Analysis of RBI’s Financial Stability Report – July 2021

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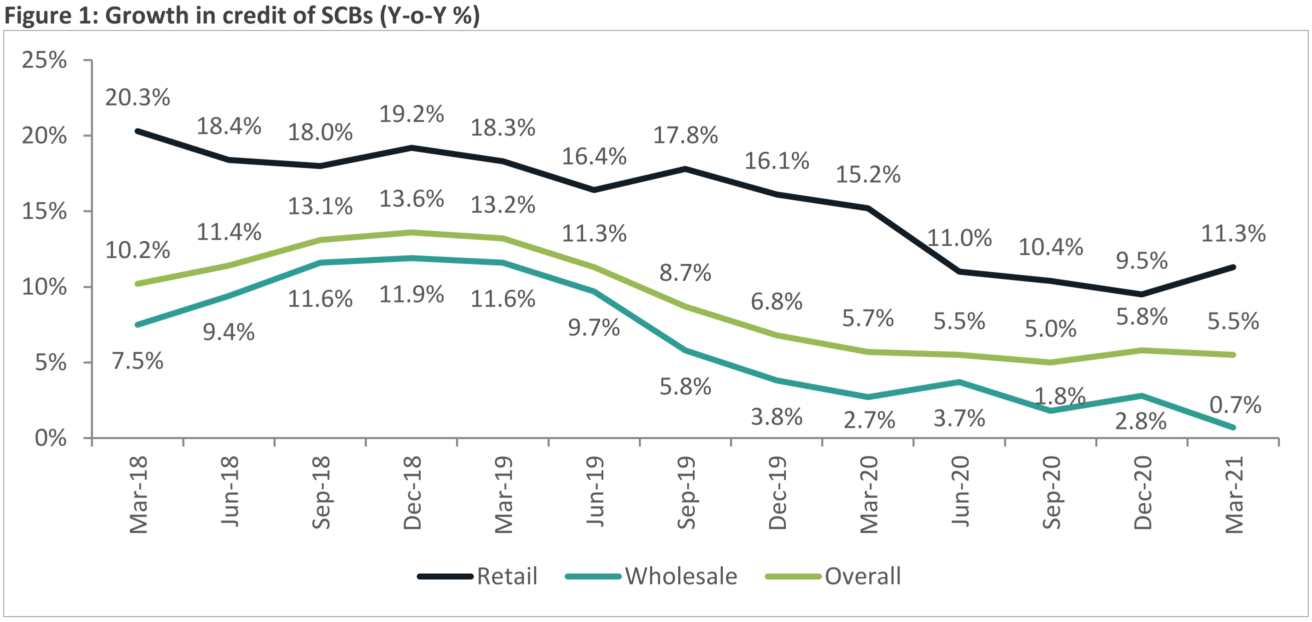
The Financial Stability Report of the RBI presents a contemporary picture of the Banking and Financial Services sector which is going through challenging times due to disruptions caused by Covid-19 pandemic and the consequential stressed economic environment. All comparisons are y-o-y, unless otherwise stated.

The continued policy support and gathering pace in vaccination drives are witnessing recovery in the global economy. Policy support has helped to improve the financial position of banks, which resulted in maintaining asset quality, solvency and liquidity.

Scheduled Commercial Banks

Figure 1: Growth in credit of SCBs (Y-o-Y %)



Source: RBI

Credit growth (y-o-y) of scheduled commercial banks (SCBs), which had increased by 5.8% in December 2020 (vs. 5.0% in September 2020), slid again to 5.5% in March 2021 (vs. 5.7% in March 2020). Bank credit in FY21 remained subdued and was lowest in last four financial years. The subdued credit growth can be ascribed to risk aversion (both lenders and borrowers) and continued parking of excess liquidity with RBI. In addition, the regional lockdown imposed by states due to second wave has again restricted the growth to some extent, despite low base of previous year. Credit by public sector banks (PSBs) and private sector banks (PVBs) increased by 3.2% (3.0% growth in March 2020) and 9.9% (11.3% growth in March 2020), respectively, which indicates that PVBs continue to gain market share from PSBs. The second wave of COVID-19 has increased the slowdown in wholesale credit as compared to retail credit, as risk aversion was largely towards corporate borrowers. In addition, absence of strong demand for credit, bank holdings in SLR securities and state development loan stood at highest levels in March 2021 since March 2010.

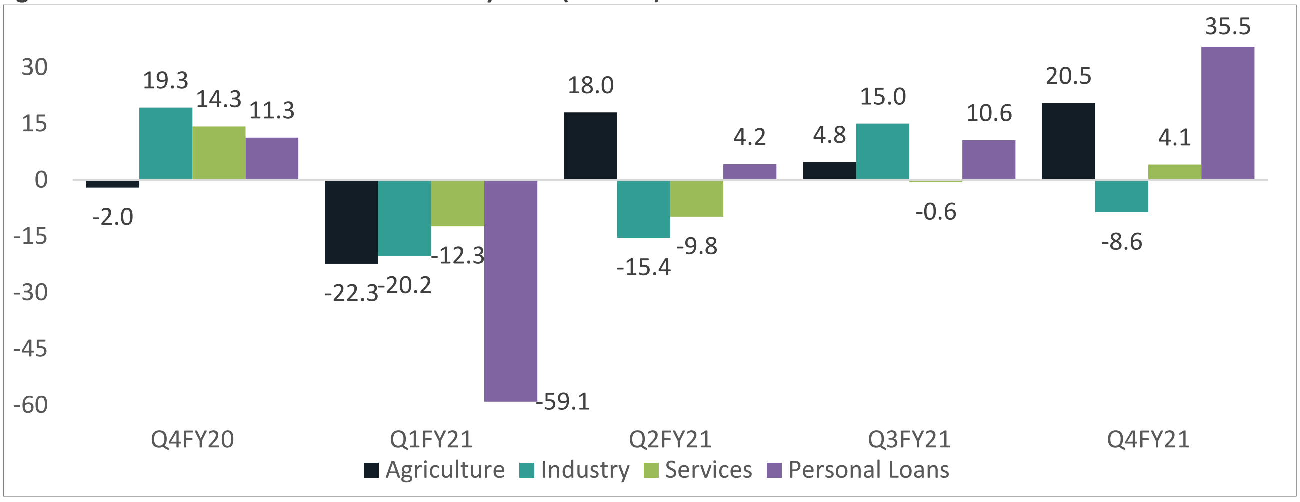
Figure 2: Aggregate mobilisation of funds

Outstanding Amount (Rs 000' crore)	Mar-20	Share %	Mar-21	Share %	y-o-y
Commercial Papers (CPs)	346	4.0%	365	4.1%	5.5%
Non-convertible Debentures (NCDs)	2,712	31.4%	3,017	33.5%	11.2%
Wholesale credit	5,582	64.6%	5,620	62.4%	0.7%
Total	**8,640**		**9,002**		**4.2%**

Source: RBI

The aggregate mobilisation of funds by wholesale corporate borrowers (from the banking sector and through market instruments) has increased by 4.2% y-o-y in March 2021. It was largely led by funding through capital market instruments (by large corporates and as yields softened for these instruments – TLTRO, PCG, etc), despite measures/schemes such as the Emergency Credit Line Guarantee Scheme (ECLGS) and its expanded scope.

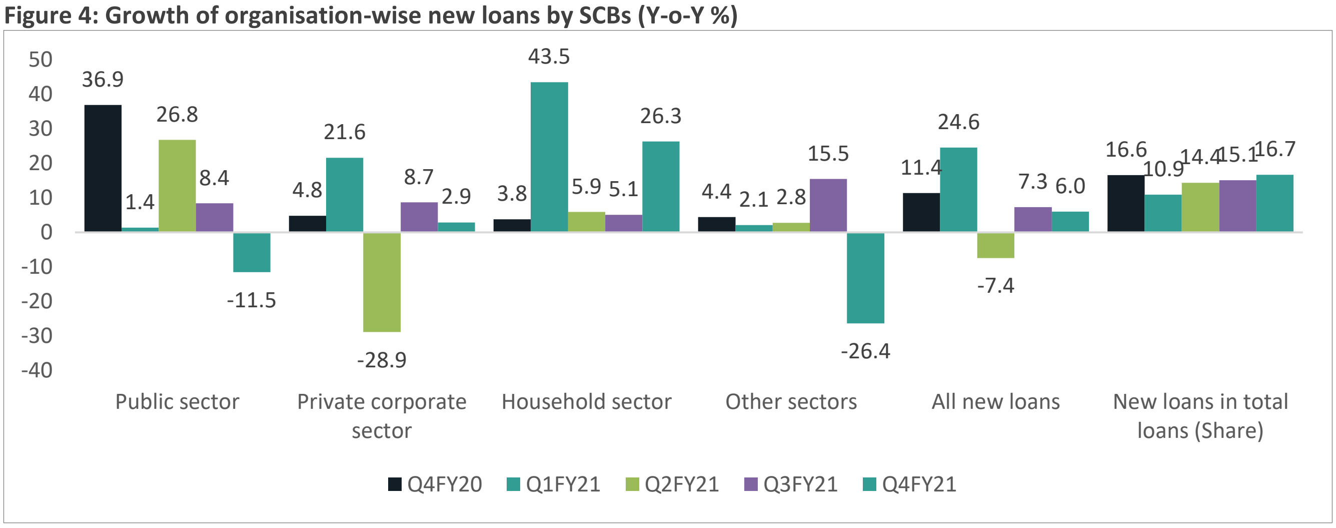
Figure 3: Growth of sector-wise new loans by SCBs (Y-o-Y %)



Source: RBI

New loans extended by SCBs witnessed a recovery in the H2FY21, specifically in agricultural and personal loan segments. In overall credit, share of agriculture and personal loan segment has increased by around 100-200 bps from March 2020 to March 2021. During the year, agriculture credit was supported by favourable monsoons, good harvest season and government measures. Within retail/personal loans segment, growth in housing loans was healthy led by retail credit push mainly personal unsecured loans to prime borrowers and concession on home loan interest rates. Growth in credit card and consumer durable segment slowed down as discretionary spending was halted/postponed and preference was towards precautionary savings due to pandemic-led uncertainties. Within industry segment, large industry segment registered a negative to muted growth. The healthy growth in medium segment was largely driven by disbursements in ECLGS scheme. New loans to household sector (which includes Individuals, proprietary concerns, partnership firms and HUFs) recovered in the subsequent period. If we observe, share of new loans in total loans increased in Q4FY21 showing signs of revival, as economic activities started gathering pace due to gradual unlocking.

Figure 4: Growth of organisation-wise new loans by SCBs (Y-o-Y %)



Source: RBI

MSME credit

Figure 5: Growth in bank credit to MSME sector

Mar-21	PSBs	PVBs
Exposures < Rs.25 lakh crore	8.1%	8.0%
Aggregate MSME exposures	0.9%	9.2%

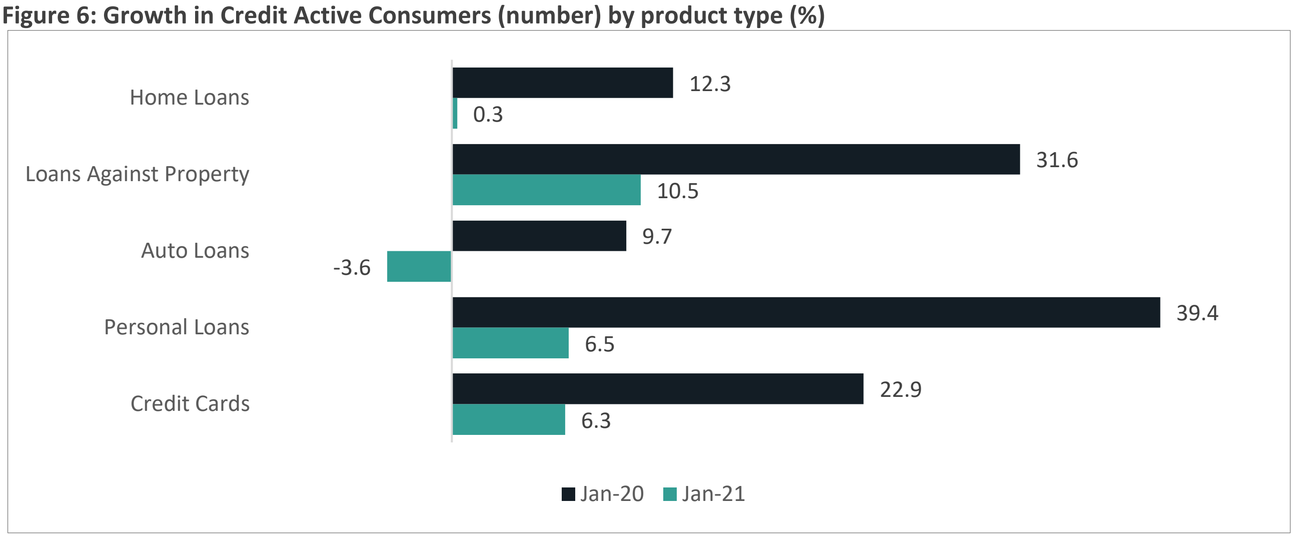
Source: RBI

Growth in MSME segment was led by disbursements under ECLGS scheme. Disbursements under ECLGS segment were Rs.2.69 lakh crore (which is around 90% of earlier targeted Rs.3.0 lakh crore). Micro, small & medium (MSME) industries grew by 6.7% in March 2021 (which offset the fall in large segments) as compared with a growth of 1.1% in March 2020. Within MSME, micro & small industries registered a growth of 0.5%, while medium industries registered a growth of 28.8%, and large industries registered a de growth. The higher growth of medium segment offset the fall in large segment and overall industry segment registered a growth of 0.4% in March 2021.

Consumer Credit

As defined by RBI, consumer credit includes home loans, loans against property, auto loans, two-wheeler loans, commercial vehicle loans, construction equipment loans, personal loans, credit cards, business loans, consumer durable loans, education loans and gold loans. The overall demand for consumer credit was muted in Q4FY21 (as there was a steep fall in inquiries especially in the month of March 2021) after an increase during the festive season in Q3FY21, after the first COVID-19 wave receded. However, the second wave has sharply affected credit demand, with a substantial fall in inquiries across product type in April 2021. Consumer credit (in terms of active customers) deteriorated after the loan moratorium scheme came to an end in September 2020. Growth in credit active consumers (i.e., consumers with at least one outstanding credit account) and outstanding balances, however, remains sluggish as compared with previous year. The delinquencies (90 dpd) in aggregate consumer credit were significantly higher for NBFCs/HFCs (6.7% in January 2021 vs. 4.8% in March 2020) as compared with banks. Within banks, PVBs witness higher stress (2.4% in January 2021 vs. 1.0% in March 2020 as compared with PSBs (1.8% in January 2021 vs. 3.0% in March 2020).

Figure 6: Growth in Credit Active Consumers (number) by product type (%)



Source: RBI

SCBs deposit growth improved to 11.9% in March 2021 as compared with a growth of 8.6% in March 2020. Current account and savings account (CASA) deposits grew at a faster pace as compared with term deposit, as per RBI it is possibly due to preference of depositors to hold more liquid assets in the highly uncertain pandemic situation. The increase in deposits can also be attributed to outflows in equity mutual fund, primarily due to profit booking by investors. In addition, in the unforeseen pandemic situation, deposits with banks are considered as a safer option.

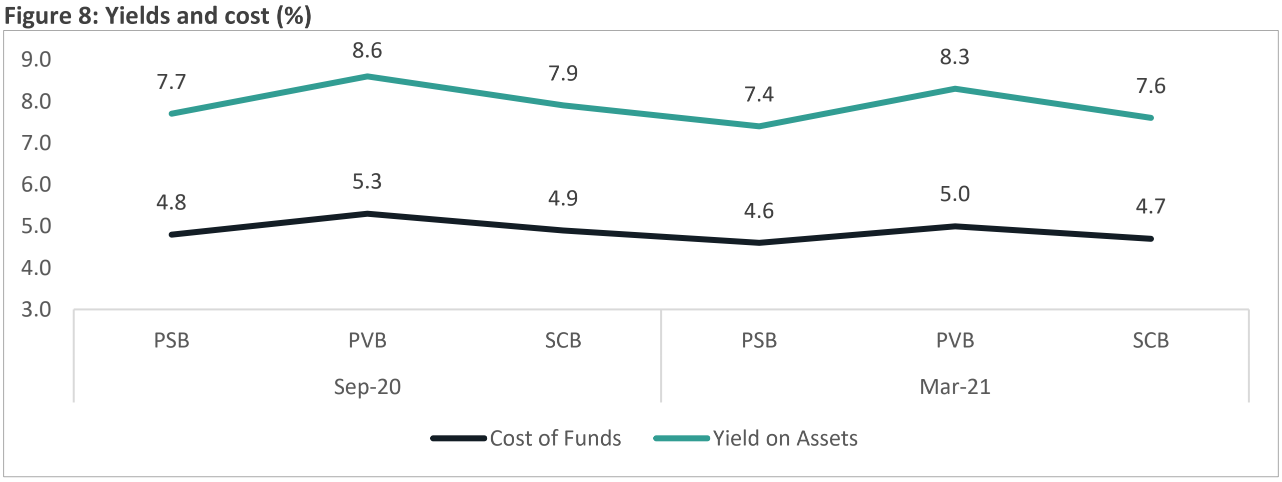
Figure 7: Performance of SCBs (%)

Financial Performance	Mar-19			Mar-20			Mar-21		
	PSB	PVB	SCB	PSB	PVB	SCB	PSB	PVB	SCB
Credit Growth (Y-o-Y)	9.6	21.0	**13.2**	3.0	11.3	**5.9**	3.5	9.7	**5.4**
Deposit Growth (Y-o-Y)	6.5	17.5	**9.9**	6.9	11.1	**8.6**	10.1	15.9	**11.9**
Ratios									
RoE	-13.0	10.8	**-1.5**	-3.5	6.7	**2.0**	4.3	10.7	**7.7**
RoA	-0.9	1.2	**-0.1**	-0.2	0.7	**0.2**	0.3	1.2	**0.7**
GNPA Ratio	12.6	3.7	**9.3**	11.3	4.2	**8.5**	9.5	4.8	**7.5**
PCR	60.8	57.0	**60.6**	64.8	67.5	**65.4**	68.4	70.0	**68.9**
CRAR	12.2	16.3	**14.3**	13.1	16.7	**14.8**	13.8	18.4	**16.0**

Source: RBI

Net interest income (NII) of SCBs registered a growth of 13.1% y-o-y in March 2021, whereas the net interest margin (NIM) of SCBs stood at 3.3%, largely at similar level as observed in March 2020. The cost of funds and yield on assets declined across bank groups and stood at the lowest level in last two decades, as RBI eased the monetary conditions due to pandemic. The quantum of provisions made during FY21 declined by 20% y-o-y, with risk provisions declined by around 28.0% y-o-y. The return on assets (ROA) and return on equity (ROE) turned positive for PSBs and stood at 0.3% and 4.3%, respectively, whereas the return ratios declined marginally for PVBs and FBs on a sequential basis.

Figure 8: Yields and cost (%)



Source: RBI

The capital to risk-weighted assets ratio (CRAR) of SCBs improved to 16.0% in March 2021 from 14.8% in March 2020 and 15.8% in September 2020, as few banks access markets for fresh capital and PSBs were recapitalised. In bank groups, PVBs and PSBs recorded a marginal increase in CRAR.

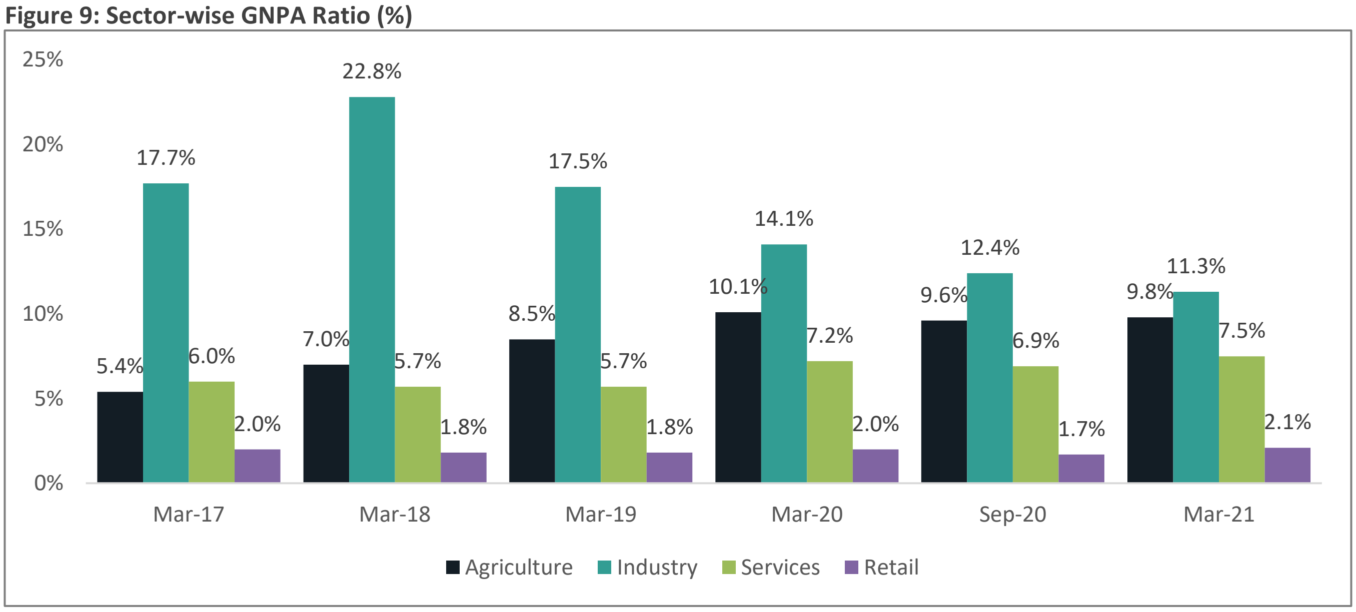
Asset Quality

SCBs' GNPA and NPA ratios stood at 7.5% and 2.4%, respectively. Write off to GNPA ratio declined for SCBs to 20.5% in March 2021 as compared with 22%-24% range in March 2020. Within SCBs, PSBs and FBs witnessed a fall in write off to GNPA ratio, whereas PVBs witnessed an increase as compared with the previous year. Overall, GNPAs declined by 5.9% mainly due to a fall of 8.4% in bad loans of PSBs. Pressure on asset quality expected to continue due to restructuring especially in MSME segment. The second wave is also expected to witness significant stress in retail loans (largely unsecured loans). The downside risks include lockdown in key states, which may impact the industrial as well as service segments. Another risk includes the ending of the ECLGS scheme in September 2021, which had propped up the MSME credit.

The GNPA ratios of SCBs for two major sectors, i.e., agriculture and industry, declined during FY21, however, increased for the personal loan segment. Within the industrial sector, the ratio declined for all the sub-sectors in March 2021 as compared with the previous year.

The slippage ratio (fresh accretion to NPAs) for SCBs declined to 2.5% in March 2021 vs 3.8% in March 2020. Within bank groups, PSBs and PVBs both witnessed a fall in their slippage ratio. We believe that the lower slippages could be due to various regulatory measures such as moratorium, standstill on asset classification, ECLGS support for MSMEs and restructuring allowed to ease disruptions caused by the pandemic. The real state of balance sheet will be visible only after the impact of regulatory measures completed.

Figure 9: Sector-wise GNPA Ratio (%)



Source: RBI

SCBs' large borrowers accounted for around 53.0% and around 80.0% of the aggregate advances and GNPAs, respectively, in March 2021. Furthermore, the top 100 borrowers accounted for 18.1% of gross advances, however, only 8.6% of GNPAs of SCBs in March 2021. The GNPA ratio of large borrowers improved during H2FY21 across bank groups (PSB, PVBs and FBs), this is despite the sequential uptick in growth of loans in SMA1 category. The standstill on asset classification has resulted in significant fall in SMA2 category. However, SMA2 ratio of large borrowers of PSBs and PVBs were higher in March 2021 compared with March 2020 and September 2020 levels.

MSME stress - As per the reported data, NPAs in MSME segment were lower for PVBs as compared with PSBs. In a view of elevated debt stressed levels in this segment, the impact of second wave could be significant. Total Rs.71,431 crore of MSME loans were restructured by PSBs and PVBs together since 2019, in which PSBs share was around 80%. Despite the restructuring, the stress in MSME segment remains high for PSBs.

Figure 10: Restructuring of MSME Segment – Bank group wise

Restructuring Scheme	Aggregated Restructured Portfolio (Rs Crore)	
	PSBs	PVBs
Restructuring - January 2019 Scheme	26,190	2,174
Restructuring - February 2020 Scheme	5,860	1,364
Restructuring - August 2020 Scheme	24,816	11,027

Source: RBI

There was a significant stress witnessed across all SMA category for MSME segment during pandemic. Comparatively, PVBs have witnessed lower stress (except in 0 DPD category). The credit flow in MSME segment increased substantially due to disbursements under ECLGS scheme in FY21. Hence, there could be a further increase in stress level of MSME segment once timeline/limit of various measures/support policies are completed.

Figure 11: SMA distribution of MSME Segment – Bank group wise

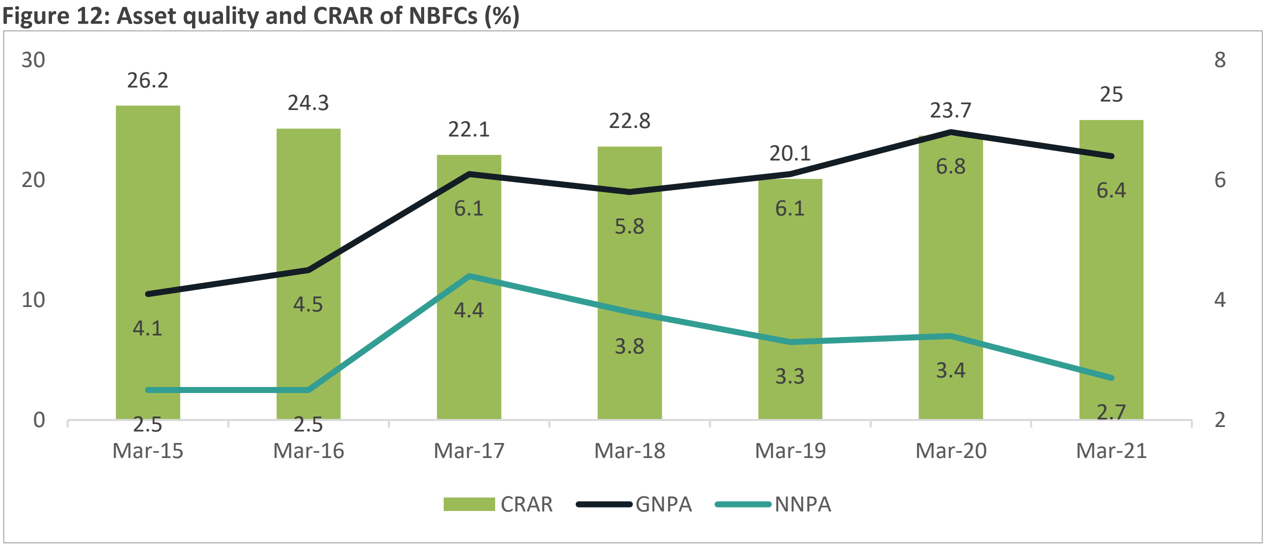
	PSBs (%)					PVBs (%)				
	0 DPD	SMA-0	SMA-1	SMA-2	NPA	0 DPD	SMA-0	SMA-1	SMA-2	NPA
Mar-20	65.0	6.9	5.7	4.2	18.2	88.6	4.4	1.9	0.7	4.3
Jun-20	63.3	18.2	2.2	2.6	13.7	88.6	7.0	0.9	0.6	2.9
Sep-20	65.9	13.4	3.2	2.6	14.9	87.9	8.1	0.9	0.6	2.6
Dec-20	65.7	7.8	5.6	7.8	13.1	88.1	4.8	2.6	2.4	2.0
Mar-21	60.7	10.6	9.2	3.6	15.9	89.6	3.7	2.4	0.8	3.6

Source: RBI

Non-Banking Financial Services (NBFCs)
Credit extended by NBFCs registered an increase of 8.8% y-o-y during FY21 (as economic activities gathered pace in H2FY21 where complete nationwide lockdown was lifted), after a deceleration in FY20 due to credit events in the sector and muted demand. Despite the pandemic conditions during the year, the fall in GNPA ratio for the sector was more intense as compared with the fall in NNPA ratio, which can be attributed to higher provisioning during the period. Capital adequacy improved further for NBFCs in FY21 to highest levels in last five years, despite multiple shocks such as demonetization, GST, Covid, etc. over the periods.

The NBFC-MFIs have witnessed an asset quality stress due to pandemic in FY21. The GNPA ratio jumped from 2.0% in March 2020 to 4.9% in March 2021 as collections and recoveries impacted negatively. In addition, SMA2 portfolio increased from 0.2% in March 2020 to 1.3% in March 2021. The decline in collection efficiencies may impact ALM of NBFC-MFIs negatively, and further, it may impact the quality of their borrowings.

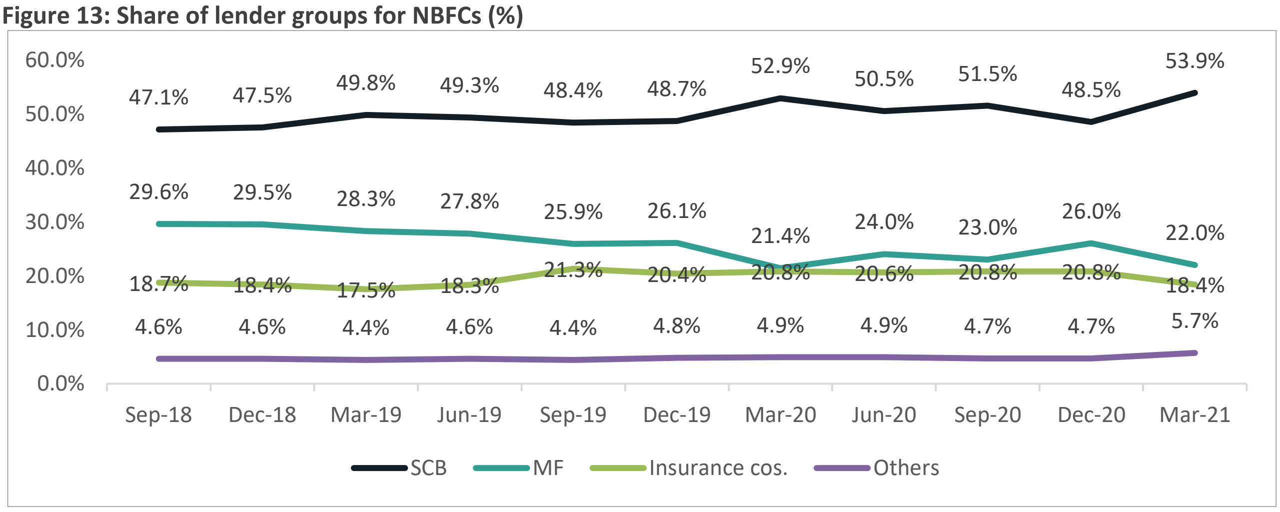
Figure 12: Asset quality and CRAR of NBFCs (%)



Source: RBI

Capital adequacy ratios of seven NBFCs were below the minimum regulatory requirement of 15% in March 2021. Under medium and high-risk scenario, the system level CRAR may fall to 12.6% and under high-risk scenario, it may fall to 14%.

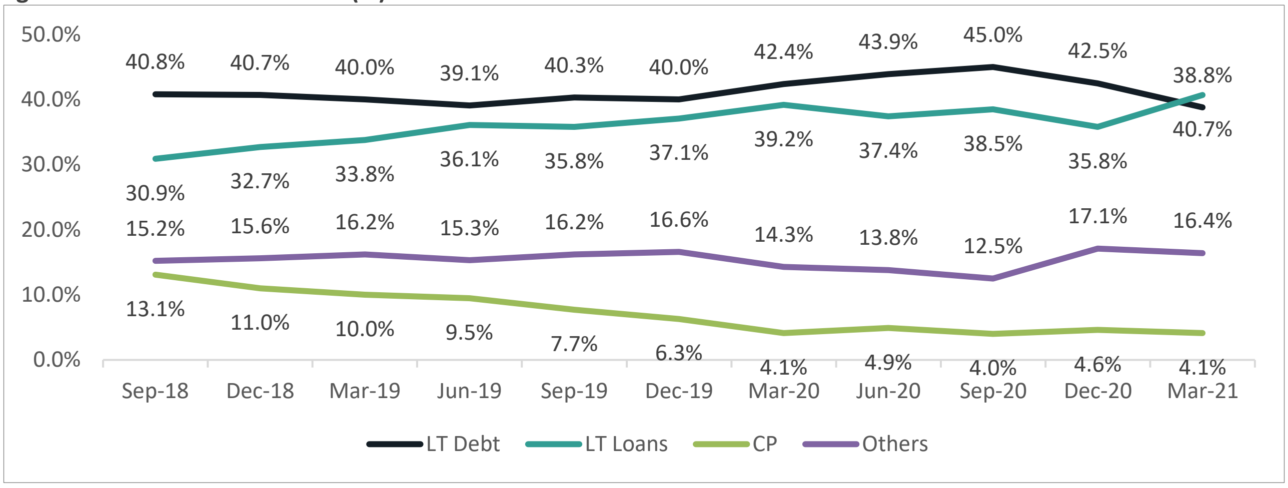
Figure 13: Share of lender groups for NBFCs (%)



Source: RBI

NBFCs continue to be the largest net borrowers of funds from the financial system. NBFCs owned highest share of 53.9% to SCBs followed by 22.0% to MFs and 18.4% to insurance companies. The proportion of SCBs has increased substantially as compared with FY19 levels. As share of bank funding increased, NBFCs have lost the competitive pricing advantage to the banks. If we observe, the share of MFs have witnessed a downward trend for several quarters, but increased in June 2020, largely due to substantial fund raised by selected highly rated PSU Infrastructure NBFCs.

Figure 14: Share of instruments (%)

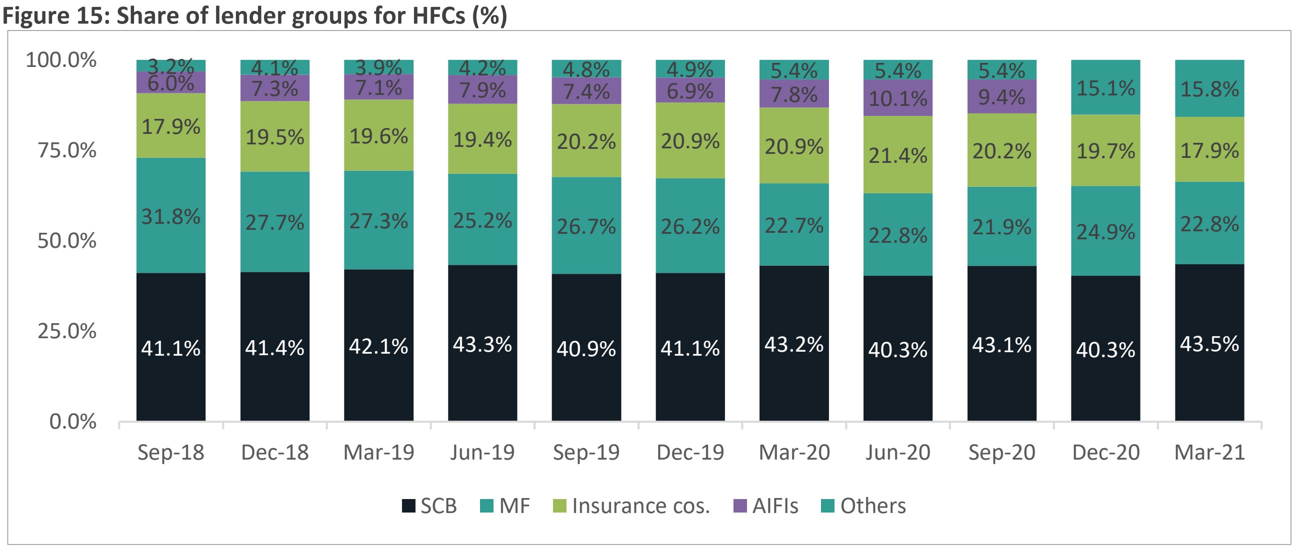


Source: RBI

The borrowing mix of NBFCs shows the increasing share of LT loans (provided by SCBs and AIFIs), while the share of CPs (primarily subscribed to by AMC-MFs and by SCBs) and LT debt (usually subscribed by insurance companies and AMC-MFs) witnessed a declining trend.

Housing Finance Companies (HFCs)

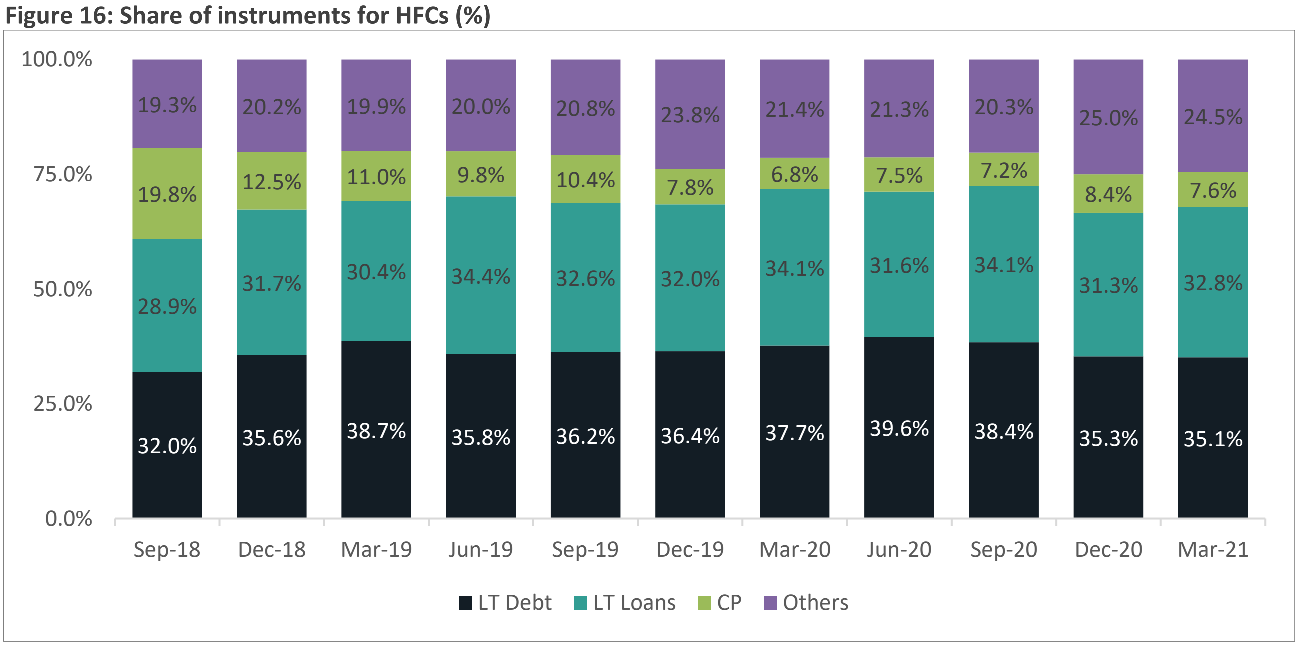
Figure 15: Share of lender groups for HFCs (%)



Source: RBI

HFCs were the second-largest borrowers of funds from the financial system. HFCs have followed a borrowing pattern, which is similar to the other NBFCs. MFs as a funding source reduced in Q4FY21, however, the same increased in December 2020. In contrast, the relative share of SCBs showed an upward trend in quarter ended March 2021, however, has dipped in December 2020.

Figure 16: Share of instruments for HFCs (%)



Source: RBI

If we observe, the funding mix of HFCs has been volatile for last several quarters. Funding on CPs (subscribed primarily by MFs and followed by SCBs) continued to witness a substantial fall since March 2019, as many large HFCs' emphasis to reduce short-term borrowings and improve asset liability profiles. This reduction has been offset by an increase in the share of LT Debt and LT loans (from banks and AIFIs), whereas LT loans fall in December 2020 and again increased in March 2021. The borrowing mix has shifted from short term to a longer tenure to improve the ALM position.

Concluding remarks and outlook:

The global economic performance improved in the H1FY21, however, uneven recovery may emerge as a downside risk going forward. The regulatory measures and continued policy support have supported the recovery. The banks worldwide may face asset quality challenges in the near term, especially from corporate segment. The progress of bank's overall health is closely linked to the pace of economic recovery and continuation of policy support. We believe, the second wave and anticipated third wave may further dent or postpone the economic recovery.

SCBs may face asset quality challenges due to restructuring especially in MSME segment. The overall stress is likely to increase in MSME segment once timeline/limit of various measures/support policies are completed. The second wave where selected regions were under lockdown and anticipated third wave may add pressure. However, retail loans, especially unsecured loans, are also expected to witness significant stress. The downside risks include lockdown in key states, which may impact the industrial as well as service segments. The transfer of bad loans to NARCL would reduce the headline stress figure, which would help banks to focus on credit. However, stress would continue to be present in the system.

According to the RBI's macro stress tests for credit risk, the GNPA ratio of SCBs may increase from 7.5% in March 2021 to 9.8% by March 2022 under the baseline scenario, and if the macroeconomic environment worsens further, the ratio may escalate to 11.2% under very severe stress. For PSBs, GNPA ratio of 9.5% in March 2021 may increase to 12.5% by March 2022. As per the stress test, SCBs have sufficient capital (at aggregate level and at individual level) even in severe stress scenario.

The credit growth for FY22 is likely to remain in low double digit on the back of muted economic activity, which could further delay the anticipated pick-up in credit growth, apart from the likely impact on asset quality. Retail loan segment is expected to do well as compared with industry and service segment supported by retail credit push. The downside risks include limited capex plans, lower discretionary spending compared to pre-pandemic levels, concerns over third wave, partial/complete lockdown in key states, which may impact the industrial as well as service segments.

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