Analysis of NPA Movement

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All growth comparisons are in y-o-y terms, unless stated otherwise.

The study looks at India's position in the global NPA situation and then analyses the movement in domestic NPAs. Finally, estimation has been performed to arrive at the expected NPAs.

Summary

The GNPA ratio of SCBs stood at 8.2% in Q1FY21 against 9.5% in Q1FY20. SCBs' asset quality has seen some improvement (GNPA reduction) due to recoveries and higher write-offs.

The end of FY21 GNPA numbers would move significantly ahead from the 8.5% level witnessed at the end of FY20, but would be moderated by the one-time restructuring scheme and ongoing write-offs. The additions to the GNPAs would primarily from i) Loans under SMA 1 and SMA 2 categories which were under moratorium and not eligible for restructuring, ii) lower rated/ stressed corporates and personal loans not eligible for the restructuring scheme and iii) banking exposure to unsecured personal loans. Given the above conditions, as per CARE estimates, the restructuring is expected to be 4% - 5% of overall bank credit outstanding and the Gross NPA ratio is likely to be 11%-11.5% by end of FY21.

Further, the asset quality data post the Covid-19 lockdown is uncertain due to a developing regulatory scenario; multiple stakeholder objectives and moratorium computation with various firms have varying ways of computing moratorium.

Overall, growth in GDP continues to remain weak, though financial markets have stabilised due to the multiple fiscal and monetary stimulus undertaken by various central banks and governments.

Introduction

India's NPA ratio is one of the highest among the comparable countries. Only Greece and Russia reported a higher ratio, while other countries with a higher ratio than India include Ukraine, Cyprus, Ghana and Kenya. Non-performing loans eased in advanced economies due to continued deleveraging, institutional and government intervention. Till 2019, the asset quality of banking sector across countries has shown a mixed picture, improving in Brazil and India but deteriorating in Russia, due to due to fragile economic conditions and sanctions. The Covid-19 pandemic is also expected to cause significant disruptions to the global economic growth.

Figure 1: Country-wise - Bank nonperforming loans to gross loans (%)

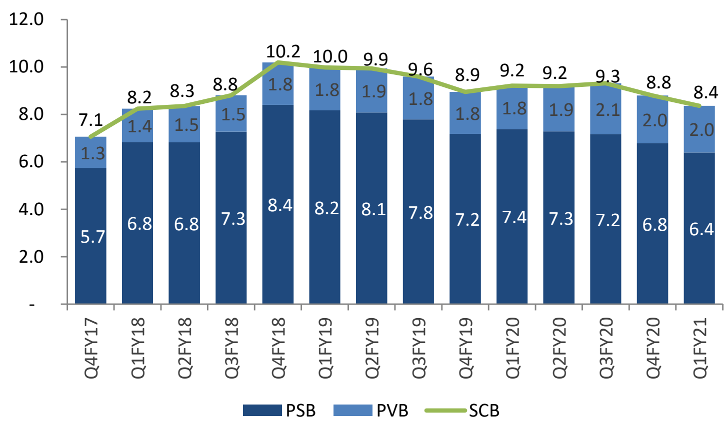
Country Name	2012	2013	2014	2015	2016	2017	2018	2019
Greece	23.3%	31.9%	33.8%	36.6%	36.3%	45.6%	42.0%	36.4%
Russian Federation	6.0%	6.0%	6.7%	8.3%	9.4%	10.0%	10.1%	9.3%
India	3.4%	4.0%	4.3%	5.9%	9.2%	10.0%	9.5%	9.2%
Italy	13.7%	16.5%	18.0%	18.1%	17.1%	14.4%	8.4%	6.7%
South Africa	4.0%	3.6%	3.2%	3.1%	2.9%	2.8%	3.7%	3.9%
Spain	7.5%	9.4%	8.5%	6.2%	5.6%	4.5%	3.7%	3.2%
Brazil	3.4%	2.9%	2.9%	3.3%	3.9%	3.6%	3.1%	3.1%
France	4.3%	4.5%	4.2%	4.0%	3.6%	3.1%	2.7%	2.5%
Indonesia	1.8%	1.7%	2.1%	2.4%	2.9%	2.6%	2.3%	2.4%
Malaysia	2.0%	1.8%	1.6%	1.6%	1.6%	1.5%	1.5%	1.5%
Singapore	1.0%	0.9%	0.8%	0.9%	1.2%	1.4%	1.3%	1.3%
United States	3.3%	2.5%	1.9%	1.5%	1.3%	1.1%	0.9%	0.9%
Hong Kong SAR, China	0.6%	0.5%	0.5%	0.7%	0.9%	0.7%	0.5%	0.6%

Note: Note: India: Fiscal year end: March 31, reporting period for national accounts data, FY; Indonesia: Fiscal year end: March 31, reporting period for national accounts data: CY; Data for Indonesia include Timor-Leste through 1999 unless otherwise noted; Singapore: Fiscal year end: March 31; reporting period for national accounts data: CY; Source: World Bank

Furthermore, it is interesting to note that the GNPA ratio of even the PVBs (Private Sector Banks) in India is significantly higher than the NPA ratio reported by the banking sector in US, or Singapore.

GNPA Movement in India[1]

Figure 2: Movement in Gross NPA (Rs. lakh crore)



Gross NPAs increased steadily from Rs.7.1 lakh crore in Q4FY17 to Rs.8.8 lakh crore in Q3FY18 (25% increase over Q4FY17) and then rose sharply to reach Rs.10.2 lakh crore in the next quarter, i.e., Q4FY18 (44% increase over Q4FY17). The highest incremental NPA addition of Rs.1.4 lakh crore was witnessed in Q4FY18. Post this increase, the NPAs witnessed moderation and reached Rs.8.4 lakh crore in Q1FY21.

PSBs accounted for around 80% of SCBs' GNPA till Q1FY20. Over the last couple of years, the PSBs registered substantial contraction in their GNPA amount as they stood at Rs. 6.4 lakh crore at the end of June 2020 as compared with Rs.7.4 lakh crore as at the end of June 2019. GNPA amount of PVBs has sustained within Rs.2 lakh crore since September 2017 till September 2019. Unlike the PSBs, the PVBs have recorded a rise in their GNPA amount from

[1] *Based on 31 Scheduled Commercial Banks (SCBs) (12 public sector banks (PSB) and 19 private sector banks (PVB))*

Rs.1.8 lakh crore in March 2018 which breached the Rs.2 lakh crore levels in December 2019 but subsequently retreated to Rs 1.97 lakh crore in Q1FY21.

The quantum of gross NPAs of SCBs declined during Q1FY21 as compared with the previous year. The gross NPA of PSBs contracted between Q1FY19 to Q1FY21. Among PSBs, the State Bank of India (SBI) which accounts for the highest share at 20.0% of the GNPAs of SCBs in Q1FY21 reported the highest asset quality improvement, with a decline in GNPA ratio to 5.4% in Jun-20 vs 7.5% in Jun-19.

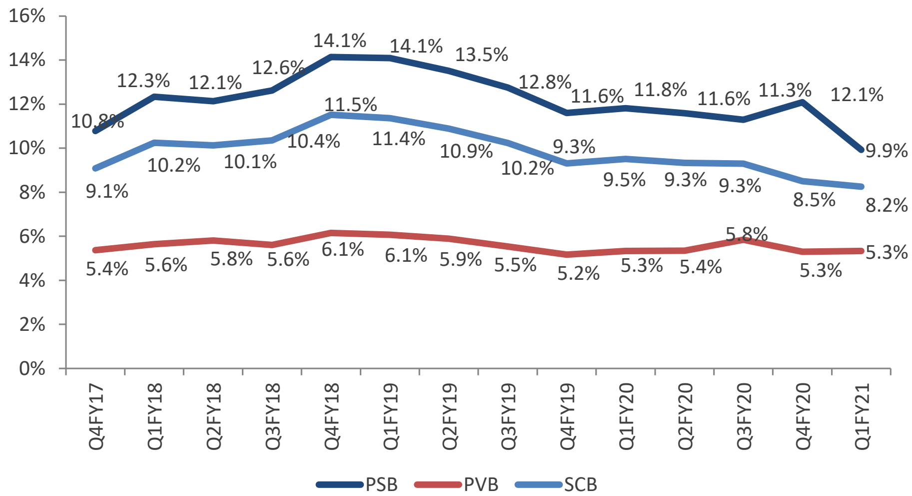
The asset quality pressure witnessed by the Indian banks over the last five years post the asset quality review (AQR) has been reducing in the last couple of years. After the initial issues, the implementation of the Insolvency and Bankruptcy Code (IBC) has started yielding results with FY20 seeing recoveries from few of large ticket size NPAs which has helped the profitability of banks during FY20. While NPA levels have reduced, the challenge for banks continues in the current year due to the Covid-19 and the nationwide lockdown which has resulted in contraction of the economic activities across the country.

Figure 3: Growth in GNPA Amount (% yoy)

Quarter	PSB	PVB	SCB
Q4FY18	46.2%	36.0%	44.3%
Q1FY19	19.5%	28.2%	21.0%
Q2FY19	18.4%	21.6%	18.9%
Q3FY19	7.1%	18.2%	9.0%
Q4FY19	-14.5%	-1.0%	-12.2%
Q1FY20	-9.6%	1.2%	-7.6%
Q2FY20	-10.0%	3.3%	-7.5%
Q3FY20	-7.9%	17.8%	-3.0%
Q4FY20	-23.4%	13.9%	-1.6%
Q1FY21	-13.4%	7.5%	-9.2%

Gross NPAs of SCBs declined by 9.2% in Q1FY21 over March 2020 levels. The growth in GNPA has been moderating for SCBs at an overall level given the loan write offs. As of June 30, 2020, the PSBs registered a contraction in their Gross NPA amount by 13.4%, while Gross NPA amount of PVBs grew by 7.5% as of June 30, 2020. The magnitude of NPAs held by PVBs is substantially lower than the PSBs. However, unlike the PSBs who have been recording a considerable decline in GNPA amount since March 2019, PVBs have been recording growth in their slippages post March 2019 on account of exposure to entities with solvency issues.

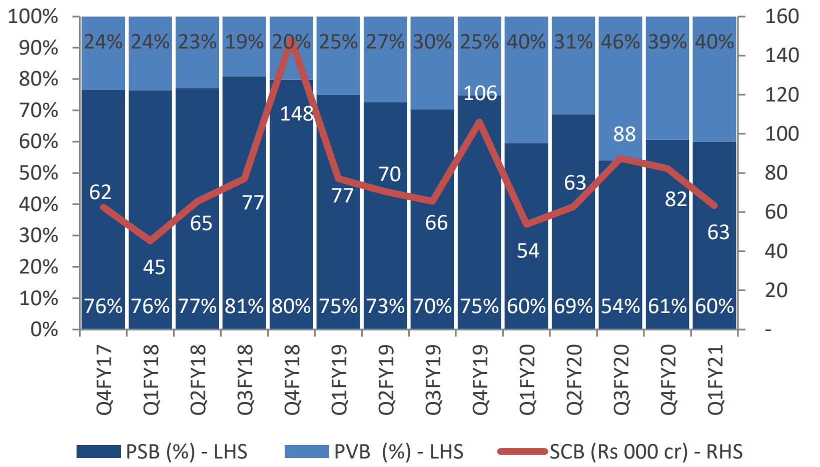
Figure 4: Steady reduction in GNPA Ratio



The GNPA ratio of SCBs had been on a downward trajectory almost every quarter since last two years and stood at 8.2% against 9.5% in the year-ago period. SCBs asset quality has seen some improvement (GNPA reduction) due to recoveries (e.g. SBI: Rs.4,056 crores, Canara Bank: Rs.1,440 crores, Punjab National Bank: Rs.1,069 crores and Bank of India: Rs.546 crores) and higher write-offs by the multiple banks. e.g. SBI (Rs.4,363 crores), Punjab National Bank (Rs.4,120 crores), Bank of India (Rs.3,505 crores), Bank of Baroda (Rs.3,458 crores), Canara Bank (Rs.3,216 crores), Axis Bank (Rs.2,284 crores), ICICI Bank (Rs.1,426 crores), and IDBI Bank (Rs.1,101 crores).

The PSB NPA ratio continues to remain significantly higher than the private banks NPA ratio. The PSBs NPA ratio moved up by 336 bps in the Q4FY17 – Q4FY18 period to reach 14.1%. Subsequently, the ratio has been on a declining trend but increased marginally in the last quarter. In case of private banks, the ratio trended downwards from Q4FY18, but then moved upwards for the last quarter. Further, as PVBs have primarily contributed to the incremental credit growth and are recognizing their exposures to certain stressed groups and sectors, their GNPA ratio has not witnessed any major improvement.

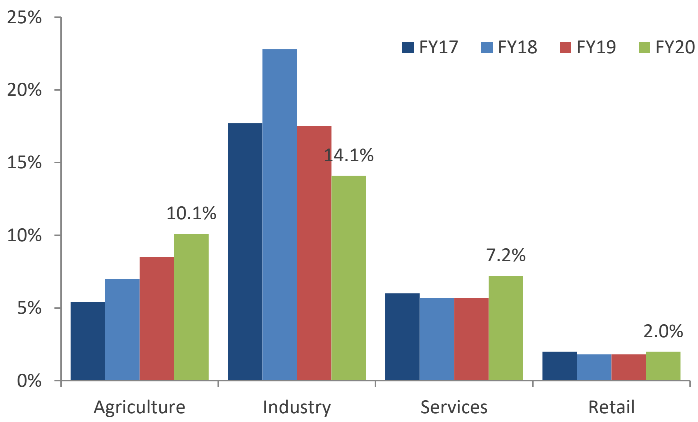
Figure 5: Movement in Provisions



During April 2020, RBI had mandated all banks to make 10% additional provisioning over a period of two quarters (5% each in March and June 2020 quarters) on loan accounts where moratorium benefit is extended. Following this, banks provided higher additional provisions beyond the RBI's mandatory rate during the Mar-end quarter itself. However, the Covid-19 related provisions surged in June-end quarter. The banks which have provided higher additional provisions during the quarter includes ICICI Bank (Rs.5,550 crore), SBI (Rs.1,836 crore), IndusInd Bank (Rs.1,203 crore), Bank of Baroda (Rs.996 crore), Axis Bank (Rs.733 crore) and Kotak Mahindra Bank (Rs.667 crore) along with others. The total provisions excluding Covid-19 related provisions amounts Rs.0.47 lakh crores in June 2020 (PSBs: Rs.0.33 lakh crores and PVBs: Rs.0.14 lakh crores, a decline of 13% as compared to the same quarter in the previous year. In the coming quarter's provisions of SCBs are likely to remain elevated on account of recognition of stressed assets owing to Covid-19 and its disruptions affecting businesses which could impact the financial performance.

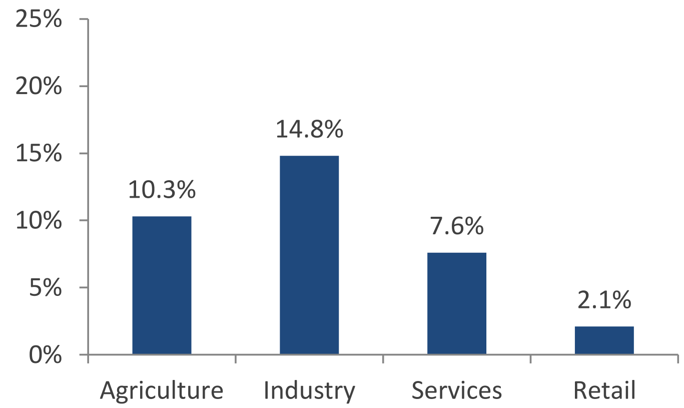
Further as per the FSR July 2020, the GNPA ratio fell to 8.5% in March 2020 from 9.3% in March 2019 and the overall PCR improved to 65.4% from 61.6% over this period. PCRs of both PSBs and PVBs increased March 2020.

Figure 8: Sector-wise GNPA Ratio



Source: RBI

Figure 9: Stressed assets ratio (FY20)



Source: RBI

Looking at sectoral GNPA, the agriculture sector GNPA stood at 10.1% on March 2020 as compared with 8.5% reported in March 2019. Industrial sector reported 14.1% GNPA Ratio in March 2020 as compared with 17.5% GNPA ratio in March 2019 and 22.8% of March 2018. Services and Retail sectors reported 7.2% and 2% GNPA in March 2020 as compared with 5.7% and 1.8% reported in March 2019, respectively. Among major sub-sectors within industry, GNPA ratios of construction and gems and jewellery sectors increased in March 2020. SCBs large borrowers accounted for 51.3% and 78.3% of the aggregate advances and GNPAs, respectively, in March 2020. Further, the top 100 borrowers accounted for 17.5% of gross advances, but only 12.6% of GNPAs of SCBs in March 2020.

Loan Moratorium and One Time Restructuring (OTR) Scheme

Even as the RBI held interest rates steady, it has provided funds for additional liquidity to SIDBI, NHB and NABARD along with several other measures to strengthen credit discipline; improve credit flow and deepen digital payments. In addition to liquidity measures, in order to protect the borrowers and economy from sudden shock, RBI announced a moratorium on loans for three months, which was subsequently extended to a total of six months. In its Financial Stability Report July 2020, RBI stated that the system moratorium was around 50% both by the number of accounts as well as the value of loans for the banking system for April 2020 end. Additionally, owing to Covid-19 coupled with lockdown, on an average 20-30% of the loan book value across all SCBs was under moratorium as of June 2020. Now that the moratorium offered by the banks has been lifted on September 01, 2020, the after-effect and the impact on the banks' balance sheets may be witnessed in the latter part of the year and subsequent period.

Consequently, as a part of additional measures, RBI has permitted a one-time restructuring of loans (OTR), as the ongoing Covid-19 pandemic is significantly impacting businesses across the board. The loan restructuring can be divided across three segments, corporate loans, MSME loans and personal loans. The OTR scheme for corporates and personal accounts would have to be invoked by December 31, 2020 and is intended for regular and SMA 0 accounts and the tenor of the loan can be extended by a period not exceeding two years. Apart from the earlier points, the salient items in the framework for the OTR plan for corporate accounts are as follows:

- Exclude exposures to financial sector entities as well as central government, state government, municipal bodies
- The OTR would have to be implemented within 180 days of invocation
- In case of resolution,
    - For ICA signatories, half of the provisions may be written back upon the borrower paying at least 20% of the residual debt without slipping into NPA post implementation of the plan and the remaining half may be written back upon the borrower paying another 10% of the residual debt without turning into NPA.
    - For non-ICA signatories while half of the provisions may be reversed upon repayment of 20% of the carrying debt, the other half may be reversed upon repayment of another 10% of the carrying debt, subject to the required IRAC provisions being maintained.
- Lenders to maintain additional 10% provisions against post resolution debt. Lenders which do not sign the ICA within 30 days of invocation of resolution plan to create a 20% provision.
- Account will continue to remain standard asset classification after implementation of the plan.
- When a loan is converted into other instruments, such debt to be included as a part of the post-resolution debt.
- In cases of multiple banking/ consortium banking, disbursements and payments to be routed through an escrow account maintained with one of the lenders.
- Resolution plans in respect of accounts where the aggregate exposure is Rs.100 crore and above, shall require an independent credit evaluation (ICE) by any one credit rating agency (CRA) authorized by the RBI.
- Follow the KV Kamath committee's financial parameters, along with the sector specific benchmarks.

The salient points in the framework for the one-time restructuring plan for personal accounts are as follows:

- The eligible borrowers' accounts should continue to be classified as Standard till the date of invocation of resolution under this framework. For this purpose, the date of invocation shall be the date on which both the borrower and lending institution have agreed to proceed with a resolution plan under this framework.
- The OTR would have to be implemented within 90 days of invocation
- Lenders to create a provisions from the date of implementation, the higher of the following
    - Provisions held as per the extant IRAC norms immediately before implementation
    - 10% of the renegotiated debt exposure of the lending institution post implementation (residual debt).
- In case of personal loans, half of the above provisions may be written back upon the borrower paying at least 20% of the residual debt without slipping into NPA post implementation of the plan and the remaining half may be written back upon the borrower paying another 10% of the residual debt without slipping into NPA subsequently

The MSME framework has been extended as per the following conditions:

- Total exposures to not exceed Rs. 25 crore and the company should be a standard asset as on March 1, 2020.
- Restructuring to be implemented by March 31, 2021.
- Borrower has to be GST-registered excluding MSMEs that are exempt from GST-registration.
- Asset classification could be retained as such, whereas the accounts which may have slipped into NPA category between March 2, 2020 and date of implementation may be upgraded as 'standard asset', as on the date of implementation of the restructuring plan. The asset classification benefit will be available only if the restructuring is done as per provisions of this circular.
- Banks to maintain additional provision of 5% over and above the existing provision.

The resolution plan announced by RBI is a significant relief to entities which have been affected by severe stress caused by the Covid-19 pandemic and subsequent economic disruption. This version of the loan restructuring scheme with several requirements on eligibility, provisioning, and loan extension, is more rigorous compared to the earlier restructuring options.

NPA and OTR Analysis

As RBI has allowed restructuring to be initiated up to December 31, 2020, it would allow the financial institutions to take appropriate actions after understanding ground realities post moratorium, opening of the economy and impact of the Covid-19 pandemic. However, as individual banks have created buckets for restructuring of personal loans, they would also evaluate individual corporates and basis the credit assessment, banks may or may not extend OTR to the relevant corporates.

The OTR scheme is expected to dilute Covid-19's impact on the asset quality of banks. Additionally, as per trends in reduction of moratorium over Phase I & II, moratorium levels could reduce even further and a few companies would not need to have their debt restructured as they would be able to service their debt obligations due to the opening up of the economy. Furthermore, specific segments (NBFCs) kept out the ambit of scheme would also lower the quantum of debt which would be available for OTR. The portion of the corporate loans which were already in the SMA 1 and SMA 2 bracket would not be eligible for restructuring. Consequently, approximately, 4% - 5% of overall bank credit outstanding would be restructured under the OTR scheme.

Policy measures have enabled recoveries leading to some improvement in the GNPA, provision coverage ratios and lowering of the slippage ratio. However, bank NPAs continue to dominate the headlines even as the government and RBI work towards resolving the issue. Till the September 2019 quarter, the impression was that barring a few banks, SCBs had generally turned the corner on NPAs. However, considering that there has been no substantial improvement in the economy, ageing provisions and coupled with the outbreak of 'Covid-19', the banking sector would witness an adverse impact on credit delivery and asset quality.

Banks have received deposits, but credit growth has seen decline and is expected to remain muted for the year. Deposit growth increased faster at 10.5% as compared to the last two years, where deposit registered growth between 8-10%. However, credit growth continues to remain low at 5.1%, compared to last year's level of 10.4% and 8.9% respectively (as of September 13, 2019 and September 27, 2019) reflecting weak demand and risk aversion in the banking system.

The FY21 GNPA numbers would move significantly ahead from the current 8.5% level, but would be lower due to the one-time restructuring scheme. The additions to the GNPAs would primarily from i) SMA 1 and SMA 2 corporate loans under moratorium and not eligible for restructuring, ii) lower rated corporates not eligible for the restructuring scheme basis parameters of the Kamath committee or would be negatively affected by the economy; iii) already stressed companies which could face liquidity constraints in a challenging economy and iv) banking exposure to unsecured personal loans.

RBI has permitted a one-time restructuring of loans across three segments – corporate loans, MSME loans and personal loans. This would mitigate the expected rise the in the GNPA numbers. The credit growth for the current financial year is expected to be muted and remain in the low single digits, and the slippage ratio is also expected to remain elevated. Consequently, as per CARE estimates, the Gross NPA ratio is likely to reach 11%-11.5% by end of FY21. Overall, growth in GDP continues to remain uncertain, though financial markets have stabilised due to the multiple fiscal and monetary stimulus undertaken by various central banks and governments.

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