Cumulative losses at public sector banks (PSBs) were large enough to wipe out almost all of the government's capital injections of $13 billion in 2017-18, said ratings agency Fitch Ratings. It added weak performance was likely to continue.

The heavy losses and capital erosion reported by banks in 2017-18 has added to pressure on viability ratings, it added. Losses were reported by 19 of the 21 state banks in 2017-18, including State Bank of India. Earnings at large private banks also came under pressure, with Axis Bank reporting its first-ever quarterly loss.

Fitch accounts these losses to the acceleration of bad loan recognition, with the introduction of non-performing loans (NPL) framework. While this framework is part of a clean-up that should improve the health of the banking sector over the long term, the initial effect has been to raise credit costs. Average credit cost at state-run banks reached 4.3 per cent of loans in 2017-18, compared to 2.5 per cent in 2016-17.

“The sector NPL ratio rose to 12.1 from 9.3 per cent, and exceeded our previous forecast of 11.5 per cent. The state banks’ average NPL ratio was 14.5 per cent. IDBI Bank, UCO Bank and Indian Overseas Bank’s ratios were over 25 per cent,” said Fitch.

Six state-owned banks reported common equity Tier 1 (CET1) ratios that did not meet the regulatory levels, including Punjab National Bank, the second-largest state bank. Banks will have to meet a higher minimum regulatory CET1 requirement of 8 per cent in 2018-19, including the capital conservation buffer.

While the government’s additional infusion of $11 billion for recapitalisation in 2018-19 will help banks avoid breaching regulatory triggers, more government capital is required to stabilise banks’ balance sheets, meet regulatory requirements and support growth.

Fitch said it was possible that more state banks will be placed in the Reserve Bank of India's prompt corrective action (PCA) framework.

Fitch said the sector was moving close to full recognition of legacy bad loans and there was an improvement in provision coverage ratios. The speedier recovery from the National Company Law Tribunal accounts can release some capital, if recoveries prove higher than current provisions, as was the case in some recent resolutions. Funding for state banks has remained stable. However, the extended period of poor performance is putting stress on state banks' standalone profiles, it added.