CARE Ratings
Professional Risk Opinion

Highlights of RBI's Financial Stability Report

Banking business has been under pressure in the first half of the year**.** The banking stability indicator of the RBI shows that risks to this sector increased mainly on account of deteriorating asset quality, lower soundness and sluggish profitability. **Some of the highlights are presented below.**

- ***Further decline in both deposit and credit growth.***
- ***Asset quality***
  - Gross NPAs as percentage of gross advances increased to 5.1% from 4.6% between March and September 2015.
  - The restructured standard advances as percentage of gross advances declined to 6.2% from 6.4%, while the stressed advances ratio increased to 11.3% from 11.1% during the same period.
  - PSBs recorded the highest level of stressed assets at 14.1% followed by PVBs at 4.6% and FBs at 3.4%.
  - Sectoral data as of June 2015 indicates that among the broad sectors, industry continued to record the highest stressed advances ratio of about 19.5%, followed by services at 7% and retail 2%.
    - In terms of size, medium and large industries each had stressed advances ratio at 21%, whereas, in the case of micro industries, the ratio stood at over 8%.
  - As of September 2015, 34 SCBs with 12% share in advances showed very low stressed advances ratio of less than 2%, whereas, 16 banks with 27% share in advances had high stressed advances ratio of over 16%.
  - Five sub-sectors viz. mining, iron & steel, textiles, infrastructure and aviation, which together constituted 24.2% of the total advances as of June 2015, contributed to 53.0% of the total stressed advances.
  - Stressed advances in the aviation sector increased to 61.0% in June 2015 from 58.9% in March, while those of the infrastructure increased to 24.0% from 22.9% during the same period. The performance of these sectors and their impact on the asset quality of banks continue to be a matter of concern.
  - Net NPAs increased to 2.8% from 2.5% during the same period.
    - At the bank group level, the NNPA ratio of PSBs increased from 3.2% to 3.6%, whereas, in the case of PVBs and FBs it remained unchanged at 0.9% and 0.5% respectively.

- ***CAR registered some deterioration during the first-half of 2015-16.***
    - Public sector banks (PSBs) continued to record the lowest CRAR among the bank groups. The capital to risk-weighted assets ratio (CRAR) of SCBs at the system level declined to 12.7% from 13.0% between March and September 2015, whereas, Tier-I leverage ratio increased to 6.5% from 6.4% during the same period.
- **Profitability of SCBs deteriorated further.**
    - Both RoA and RoE declined further to 0.7% and 8.5% respectively as of September 2015 from 0.8% and 9.3% as of March 2015.
        - Bank-wise distribution of RoA shows that 9 SCBs with a share of 7% in the total assets recorded negative RoA during first half of the financial year 2015-16.
        - 6 banks with a share of 9% in total assets recorded RoA in the range of zero to 0.25%
    - Net profit declined by 4.4% during the first half of FY16, due to lower growth in earnings before provisions and taxes (EBPT) and higher provisions and write-offs.
    - Among the bank groups, PAT declined by 22.7% for PSBs, while it increased by 11.5% for PVBs and 4.6% for FBs during the same period.
- ***Other financial institutions***
    - Asset quality of both scheduled urban co-operative banks (SUCBs) as well as non-banking financial companies (NBFCs) deteriorated during the first-half of 2015-16.
- ***Corporate debt situation***
    - The proportion of companies in a sample (2711), either with negative net worth or DER >=2 (termed as 'leveraged' companies) increased over last three half years from 18.4% in September 2014 to 19.4% in September 2015, whereas their share in the total debt of all companies in the sample marginally declined to 30.5% in September 2015 from 33.8% in March 2015.
        - The proportion of companies among the leveraged companies with DER>=3 (termed as 'highly leveraged' companies) increased from 13.6% in September 2014 to 15.3% in September 2015, while the share of debt of these companies in the total debt increased from 22.9 to 24.9%.
    - An analysis of the current trends in debt servicing capacity and leverage of weak companies was undertaken where 'weak' companies were defined as those having ICR <1. Companies with DER >= 2 were classified as 'leveraged'. The 'leveraged weak' companies are those with DER >= 2 or negative net worth among the weak companies.

- The analysis shows that 15.8% of companies were weak in the select sample in September 2015.
- The DER of these weak companies declined marginally from 1.8 in second half of 2014-15 to 1.7 in the first half of 2015-16. The share of debt of these weak companies constituted 27.3% of total debt.
- The leveraged weak companies were 2.4% in the sample and accounted for 11.8% of the share of total debt.
- The number of companies and share in total debt for both weak as well as leveraged weak companies increased in 2014-15, but declined marginally in the first half of 2015-16.

- ***Non-banking financial companies***
  - As of September 30, 2015, there were 11,781 NBFCs registered with RBI, of which 212 were deposit-accepting (NBFCs-D) and 11,569 were non-deposit-accepting (NBFCs-ND). There were 210 Systemically Important Non-Deposit accepting NBFCs (NBFCs-ND-SI). All NBFCs-D and NBFCs-ND-SI are subject to prudential regulations such as capital adequacy requirements and provisioning norms along with reporting requirements.
  - The aggregated balance sheet of the NBFC sector expanded by 14.2% on y-o-y basis in September 2015 compared with 16.8% in March. Loans and advances increased by 14.2% and total borrowings by 14.5%
  - The financial performance of the NBFC sector deteriorated during the quarter ended September 2015 compared with March 2015. The net profit as a percentage to total income declined from 18.8% to 15.0% between March and September 2015.
    - RoA declined sharply from 2.2% to 1.0%.
  - Gross NPAs increased to 3.5% in September 2015 from 3.4% in March.
  - Net NPAs increased to 2.0% from 1.8% during the same period
  - As per the extant guidelines, NBFCs are required to maintain a minimum capital consisting of Tier-I and Tier-II capital, of not less than 15% of their aggregate risk-weighted assets. The CRAR of NBFCs declined to 23.8% as of September 2015 from 27.3% as of March 2015.
    - At the disaggregated level, 8 NBFCs were unable to meet the regulatory required minimum CRAR of 15% as of September 2015.

Some conclusions that may be drawn from these findings are:

- The banking system is definitely under stress and given these three problems of asset quality, capital and profitability, would be circumspect when lending. This could also be one reason as to why banks have been relatively slow in lowering interest rates as risk perception is still high.

- Clearly, steps have to be taken to put the PSBs on a strong footing and the recent Bankruptcy Code could provide a way out for addressing the issue of NPAs.

- PSB bank capitalization is also required to be taken up with immediacy and while there have been allocations made for the same in the supplementary budget, the process has to be sped up to ensure that when the demand for credit increases, the PSBs are in a position to support the same.

- Companies will have to progressively move to the corporate bond market to source funds given the time taken to resolve the issues confronting PSBs. While ECBs were attractive earlier, the tendency for interest rates to come down in domestic market and to increase in the USA would lower the advantage of overseas borrowing given that the rupee will continue to be volatile thus exposing companies to forex risk.

- The NBFC segment too needs to be watchful on the quality of assets front. A change in the course of the economy would be beneficial in this context.

- Corporate debt situation also needs to be monitored closely given the leverage and interest cover ratios could be turning adverse for some companies. These indicators would provide indications of future corporate stress.

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