Asset Quality Figures Now Moving Towards Pre-AQR Levels

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Synopsis

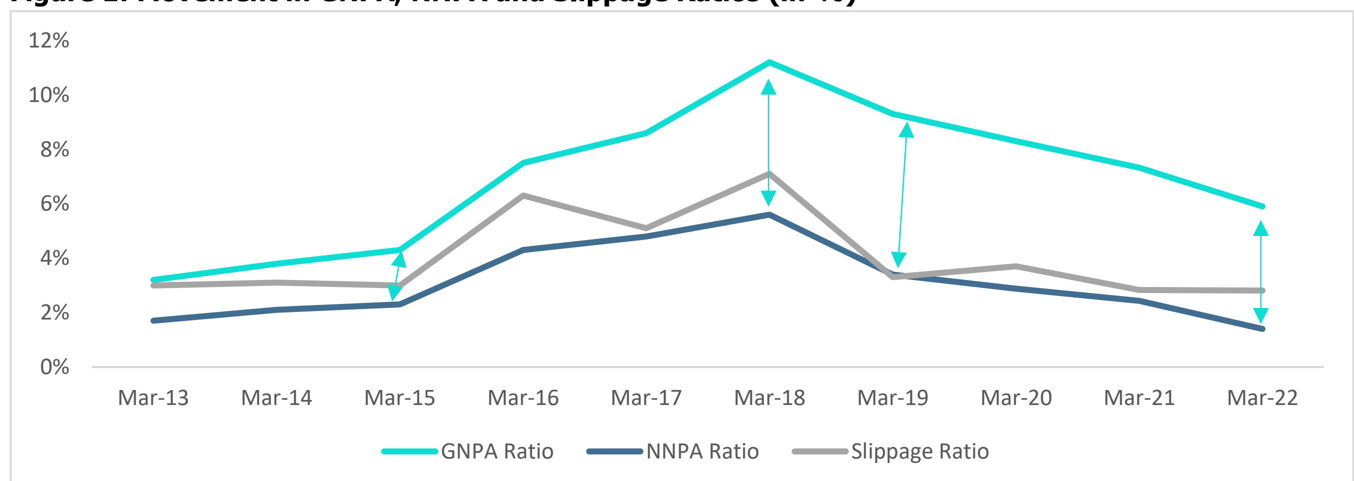
Driven by moderation in slippages, healthy PCR resulting in lower credit costs, higher bank credit growth, and a declining trend in the stock of GNPAs and the proposed transfer of larger accounts to NARCL and other ARCs in this fiscal year, the SCB GNPA ratio could improve from 5.9% in FY22 to 5.0%-5.2% by the end of FY23. At these levels, GNPA figures would be closer to pre-asset quality review levels of around 4%. On the other hand, the possibility of increased slippages arising from sectors that were relatively more exposed to the pandemic continues as support measures are unwound along with rising interest rates. The performance of restructured accounts continues to be monitorable in the current fiscal.

Asset Quality to Continue Witnessing Improving Trend

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.

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 GNPA, NNPA and Slippage Ratios (in %)



Source: RBI

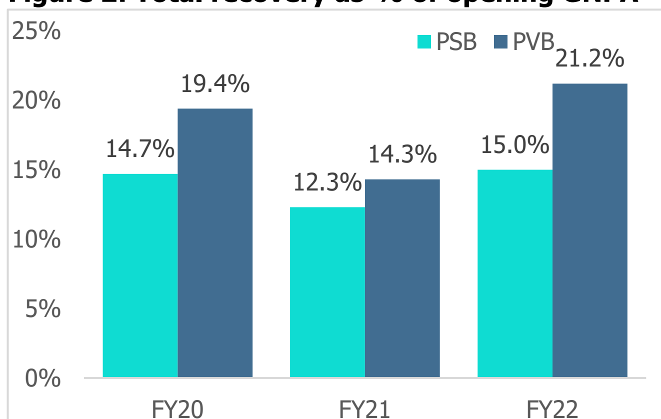
The GNPA ratio of SCBs had been on a downward trajectory since Mar-19, which continued even during the pandemic period, led by increasing deleveraging and regulatory intervention. These regulatory and government support schemes also helped borrowers to access liquidity and conserve cash flows. These regulatory and government support schemes also helped borrowers to access liquidity and conserve cash flows. These schemes include (1) a moratorium on loan repayments for six months, (2) a covid-related restructuring scheme for large

corporates, MSMEs, and personal loans (3) ECLGS to enable Banks and NBFCs to 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.

SCBs asset quality has also seen some improvement (GNPA reduction) due to recoveries and higher write-offs by banks, Covid-related relief measures, etc. The PSB GNPA ratio (7.29% in FY22) continues to remain significantly higher than the private banks' NPA ratio (3.84% in FY22).

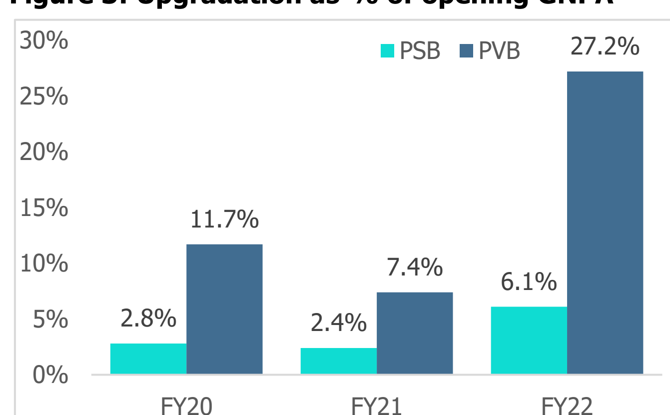
In FY22, the GNPA ratio fell to 5.9%, a six-year low and the overall provision coverage ratio (PCR) improved to 70.9%. The PCRs of both PSBs and PVBs increased in March 2022. The slippage ratio and write-offs declined across bank groups in FY22 indicating lower accretion of fresh NPAs as well as the fact that banks had already written off older NPAs. 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 7.7% in March 2022. Large borrowers accounted for 47.7% and 62.3% of the aggregate banking advances and GNPAs, respectively, in March 2022.

Figure 2: Total recovery as % of opening GNPA



Source: RBI

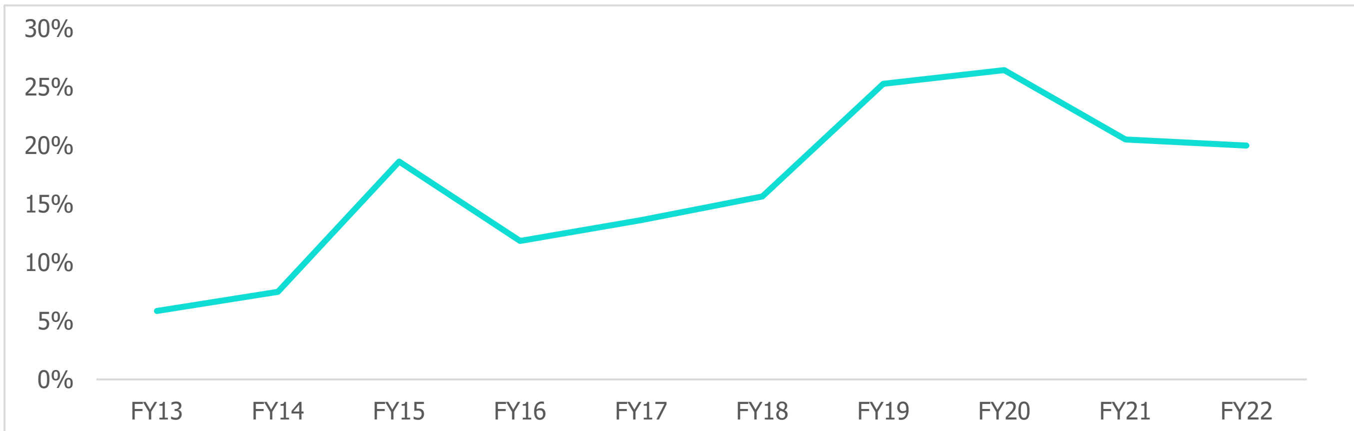
Figure 3: Upgradation as % of opening GNPA



Source: RBI

As can be observed in figures 10 and 11, recovery, as well as upgradation levels, have crossed the pre-pandemic levels, with PVBs continuing to outpace PSBs. In a similar vein, GNPAs rose earlier and then write-off as a percentage of GNPA rose in a lagged manner. The write-offs seem to have peaked in FY20 and have then declined in the next two successive years.

Figure 4: Trend in write-offs (Write-off as a % of GNPA)

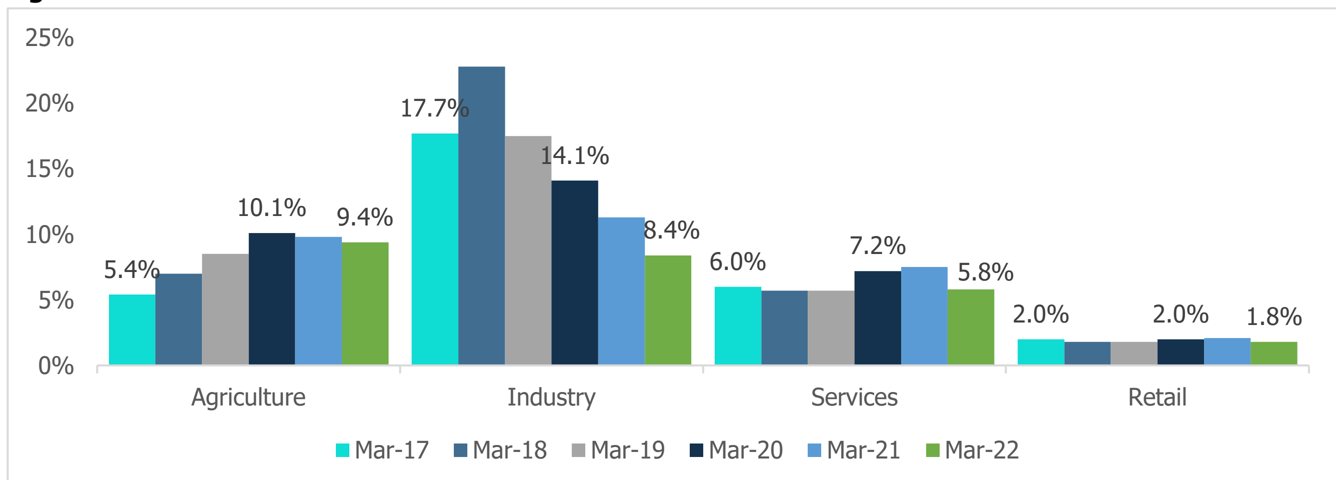


Note: Write-off ratio is the ratio of write-off during the year to GNPA at the beginning of the year. Source: RBI

Looking at sectoral GNPA, the agriculture sector GNPA ratio stood at 9.4% in March 2022 as compared with 10.1% reported in March 2020 having increased from 5.4% in March 2017. Agriculture GNPA generally rises due to droughts and elections - the anticipation of loan waivers.

The industrial sector reported an 8.4% GNPA ratio in March 2022 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.

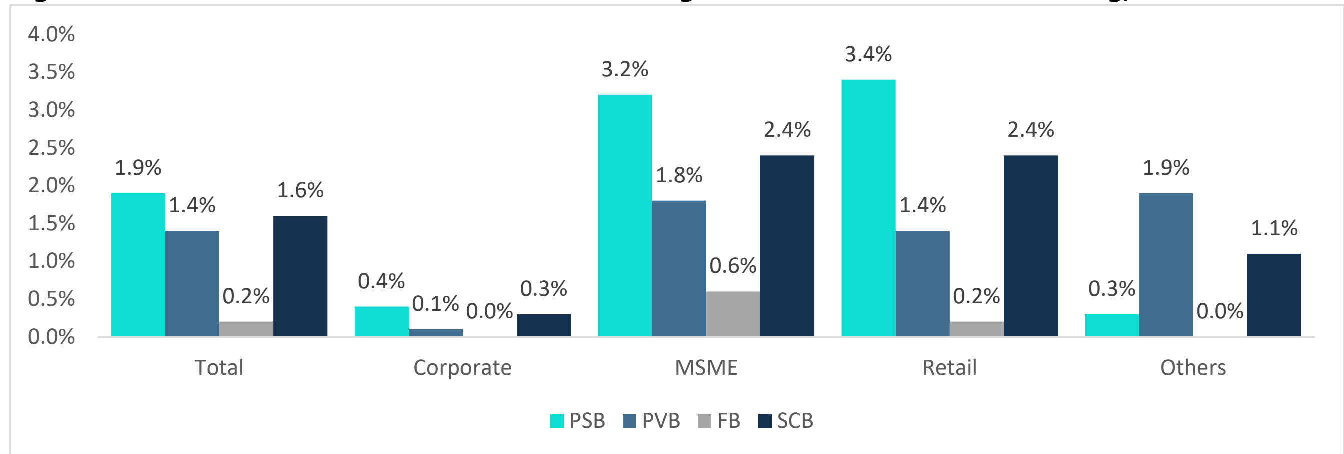
Figure 5: Sector-wise GNPA Ratio



Source: RBI

The services and retail sectors reported 5.8% and 1.8% GNPA in March 2022 as compared with 7.2% and 2.0% reported in March 2020, respectively. Retail NPAs can largely be attributed to the increased stress on unsecured loans. The aggregate GNPA Ratio (PSBs and PVBs) in the MSME sector has moderated from 10.8% in March 2021 to 9.3% in March 2022 due to regulatory measures coupled with the continued flow of credit under ECLGS. However, compared to other segments in figure 5, they remain relatively high.

Figure 6: Restructured Advances Under RF 2.0: Segment-wise Amount Outstanding, December 2021



Source: RBI

Within standard assets, the share of restructured standard advances (RSA) increased from 0.4% in March 2020 to 0.8% in March 2021, largely due to the one-time restructuring scheme for standard advances announced by RBI in August 2020. The restructured assets further increased to 1.8% at end of September 2021 due to Resolution Framework (RF) 2.0 for retail and MSMEs which did not entail an asset classification downgrade.

Restructuring of loans by entities impacted by the second wave of COVID-19 under the RF 2.0 stood at 1.6% of total advances in December 2021. Restructured assets constituted 2.4% each of the advances under MSME and retail sectors. PSBs had a relatively larger share of restructured loan assets in their books. The restructuring under RF 2.0 was 50 bps higher than the restructuring under RF 1.0 which was limited to 1% of total advances indicative of the stress exerted by the second wave of the pandemic.

CareEdge View

Despite two years of pandemic impact and likely slippages from the pandemic-induced restructured book, a substantial decline in headline GNPA numbers is anticipated in the current fiscal. 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 proposed transfer of larger accounts to NARCL and other ARCs in this financial year, the SCB GNPA ratio could improve from 5.9% in FY22 to 5.0%-5.2% by FY23 end. At these levels, GNPA figures would be closer to pre-asset quality review levels of around 4%. On the other hand, the possibility of increased slippages arising from sectors that were relatively more exposed to the pandemic continues as support measures are unwound along with rising interest rates. The performance of restructured accounts continues to be monitorable in the current fiscal.

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