ICRA

PRESS RELEASE
December 26, 2019

Bank credit growth to moderate to 6.5-7.0% during FY2020 from 13.3% in FY2019: ICRA

- *Capital requirements for PSU Banks addressed to a large extent, but profitability to remain weak*
- *Deposit mobilisation to remain key challenge for growth of private sector banks*

The year-on-year (Y-o-Y) growth in bank credit is expected to decelerate sharply to 6.5-7.0% during FY2020 from 13.3% during FY2019, following limited incremental credit growth during FY2020 till date. The incremental bank credit has increased by only Rs. 0.80 trillion during FY2020 till December 6, 2019 to Rs 98.1 trillion, in contrast to the rise of Rs. 5.4 trillion and Rs. 1.7 trillion during previous corresponding periods of FY2019 and FY2018 respectively. Even in a high growth scenario, whereby incremental credit rises to Rs. 6.5-7.0 trillion during H2 FY2020 from Rs. 5.7 trillion during H2 FY2018 and Rs. 7.2 trillion during H2 FY2019, ICRA Ratings projects a 40-45% Y-o-Y decline in incremental net bank credit to Rs. 6.3-6.8 trillion during FY2020 from Rs. 11.9 trillion during FY2019, while somewhat comparable to Rs. 6.5 trillion in FY2018. This will translate to a considerable deceleration in Y-o-Y bank credit growth to 6.5-7.0% during FY2020 from 13.3% during FY2019 and 10.5% during FY2018.

A shift of large borrowers such as non-banking financial companies (NBFCs) and housing finance companies (HFCs) to the banking system for their funding requirements, had boosted bank credit growth in FY2019. However, factors such as muted economic growth, lower working capital requirements, as well as risk aversion among lenders, have compressed the incremental credit growth in FY2020.

The recent data on bank credit released by the Reserve Bank of India (RBI) reveals that the **contraction in incremental credit** outstanding to the services as well as the industrial segments, offset the entire growth in credit to the retail segment during 7M FY2020. Within services, the credit outstanding to NBFCs has increased. However, the decline in trade credit and other services (which also includes HFCs) has resulted in the overall contraction in credit outstanding to the services segment in 7M FY2020. A sizeable portion of growth in retail credit is also driven by the purchase of retail loan portfolios of NBFCs and HFCs by banks.

On the positive side, **the incremental deposit accretion** of the Indian banking system at Rs 5.3 trillion remained higher than credit growth till December 6, 2019 and similar to Rs 4.6 trillion during previous corresponding period of FY2019. The overall deposit base increased to Rs. 131.1 trillion as on December 6, 2019, a Y-o-Y growth of 10.3% and credit to deposit ratio of 75.8. Apart from the muted increase in currency in circulation, the build-up in the deposit base of the banks could be attributed to factors such as lower increase in asset under management (AUM) of debt mutual funds as well as higher liquidity maintained by various corporate entities. Overall ICRA expects the Y-o-Y deposit growth to remain higher than credit growth at 8.4-9.0% for FY2020, but it will be lower than 10.0% witnessed during FY2019 and higher than 6.70% of FY2018, i.e. the year after demonetisation. Because of high incremental deposit growth and lower incremental credit growth, the daily average liquidity surplus in the banking system has remained unprecedently high at Rs 1.26 trillion during Q2 FY2020 and further increased to Rs 1.95 trillion during October and Rs 2.40 trillion during November 2019.

ICRA

The Y-o-Y **credit growth of the banks** in ICRA's sample set (19 public sector banks - PSBs including IDBI Bank and 18 private sector banks - PVBs) stood at 7.9% as on September 30, 2019 with Y-o-Y credit growth of 4.4% for PSBs and 15% for PVBs. With strong capital position for most of PVBs, their ability to pursue credit growth will continue to be driven by their abilities to mobilise deposits given their high credit/deposit (CD) ratio of 90% as on September 30, 2019, though on incremental basis, because of slower credit growth, it has improved to 73% during trailing twelve months ending September 2019. PVBs may also face challenges in deposit mobilisation in the back drop of issues related to asset quality, profitability and capital faced recently by some private sector banks, which may increase risk aversion among some depositors.

With slowing GDP growth, the Reserve Bank of India has cut repo rates by 135 bps and the yield on benchmark 10-Year government security has declined by 80 bps, January 2019 to December 23, 2019. Against this, the cumulative cut in 1-Year deposit rates for banks during this period stood at 55 bps, whereas the decline in 1-year MCLR stood at 43 bps during this period. However, given the lag in repricing of existing bank deposits, the cost of interest bearing funds for the banking system saw limited decline to 5.29% during Q2 FY2020 as compared to 5.32% during Q3 FY2019. As the banks have continued to cut the deposit rates since beginning of the FY2020, we expect the cost of funds to decline further during next 1 year, which shall translate in lower lending rates to spur up the credit growth.

On the **capital front**, ICRA expects that GoI has sufficiently budgeted Rs 700 billion for FY2020, of which it has already infused Rs 598 billion during September 2019 into PSBs (including Rs 45.57 billion in IDBI Bank). Accordingly, the Core equity capital (CET-I) of PSBs improved to 10.2% as on September 30, 2019 as compared to 9.0% as on March 31, 2019. As per estimates the incremental capital requirements for PSBs for 6-8% growth in risk weighted assets and increasing regulatory requirements will remain limited at Rs 100-200 billion for FY2020, which can be easily managed through balance capital yet to be allocated.

Given our expectations of improvement in profitability of PSBs during FY 2021, the capital requirements of PSBs are expected to be limited to Rs 100-200 billion only as compared to Rs 3.16 trillion infused by GoI during FY2016- 2020. ICRA's estimates for capital requirement, however does not factor in the impact of transition to IND-AS, which will pose additional capital requirements for banks as and when it happens.

Most of the PVBs remain well capitalised with overall CET-I of 13.7% as on September 30, 2019 as compared to 13.5% as on September 30, 2019, except for few banks which will require capital such as Yes Bank, South Indian Bank, Laxmi Vilas bank and Jammu and Kashmir Bank. Collectively these banks will require ~Rs 100-150 billion of capital over next few quarters.

The **asset quality** for the banking sector continues to improve with declining slippages and expected improvements in recoveries during FY2020 even though loan write-offs continue to remain at elevated levels. The slippages (PSBs and PVBs) continue to moderate with fresh gross slippages of Rs 0.80 trillion (3.7% of standard advances) during Q2FY2020 as compared to Rs 0.86 trillion during Q1FY2020 (3.9%) and Rs 3.21 trillion (4.2%) during FY2019. The **Gross NPAs** for PSBs declined to 12.1% as on September 30, 2019 as compared to 14.1% as on September 30, 2018 and 12.0% as on March 31, 2019. The Gross NPAs for PVB also declined on Y-o-Y basis to 4.3% as on September 30, 2019 as compared to 4.4% as on September 30, 2018, however they rose from 4.1% as on March 31, 2019. Overall, the GNPAs for the sector declined on Y-o-Y basis to 9.4% as on September 30, 2019 from 11.0% as on September 30, 2018. With sizeable capital infusion in PSBs and accelerated provisions, the net NPAs for PSBs also declined sharply to 4.8% as on September 30,

2019 from 7.2% as on September 30, 2018 and 4.9% as on March 31, 2019. Similarly, for PVBs the Net NPAs declined to 1.7% as on September 30, 2019 from 1.9% as on September 30, 2018 but were marginally higher than 1.6% as on March 31, 2019. Overall the Net NPAs for the sector declined to 3.7% as on September 30, 2019 from 5.4% as on September 30, 2018 and 3.8% as on March 31, 2019. Going forward, ICRA expects the Net NPAs for the banking sector to decline to 3.2-3.3% by March 2020 and remain at similar level of 3.1-3.2% by March 2021. With decline in Net NPAs, we expect the solvency profile of the banking sector to improve further with net NPAs / core equity improving to ~29% by March 2020 and ~27% by March 2021 from 33% as on September 30, 2019.

With reduction in Net NPA levels, the **credit provisions** for the banking sector are also expected to decline to 1.6-1.8% of advances during FY2020 and 0.8-0.9% during FY2021 from 3.6% during FY2019. The decline in the credit provisions will largely be driven by PSBs, whereby the credit provisions will decline to 2.1-2.3% during FY2020 and 1.0-1.1% during FY2021 from 4.4% during FY2019, whereas for the PVBs it is expected to decline to 0.8-1.0% for FY2020 and 0.4-0.5% during FY2021 from 2.0% during FY 2019. Despite an expected decline in credit provisions for PSBs during FY2020, the credit provisions are expected to remain elevated in related to operating profits, thereby translating in weak return on equity (RoE) of 1.5-2.6% during FY2020 and is estimated to improve further to 10.3-10.8% during FY2021 as compared to -14.4% during FY2019. For private banks, supported by lower credit provisions, superior loan growth and better asset quality, the RoE is expected to improve to ~13.4-13.9% during FY2020 and further to ~15% during FY 2021 from 9.1% during FY 2019.

For further information, please contact:

Media Contacts:

Naznin Prodhani
Head Media & Communications
ICRA Ltd
Tel: + (91 124) 4545300, Dir - 4545860
Email: naznin.prodhani@icraindia.com

Poornima Tyagi
Deputy Manager- Media & Communications
ICRA Ltd
Tel: +(91-124)4545300, Ext: 840
Email: poornima.tyagi@icraindia.com

Girish Dikey/ Khushal Devera
Ketchum Sampark
Mob: 7738020260/ 9819666376
Email:girish.dikey@ketchumsampark.com/
khushal.devera@ketchumsampark.com

© Copyright, 2018 ICRA Limited. All Rights Reserved.

All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies, while publishing or otherwise disseminating other reports may have

presented data, analyses and/or opinions that may be inconsistent with the data, analyses and/or opinions presented in this publication. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.

Disclaimer:

This Press Release is being transmitted to you for the sole purpose of dissemination through your newspaper/magazine/agency. The Press Release may be used by you in full or in part without changing the meaning or context thereof, but with due credit to ICRA Limited. However, ICRA Limited alone has the sole right of distribution of its Press Releases for consideration or otherwise through any media including, but not limited to, websites and portals.

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in