> in its third quarter review of the Monetary Policy for 2009-10.

	Deposits Growth (%)			Advances Growth (%)		
	FY07	FY08	FY09	FY07	FY08	FY09
SCBs	24.6	23.1	22.4	30.6	25.0	21.2
SBI and Associates	16.9	21.6	28.9	28.8	21.0	21.6
Nationalised Banks	24.7	23.1	26.9	29.6	24.8	25.7
Old Private Sector Banks	6.3	19.8	20.3	12.1	20.2	15.1
New Private Sector Banks	39.8	23.1	5.4	35.7	26.4	9.9
Foreign Banks	32.9	26.8	12.0	29.5	27.5	2.7

Source: RBI

The pressure on asset quality was slightly relieved by RBI’s window permitting restructuring of select advances. The top 12 banks restructured assets worth Rs.32,530 crore in Q1FY10, taking the total restructured assets to nearly Rs.73,000 crore. Significant variation was observed among the individual banks in restructuring of loans with public sector banks showing a higher percentage of restructured loans to total loans as compared to private sector banks. Given the huge quantum of

<sup>1</sup> Projected credit growth lowered from 20% (Q1 Monetary Policy) to 18% (Q2 Monetary Policy)

<sup>2</sup> Projected deposit growth lowered from 19% (Q1 Monetary Policy) to 18% (Q2 Monetary Policy)

restructuring, arresting asset quality deterioration would be a key focus area for most banks. Though we expect the pressure on interest margins to ease following the re-pricing of high-cost deposits, the increased provisioning for standard Commercial Real Estate (CRE) loans to 1% (from the present level of 0.40%) and the increase in Provision coverage ratio to 70% by September 2010 could slightly temper profits for some banks during 2010. Margins may be further impacted by RBI's proposed guidelines replacing the BPLR with the Base Rate.

	<b>Mutual Funds - Assets Under Management (Rs. crore)</b>			
	<b>March 09</b>	<b>June 09</b>	<b>Sept 09</b>	<b>Dec 09</b>
Average AUM for the Month	4,93,188	6,70,935	7,42,910	7,94,486
Q-Q Change (%)	-	36.0	10.7	6.9

Source: AMFI (excluding fund of funds domestic but including fund of funds overseas)

The average Assets Under Management (AUM) of mutual fund industry reduced by 6.9% YoY during FY09 due to the redemption pressure faced by the sector in money market schemes. Redemption was high beginning September 2008 due to the liquidity crisis. The sector has since recovered with AUM growth of 61.1% during the 9-month period Mar-Dec 2009 due to improvement in overall market liquidity and in capital market valuations. There was however a decline in AUM during January 2010 as banks withdrew a substantial amount of their investments from mutual funds after RBI's observation that there has been some circularity in the movement of funds between mutual funds and banks. Also during August 2009, the Securities & Exchange Board of India (SEBI) had banned charging of entry load from investors on mutual fund investments which has moderated the growth in AUM.

Life insurance premiums<sup>3</sup> declined by 6.3% YoY for FY09. While premiums for private sector life insurance companies increased marginally by 1% over this period, premiums for Life Insurance Corporation (LIC) declined by 10.5%. Life insurance premiums for 9MFY10 showed substantial improvement and increased by 29.2% Period Over Period (PoP) which was mainly contributed by increase in premiums collected by LIC. General insurance premium increased by 9.1% YoY during FY09 and by around 10% PoP during 9M FY10.

<sup>3</sup> As per IRDA Journals May 2009 and Feb 2010

## Budget Proposals

1. Public Sector Bank (PSB) Capitalisation: Following the infusion of Rs.1,900 crore in 2008-09<sup>4</sup>, an additional sum of Rs.1,200 crore is being infused now. For the year 2010-11, an additional infusion of Rs.16,500 crore is proposed to ensure that the PSBs are able to attain a minimum 8% Tier-I capital by March 31, 2011.
2. Additional Banking Licenses proposed to be issued to private sector players. NBFCs may also be considered, if they meet RBI's eligibility criteria
3. Interest Subvention
  - Extension of existing interest subvention of 2% for one more year for exports covering handicrafts, carpets, handlooms and small and medium enterprises.
  - Incentive of additional 1% interest subvention to farmers who repay short-term crop loans as per schedule, increased to 2% for 2010-11.
  - Scheme of 1% interest subvention on housing loan upto Rs.10 lakh, where the cost of the house does not exceed Rs.20 lakh (announced in the last Budget) extended up to March 31, 2011. Rs.700 crore provided for this scheme for the year 2010-11.
4. Debt Relief - the period for repayment of the loan amount by farmers extended by six months from December 31, 2009 to June 30, 2010 under the Debt Waiver and Debt Relief Scheme for Farmers.
5. Refinancing/Take-out Financing – IIFCL is expected to provide finance for about Rs.25,000 crore in the next three years under the take-out financing scheme announced in the last budget. IIFCL has refinanced bank lending to infrastructure projects of Rs.3,000 crore during FY10. IIFCL's disbursements are expected to touch Rs.9,000 crore by end March 2010 and reach around Rs.20,000 crore by March 2011.
6. Financial Inclusion –
  - Banks' target for agricultural credit flow for FY11 set at Rs.3,75,000 crore (an increase of 15% over last budget's target of Rs.3,25,000 crore)
  - To provide banking facilities to habitations having population in excess of 2000 by March 2012. Augmentation of Rs.100 crore each for the Financial Inclusion Fund (FIF), and the Financial Inclusion Technology Fund which shall be contributed by the GOI, RBI and NABARD.

<sup>4</sup> Vijaya Bank (Rs.500cr), Central Bank (Rs.700 cr), UCO Bank (Rs.450cr), UBI (Rs.250 cr)

- Recapitalisation of Regional Rural Banks proposed so that they have adequate capital base to support increased lending to the rural economy. They were last capitalised in 2006-07.
  - Insurance and other services to be provided using the Business Correspondent (BC) model. It is proposed to cover 60,000 habitations by this arrangement
7. Establishment of an apex level Financial Stability and Development Council to monitor macro prudential supervision of the economy, including the functioning of large financial conglomerates, address inter-regulatory coordination issues and also focus on financial literacy and financial inclusion

### **Budget Impact: Industry**

1. Continued commitment of the government towards supporting public sector banks is a clear positive for the PSBs as well as the stability of the banking sector. As PSBs have the major share of the banking sector in India, 8% Tier I Capital Adequacy Ratio (CAR) for the sector would add significantly to the systemic strength. IDBI Bank, Bank of Maharashtra and Dena Bank could be key beneficiaries
2. The possibility of NBFCs getting banking licence is a positive for the NBFC sector, however the final impact can only be assessed after considering the structure of specific NBFCs that get banking license. An NBFC which converts to a Bank will have the advantage of lower cost of funds but will also have to follow regulatory norms applicable to Banks that are generally more stringent than those for NBFCs. This could result in increased competition for the existing private sector banks.
3. Interest subvention in the farm sector will provide an incentive for timely repayment and help in improving asset quality of this portfolio. Interest subvention in exports and housing will serve the objective of supporting these critical segments without putting burden on the banks.
4. Extension of loan repayment period for draught stricken farmers would provide temporary relief to them and allow them some time to manage their financial position for future.
5. Government's commitment towards providing infrastructure finance is evident from the growth in disbursements and refinance of bank lending for infrastructure projects done through IIFCL. Take out financing scheme would allow the banks to appraise and provide loans for infrastructure while also managing their Asset-Liability Mismatches (ALM) as IIFCL will take out these loans after a pre-defined period.

6. Recapitalisation of RRBs and use of BC model will not only help in expanding banking reach and improve financial inclusion but also help in providing insurance coverage to the rural population.
7. While the Indian financial system proved to be very resilient during the global credit crisis, the establishment of an apex body will enable better oversight, improve co-ordination among various regulators and aid in crisis management.

**Budget Impact:**

Overall	Applicable Proposals	Overall Impact
Public Sector Banks	1,3,4,5,6	▲▲
Private Sector Banks	2,4,5	▲
Non Banking Financial Companies - Infrastructure	2,5	▲
Non Banking Financial Companies – Others	2	▲
Housing Finance Companies	3	◀▶

**Legends:**

▲▲	Highly Positive	▼	Negative	◀▶	Neutral
▲	Positive	▼▼	Highly Negative	∅	No Proposals