Gross NPAs to decline in FY21

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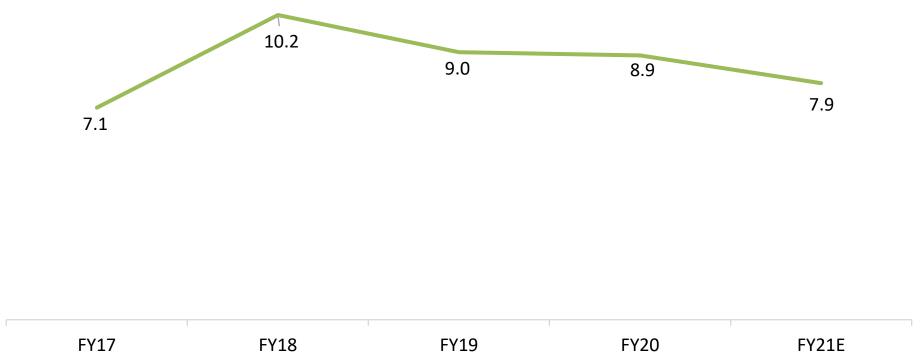
Overview

In FY21, bank credit growth was muted (lowest since last four years) as lenders and borrowers remained risk averse due to the pandemic-led uncertainty. The bank credit was largely supported by the agriculture, retail segment and disbursements under Emergency Credit Line Guarantee Scheme (ECLGS) scheme, while industry growth was largely muted. The growth in retail segment was driven by credit push and interest rate concessions on home loans. It was further aided by various regulatory measures by RBI in the form of interest rate cuts and cash reserve ratio (CRR) exemption on credit disbursed to new MSME borrowers during FY21. On the other hand, banks have ample liquidity due to a stable deposit growth. In FY21, banks raised significant amount of capital to increase the loss absorption capacity in case of increase in credit losses.

However, **NPAs are expected to decline in FY21** due to restructuring, write-offs and resilience in the economy. Several regulatory and government support schemes also helped borrowers to access liquidity and conserve cash flows. These schemes include (1) moratorium on loan repayments for six months till August 30, 2020, (2) covid-related restructuring scheme for large corporates till December 31, 2020, and for MSMEs till March 31, 2021; RBI has announced the Resolution Framework 2.0 scheme for personal loans and MSMEs till September 30, 2021, (3) ECLGS to enable Banks and NBFCs provide funding to MSMEs, (4) TLTROs, (5) Special refinance facilities to NABARD/SIDBI/NHB to address sectoral credit needs, and (6) Extended Partial Guarantee Scheme.

GNPA Movement

Figure 1: Movement in Gross NPA (In Rs lakh crores)



Note: Based on 30 Scheduled Commercial Banks (SCBs) (12 public sector banks (PSB) and 18 private sector banks (PVB)). For 13 SCBs (8 PSBs and 5 PVBs), December 2020 numbers have been used as March 2021 (as March 2021 numbers for these 13 SCBs numbers are yet to be released); Source: Company filings, CARE Ratings.

Encouraging trends in FY21

- Wholesale NPAs have been declining during FY21.
- Banks are adequately provided with PCR above 75%, as RBI has been pushing banks to provide additional cover.
- Write-offs have been high – especially PVBs due to strength of their P&L. Need to see how much write-offs PSBs do in Q4FY21.
- Slippages during the year are largely from MSME (tempered due to access to ECLGS funds) and retail.

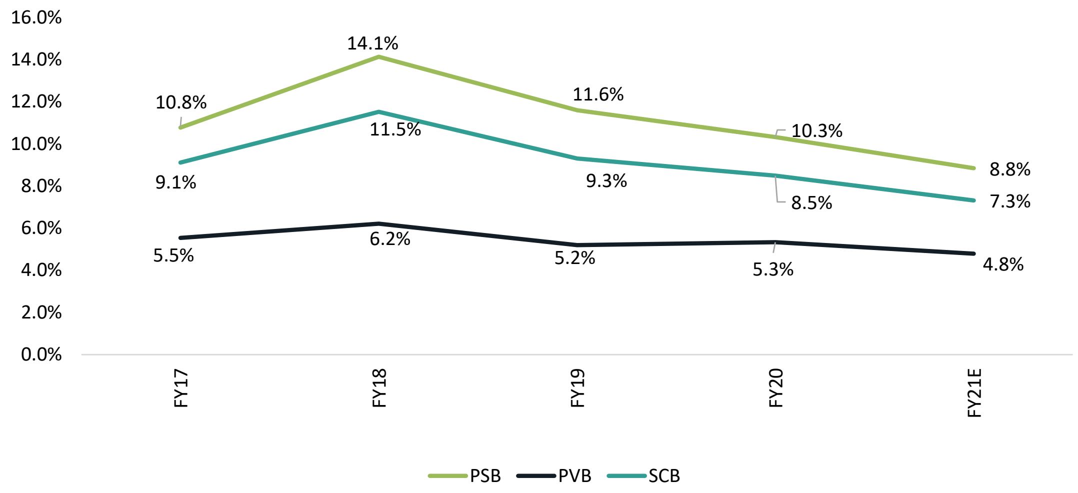
Gross NPAs increased sharply by 43.7% from Rs.7.1 lakh crore in March 2017 to reach Rs.10.2 lakh crore by the end of March 2018. The asset quality deterioration in SCBs can be attributed to (1) regulatory challenges (2) shift in technology, (3) project delays and cost overruns; (4) absence of a strong bankruptcy regime, (5) wilful default/loan frauds/corruption in some cases, and (6) economic slowdown.

Post this increase in FY18, the NPAs witnessed moderation and reached Rs.8.9 lakh crore by end of March 2020. The asset quality pressure witnessed by the Indian banks over post the asset quality review (AQR) had been reducing in the couple of years prior to Covid. The improvement was driven by write-offs, lower slippages, and resolution of a few large accounts through the Insolvency and Bankruptcy Code (IBC).

Despite a challenging year, the quantum of gross NPAs of SCBs are expected to decline by the end of March 2021 as compared with the previous year due to write-offs, lower slippage, restructuring schemes and ECLGS support for MSMEs. However, as anticipated with the Supreme Court judgement allowing for the recognition of NPAs, FY21-end numbers are expected to be either similar or slightly above the Q3FY21 numbers.

PSBs accounted for more than 80% of SCBs' GNPA till FY19. Over the last couple of years, the PSBs registered substantial contraction in their GNPA amount as they are expected to be around Rs.6.0 lakh crore at the end of March 2021 as compared with Rs.6.8 lakh crore as at the end of March 2020. GNPA amount of PVBs had remained 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 Rs.1.8 lakh crore in March 2018 which breached the Rs.2 lakh crore levels in December 2019 but subsequently are expected to have retreated to around Rs 1.96 lakh crore by the end of March 2021.

Figure 2: Steady reduction in GNPA Ratio (In %)



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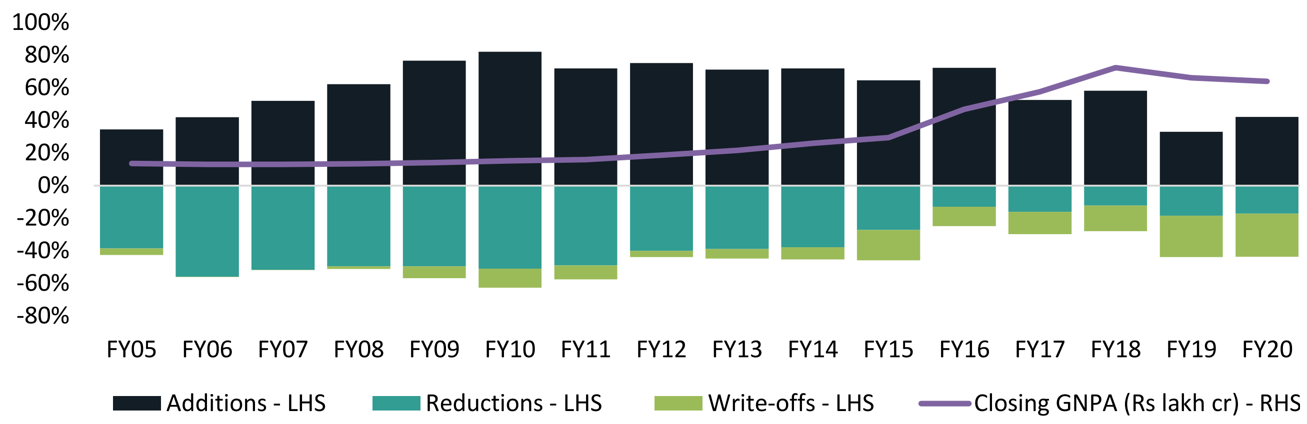
The GNPA ratio of SCBs had been on a downward trajectory since last two years. SCBs asset quality has seen some improvement (GNPA reduction) due to recoveries and higher write-offs by multiple banks, OTR schemes announced by RBI, etc. The PSB GNPA ratio continues to remain significantly higher than the private banks NPA ratio. The PSBs NPA ratio moved up by 336 bps in the FY18 to reach 14.1%. Subsequently, the ratio has been on a declining trend.

Figure 3: Increased share of Write-offs



Source RBI, CARE Ratings

The earlier figures showcase that GNPA had reduced significantly from the earlier peaks (Rs.10.2 lakh crore and 11.5% in FY18), however, it should be noted that write-offs have accounted for quite a large share of the same. Figure 3 indicates that, in the earlier years, write-offs had a smaller share, but post FY18, the share has markedly increased indicating that SCBs have cleaned their books taking a hit and recoveries have had a smaller share of the same.

National Asset Reconstruction Company Limited (NARCL) – Completing the unwinding of massive AQR exercise.
If the proposed transfers of NPAs from Banks to NARCL are considered on the likely book at the end of FY21, the GNPA figure would come down below 6%. The revised GNPA ratio post transfer could be around the same levels prior to the AQR exercise.

As per reports, nearly Rs.2 lakh crore of the NPAs would be transferred to the NARCL from SCBs. These NPAs have been reportedly fully provided for by the banks. Consequently, a similar amount would be removed from the systemic GNPA numbers resulting in a reduction of aggregate GNPA. Once the transfer is carried out, the revised estimated GNPA number (for the sample under consideration) would be approximately Rs.5.93 lakh crore and the revised estimated GNPA ratio would be around 5.6%. Consequently, it is estimated that the GNPA ratio would go down by 1.6%-1.8%.

Despite this reduction, India's NPA ratio would continue to be one of the highest among the comparable countries. However, with this transfer, the GNPA ratio would at least be in the ballpark range as indicated by the figure below.

Figure 4: Bank nonperforming loans to total gross loans (%)

Country Name	2012	2013	2014	2015	2016	2017	2018	2019
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: 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

Concluding remarks

- Credit growth to improve to around 10% with sluggish recovery in economy and base effect. Retail loans are expected to do well as compared with industry and service segment. Extension of the TLTRO operations and on lending norms could support growth.
- Pressure on asset quality expected to continue due to restructuring especially in MSME segment (tempered currently due to the ECLGS scheme). Second Covid wave requiring lockdowns in selected geographies likely to 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. Another risk includes the ending of the ECLGS scheme in June 2021, which had propped up the MSME credit.
- Transfer to the NARCL would reduce the headline number; however, stress would continue to be present in the system. However, even before the Covid-19 pandemic, India has been grappling with a significant level of non-performing loans in its banking system and systemic GNPA ratio would continue to remain above international levels.
- Overall, due to the fund-raising activities, the banking sector has adequate capitalisation, and with the RBI mandated provisioning norms, the provision coverage is also adequate.
- Overall outlook for the banking sector is stable.

Annexure

Quarterly Movement in GNPAs for select banks (Rs lakh crores)

Bank	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
PSB	5.74	6.83	6.83	7.27	8.40	8.16	8.08	7.78	7.18	7.38	7.27	7.17	6.82	6.39	6.09	5.77	5.97
PVB	1.36	1.46	1.57	1.58	1.81	1.84	1.88	1.85	1.79	1.85	1.94	2.17	2.04	2.00	1.87	1.72	1.96
SCB	**7.11**	**8.29**	**8.39**	**8.85**	**10.21**	**10.00**	**9.96**	**9.63**	**8.97**	**9.23**	**9.21**	**9.34**	**8.86**	**8.39**	**7.96**	**7.49**	**7.93**

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