India's High Credit Growth Regime and its Sustainability

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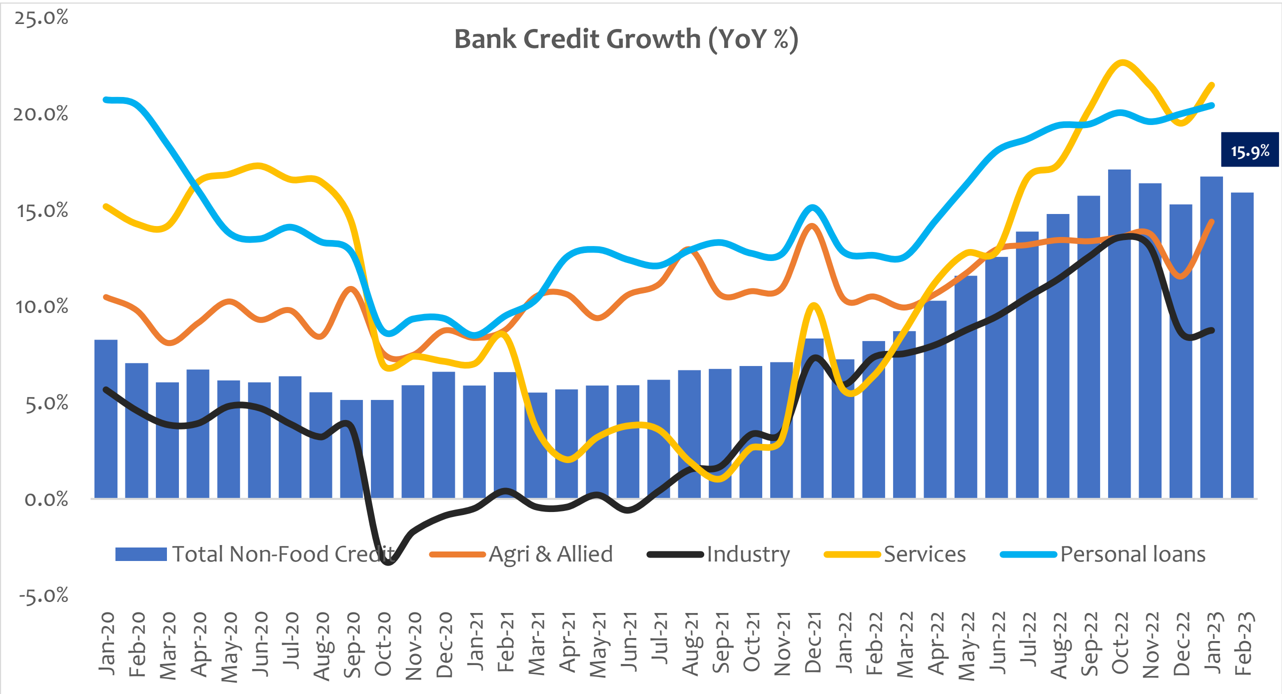
Introduction

Once the pandemic-hit economy recovered from its slump, credit offtake in the Indian banking sector reached a new high. Credit growth of Schedule Commercial Banks (SCBs) hit a high of 17.1% in October 2022, after hovering in the single digits for three years. Based on the most recent available information from the RBI, the SCB's credit offtake rose by 15.9% in February 2023 compared to the same period last year.



Source: Reserve Bank of India

The robust credit demand is broad based and is driven by pent up demand from all segments. The mass financial inclusion programmes and improved credit delivery mechanism through digital channels have been supporting retail credit growth for last couple of years. Moreover, some of the largest commercial banks are strategically moving towards retail credit due to lower delinquency and higher yield. Personal credit growth that includes credit for housing, automobiles, consumer durables, education, gold loans etc. have registered its highest ever growth in last three years (20.4%) in January 2023.

Other components including Agriculture and Services sector credit demand has been robust followed by Industrial credit demand. Though industrial credit growth was in double digit from July-November 2022, the slowdown in the global economy and imminent sign of soft landing in some of the major trade partners have subdued the industrial credit growth recently.

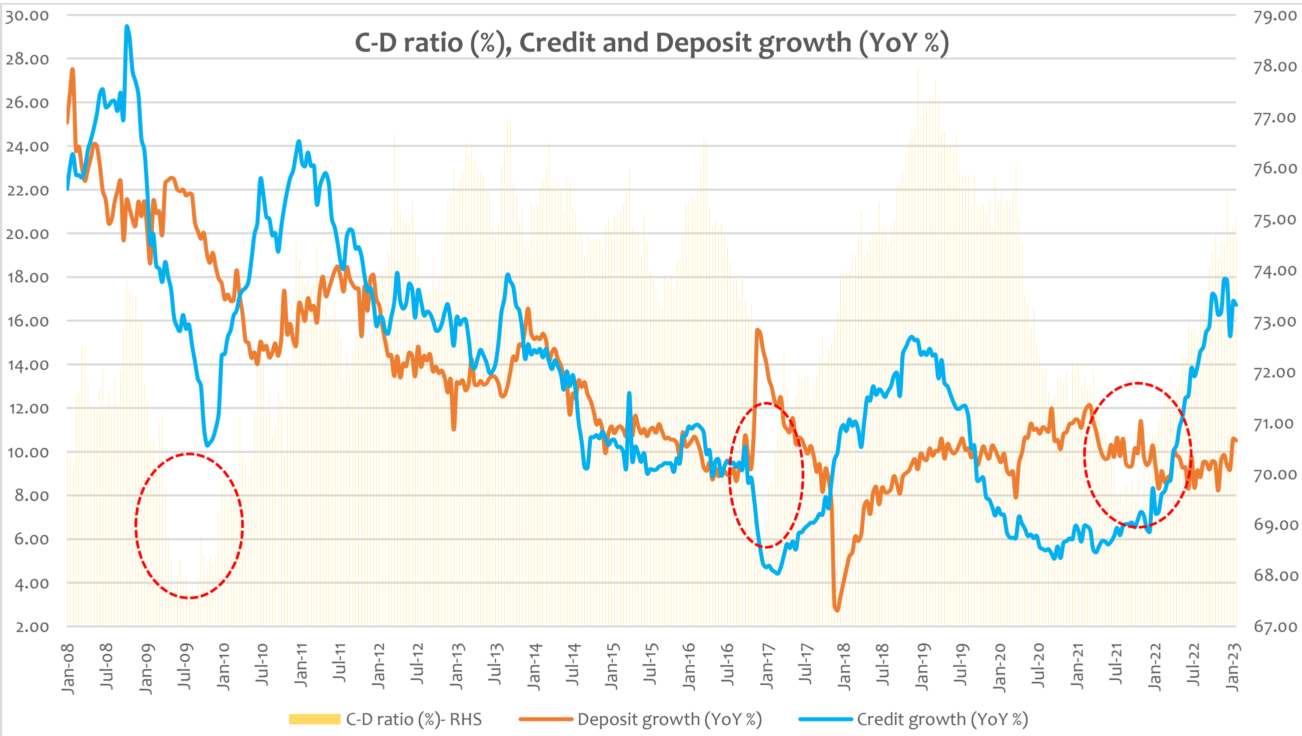
While the retail, MSME and agriculture have been the key drivers of credit growth in the recent past, rising yields for overseas borrowings and in domestic capital markets have created a conducive demand environment for wholesale funding from banking channels. Loans to MSMEs, especially, have risen by an average of 27.4% between April 2022 and January 2023, supported by the INR 5-trillion Emergency Credit Line Guarantee Scheme.

Elevated Credit-Deposit ratio

The story of both credit and deposit growth in India have their own histories. After the new economic policy and entry of new private banks, deposit growth in the last few years of 20th century were higher. This was followed by another round of strong deposit growth (2004-2008) mainly aided by higher economic growth. Global Financial Crisis (GFC) of 2008 and subsequent high inflation led to a depletion in the deposit base in India from 2009-2014. From 2015-2018, low interest rates weighed on deposit growth though the demonetisation gave some temporary relief with immediate spur in deposits in FY16. Subsequently, deposit growth rebounded in FY21 due to stringent lockdown and risk aversion behaviour with rise in precautionary savings. Post pandemic, the deposit growth has been sluggish due to higher spending, higher inflation and availability of better investment opportunities other than bank deposits.

The Indian economy witnessed a similar credit boom during the period 2008 to 2014 with credit registering a CAGR of 16.8%. However, in the subsequent years (2014 to 2021), credit growth decelerated to a CAGR of 8.3%. This was influenced by a weak industrial sector credit growth and banks being loaded with high levels of bad assets (NPAs), which had risen steeply due to the economic slowdown, overcapitalization of certain sectors, and certain other factors creating stress in corporate balance sheets, impacting the ability of banks to further lend, and increasing credit gap.

Credit-Deposit ratio (C-D ratio) that shows how much a bank's core funds are utilised for lending has been peaked recently. Though a high C-D ratio suggests an overstretched balance sheet, and may also hint further capital adequacy issues, but the pent up demand and the quality fiscal expenditure of the government, mainly capex focussed is supporting the lending activities. With deposit growth trailing credit demand for eleven months in a row, banks are now aggressively competing for customer deposits even though the cost of deposits are rising with tightening of monetary policy of the RBI.

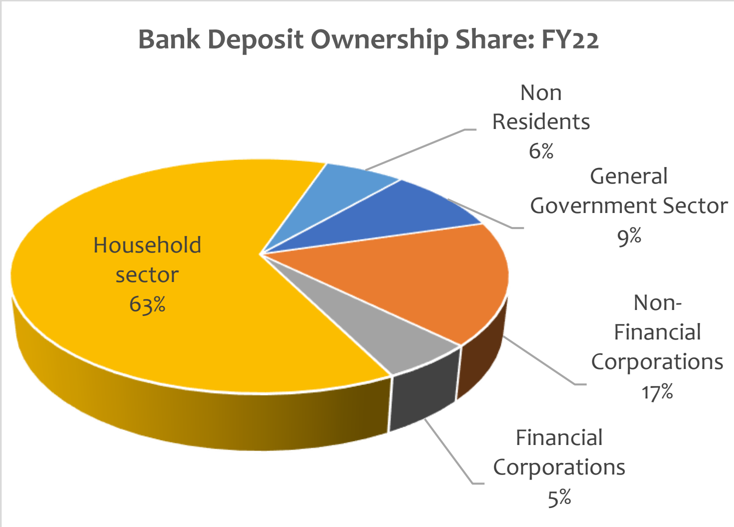


Source: Reserve Bank of India

Deposit growth scenario

Historically, household sector has been the major source of bank deposits in India. However, the development of the capital market with higher retail participation and availability of alternate investment avenues including real estate and crypto is reducing the share of household sector in total deposits. Even today, nearly 63% of the bank deposits are from household sector followed by non-financial corporations (17%). As high inflation has been directly impacting the household balance sheets, ultimately leading to depletion in deposit base. Additionally, after a prolonged business sluggishness due to pandemic and subsequent restrictions, non-financial corporations have started drawing down their deposits recently to expand the business and meet the building in pent up demand and ultimately reducing their deposits in the banking system.

Deposit accretion is continuing and scheduled commercial banks' reliance on bulk deposits and borrowings has been intensifying. Higher interest rates offered by the Government on small saving schemes are competing against bank deposits. As per the latest announcements (for January-March 2023 quarter), the Government has raised interest rates on eight of twelve small savings instruments. The newly introduced women-focussed small savings scheme in the last budget will also be competing against bank deposits. As Government finances almost 3% of its deficit through small savings borrowings, a higher interest rate on these schemes is eating up a bank deposit. The effective transmission has led to rise in term deposit rates for the entire banking system over the last three quarters.



Source: Reserve Bank of India

Health of Indian Banking

A higher credit growth over deposits is always a double edged sword. Though it shows strong demand for credit in an environment of slower deposit growth, a high C-D ratio indicates more reliance on deposits for lending purposes and may be risky. It may become difficult to cover any unforeseen fund requirements and may affect capital adequacy and asset-liability mismatch. As of January 2023, the incremental C-D ratio rose sharply both on annual (113%, YoY) and half-yearly basis (125% January 2023 over July 2022). The accumulation of deposits in the past few years has enabled banks to fund the growing credit demand without much huddle.

Today, Indian banking is at a much better position compared to its peers. As per the stress test exercise of the RBI, SCBs are well-capitalised and capable of absorbing macroeconomic shocks, even in the absence of any further capital infusion by stakeholders. Under the baseline scenario, the aggregate capital to risk weighted asset ratio (CRAR) of 46 major banks has been projected to slip from 15.8% in September 2022 to 14.9% by September 2023. It may go down to 14.0% in the medium stress scenario and to 13.1% under the severe stress scenario by September 2023, but it stays well above the minimum capital requirement, including capital conservation buffer (CCB) requirements of (11.5%).

Table 1: Net Profit (in INR Billion)

Bank	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	QoQ %	YoY %
SBI	84.32	91.14	60.68	132.65	142.05	7.10	68.50
PNB	11.27	2.02	3.08	4.11	6.29	53.00	-44.20
BoB	21.97	17.79	21.68	33.13	38.53	16.30	75.40
Canara	15.02	16.66	20.22	25.25	28.82	14.10	91.90
UBI	10.85	14.40	15.58	18.48	22.45	21.50	106.90
BoI	10.27	6.07	5.61	9.60	11.51	19.90	12.10
Indian Bank	6.90	9.84	12.13	12.25	13.96	14.00	102.30
HDFC Bank	103.42	100.55	91.96	106.06	122.60	15.60	18.50
Axis Bank	36.14	41.18	41.25	53.30	58.53	9.80	61.90
ICICI Bank	61.94	70.19	69.05	75.58	83.12	10.00	34.20

Source: Individual Bank Websites

Analysis of the latest quarterly financial results of Indian Banks (December 2022) shows that the asset quality, margins, capital position, profitability and market cap of almost all banks have improved.

Table 2: Net Non Performing Asset (NNPA)

Bank	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	QoQ (bps)	YoY (bps)
SBI	1.34	1.02	1.00	0.80	0.77	-3.0	-57.0
PNB	4.90	4.80	4.28	3.80	3.30	-50.0	-160.0
BoB	2.25	1.72	1.58	1.16	0.99	-17.0	-126.0
Canara	2.86	2.65	2.48	2.19	1.96	-23.0	-90.0
UBI	4.09	3.68	3.31	2.64	2.14	-50.0	-195.0
BoI	2.66	2.34	2.21	1.92	1.61	-31.0	-105.0
Indian Bank	2.72	2.27	2.12	1.50	1.00	-50.0	-172.0
HDFC Bank	0.37	0.32	0.35	0.33	0.33	0.0	-4.0
Axis Bank	0.91	0.73	0.64	0.51	0.47	-4.0	-44.0
ICICI Bank	0.85	0.76	0.70	0.61	0.55	-6.0	-30.0

Source: Individual Bank Websites

Even the Economic Survey 2022-23 have quoted that Indian Banks are resilient and well-capitalised. The calibrated policy approach of the RBI, robust regulatory and supervisory framework, implementation of 4R's approach (Recognition, Resolution, Recapitalisation and Reforms) have cleaned and have strengthened the balance sheet of the banking system. The announcement of zero budgetary support in the form of recapitalization of public sector banks in the Union Budget 2023-24 was a signature mark on bank's health. This led to the end of the budgetary provision of recapitalization since the Union Budget 2016-17.

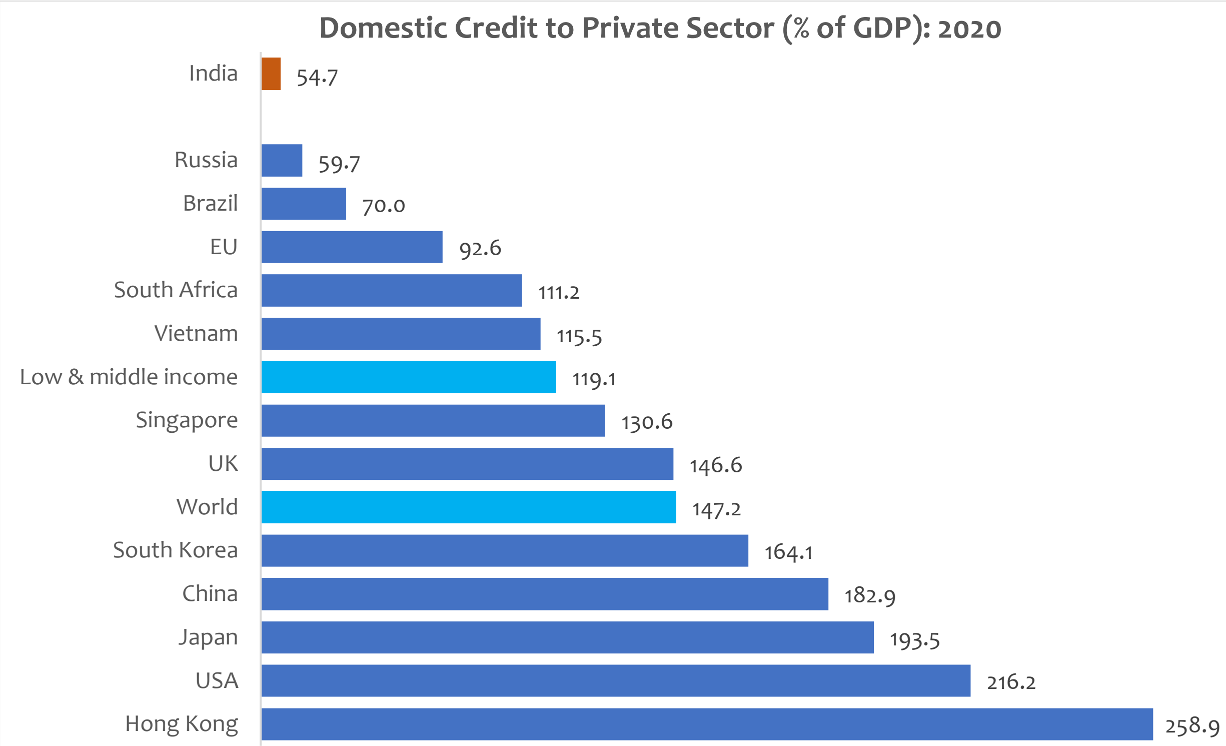
Sources of Funds to Sustain robust credit growth

In a scenario of credit growth outpacing deposits growth and a continuous rising C -D ratio, the sustainability of double digit credit growth has become a crucial point of analysis. It is important to discuss the pertinent sources of funds to support the double digit credit growth. At present, Indian banking system has come to the liquidity deficit mode mainly due to advance tax outgo and most recently on March 17, the RBI has injected INR 1.1 trillion into the system. However, Indian banking system is sitting on a huge surplus of high-quality-liquid assets (HQLA). For the week ending February 24, 2023, the commercial banks are having excess SLR deposits of INR 19 trillion, 9.93% above its mandatory NDTL requirement limit of 18%. Most importantly to support credit growth banks have been drawing down their HQLAs. This has brought down the overall LCR from a high of 173.0% in September 2020 to 135.6% as of September 2022, comfortably above the regulatory prescription of 100%.

The incremental credit growth in the first 11 months of FY23 has been INR 15.6 trillion vis-a-vis INR 7.9 trillion during the corresponding period of FY22. Further, banks are already in competition to raise deposits via higher rates. Incremental deposits have in eleven months (Apr-Feb) of FY23 was INR 14.0 trillion vis-a-vis INR 11.0 trillion during the corresponding period of FY22. Deposit growth is keeping pace and is expected to be robust, going forward, as banks pass on the latest repo rate hike. Besides, deposits, Indian banks are raising funds by selling additional Tier 1 (AT1) bonds as they keep capital ready to participate in the credit fiesta. Their focus has shifted to raising long-term capital through green infrastructure bonds as well.

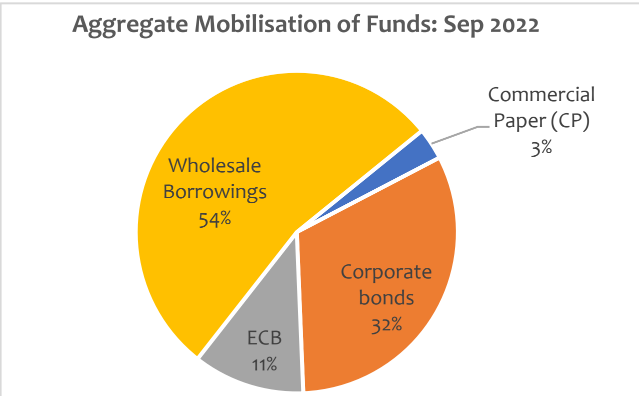
Scope for the banking credit

Given high credit growth, the fear of leverage is pertinent. Leverage among Indian households and corporates are at low level compared to its peers. Household leverage in India is at much lower rate. Similarly, going by the World Bank data on domestic credit to the private sector, the ratio for India is 55% of GDP, remarkably below the world average (148%), Low & Middle income group (119%) and lowest among its Asian and BRICS peers – China (183%), South Korea (164%), Vietnam (148%), South Africa (111%), Brazil (70%) and Russia (60%).



Source: World Bank, WDI Indicator

As there are mainly two primary sources of private debt in India - bank credit and corporate bond market, given the tight financials globally and increased rates in the international market, corporate are preferring bank borrowing. As per RBI's latest Financial Stability report (FSR) December 2022, aggregate mobilisation of funds in the quarter



Source: Reserve Bank of India

ending September 2022 were heavily dependent (54%) on Wholesale Borrowings (loans higher than INR 50 million or more) from Banks followed by Corporate Bonds (32%). However, a further shift in funding away from market borrowings is seen in recent months due to global financial tightening. Rising yields on corporate bonds and higher interest/hedging costs on ECBs have made these instruments less attractive than the previous year. Given the moderation in overseas issuances and lower investments by private equity and venture capital firms, the financing requirements of the corporate sector are being met through domestic resources– mainly banks.

Conclusions

The well-capitalised banking system with a better asset quality and more robust corporate sector fundamentals is expected to support the robust credit growth, notwithstanding the rising interest rates. Two major growth drivers are personal credit and MSME credit are going to support credit growth in the event of global slowdown. However, the current high credit growth is on a low base of the previous couple of years. The accumulation of past deposits, drawing down of HQLAs, strong capital base and balance sheet has been encouraging banks to further leverage.

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