India's Improving Asset Quality Moves Closer in Line with Global Level

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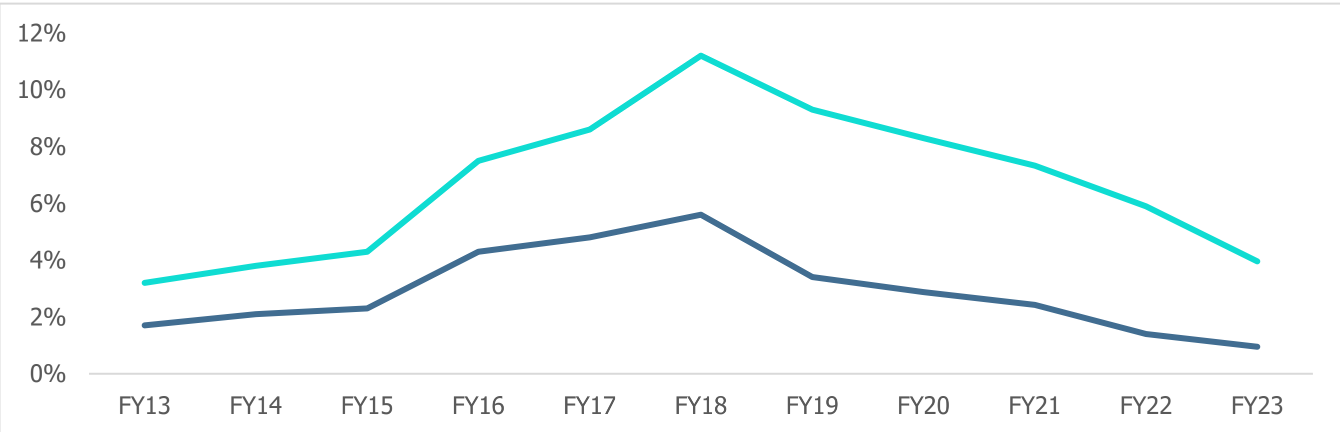
Synopsis

Driven by moderation in slippages, appropriate PCR levels resulting in lower incremental credit costs, sustained high bank credit offtake, corporate deleveraging leading to improved financials, a declining trend in legacy GNPAs and sustained retail GNPA levels in spite of high levels of unsecured loans, the SCB GNPA ratio could improve from 3.96% in FY23 to 2.90%-3.05% by FY24 end. At these levels, GNPA figures would have reached the pre-asset quality review levels. The performance of MSMEs and restructured accounts continues to be monitorable in the current fiscal. On the other hand, downside risks include elevated interest rates, global uncertainties, and the prolonged Russia-Ukraine conflict.

Asset Quality to Continue Witnessing Improving Trend

Post the asset quality review (AQR) in 2015-2016, banks witnessed a sharp jump 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. With the elevated provisions, the sharp rise in the GNPAs because of the AQR process led to a rise in the difference between GNPAs and NNPAs. This difference peaked in FY19 and has started to reduce given the write-offs and provisions.

Figure 1: Movement in Asset Quality Ratios (in %)



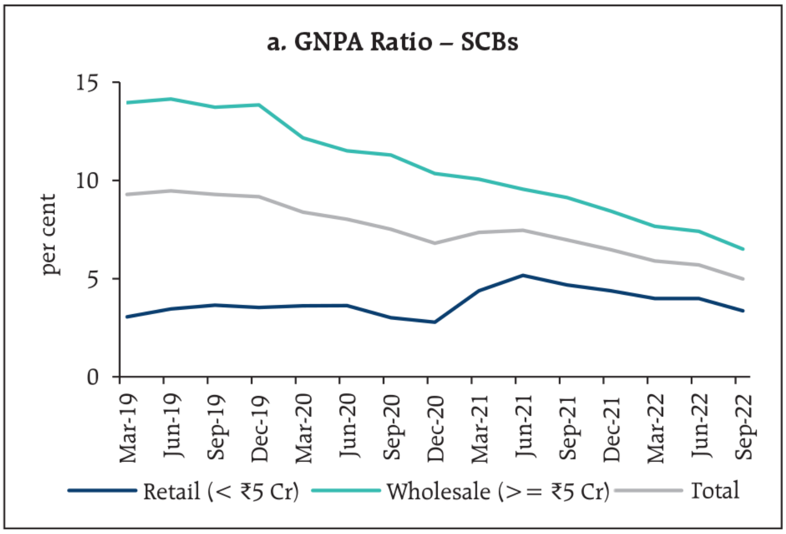
Source: RBI

The GNPA ratio of SCBs had been on a downward trajectory since March 2019, 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.

Large borrowers have been witnessing a decline in their share of total credit which can be attributed to deleveraging and the rise of personal loans and diversification of borrowers. The GNPA ratio of large borrowers has been declining over the last two years to reach 4.5% in March 2023. Large borrowers accounted for 46.4% and 53.9% of the aggregate banking advances and GNPAs, respectively, in March 2023.

Asset quality of the banking system continued to improve: the gross non-performing asset (GNPA) ratio declined sequentially for wholesale advances and retail loans.

Figure 2: Movement in GNPA Ratio: Wholesale vs. Retail



In FY23, the SCBs GNPA ratio fell to 3.9%, a decadal-year low. The asset quality has improved due to recoveries, higher write-offs by banks, rising advances, etc. The slippages have declined across bank groups in FY23 indicating lower accretion of fresh NPAs. The PSB GNPA ratio (4.97% in FY23) continues to remain significantly higher than the private banks' GNPA ratio (2.35% in FY23).

Figure 3: Write-Offs of Select Banks (Rs. Crore)

PSBs	Q4FY22	Q3FY23	Q4FY23	Y-o-Y (%)	Q-o-Q (%)
SBI	4,856	10,024	6,677	37.5%	-33.4%
BoB	4,425	4,725	4,935	11.5%	4.4%
PNB	10,548	4,375	6,094	-42.2%	39.3%
UBI	812	1,249	2,679	229.9%	114.5%
Canara	2,989	2,836	4,317	44.4%	52.2%
BOI	313	2,522	1,909	509.9%	-24.3%
Total	**23,943**	**25,731**	**26,611**	**11.1%**	**3.4%**
PVBs	**Q4FY22**	**Q3FY23**	**Q4FY23**	**Y-o-Y (%)**	**Q-o-Q (%)**
HDFC	1,700	3,100	2,400	41.2%	-22.6%
ICICI	2,644	1,162	1,158	-56.2%	-0.3%
Axis	1,697	1,652	2,429	43.1%	47.0%
IndusInd	1,353	795	569	-57.9%	-28.4%
IDBI	160	5,622	10,566	nm	87.9%
Total	**7,554**	**12,331**	**17,122**	**126.7%**	**38.9%**
G. Total	**31,497**	**38,062**	**43,733**	**38.8%**	**14.9%**

Source: Banks Presentation,

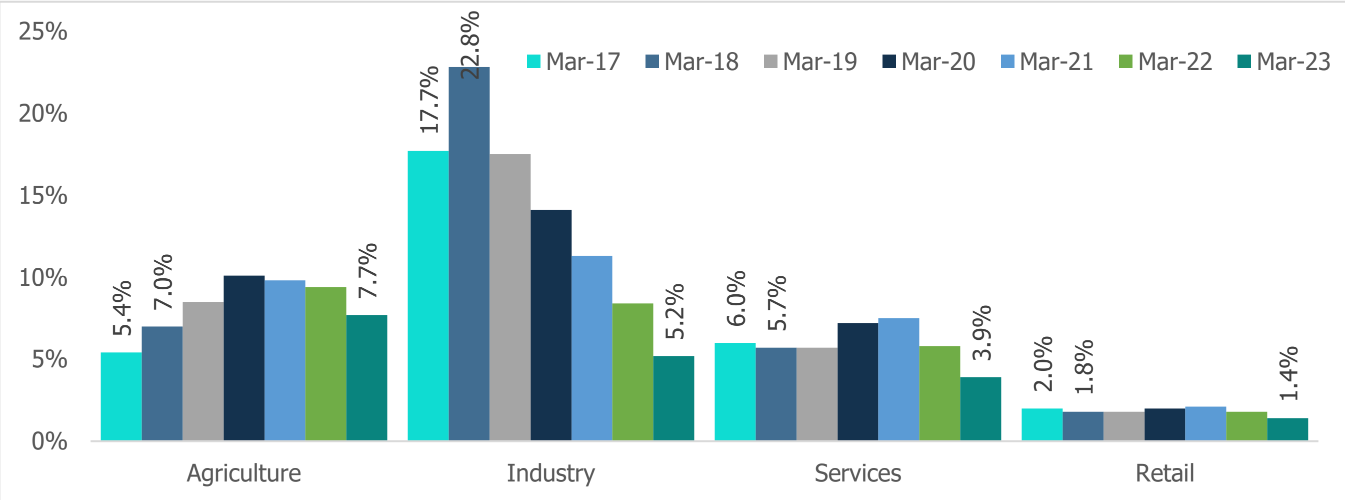
The table above showcases that the pace of write-offs has continued and has accounted for a significant share in the reduction of GNPAs.

Sectoral Asset Quality

Looking at sectoral GNPA, the agriculture sector GNPA ratio reduced to 7.7% in March 2023 compared to 10.1% reported in March 2020, which increased from 5.4% in March 2017. Agriculture GNPA generally rises due to droughts and elections - the anticipation of loan waivers. Further, incremental additions are concomitant to the impact of the monsoon.

The industrial sector reported a 5.2% GNPA ratio in March 2023 as compared with a 14.1% GNPA ratio in March 2020 and 22.8% in March 2018 given the corporate deleveraging, corporate resolutions and write-offs. Among major sub-sectors within the industry, there was a broad-based improvement in the GNPA ratio, though it remained elevated for gems and jewellery and construction sub-sectors.

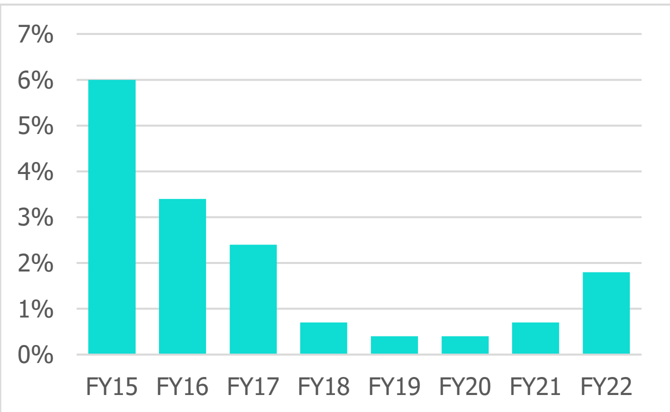
Figure 4: Sector-wise GNPA Ratio



Source: RBI

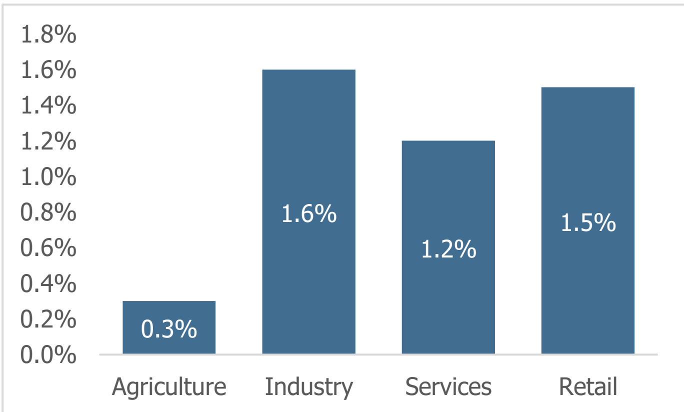
The services and retail sectors reported 3.9% and 1.4% GNPA in March 2023 as compared with 7.2% and 2.0% reported in March 2020, respectively. Retail NPAs can largely be attributed to stress on unsecured loans. The aggregate GNPA Ratio (PSBs and PVBs) in the MSME sector has moderated from 10.8% in March 2021 to 6.8% in March 2023 due to regulatory measures coupled with the continued flow of credit under ECLGS. However, compared to other segments in Figure 4, they remain relatively high.

Figure 5: Movement in Restructured Std Adv to Gross Advances (%)



Source: RBI

Figure 6: Sector-wise Restructured Std Adv as of March 2023



Source: RBI

The AQR resulted in a reclassification of standard restructured accounts enabling the steady downtrend. However, due to covid and the associated business disruptions have led to an increase in Restructured Standard Assets over the past two years. 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 a gradual rundown of these assets.

International

Figure 7: Country-wise - Bank nonperforming loans to gross loans (%)

Country	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
US	3.32	2.45	1.85	1.47	1.32	1.13	0.91	0.86	1.07	0.81
UK	3.59	3.11	1.65	1.01	1.69	1.36	1.10	1.02	0.98	0.97
Malaysia	2.02	1.85	1.65	1.61	1.61	1.55	1.47	1.52	1.57	1.68
China	0.95	1.00	1.25	1.67	1.74	1.74	1.83	1.86	1.84	1.73
Brazil	3.45	2.86	2.25	2.85	3.08	2.88	2.60	2.66	1.87	2.08
Indonesia	1.68	1.61	1.97	2.32	2.77	2.44	2.21	2.34	2.64	2.64
Spain	5.71	7.12	6.38	5.09	4.72	4.46	3.69	3.15	2.85	2.92
Thailand	2.43	2.30	2.31	2.68	2.99	3.07	3.08	3.13	3.23	3.11
Philippines	2.20	2.44	2.02	1.89	1.72	1.58	1.67	1.97	3.53	3.96
South Africa	4.04	3.64	3.24	3.12	2.86	2.84	3.73	3.89	5.18	4.45
Russia	6.06	6.02	6.81	8.38	9.24	9.66	9.75	8.83	8.26	

Source: World Bank

Non-performing loans eased in advanced economies due to continued deleveraging, and institutional and government intervention. Despite a declining GNPA trend, Loss assets in India continue to be at comparatively higher levels vs. other countries. Indian banks GNPA usually operated at 2.5% plus levels prior to the AQR and is now approaching that level again. Hence the NPA levels are likely to come closer to other countries.

CareEdge View

Driven by moderation in slippages, appropriate PCR levels resulting in lower incremental credit costs, sustained high bank credit offtake, corporate deleveraging leading to improved financials, a declining trend in legacy GNPAs and sustained retail GNPA levels in spite of high levels of unsecured loans, the SCB GNPA ratio could improve from 3.96% in FY23 to 2.90%-3.05% by FY24 end. At these levels, GNPA figures would have reached the pre-asset quality review levels. The performance of MSMEs and restructured accounts continues to be monitorable in the current fiscal. On the other hand, downside risks include an increase in crude oil prices, global economic slowdown, global monetary and liquidity tightening, elevated interest rates, and the prolonged Russia-Ukraine conflict.

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