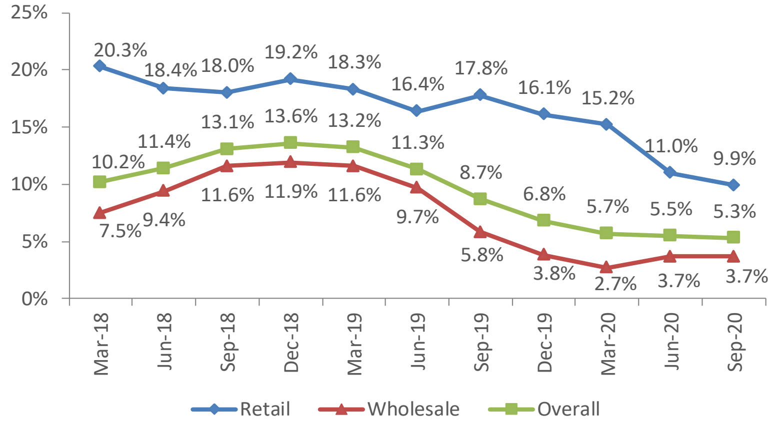
Select Extracts of RBI's Financial Stability Report - January 2021

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 the Covid-19 pandemic and the consequential stressed economic environment.

Scheduled Commercial Banks

Figure 1: SCBs - Credit Growth (y-o-y)

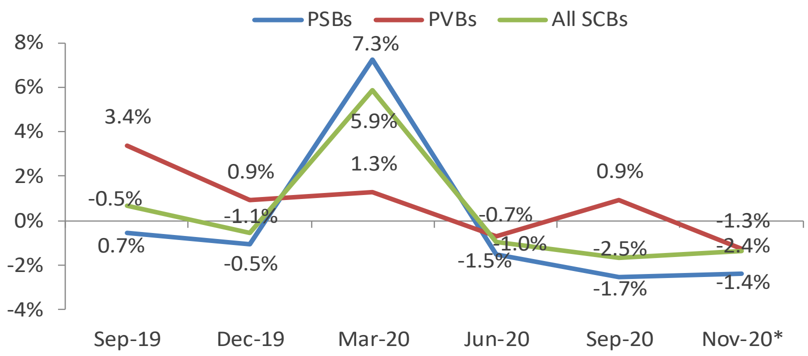


Source: RBI

Credit growth (y-o-y) of scheduled commercial banks (SCBs), which had declined to 5.7% by March 2020 (vs. 13.2% in March 2019), slid further to 5.3% by September 2020 (vs. 8.7% in September 2019). Furthermore, the credit growth rate in September 2020 was lower than the inflation rate of 7.3% during the same period.

Credit growth of public sector banks (PSBs) picked up from 3.0% (y-o-y) in March 2020 to reach 4.6% in September 2020, while for private sector banks (PVBs) it eased to 7.1% from 10.4% in March 2020 (which is still more than 2 times the PSB growth rate).

Figure 2: Growth in Wholesale Credit (q-o-q)



*Note: *Growth over September 2020; Source: RBI*

The wholesale credit declined in H1FY21 (-1.0% q-o-q in Q1FY21 and -1.7% in Q2FY21) and in Q3FY21 (-1.36% q-o-q up to November) reflects a subdued credit situation pointing to risk aversion and muted demand (refer figure 2). With the onset of COVID-19, retail credit growth (y-o-y)

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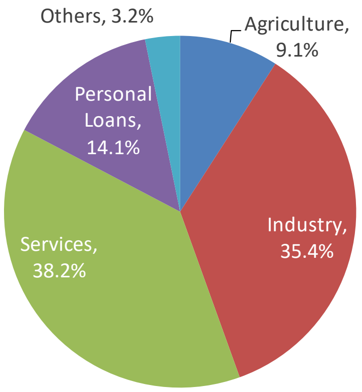
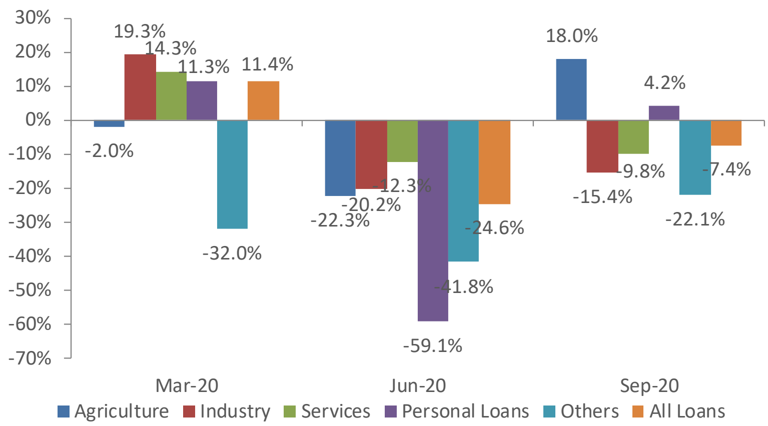
too has suffered, while wholesale credit growth has held up though at low levels. The wholesale credit growth was capped at 3.7% y-o-y and prevented from falling further in September 2020 (vs. 5.8% y-o-y growth in September 2019) could be largely led by disbursements under ECLGS scheme (Emergency Credit Line Guarantee Scheme). Loans disbursed through new accounts declined by almost one-fourth in Q1FY21 on y-o-y basis but subsequently, there has been some recovery. In Q2FY21 growth in new loans was witnessed primarily in the agriculture sector and in the personal loans segment (refer figure 4).

Figure 3: Share of sector-wise new loans by SCBs (FY20)



Source: RBI

Figure 4: Growth of sector-wise new loans by SCBs (y-o-y)



Source: RBI

SCBs deposit growth improved to 8.6% in March 2020 and further increased to 10.3% in September 2020 (vs. 9.9% in March 2019 and 10.2% in September 2019). The increase in overall deposits was largely due to stocking up funds in banks by depositors. Also, debt mutual funds and equity mutual funds witnessed outflows during the quarter ended Sept-20 (equity mutual fund observed net outflows after four years since Mar-16), indicative of risk aversion by investors which could support the rise in bank deposits (refer report '<u>Credit growth decelerated further in Q2FY21, while deposits growth continued to increase</u>'). Deposit growth in both PSBs and PVBs outpaced their credit growth, although deposit growth in PSBs was marginally slower at 9.6% y-o-y in September 2020 vs. 10.4% for PVBs.

Net interest income (NII) grew at a much higher rate (16.2%) in September 2020 (13.0% in March 2020) as compared with 13.0% in September 2019 (refer report '<u>In Q2FY21, RBI's moratorium along with higher write-offs by SCBs resulted in lower GNPAs</u>'). The Return on Assets (RoA) of PSBs turned positive at 0.3% as compared with negative growth in the last few quarters. The RoA of SCBs stood at 0.7% for the same period compared with 0.4% in the previous year.

The capital to risk-weighted assets ratio (CRAR) of SCBs improved to 15.8% in September 2020 from 14.8% in March 2020 and 15.1% in September 2019; PVBs recorded a marginal rise in CRAR whereas the ratio remained at similar level for PSBs. PVBs were more active in raising capital until the quarter ended September 2020, while in the third quarter of FY21 PSBs had also started raising capital.

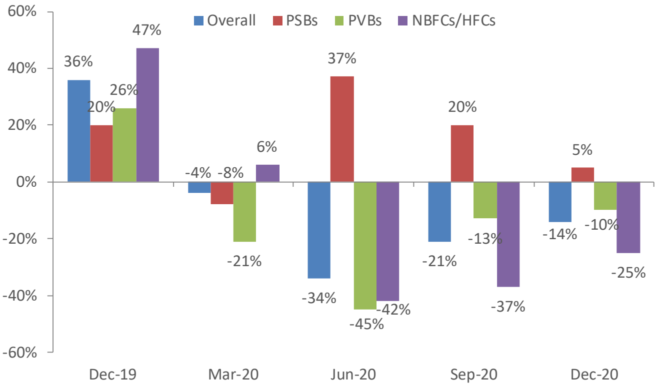
Figure 5: Performance of SCBs (%)

Financial Performance	Mar-18			Sep-18			Mar-19			Sep-19			Mar-20			Sep-20		
	PSB	PVB	SCB	PSB	PVB	SCB	PSB	PVB	SCB	PSB	PVB	SCB	PSB	PVB	SCB	PSB	PVB	SCB
Credit Growth (Y-o-Y)	6.3	21.3	**10.4**	9.1	22.5	**13.1**	9.6	21.0	**13.2**	4.8	16.5	**8.7**	3.0	11.3	**5.9**	4.6	7.1	**5.0**
Deposit Growth (Y-o-Y)	3.3	17.7	**6.9**	5.0	18.4	**8.7**	6.5	17.5	**9.9**	6.6	19.0	**10.2**	6.9	11.1	**8.6**	9.6	10.4	**10.3**
Ratios																		
RoA	-0.9	1.3	**-0.2**	-0.7	1.2	**0.0**	-0.9	1.2	**-0.1**	-0.1	1.0	**0.4**	-0.2	0.7	**0.2**	0.3	1.3	**0.7**
GNPA Ratio	15.6	4.0	**11.6**	14.8	3.8	**10.8**	12.6	3.7	**9.3**	12.7	3.9	**9.3**	11.3	4.2	**8.5**	9.7	4.6	**7.5**
PCR	47.1	51.0	**48.1**	51.4	56.2	**52.4**	60.8	57.0	**60.6**	61.7	58.5	**61.5**	64.8	67.5	**65.4**	70.5	78.3	**72.4**
CRAR	11.7	16.4	**13.8**	11.3	16.5	**13.7**	12.2	16.3	**14.3**	13.5	16.6	**15.1**	13.1	16.7	**14.8**	13.5	18.2	**15.8**

Source: RBI

Consumer Credit

Figure 6: Growth in inquiry volume (y-o-y)



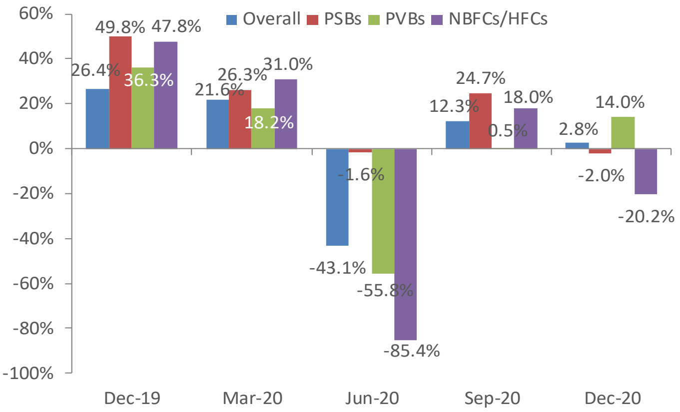
Source: RBI

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 has remained depressed since the outbreak of the pandemic as reflected in the inquiry volumes. The overall growth (aggregate of PSBs, PVBs and NBCs/HFCs) in inquiry volume registered de-growth of 14.0% in December 2020 compared with a significant growth of 36.0% in the previous year.

Bank Credit to MSME Sector

Figure 7: Volume of inquiries for MSME credit (y-o-y)



Source: RBI

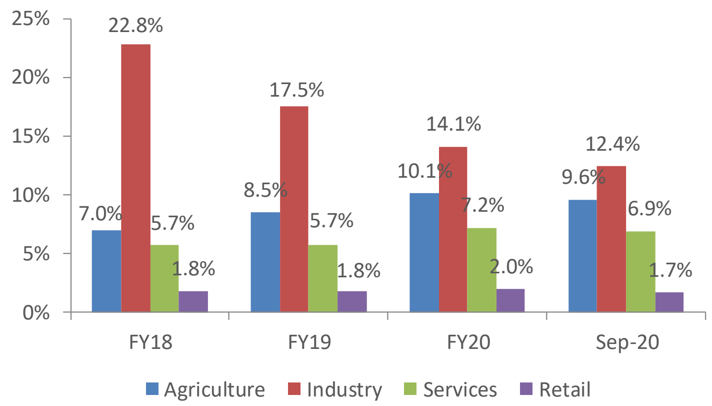
In contrary to consumer credit, the overall MSME segment reflected robust growth in inquiry volumes in the last two quarters compared with a declining growth during quarter ended June 2020. The growth in the MSME segment has been supported by the ECLGS scheme of the government which has been extended further until March 31, 2021.

As on September 29, 2020, PSBs sanctioned Rs.80,061 crores and disbursed Rs. 66,848 crores (the average sanction and average disbursement by PSBs per account is Rs. 2.37 lakh and Rs. 3.06 lakh, respectively); while PVBs sanctioned Rs.95,061 and disbursed Rs. 60,741 crores to MSMEs under the ECLGS scheme. The average sanction and average disbursement per account by PVBs is Rs. 9.73 lakh and Rs. 16.08 lakh, respectively, indicating that PVBs have targeted the higher end of the MSME segment (refer report '[ECLGS Update: Banks and NBFCs sanction ~62%; Private Banks continue to lead sanctions]').

Stressed Assets

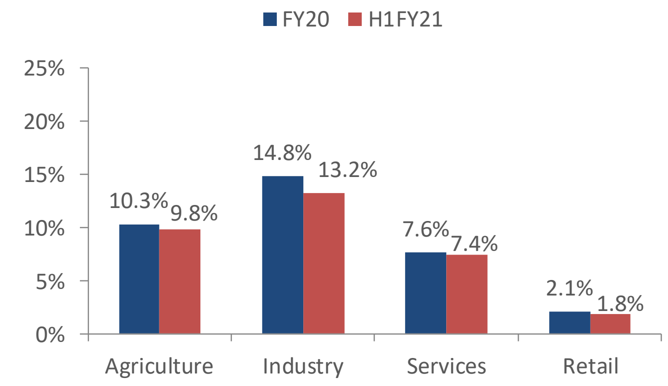
The gross non-performing assets (GNPA) ratio continued to decline and stood at 7.5% in September 2020 (8.5% in March 2020) compared with 9.3% registered in September 2019. The improvement was aided by write-offs made by multiple banks along with recoveries; this was further supported by regulatory dispensations extended in response to the COVID-19 pandemic (In the wake of COVID-19 pandemic related disruptions, RBI permitted lending institutions to (i) extend moratorium on term loan instalments and interest on working capital facilities for six months from March 1, 2020 to August 31, 2020 in case of qualifying borrowers, without any impact on their 'standard' status; and (ii) restructure credit facilities meeting the prescribed criteria, without any consequent downgrade in asset classification). The provision coverage ratio (PCR) of SCBs taken together improved across all bank groups and rose from 65.4% in March 2020 to 72.4% in September 2020 (refer figure 5).

Figure 8: Sector-wise GNPA Ratio



Source: RBI

Figure 9: Stressed assets ratio



Source: RBI

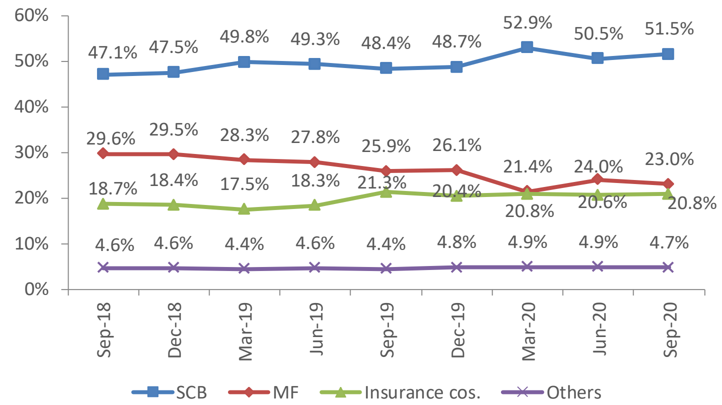
Looking at sectoral GNPA, asset quality improved noticeably in all four segments in September 2020 over March 2020, with a decline in GNPA and stressed assets ratio. The agriculture sector GNPA stood at 9.6% as of September 2020 as compared with 10.1% reported in March 2020. Industrial sector reported 12.4% GNPA ratio in September 2020 as compared with 14.1% GNPA ratio in March 2020. Within industry, a broad-based decline in GNPA ratio was visible across all major sub-sectors. Services and retail sectors reported 6.9% and 1.7% GNPA in September 2020 as compared with 7.2% and 2.0% reported in March 2020, respectively.

SCBs large borrowers accounted for 50.5% and 73.5% of the aggregate advances and GNPAs, respectively, in September 2020. The top 100 borrowers accounted for 17.0% of gross advances, but only 8.8% (share) of GNPAs of SCBs in September 2020.

Non-Banking Financial Services (NBFCs)

NBFCs registered decline in the financial year ended March 2020 largely due to isolated credit events in a few large NBFCs, challenges in accessing funds and the overall economic slowdown coupled with the pandemic's impact adding to the stress in the later period. During FY20, credit extended by NBFCs grew by 4.4% as compared with 22% in FY19. Gross NPAs of NBFCs increased from 5.3% of total advances as on March 2019 to 6.3% as on March 2020. Asset quality is expected to deteriorate further due to disruption of business operations caused by the pandemic, especially in the industry sector (one of the major recipients of NBFC credit).

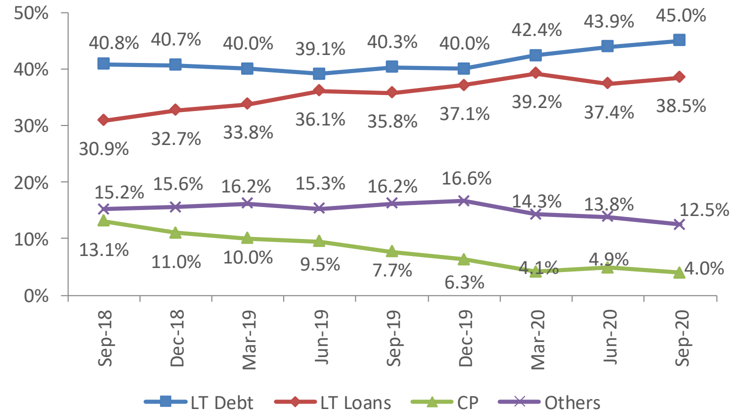
Figure 10: Share of lender groups for NBFCs



Source: RBI

NBFCs were the largest net borrowers of funds from the financial system. NBFCs owed 51.5% to SCBs followed by 23.0% to MFs and 20.8% to insurance companies. The share of SCBs which had increased in FY19 registered a moderation in the following quarters (quarter ended Jun-19, Sep-19 and Dec-19) however it picked up and by the end of March 2020 it accounted for more than half of the funding source. A point to be noted is that with the rise of the bank funding, NBFCs have inherently lost a competitive pricing advantage to the banks. However, the share of MFs has been on a consistent declining trend for the last several quarters but increased in June 2020, mainly due to significant fund raise by select highly rated PSU NBFCs which finance infrastructure assets. Furthermore, if the funding mix is considered, the share of SCBs would be higher due to the significant loan asset sell down (direct assignment) as a funding source which is not included in the above computation (PSBs were significant acquirers of these assets).

Figure 11: Share of instruments

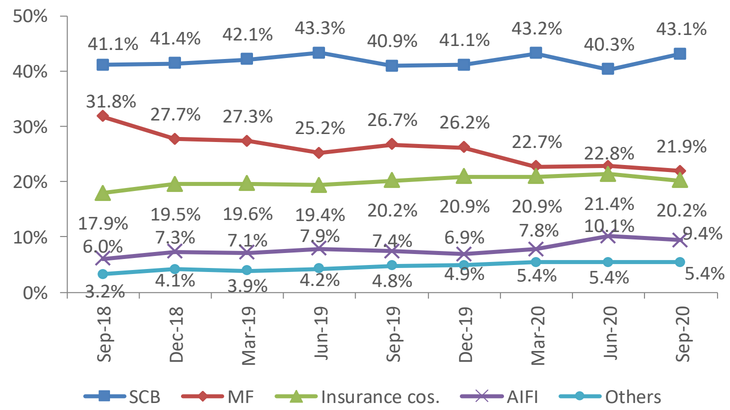


Source: RBI

The NBFC borrowing mix clearly highlights the increasing role of LT loans (provided by SCBs and AIFIs) and a declining share of CPs (primarily subscribed to by AMC-MFs and by SCBs) and LT debt (usually subscribed by insurance companies and AMC-MFs).

Housing Finance Companies (HFCs)

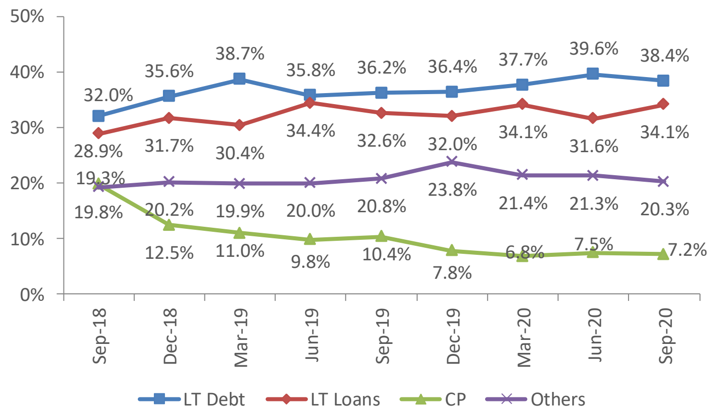
Figure 12: Share of lender groups – HFCs



Source: RBI

HFCs were the second largest borrowers of funds from the financial system. HFCs have followed a borrowing pattern which is quite similar to that of the other NBFCs, with AIFIs also accounting for a significant share. MFs as a funding source reduced significantly in December 2018; however, the same increased marginally in September 2019 and has declined for the next three quarters. In contrast, the relative share of SCBs showed an upward trend in quarter ended December 2019 and March 2020, but has dipped in June 2020 and again increased in September 2020. Furthermore, certain HFCs resorted to sell-downs or securitisation of their retail assets in order to generate liquidity. Hence, the funding mix if these direct assignments are considered, the share of SCBs would be even higher as SCBs, especially PSBs, had acquired these assets.

Figure 13: Share of instruments



Source: RBI

The funding mix of the HFCs has been volatile for the last several quarters. Funding on CPs (subscribed primarily by MFs and followed by SCBs) continued to witness a sharp fall since March 2019 as many large HFCs made conscious effort to reduce short term borrowings and improve asset liability matching profiles. This decrease has been offset by a significant rise in the share of LT Debt and LT loans (from banks and AIFIs), however LT loans dipped in June 2020 and again rose in September 2020. The borrowing mix has shifted from short term to a longer tenure.

Concluding remarks

The global economic activity remained uncertain by the COVID-19 pandemic, more recently by the second wave that has forced re-clamping of lockdowns across Europe and a resurgence of infections in the US. Overall, growth in global 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. Furthermore, the RBI's stress tests indicate that SCBs have sufficient capital at the aggregate level even in the severe stress scenario but at the individual bank level, several banks may fall below the regulatory minimum if stress aggravates to the severe scenario. The need of the hour is for banks to assess their respective stress situations and follow it up with measures to raise capital proactively. This has been evinced by several banks announcing capital raising plans.

Additionally, according to the RBI's macro stress tests, the GNPA ratio of all SCBs may increase from 7.5% in September 2020 to 13.5% by September 2021 under the baseline scenario and if the macroeconomic environment worsens into a severe stress scenario, the ratio may escalate to 14.8%. Under the baseline scenario, PSBs' GNPA ratio of 9.7% in September 2020 may increase to 16.2% by September 2021; while the GNPA ratio of PVBs may increase from 4.6% to 7.9%, over the same period. Further, SCBs capital to risk-weighted assets ratio (CRAR) is projected to drop from 15.6% in September 2020 to 14.0% in September 2021 under the baseline scenario (12.5% under the severe stress scenario). While underlying assumptions for such assessments are currently being discussed, it indicates the need for SCBs to be mindful of the asset quality and take appropriate steps such as to shore up capital.