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Highlights: Trends in Indian Banking

RBI has recently released its annual report on "Trend and progress of banking in India 2023-24". This report encompasses all major aspects which have had an impact on India's banking sector. Topics range from global developments, regulatory changes, and technological changes to movement in balance sheets of-banks, NBFCs, RRBs, and cooperative banks. Certain key case studies have also been undertaken in the report, results of which are also discussed in our report here.

Key highlights (SCBs)

- Mindful of the persistence of inflation above the target, the monetary policy committee (MPC) kept the policy repo rate unchanged at 6.5% during 2023-24 and 2024-25 (up to Dec'24).
- MPC has changed the monetary policy stance from 'withdrawal of accommodation' to 'neutral'.
- RBI also decided to reduce the cash reserve ratio (CRR) of all banks to 4.0% of NDTL in two equal tranches of 25bps each, effective fortnight beginning December 14 and December 28, 2024.
- The weighted average call rate (WACR) – the operating target of monetary policy – averaged 6.63% in 2023-24 as compared with 5.39% in 2022-23, reflecting the increase in the policy repo rate and the evolving liquidity conditions. The WACR averaged 6.54% in 2024-25 (up to December 17, 2024).
- The average daily net absorption under the LAF stood at Rs 0.65 lakh crore during 2024-25 (up to December 17, 2024). While average daily absorption under the SDF and reverse repos was Rs 1.3 lakh crore, the recourse under the MSF averaged Rs 0.07 lakh crore.
- In India, strong macro fundamentals have helped banks' profitability improve for the 6th consecutive year in 2023-24, while their gross non-performing assets (GNPA) ratio reached its lowest level in 13 years at 2.7% by end-Mar'24.
- Gains in profitability of SCBs continued in H1FY25 with RoA at 1.4% and RoE at 14.6%.
- The consolidated balance sheet of SCBs, excluding RRBs, increased by 15.5% during 2023-24 (including the impact of HDFC merger), as compared with 12.2% during 2022-23.
- On the assets side, this expansion was driven by buoyant bank credit, which increased by 16.0% in 2023-24 (excluding the impact of the merger) on top of 17.4% growth a year ago.
- SCBs' investments grew by 11.6% in 2023-24 (excluding the impact of the merger) as compared with 11.4% a year ago.
- The share of PSBs in the consolidated balance sheet of SCBs fell to 55.2% at end-Mar24 from 57.6% at end-Mar'23, with that of PVBs increasing from 34.7% to 37.5%.
- PSBs accounted for 59.3% of total deposits of SCBs and 55.5% of total advances.
- Deposit growth of commercial banks accelerated to 13.4% in 2023-24 (excluding the merger impact) from 11.0% a year ago.

- During 2023-24, the maturity mismatch widened in the short-term bucket from a year ago, although it remained low relative to pre-pandemic levels. The gap remained positive across other buckets. This mainly reflected an increase in shorter maturity deposits raised by banks.
- The interest expense to interest income ratio increased to 57.4% during 2023-24 from 52.2% in the previous year.
- The median Net Interest Margin (NIM) was the highest for PVBs, followed by FBs and PSBs.
- The PCR (not adjusted for write-offs) of SCBs expanded by 210 basis points (bps) y-o-y to reach 76.2% at end-Mar'24, mainly reflecting lower slippages. It further improved to 76.7% at end-Sep'24, largely driven by PSBs.
- An increase of 104 bps in the cost of funds and 89 bps rise in the yield on assets narrowed the spread for SCBs during 2023-24. SFBs had the widest spreads, reflecting relatively higher interest rates on their advances.
- At end-Mar'24, all bank groups remained well-capitalised, although the CRAR of SCBs moderated by 30bps to 16.9% while Tier 1 capital stood at 14.8%. The fall in CRAR was due to an increase in risk weighted assets (RWAs) exceeding the increase in capital funds.
- Supervisory data indicate that the CRAR of SCBs was 16.8% at end-Sep'24.
- At end-Mar'24, the LCR was 130.3%, which was above the required 100%.
- GNPAs of SCBs reduced by 15.9% (YoY) to Rs 4.8 lakh crore as on March 31, 2024. The GNPA ratio declined to 2.7% at end-Mar'24.
- The net NPA (NNPA) ratio also declined to a decadal low of 0.62% at end-Mar'24, driven by stronger provision buffers. At end-Sep'24, the NNPA ratio improved further to 0.57%.
- Based on the date of occurrence of frauds, in 2023-24, the share of internet and card frauds in the total stood at 44.7% in terms of amount and 85.3% in terms of number of cases.
- The GNPA ratio remained the highest for the agricultural sector (6.2%) and the lowest for retail loans (1.2%) at end-Sep'24.
- The asset quality of the industrial sector has been improving since Mar'18, with the GNPA ratio declining to 2.9% at end-Sep'24.
- The GNPA ratio of education loans fell from 5.8% at end-Mar'23 to 3.6% at end-Mar'24 and 2.7% at end-Sep'24 but it remained the highest across retail loan segments, followed by credit card receivables and consumer durables.
- In the services sector, the GNPA ratio of tourism, hotel and restaurants sector remained elevated.
- Among the industrial sub-sectors, the GNPA ratio of the gems and jewellery segment moderated.
- At end-Sep'24, the leather and leather products industry had the highest GNPA ratio of 7.3%, despite some recent improvement.
- Banks' exposure to the capital market and real estate is reckoned as sensitive in view of the risks inherent in fluctuations in asset price. At end-Mar'24 PSBs' exposure to these sectors was 22.1% of their total loans and advances, marginally higher than 21.7% a year ago. PVBs' exposure to sensitive sectors increased to 34.7% of their total loans and advances from 27.8% a year ago, largely reflecting the merger impact.

- The share of unsecured loans in total credit of SCBs had been increasing since end-Mar’15, touching 25.5% by end-Mar’23. This share declined marginally to 25.3% at end-Mar’24.
- Among various bank groups, PSBs had the lowest share of unsecured advances, followed by PVBs.
- While highlighting key risks to banking, RBI has cautioned lenders to closely monitor-gold loans and top-up loans and has also cautioned that high employee attrition could also pose a threat.
- Employee attrition rates are high across select private sector banks (PVBs) and small finance banks (SFBs). High attrition and employee turnover rate pose significant operational risks, including disruption in customer services, besides leading to loss of institutional knowledge and increased recruitment costs.

Key highlights (RRBs)

- The growth in the combined balance sheet of RRBs decelerated to 8.9% during 2023-24 from 9.4% in the previous year on account of a slowdown in borrowings on the liabilities side, even as there was an acceleration in deposits and credit growth.
- Deposits accounted for 78.5% of RRBs’ total sources of funds.
- The C-D ratio of RRBs increased to 71.4% at end-Mar’24, its highest level in 33 years.
- The GNPA ratio of RRBs reached a decadal low of 6.2% at end-Mar’24.

Key highlights (SFBs, PBs, UCBs)

- The C-D ratio of SFBs moderated to 90.1% at end-Mar’24 from 93.0% a year ago, though it remained higher than that of SCBs.
- During 2023-24, the combined balance sheet growth of Payment Banks (PBs) decelerated, primarily driven by slowdown in deposit growth on the liabilities side as well as slowdown in growth of cash and balances with the RBI and investments on the asset side. Deposits constituted 62.4% of the liabilities of PBs.
- During 2023-24, the consolidated balance sheet of UCBs exhibited a muted growth of 4%, albeit higher than 2.3% in the previous year. The balance sheet size of UCBs relative to SCBs fell for the seventh successive year to 2.5% at end-Mar’24 from 3.8% at end-Mar’17, dragged down by subdued deposit growth on the liabilities side and loans on the asset side.

Key highlights (NBFCs)

- Credit extended by NBFCs was 13.6% of GDP during 2023-24.
- At end-Mar’24, it accounted for 24.5% of the outstanding credit of SCBs.
- Industry and retail sectors receive a dominant share of NBFCs’ credit (71.2% of the total loan portfolio at end-Mar’24).
- During 2023-24, NBFCs recorded higher growth of credit to all sectors (except services) relative to banks.
- At end-March 2024, credit to the power sector accounted for 75.2% of total credit to industries, driven by large government-owned NBFCs.

- Vehicle loans, loans against gold and microfinance loans have been the stronghold of NBFCs, together accounting for 56.7% of their retail portfolio at end-Mar'24.
- NBFCs maintained their dominance in loans against pledge of gold ornaments and jewellery, with a share of 59.9% of total gold loans (banks and NBFCs together) at end-Mar'24.
- Gross advances under larger borrowal accounts (exposure of Rs 5 crore and above) grew by 14.1% during 2023-24 (13.5% in the previous year).
- Asset quality of these accounts exhibited significant improvement during the year, bringing down their share in total NPAs.
- At end-Mar'24, the NBFC sector maintained capital to risk-weighted assets ratio (CRAR) of 26.9%, well above the regulatory requirement.
- NBFCs' exposure to sensitive sectors increased to 23.8% of their total assets at end-Mar'24 from 21.2% at end-Mar'23, driven by lending to the capital market.
- During 2023-24, the balance sheet of HFCs increased by 13.3%, driven mainly by loans and advances extended by the middle layer HFCs.
- RoA remained same during the year, adjusted for the effect of the merger.

Results of case studies undertaken by RBI:

- Studying the relationship between GDP growth and credit-to-GDP ratio suggested:
    - A credit threshold at 113.1% of GDP for the sample countries. Although the threshold could differ for each country and vary over time depending on its structural factors.
    - Total Factor Productivity Growth (TFPG) and the investment-to GDP ratio have a positive and significant impact on GDP growth.
    - India's total credit-to-GDP ratio (including credit extended by banks as well as NBFCs) at 90.1% in 2022 was below that of AEs and of emerging market economies (EMEs) as well as the estimated threshold. As such, higher credit growth remains supportive of economic growth.
- Study on impact analysis of the Reserve Bank's policy initiatives in the Non-conventional Energy (NCE) sector was carried out.
    - Results showed that policy interventions were associated with an increase in the share of credit to the NCE sector in total credit for energy.
    - The 2015 policy intervention was effective for PSBs, whereas the 2020 policy helped in increasing PVBs' lending to the NCE sector.
    - Thus, the priority sector policy modulations have encouraged credit flows to the NCE sector. It, however, needs to be recognised that this phase also saw significant policies and incentives by the government to promote green energy sources. The results reflect the combined impact of various policy measures and incentives.
- The determinants of deposit growth in commercial banks in India was assessed for the period June 2012-March 2024.
    - Results suggest that a 1% growth in income, ceteris paribus, is associated with almost 1% increase in bank deposit growth in the long run.
    - Higher deposit interest rates (WADTDR) contribute to higher bank deposits, but their impact is not statistically significant in the long run.

- To understand why banks hold excess CRAR (as it involves an opportunity cost), RBI studied data for 33 PSBs and PVBs from Mar’12 to Dec’23.
    - The results indicate that profitability indicators like RoA or NIM positively impact excess CRAR. The average excess capital held by banks within the same category (size-wise groups of PSBs and PVBs) shows a significant and positive relationship with a bank’s own excess CRAR.
    - Excess CRAR also appears to be pro-cyclical, as evident from its positive and significant relationship with GDP growth.
    - Conversely, the ex-post credit risk of banks, measured by the lagged GNPA ratio or net NPA (NNPA) ratio, dampens excess CRAR as banks with weaker asset quality anticipate higher provisions.
    - Additionally, a larger loan portfolio (measured by loans-to-assets ratio) requires more capital, resulting in a negative relationship with excess CRAR.
    - The weighted average call rate (WACR), a proxy for opportunity cost of holding excess capital, dampens excess capital holdings.
- RBI studied if portfolio diversification reduces financial intermediation cost of banks and can enhance their profitability.
    - The results indicate a positive and significant relationship between NIM and diversification indices, suggesting that portfolio diversification has benefitted banks in terms of profitability.
    - Additionally, asset quality, measured by the GNPA ratio, is negatively correlated with NIM.
- According to a survey conducted by the Reserve Bank in October 2024:
    - 45% of the respondent REs indicated that they were using it for tasks such as providing assistance to employees and document summarisation.
    - 55% of the respondents, who were not leveraging GenAI when the survey was conducted, were considering its adoption in the near future for similar tasks.
    - 20% of the adopters reported their preference for building models from scratch for specific uses.
    - Extending the existing models via fine tuning and/or data retrieval was the most accepted approach.
    - These strategies allow REs to tailor GenAI models for specific use cases, enhance performance and seamlessly incorporate AI capabilities into existing workflows.
- Noting the determinants of Non-Interest Income in Scheduled Urban Co-operative Banks, RBI’s study reflects:
    - SUCBs with larger asset size have a higher share of non-interest income.
    - Higher profitability (RoA) seems to dampen the share of non-interest income.
    - Moreover, as profitability increases, the decline in the share of non-interest income for Tier 1 to 3 SUCBs is less, as compared to Tier 4 SUCBs.
    - Overall, the empirical analysis suggests that as banks grow in size, they are able to diversify towards non-traditional activities, which boosts their non-interest income.

- Studying the impact of recent regulatory changes on NBFCs' Unsecured Retail Lending, RBI noted:
    - Growth rate of unsecured retail loans fell in the aftermath of the increase in the risk weights.
    - All in growth of unsecured retail credit was driven by NBFCs with higher ex-ante dependence on bank borrowings.
    - Unsecured retail credit growth is positively related to NBFC size and negatively related to the GNPA ratio of the segment.
    - Countercyclical prudential measures undertaken by the Reserve Bank dampened the growth of unsecured retail lending, consistent with the policy objective.

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