Credit Scenario: August 2015

The Indian economy has displayed a mixed picture so far this year. While there have been several measures taken by the government through policy announcements (roads, stalled projects, smart cities etc.) and the Union Budget; as well as by the RBI through a cut of 25 bps in repo rate, industrial growth is still at a lower level averaging 3.2% in the first quarter of the year compared with 4.5% during the same period of FY15. This period is admittedly a lean season for industrial activity which is also reflected in the banking sector indicators.

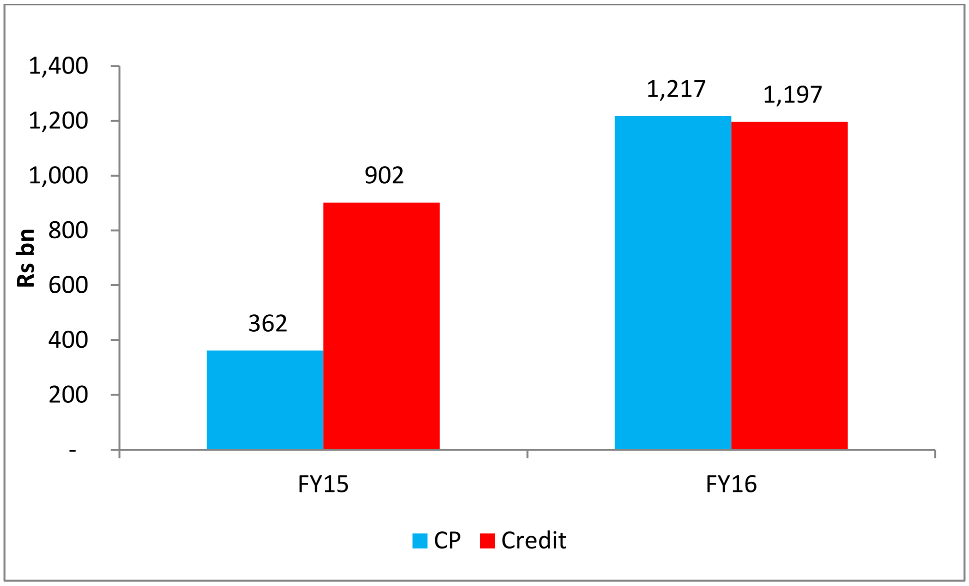
The RBI has been commenting on the slow transmission of the repo rate cuts to the base rate of banks but has pointed out that the market has been more proactive to these rate cuts as witnessed by the movement in the commercial paper (CP) rates. It has been argued that as corporates progressively make use of this route to raise finance, banks would start lowering their rates so as to not lose business.

Growth in the banking sector

Growth in bank credit during the period April-July was marginally higher in FY16 at 1.8% compared with 1.5% in FY15. In fact, there was a spurt in credit in the last week of March, (which does not get reckoned for FY15) which gets included in the FY16 numbers. If growth in credit is reckoned over April 3rd, credit declined by 4% by July end.

There has also been a shift in choice of finance from bank credit to CPs during the first 4 months of the year. The chart below juxtaposes incremental bank credit with incremental CPs outstanding to gauge how borrowers have raised funds in the market. The movement to the CP market is quite discernible this year compared with FY15.

Chart 1: Incremental CP and Credit: April-July

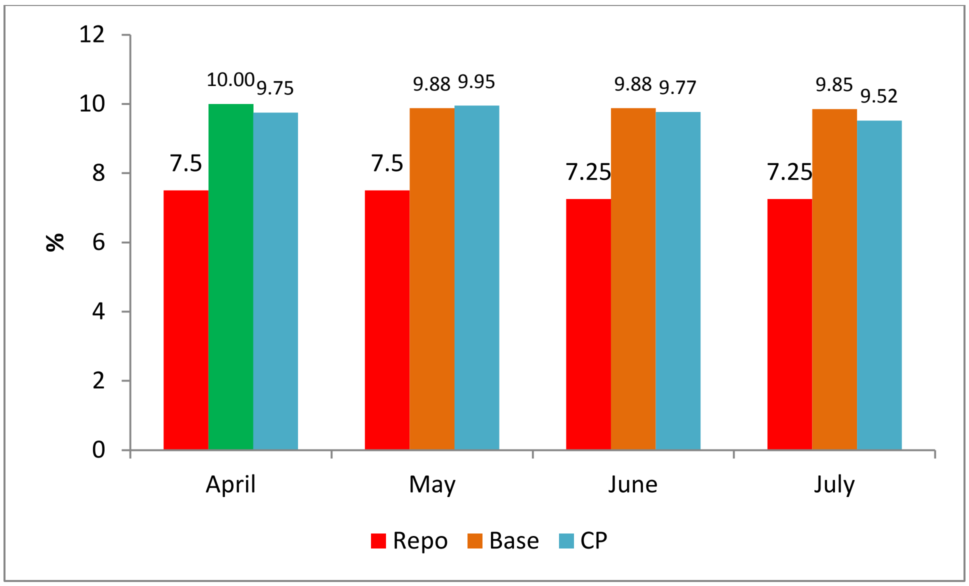


Source: RBI

The chart above shows the distinct shift in the sourcing of finance. In FY15, in incremental terms, bank finance remained the major source of finance with CPs being 40% of bank credit. However in FY16, there has been more recourse taken to CPs with incremental CPs outstanding being Rs 1,217 bn as against Rs 1,197 bn for bank credit. In terms of fresh issuances, during the first 4 months of FY16 Rs 5,083 bn of CPs were raised compared with Rs 3,488 bn in FY15. Quite clearly corporates have been raising funds through the market route.

The higher recourse to CPs could be attributed mainly to the differences in interest rates across various tenures compared with bank credit. The Chart below shows how the average CP rates (based on primary issuances) have moved relative to the repo rate and base rate.

Chart 2: Interest rates: FY16



Source: RBI

Some observations from this chart are:

- The repo rate has come down by 25 bps over this period.
- The average base rate has trended downwards with 15 bps decline on a point to point basis.
- The average CP rate has shown an uneven pattern with an increase by 20 bps in May over April followed by sharp decline of 18 bps in June and further by 25 bps in July. On a point to point basis the decline was 23 bps. This is almost the same as the change in the repo rate.

Bank credit sectoral trends: April-June

During the first quarter of the year, bank credit has grown by 1.2% compared with 1.7% in the previous year. The low growth has not been even in terms of distribution.

- Growth in credit to the manufacturing sector has been negative at 1% as against -0.3% last year. All the three segments, micro and small, medium and large have witnessed negative growth during this period.
- Growth in credit to agriculture was high at 3.8% which may be attributed more to the demand coming at the time of harvest.

- Services sector witnessed growth of 1.4% as against 0.2% last year, with trade and transport operators witnessing positive growth.
- The retail segment continued to be dominant with growth of 4% as against 2.7% last year.
    - Home loans and vehicles were the leading sectors with growth of 3.9%.
    - The latter may be linked with the higher growth in the motor vehicles and trailers and other transport segments growth in the IIP of 6.5% and 1.8% respectively.

An interesting conclusion that may be drawn is that manufacturing and services companies may have been seeking recourse more to the CPs market given then interest rate differential. Also as investment levels have been low with the capital goods industry growing by just 1.5% during this period the working capital requirements were met more though CPs than conventional banks credit.

Overall liquidity

Liquidity appears to be fairly easy by end July. During the four months period, deposits increased by Rs 3,500 bn while credit increased by Rs 1,197 bn and investments by Rs 1,587 billion. The surplus liquidity has kept GSec yields stable in the downward direction as well as call rates low. Banks have been active at the reverse repo auctions.

The corporate bond market

SEBI data indicates that while public issue of debt was lower during the first 4 months of the year at Rs 5.73 bn compared with Rs 35.60 bn last year, private placements were higher at Rs 1695.44 bn as against Rs 53.83 bn last year. CMIE data across sectors indicates that around 80% of these issuances were from the financial sector.

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