Banking Sector

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Sector Update

RBI: Trends and Progress of Banking in India

Nikhil Shah
Research Analyst
nikhil.shah@nirmalbang.com
+91-22-6273-8092

Following are the key highlights from the RBI report on Trends and Progress of Banking in India for FY22:

The key takeaways are: (i) Consolidated balance sheet - growth came in double digits after seven years (ii) CRAR - capital position of SCBs remained strong at 16.8% in FY22 vs 16.3% in FY21 (iii) Asset quality - continued to register improvement, with GNPA at 5.8% in FY22 compared to the peak of 7.3% in FY21; it further declined to 5% as on 1HFY23.

Balance Sheet:

The **consolidated balance sheet of SCBs has witnessed double-digit growth after a gap of seven years.** On the liabilities side, deposits growth moderated from the COVID-19 induced precautionary surge. On the asset side, the system reported a pick-up in credit in FY22 and has continued the momentum in FY23. At the same time, investments slowed down compared to FY21. **The PSUs still hold a majority share in the consolidated balance sheet,** accounting for 62% of total outstanding deposits and 58% of total loans & advances extended by SCBs.

Liabilities

- **The household savings rate declined to a 5-year low, which affected deposits growth.** However, the transmission of the 190bps increase in the repo rate during May-Oct'22 is expected to provide a boost to deposits growth rate.
- During FY22, the deposit funding ratio for PSBs was higher than PVBs, which indicates that the latter relied on borrowings more to fuel credit growth.
- **As a whole, borrowings of SCBs accelerated in FY22** as the deposits growth was lower compared to credit growth. This, along with the higher statutory requirement drove borrowings, led by PVBs and foreign banks.
- During FY22, **international liabilities of Indian banks, especially non-resident ordinary (NRO) INR accounts and foreign currency borrowings, increased substantially**, encouraged by interest rate differentials in favour of India.

Assets

- **Credit growth accelerated to a 10-year high as on 1HFY23, led by PVBs.** Both working capital as well as term loans witnessed steady growth during FY22, which were on a declining trajectory since 4QFY19.
- **Post covid-19 lockdown, credit flows have been higher to rural and semi-urban areas** compared to metropolitan areas. Credit market share in metropolitan areas declined to 20% by FY21-end subsequently, but as credit flows revived, metropolitan areas have regained their market share.
- In FY22, the incremental credit-to-deposit (C-D) ratio came in at a 4-year high on the back of higher credit growth while deposit growth was moderate. Moreover, as investments declined, the incremental investment-to-deposit ratio too declined.

Sectoral Bank Credit

- **The major driver of credit growth was Services and Retail loans, especially Housing.** Growth in Services recovered from a contraction in FY21.
- **In FY22, credit flow to the Industry grew at the highest rate in the last eight years. In incremental terms, 21% of the incremental credit was to the Industry sector as against 0.2% in FY21.**
- In the recent years, the Indian banks appear to have shown a 'herding behaviour' in diverting their lending away from the Industry sector towards Retail loans.

Unsecured loans

- The share of unsecured credit in total credit has been increasing since 2015. **The proportion as on FY22 stood at ~25%, which is the highest in the past decade.**

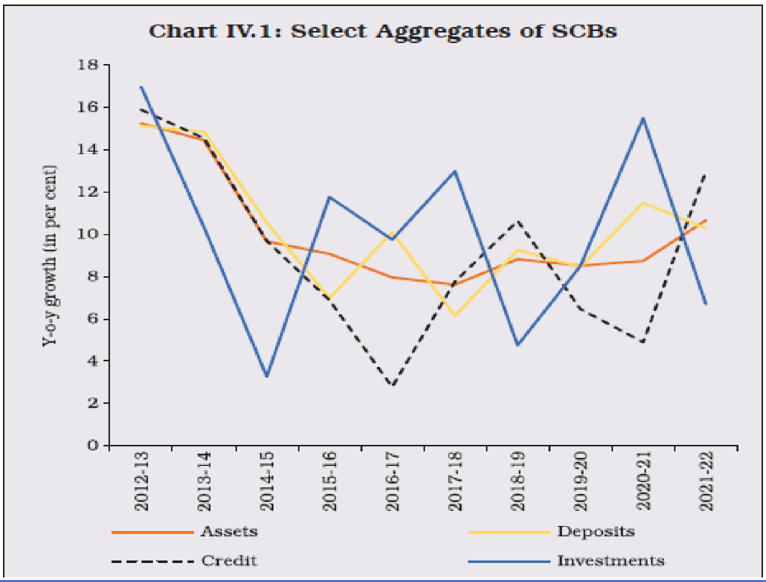
Priority sector lending

- **In FY22, outstanding advances to the priority sector grew by 12.34%**. All bank groups managed to meet their overall priority sector lending targets. After growing by only 1.3% in FY21, the amount outstanding under the operative Kisan Credit Cards (KCCs) grew by 24.5% in FY22, mainly contributed by the southern region – especially Karnataka.
- **Moreover, the share of priority sector loans in total loans increased marginally to 35.8% in FY22 from 35.3% in FY21. The share of priority sector lending in total GNPAs increased to 43.1% in FY22 from 40.4% in FY21.** This was led mainly by the Agriculture sector.
- Moreover, the SFBs extended 76% of their loans to the priority sector and ~88% of their NPAs originated from this portfolio. On the other hand, a disproportionately lower share of NPAs resulted from the priority sector for PVBs.
- The total trading volume of the priority sector lending certificates (PSLCs) registered a growth of 12.43% and the same stood at Rs6,623.9bn in FY22.
- Among the four PSLC categories, the highest trading was observed in PSLC-General and PSLC-Small & Marginal Farmers (SF/MF).
- During FY22, the weighted average premiums (WAPs) increased across the board for all categories of PSLCs, except PSLC-A, with PSLC SF/MF commanding the highest premium.

Credit to Sensitive Sectors

The Real Estate sector constituted 95% of the SCBs' lending to the sensitive sectors in FY22. Post covid-19, the Real Estate sector has started gaining traction and lending to it has also picked up pace, led by PVBs. The PSBs' lending to capital markets, which was subdued since FY18, picked up during FY22, partly reflecting the buoyant equity markets.

Exhibit 1: SCBs witnessed double-digit growth in Consolidated Balance Sheet



Source: RBI, Nirmal Bang Institutional Equities, annual accounts of respective banks

Exhibit 2: PSBs continue to have higher share of deposits

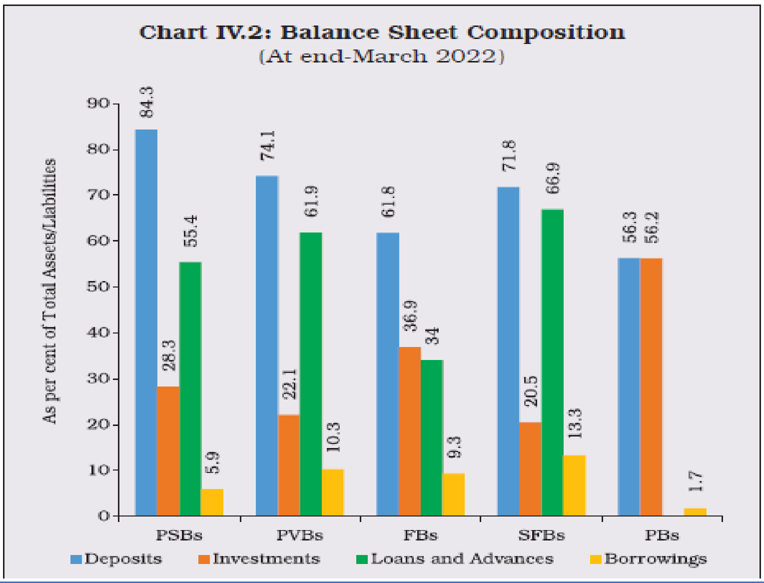


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Exhibit 3: Reduction in yield on funds has been higher than reduction in cost of funds, putting pressure on spreads

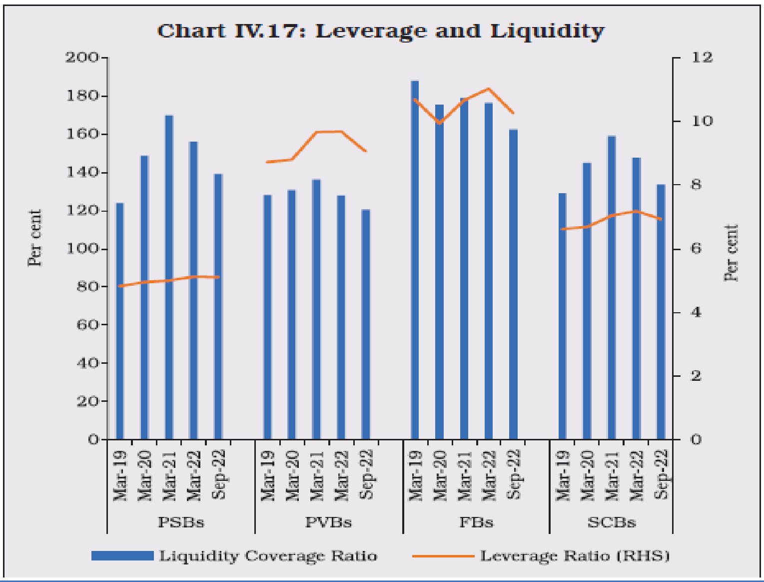
Bank Group/ Variable	Year	Cost of Deposits	Cost of Borrowings	Cost of Funds	Return on Advances	Return on Investments	Return on Funds	Spread
1	2	3	4	5	6	7	8	(8-5)
PSBs	2020-21	4.2	4.3	4.2	7.5	6.6	7.2	3.0
	2021-22	3.7	4.2	3.7	6.9	6.1	6.6	2.9
PVBs	2020-21	4.3	5.6	4.5	9.1	6.2	8.3	3.9
	2021-22	3.7	5.2	3.9	8.5	5.8	7.7	3.9
FBs	2020-21	2.4	3.3	2.5	7.1	6.0	6.5	4.0
	2021-22	2.1	3.6	2.3	7.0	5.7	6.3	4.0
SFBs	2020-21	6.8	8.8	7.3	17.1	6.8	14.9	7.6
	2021-22	5.9	7.1	6.1	15.8	5.9	13.6	7.4
PBs	2020-21	3.0	5.3	3.1	9.3	4.0	4.0	0.9
	2021-22	2.4	2.8	2.4	5.2	5.1	5.1	2.7
SCBs	2020-21	4.2	4.9	4.2	8.1	6.4	7.6	3.4
	2021-22	3.6	4.6	3.7	7.6	6.0	7.0	3.3

Source: RBI, Nirmal Bang Institutional Equities, annual accounts of respective banks

Soundness indicators

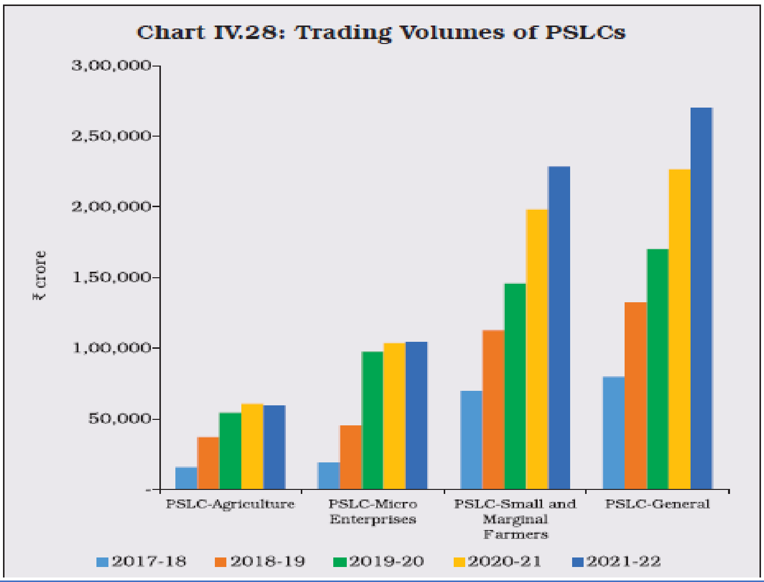
- **In FY22, SCBs' capital position, asset quality and leverage ratios improved while liquidity position remained robust.**
- **The CRAR of SCBs has been rising sequentially and stood at 16% as on 1HFY23.** Moreover, as on 1HFY23, there are no banks under the PCA framework.
- In FY22, majority of **the resources mobilised by PVBs were through private placements via bonds/debentures while during FY21, they were entirely via equity issuances.**
- PVBs and FBs maintained their leverage ratio much above the required levels. **All the banks met Basel requirement of 100% LCR as of FY22, but the ratio was lower than in FY21.**

Exhibit 4: LCR requirement was met by all SCBs



Source: RBI, Nirmal Bang Institutional Equities, annual accounts of respective banks

Exhibit 5: Highest trading volume observed in PSLC-General and PSLC-Small & Marginal Farmers



Source: RBI, Nirmal Bang Institutional Equities

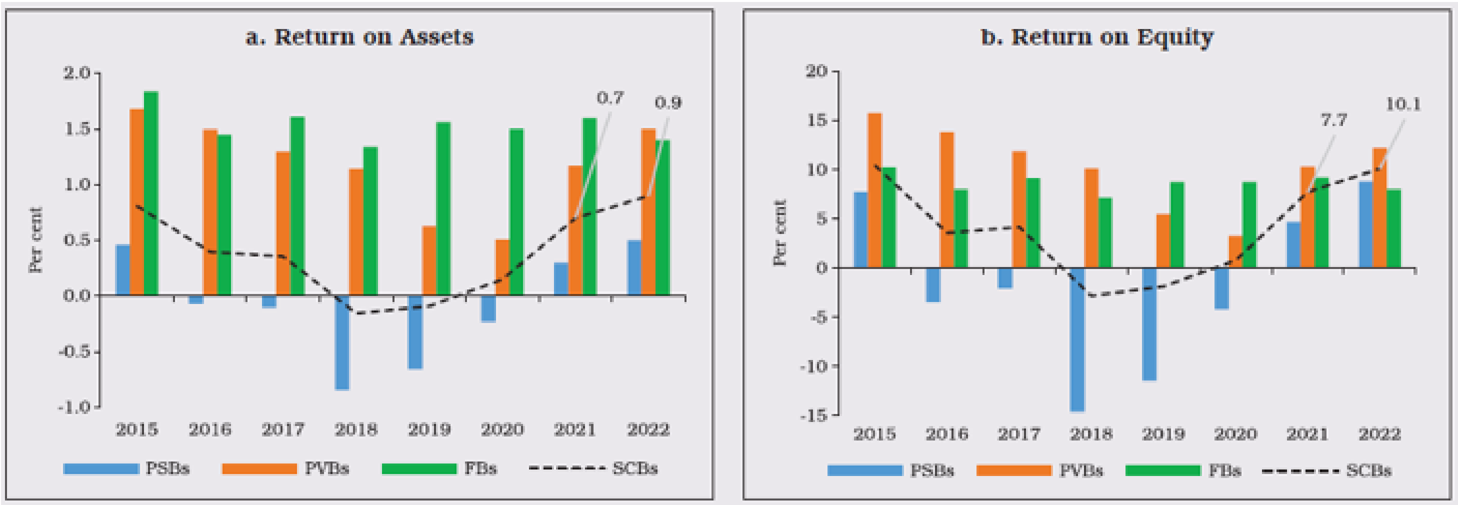
Others

- In FY22, the maturity mismatch moderated compared to FY21, which reflects the fact that there was improvement in the asset-liability management.
- Banks, especially PVBs, ramped up short-term borrowings in FY22 to take advantage of lower interest rates. Also, the investment portfolio of PVBs and FBs was concentrated in the short-term category, indicating active risk management by the banks.
- Bank branches after declining for two consecutive years, reported growth of 4.6% during FY22. The growth was led by new branches opened in Tier 4, Tier 5 and Tier 6 centres. Although the share of Tier 2 and Tier 3 centres in new branches declined in FY 22 as against last year, more than half of the new branches opened during the year were in Tier 1 and Tier 3 centres.

Financial Performance

- **Greater transparency in asset recognition and stronger capital and provision buffers** helped the banks tackle the pandemic on a stronger footing. Enhanced credit monitoring processes, coupled with portfolio diversification helped the banks to improve their asset quality and strengthen their balance sheets.
- The profitability of SCBs and RoA **improved to levels last observed in FY15.**
- **The NIMs for SCBs in FY22 stood at 2.9%.** Since the reduction in return on funds was slightly higher than the reduction in the cost of funds, the spread declined marginally. The cost of deposits declined across the board as the share of current account and savings account (CASA) deposits in total deposits increased.
- **As of FY22, 44% of SCBs' outstanding floating rate INR loans were at external benchmark linked lending rates (EBLRs)**. The comparable positions for PSBs and PVBs stood at 33% and 62%, respectively.
- **Both interest income and interest expended by banks decelerated.** But, banks' higher profits for FY22 were contributed by the acceleration in income and contraction in expenditure.
- **Interest income formed 84% of SCBs' total income.** Higher lending and investment volume led to higher interest income from these channels, notwithstanding the then prevailing lower interest rates.
- The other income of PSBs and FBs declined in FY22, which was partly due to trading losses on their investment portfolios.
- The increase in other income of PVBs was mainly contributed by acceleration in **commission and brokerage income that forms more than 60% of non-interest income.**

Exhibit 6: Return ratios are inching towards levels seen last in 2015



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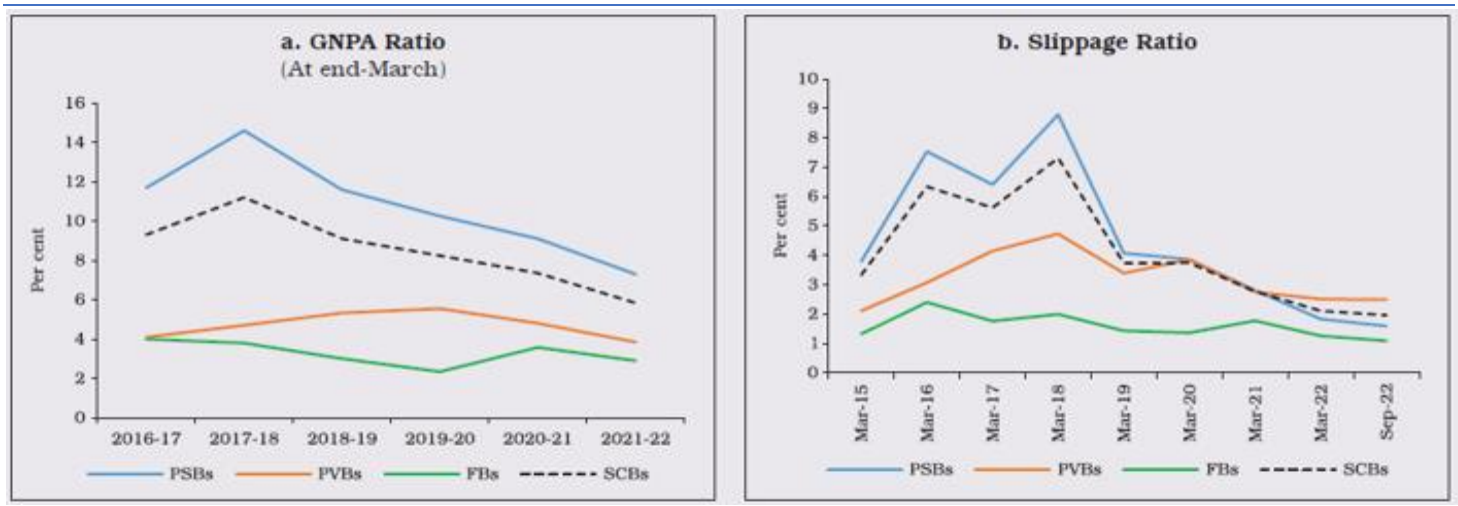
Non-Performing Assets (NPAs)

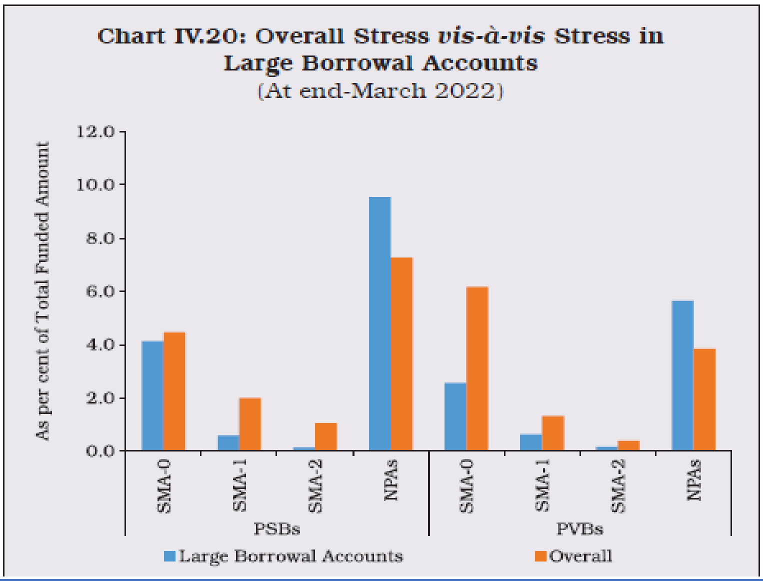
- Banks were required to maintain higher provisions on loans that were granted moratorium during the pandemic. As a result, their net profits got affected in FY20 and FY21. **However, in FY22, a reduction in provisions boosted their profitability and as the GNPAs declined, their provision coverage ratio increased.**
- From its peak in FY18, **the SCB's GNPA ratio has been declining consistently to reach 5% in 1HFY23.** This has been led by lower slippages as well as reduction in outstanding GNPAs through recoveries, upgrades and write-offs.
- The written off loans majorly contributed to reduction in GNPAs in case of PSBs whereas upgrades were the primary driver of lower GNPAs for PVBs.
- Asset quality improved across the board for all the bank groups. A decrease in NNPA was caused by lower GNPAs along with significant cumulative provisions in the recent years.
- As far as banks' domestic operations are concerned, the proportion of standard assets to total advances increased in FY22 and **there was an overall reduction in GNPAs for all bank groups, except for FBs.**
- **Large borrowers' accounts (i.e., accounts with a total exposure of Rs50mn & above) comprised 47.8% of total advances in FY22, down from 48.4% in FY21**. Their share in total NPAs declined in FY22 to 63.4% from 66.4% in FY21.
- The SMA-0 ratio increased overall as well as for large borrowers for both the bank groups (PSBs and PVBs) at the end of FY22, pointing towards temporary stress among the borrowers. **SMA-1 and SMA-2 declined to their lowest levels since FY16 for all the accounts.**
- In FY21, the Restructured Standard Advance Ratio (RSA) had increased by 0.3% for all the borrowers taken together while the comparative increase for large borrowers was 0.4%. In contrast, in FY22, the ratio increased by 1.1% for all the borrowers and by 0.5% for the large borrowers.
- Despite starting from a low base, the number of accounts that PVBs reformed using resolution frameworks 1.0 and 2.0 multiplied. On the contrary, under resolution framework 1.0, PSBs restructured fewer accounts, but under resolution framework 2.0, they picked up pace.

Exhibit 7: There has been an overall improvement in asset quality of SCBs



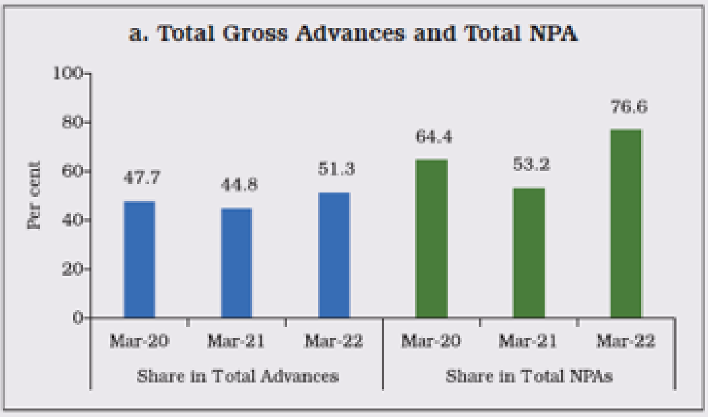
Source: RBI, Nirmal Bang Institutional Equities, annual accounts of respective banks

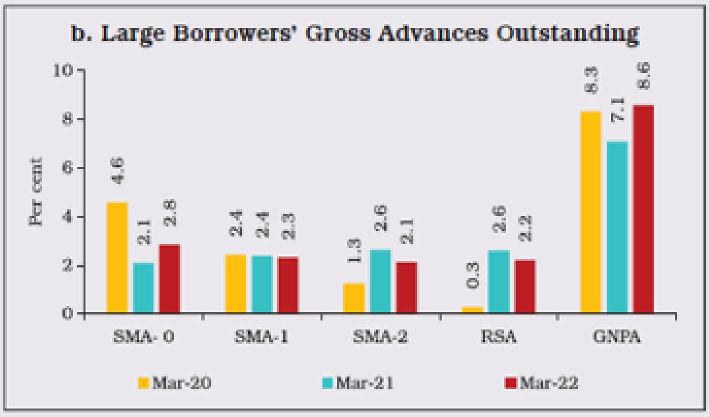
Exhibit 8: Overall stress in large borrowers' accounts decreased in proportion compared to FY21



Source: RBI, Nirmal Bang Institutional Equities, annual accounts of respective banks

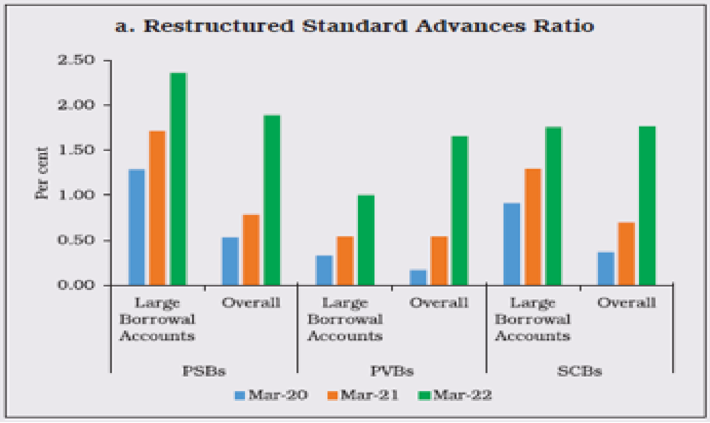
Exhibit 9: GNPA in large borrowals advances outstanding remains elevated

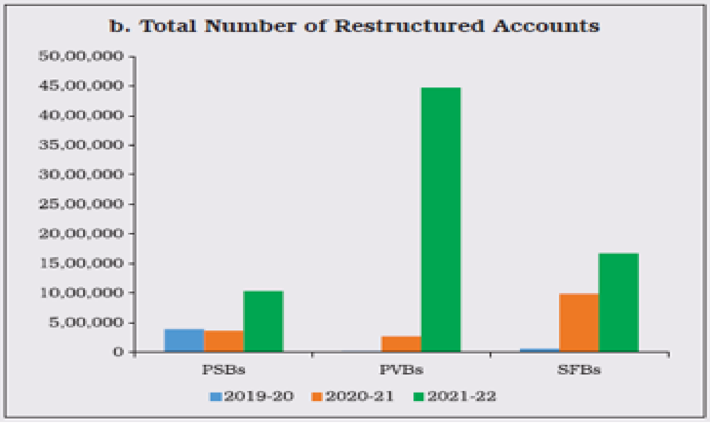




Source: RBI, Nirmal Bang Institutional Equities

Exhibit 10: Restructured book increased in FY22





Source: RBI, Nirmal Bang Institutional Equities, Annual accounts of respective banks

Exhibit 11: Bank group wise - Sector-wise GNPAs

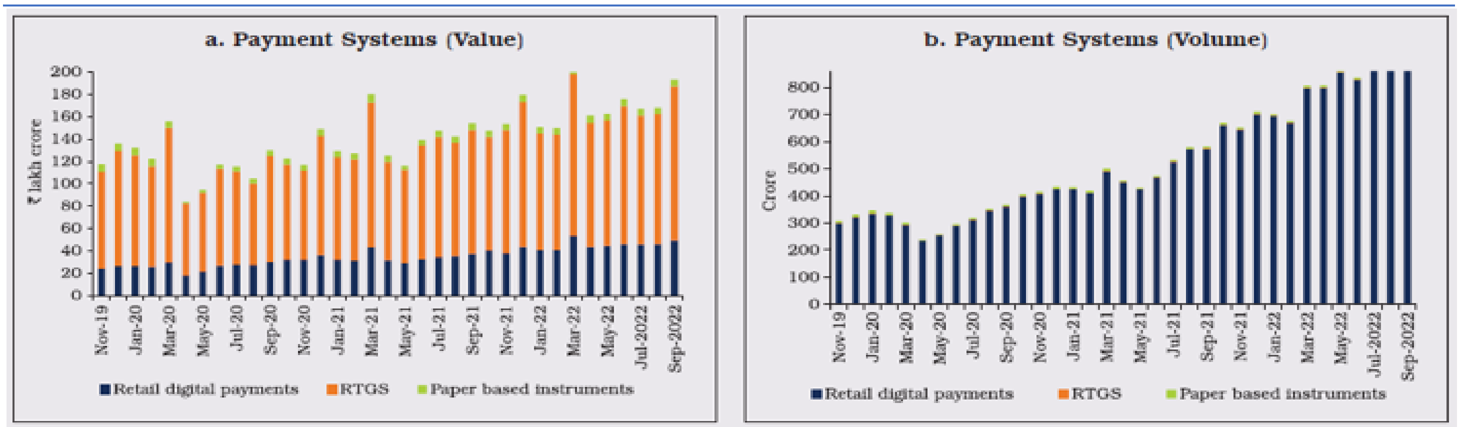
Bank Group	Priority Sector		*Of which*						Non-priority Sector		Total NPAs	
			Agriculture		Micro and Small Enterprises		Others					
	Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount	Per cent
PSBs												
2021	2,57,858	44.69	1,14,911	19.92	1,01,786	17.64	41,161	7.13	3,19,116	55.31	5,76,974	100.00
2022	2,43,283	47.94	1,10,649	21.80	96,231	18.96	36,403	7.17	2,64,225	52.06	5,07,508	100.00
PVBs												
2021	50,557	27.04	18,900	10.11	23,473	12.56	8,184	4.38	1,36,384	72.96	1,86,941	100.00
2022	48,588	28.71	20,863	12.33	17,799	10.52	9,926	5.86	1,20,676	71.29	1,69,264	100.00
FBs												
2021	1,802	17.67	329	3.23	1,194	11.70	279	2.74	8,397	82.33	10,199	100.00
2022	2,555	18.53	481	3.49	1,638	11.88	436	3.16	11,231	81.47	13,786	100.00
SFBs												
2021	4,974	83.31	1,510	25.28	2,049	34.32	1,415	23.70	996	16.69	5,971	100.00
2022	6,111	87.48	1,999	28.62	2,024	28.98	2,087	29.88	874	12.52	6,985	100.00
All SCBs												
2021	3,15,192	40.40	1,35,650	17.39	1,28,502	16.47	51,039	6.54	4,64,893	59.60	7,80,085	100.00
2022	3,00,537	43.09	1,33,993	19.21	1,17,692	16.87	48,852	7.00	3,97,006	56.91	6,97,543	100.00

Source: RBI, Nirmal Bang Institutional Equities

Payment System

- The payment ecosystem has been rapidly evolving across the world with the introduction of various innovative payment systems and instruments. **India's payments ecosystem has become a global leader due to the abundance of payment options.** The introduction and acceptance of new payment methods in the retail payment sector has contributed to this.
- The most recent analysis of Indian payment systems revealed that despite certain difficulties, their expansion remained resilient throughout the COVID-19 pandemic. **India was categorised as 'leader' in 16 out of 40 indicators when compared to 20 other jurisdictions.**
- The exercise showed that there is a need for improvement in the point of sale (PoS) and ATM acceptance infrastructure. **The Payment Infrastructure Development Fund scheme was operationalised in 2021 to enhance the acceptance infrastructure and bridge the gap.**
- **The RBI had launched a composite Digital Payments Index (DPI) in January 2021 to effectively capture the extent of digitisation of payments across the country**. The index is based on five broad parameters – (i) payment enablers (ii) payment infrastructure - demand side factors (iii) payment infrastructure - supply side factors (iv) payment performance and (v) consumer centricity. It is computed semi-annually with March 2018 as the base. **The index grew by 29.1% in FY22 over FY21.**

Exhibit 12: Digital modes of payments have grown significantly over the last few years



Source: RBI, Nirmal Bang Institutional Equities

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Team Details:			
Name		**Email Id**	**Direct Line**
Rahul Arora	CEO	rahul.arora@nirmalbang.com	-
Girish Pai	Head of Research	girish.pai@nirmalbang.com	+91 22 6273 8017 / 18
Dealing			
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 6273 8230, +91 22 6636 8833
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 6273 8102/8103, +91 22 6636 8830

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address
B-2, 301/302, Marathon Innova,
Nr. Peninsula Corporate Park,
Lower Parel (W), Mumbai-400013.
Board No. : 91 22 6273 8000/1; Fax. : 022 6273 8010