Bank Credit Watch

December 2017

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Credit growth showing signs of recovery

- After a prolonged period of muted growth, credit growth is finally showing signs of recovery. Credit growth rose to 8.8% y-o-y in November up from 6.6% the previous month. The rise in credit growth was broad based with all sectors showing improvement with credit to services showing double digit growth. More high frequency data suggest the improvement has continued to December with non-food credit growth reaching 10.7% in December.
- Fortunately, while nominal credit growth has remained subdued over the last year, there has been adequate credit availability to most sectors once the numbers are adjusted for inflation and increased borrowing from the bond market, and other non-bank funding sources. Furthermore, banks have written-off/sold loans to asset reconstruction companies (ARCs), which effectively compressed their loan books and in addition a large share of the UDAY bond issuances during the financial year represent conversion/swapping of bank credit into special securities.
- Going forward the trajectory of lending rates and thereby credit growth will be determined by the proposed rules for the base rate setting mechanism (MCLR) system. A review of the system released with the October monetary policy has noted that hat banks deviated in an ad hoc manner from the specified methodologies for calculating the base rate and the MCLR to either inflate the base rate or prevent the base rate from falling in line with the cost of funds. As such the review has recommended limiting the flexibility that banks have enjoyed by removing arbitrary and discretionary components added to the formula. The panel has suggested a risk-free curve involving rates on tbills, or certificate of deposits rates or the policy repo rate and that lending rates should be reset once every quarter.
- If these recommendations of the review panel are accepted it could certainly lead to better policy rate transmission and therefore lower lending rates.
- Even if policy rate transmission improves, we have consistently argued sustained pick up in credit growth will require a meaningful reduction in NPAs. NPA problems will not be easily solvable as banks continue to struggle with diminished profitability while at the same time the implementation of Basel III norms raise the need for additional capital. Recently things are moving in the right direction as a recent spurt of capital raising, including tier 1 bonds, equity issuances and government recapitalization has significantly improved the capital position of banks.
- Furthermore we expect that recent regulatory developments including allowing foreign ownership of asset reconstruction companies and the bankruptcy code will start to bring down NPLs sitting on bank books. After prolonged period of deterioration, asset quality trends for public sector banks are starting to stabilize.
- We believe a combination of these factors will lead t to a sustained period of credit growth.

Credit Growth Summary

Non-Food Credit Growth

- Non-food bank credit increased by 8.8% y-o-y in November 2017 as compared with 4.8% during November 2016

Credit Growth by Sector*

- Credit to agriculture (13.9%) increased by 8.4% in November 2017, as compared to 10.3% increase in November 2016
- Credit to industry (36.6%) increased by 1.0% in November 2017 as compared with a contraction of 3.4% in November 2016. Major sub-sectors which witnessed contraction of credit, were infrastructure, vehicle parts and metal products
- Credit to services sector (24.7%) increased by 14% in November 2017 higher than the 7.1% increase recorded in November 2016
- Personal loans (24.8%) increased by 17.3% in November 2017, higher than the 15.1% growth in November 2016.

Credit Deposit Ratio

- Deposit growth was 2.1% in November 2017lower than the 15.6% growth in November 2016. Deposit growth has outstripped credit growth since September 2016 until October 2017.
- The credit deposit ratio stood at 74.4% and the incremental credit deposit ratio was 315.2% compared with 69.3% and 29.9% in November 2016

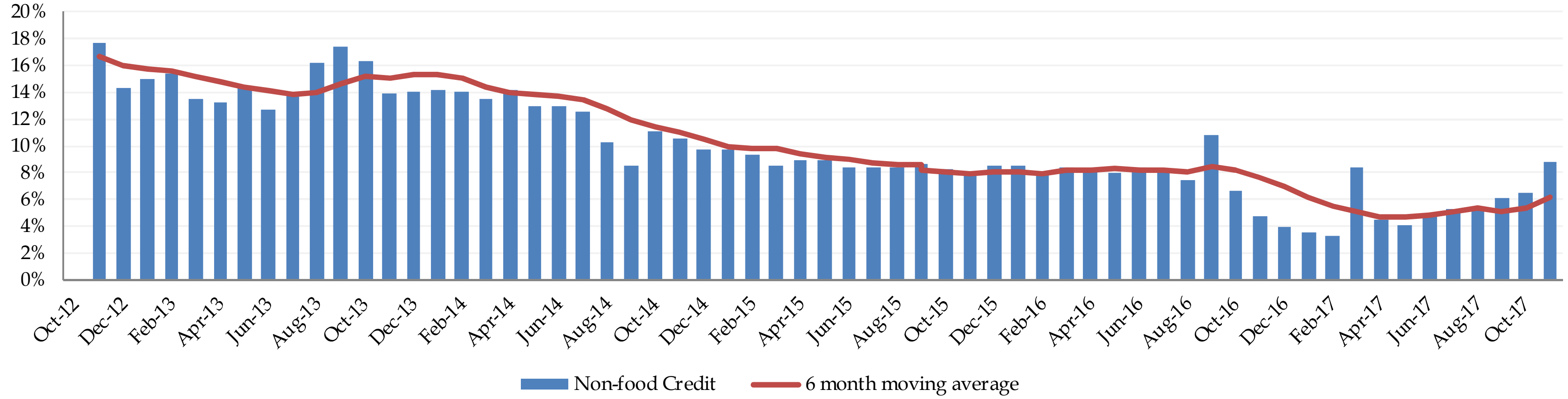
Credit Growth by Bank Group

- Credit growth differed across bank groups. Credit growth for SBI and other Public Sector banks, which make up the majority of credit, was 5.3% and 2.9% in December 2016 respectively. Private bank credit growth was 17.7% lower than 24.9% recorded in December 2015 while foreign bank credit growth was 0.8%, lower than 11.9% during the same period the prior year.

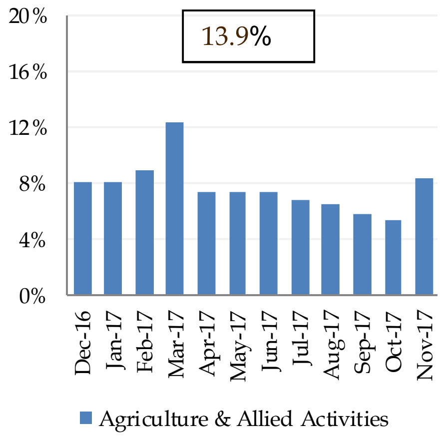
* Percentages in parenthesis refer to share of total non-food credit based on the latest available data

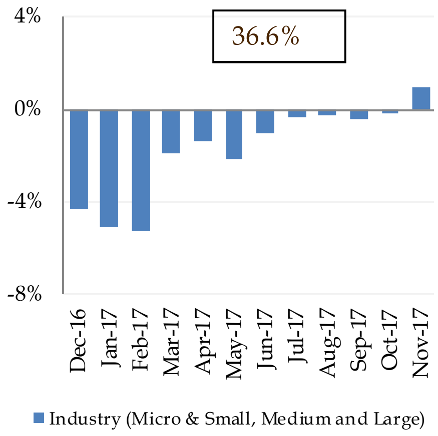
Sectoral Credit Growth Trends

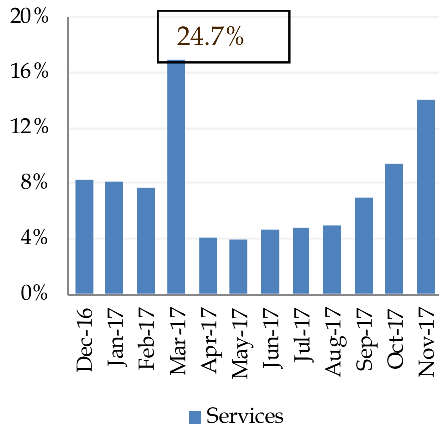
Non-food Credit Growth

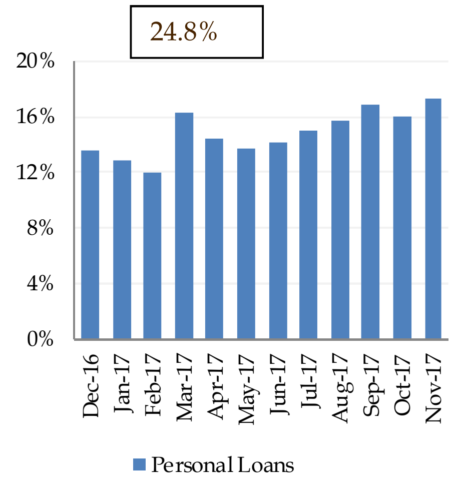


Non-food Credit Growth by Sector*









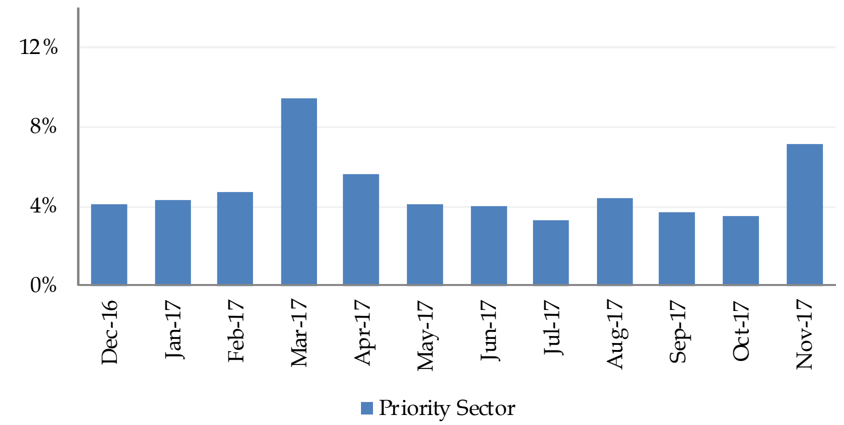
* Percentages in the boxes refer to share of total non-food credit based on the latest available data
Source: RBI, Trust Research

Sector Share of Credit

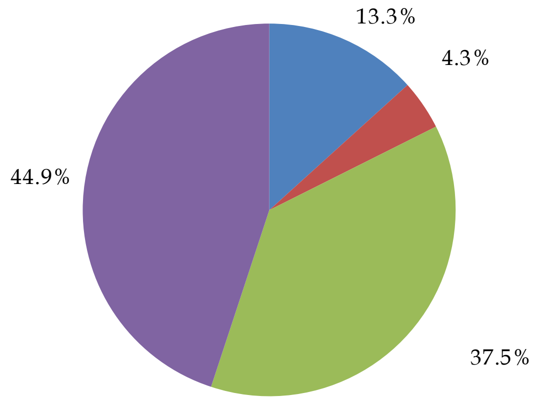
Sectoral Deployment of Credit (Rs B)

Sector	Outstanding as on			Variation (Y-oY)	
	27-Nov-2015	25-Nov-2016	24-Nov-2017	2015-16	2016-17
				%	%
Non-food Credit	62,397	65,362	71,145	4.8	8.8
Agriculture & Allied Activities	8,260	9,112	9,882	10.3	8.4
Industry	26,687	25,793	26,041	-3.4	1.0
Services	14,403	15,426	17,593	7.1	14.0
Personal Loans	13,046	15,031	17,630	15.2	17.3
Priority Sector	21,183	22,421	24,017	5.8	7.1

Priority Sector Growth

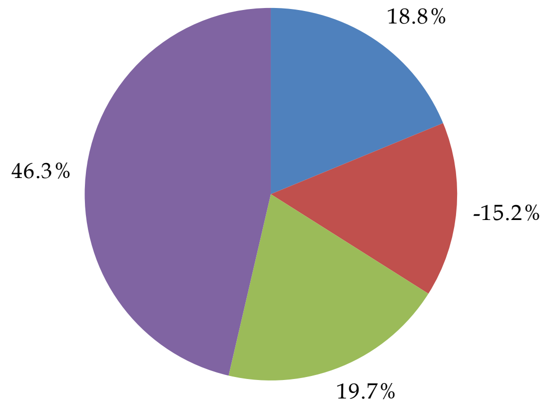


Share of Sectors in Incremental Credit Growth (November 2017)



Loans to industry and services have increased while agriculture has declined

Share of Sectors in Incremental Credit Growth (November 2016)

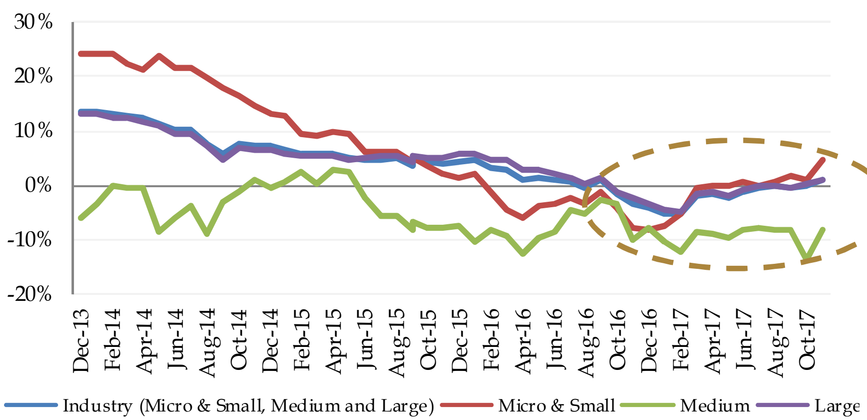


Agriculture & Allied Activities | Industry | Services | Personal Loans

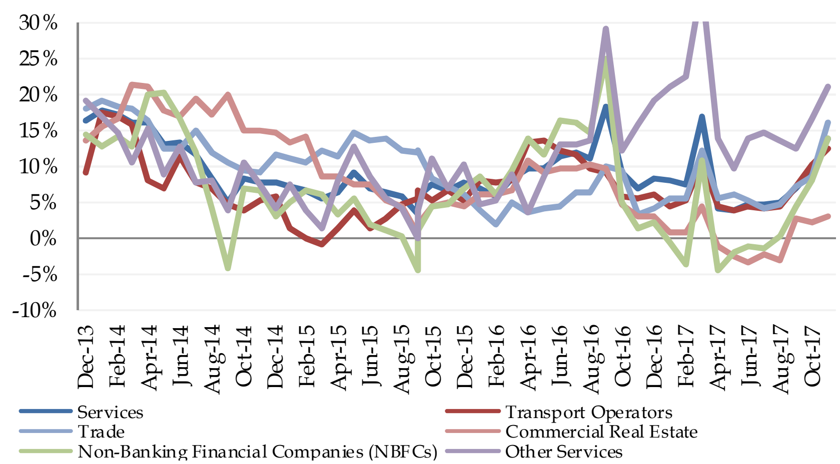
Source: RBI, Trust Research

Credit Growth Trends

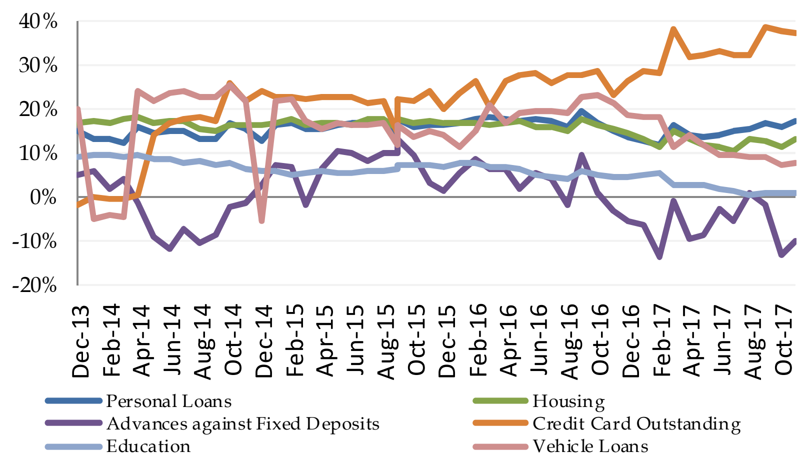
Industry Credit Growth



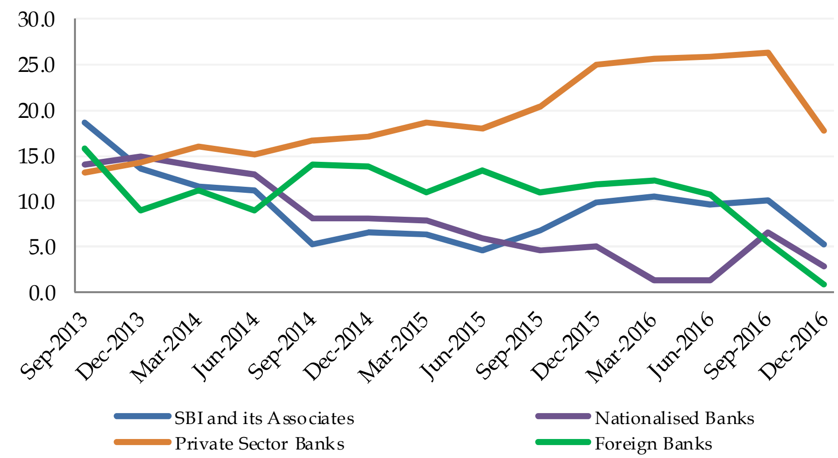
Services Sector Credit Growth



Personal Loans Credit Growth



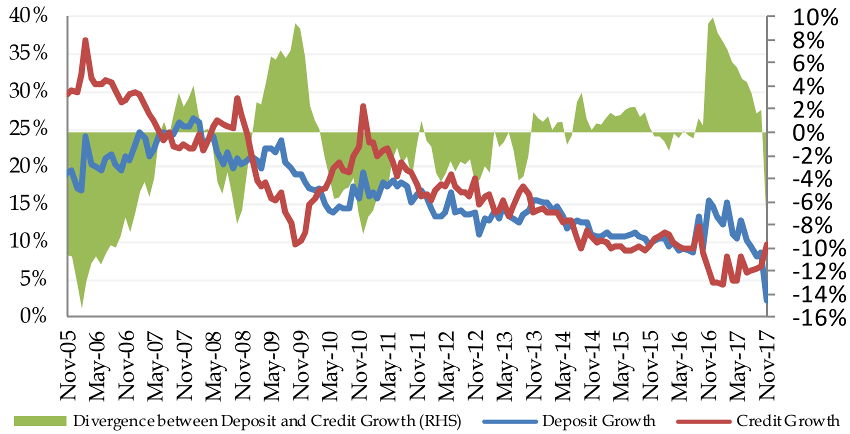
Bank Group Wise Credit Growth



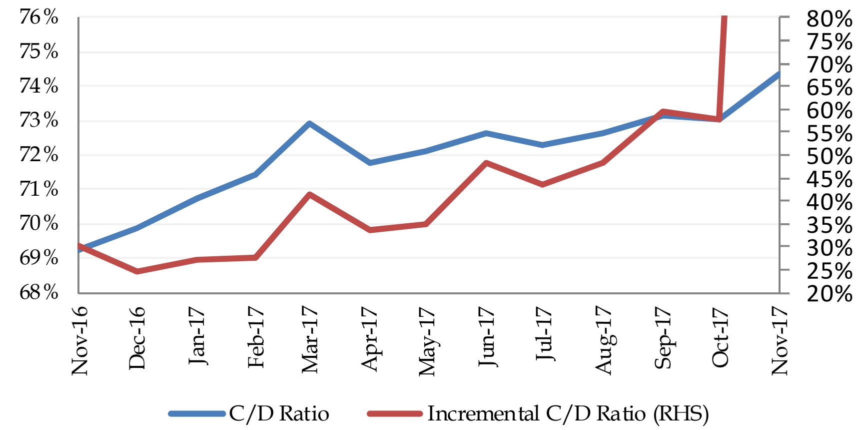
Source: RBI, Trust Research

Credit Deposit Ratio

Credit and Deposit Growth



Credit Deposit Ratio



The Insolvency and Bankruptcy Code will transform bankruptcy process

Feature	Description
Signficant Shift	• A shift from current Debtor in possession to a creditor in control regime
Consolidated	• Consolidates all existing bankruptcy related laws as well as amending existing legislation • The code would have an overriding effect on all other laws relating to Insolvency & Bankruptcy
Time Bound	• The code aims to resolve insolvencies in a strict time-bound manner - the evaluation and viability determination must be completed within 180 days. • Moratorium period of 180 days (extendable upto 270 days) for the Company.
Clearly Defined	• Clearly defined order of priority or the waterfall mechanism. • The waterfall to render government dues junior to most others
Creditor Protection	• Antecedent tranactions can be investigated and in case of any illegal diversion ofassets personal contribution can be ordered by court. • Introduce a qualified insolvency professional (IP) as intermediaries to oversee the process
Bankruptcy Board	• Establishment of Insolvency and Bankruptcy board as an independent body for the administration and governance of Insolvency & bankruptcy Law; and Information Utilities as a depository of financial information.

Currently the bulk of assets going through the insolvency process are in the referal stage awaiting resolution. As more assets go through the IBC, we believe the IBC will have a dramatic positive impact on reducing time to resolve insolvency, and ultimatly address the NPA situation decisively and further devleop the credit markets.

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Thank You

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