Decline in Banks' Stressed Assets Despite Covid induced Restructuring

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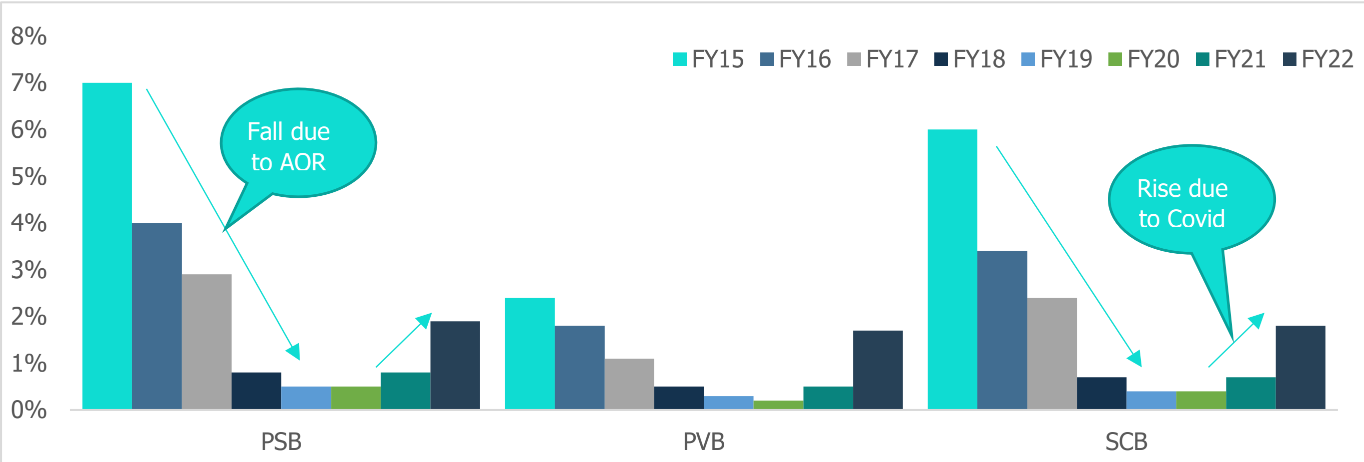
Synopsis

- Prior to AQR, the quantum of Restructured Standard Assets in PSU Banks was very high, this has been effectively addressed by the AQR.
- The growth of GNPAs was a result of recognising stress in the system being built-up over a long period in the past. The Scheduled Commercial Bank (SCB) Gross Non-Performing Asset (GNPA) ratio is likely to improve due to moderation in slippages, healthy coverage ratio, lower credit costs, higher credit growth, a declining trend in the stock of GNPAs and transfer of large accounts to new Asset Reconstruction Companies (ARCs).
- On the other hand, increased slippages from sectors that were relatively more exposed to the pandemic need to be monitored as support measures are unwound along with rising interest rates. Uncertainties in the global macroeconomic situation could impact asset quality.
- Overall, a downward movement of stressed assets (GNPAs plus restructured assets) is expected to continue.

Restructured Standard Assets Report a Rise in FY22

Figure 1: Movement in Restructured Standard Assets



Source: RBI

Prior to AQR, the quantum of Restructured Standard Assets in all banks especially PSU Banks was high as, banks used to restructure advances quite handily. However, the Asset Quality Review undertaken by the RBI effectively addressed this issue. The AQR resulted in a reclassification of significant quantum of standard restructured accounts as non-performing assets enabling the steady downtrend. However, in early calendar year 2020, the covid-19 pandemic struck the economy impacting lives and livelihoods. Hence in response to the Covid-19 pandemic, apart from the existing MSME scheme (operational since 2019), RBI announced two restructuring schemes.

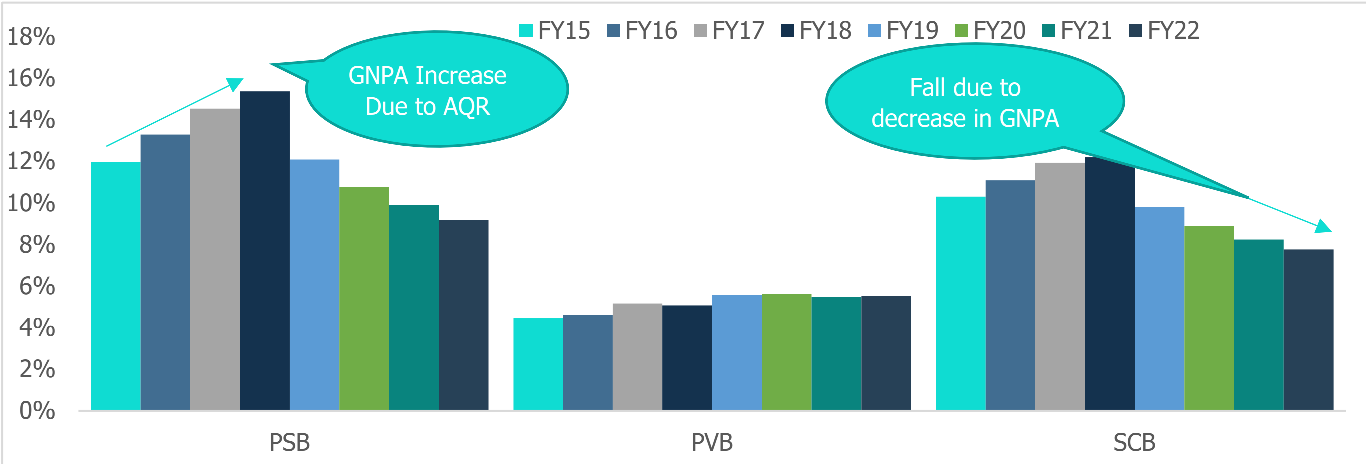
- In August 2020, RBI, announced Resolution Framework 1.0 (RF 1.0), which was largely aimed at corporate exposures and personal loans facing covid-19 related stress. The framework had a deadline of December 31, 2020 for invocation.

- Resolution Framework 2.0 (RF 2.0) announced in May 2021 and subsequently revised in June 2021, was aimed at MSMEs, individual borrowers and small businesses. This framework had a deadline of September 30, 2021, for invocation.

These schemes were aimed at businesses disrupted by Covid and not on account of any pre-existing issues. This has led to an increase in Restructured Standard Assets over the past two years, smaller in FY21 but slightly larger in FY22. According to RBI, PSU banks had restructured a lower amount in RF 1.0 and a larger amount in RF 2.0. While there was an increase in the share of restructured standard advances from March 2020 to March 2022, the same has been on a moderation trend during the current year, i.e FY23.

Mitigated by a Fall in Stressed Assets

Figure 2: Movement in Stressed Advances



Source: RBI; Stressed Assets = (GNPAs + Rest. Std. Adv.)/ Gross Advances (%)

Post the asset quality review (AQR) in 2015-2016, the banks saw a spike in GNPAs from 3.8% in FY14 to 11.2% in FY18 (and NNPAs from 2.1% in FY14 to 5.6% in FY18) largely due to weakness in the wholesale advances which required banks to make a significant amount of provisioning and write-offs over the next four to five years. Accordingly, there was an overall risk aversion among the bankers as well as the credit demand from wholesale borrowers was low. However, the GNPA ratio of SCBs had been on a downward trajectory since Mar-19, which continued even during the pandemic period, led by increasing deleveraging and regulatory intervention. These regulatory and government support schemes also helped borrowers to access liquidity and conserve cash flows. These regulatory and government support schemes also helped borrowers to access liquidity and conserve cash flows. SCBs asset quality has also seen some improvement (GNPA reduction) due to recoveries and higher write-offs by banks, Covid-related relief measures, etc. Consequently, the Stressed Assets have been on a downswing despite the rise in restructured assets due to the pandemic. The quarterly slippage ratio, which had been rising since Q3FY22, cooled off in Q2FY23, with PSBs recording significant improvement. As slippages largely being within control, banks have been reporting significant improvement in the restructured assets, with gradual rundown of these assets.

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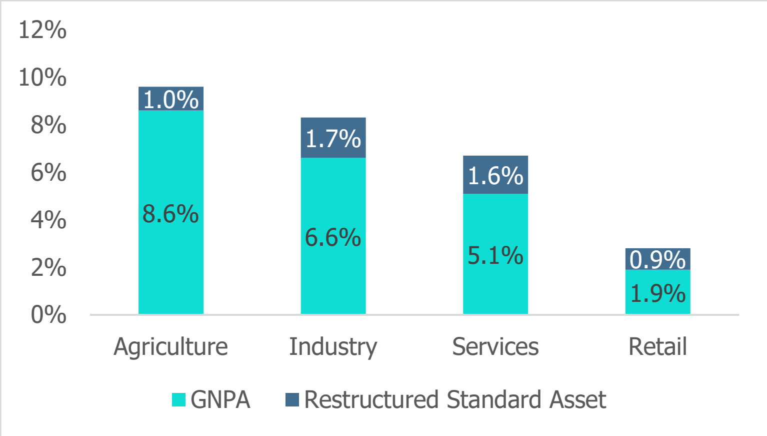
Figure 3: Sector-wise Stressed Assets as of September 2022



Source: RBI

Conclusion

- Credit offtake has been on an uptrend, with wholesale and retail contributing to the same. The growth has been driven by NBFCs, retail credit, inflation-led working capital demand, and a lower base. This higher credit growth is anticipated to continue in the near term.
- Driven by moderation in slippages, healthy PCR resulting in lower credit costs, higher bank credit growth, and a declining trend in the stock of GNPAs and the transfer of larger accounts to new ARCs, the SCB GNPA ratio is anticipated to be closer to pre-asset quality review levels of around 4% by FY24.
- On the other hand, the possibility of slippages arising from sectors that were relatively more exposed to the pandemic continues as support measures are unwound along with rising interest rates. Uncertainties in the global macro situation captured in the CareEdge publication titled "India: External Sector Navigating the Storm" may pose further challenges to the sector impinging on the asset quality. Consequently, the performance of restructured accounts needs to be continuously monitored.
- Meanwhile, a decline in the overall stressed assets (GNPA plus restructured assets) due to reduction in GNPAs on account of resolution and/or write-offs and improvement in restructured assets as the economy moves ahead and recovers from the Covid impact is expected to continue.

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