Asset Quality of Scheduled Commercial Banks to Stay Benign in FY25

March 29, 2024 I BFSI Research

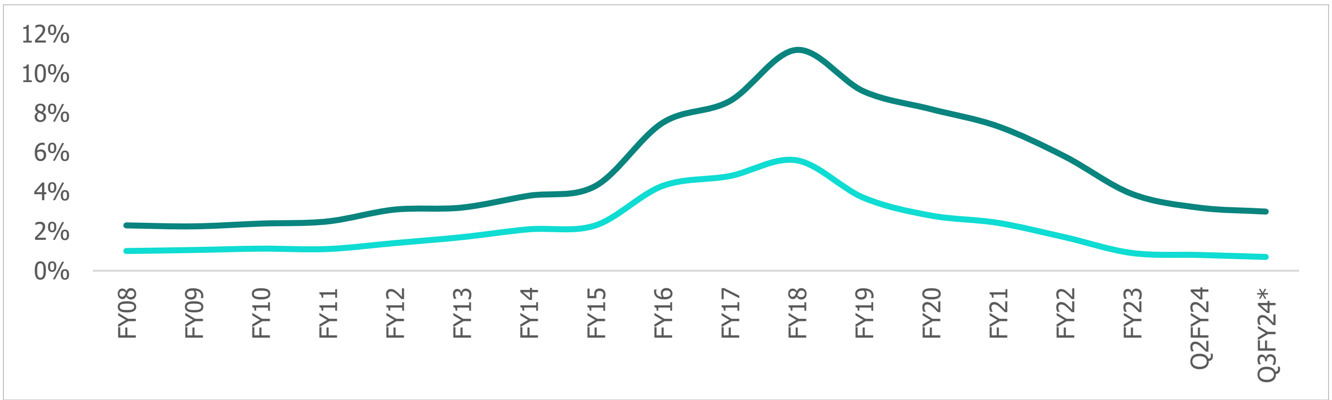
Synopsis

With improving asset quality, the SCB GNPA ratio is projected to improve from the expected 2.5%-2.7% in FY24 to 2.1%-2.4% by FY25 end. At these levels, GNPA figures would have reached the long-term levels prior to the pre-AQR levels. Additionally, credit costs are estimated to remain benign. However, downside risks include any material weakening of asset quality due to elevated interest rates, impact of regulatory changes, a tighter liquidity environment and global issues.

Asset Quality has been on a Continuously Improving Trajectory across Multiple Metrics

Post the asset quality review (AQR) in 2015-2016 which pushed banks to recognise NPAs and reduce unnecessary restructuring, banks witnessed a surge in GNPAs from 3.8% in FY14 to 11.2% in FY18 (and NNPAs from 2.1% in FY14 to 5.6% in FY18) largely due to weakness in the wholesale advances which required banks to make a significant amount of provisioning and write-offs over the next four to five years.

Figure 1: Secular Decline Continues in GNPA as well as NNPA Ratios (in %)



Source: RBI, Banking Presentations, CareEdge Estimates; Note: Q3FY24 includes 30 SCBs

The GNPA ratio of SCBs which has been on a downward trajectory since March 2019. The downward journey continued even during the pandemic period. In FY23, the SCBs GNPA ratio fell to 3.9%, a decadal-year low. The asset quality has improved due to recoveries, higher write-offs by banks and much lower slippages, etc. The slippages have declined across bank groups in FY23 indicating lower accretion of fresh NPAs. During FY23, around 45% of reduction in GNPAs was contributed by recoveries and upgradations. This reduction continued in FY24 and by the end of Q3FY24, the GNPA as well as the Net NPA ratios have touched 3.0% and 0.7% respectively.

Figure 2: Movement in Slippage Ratio

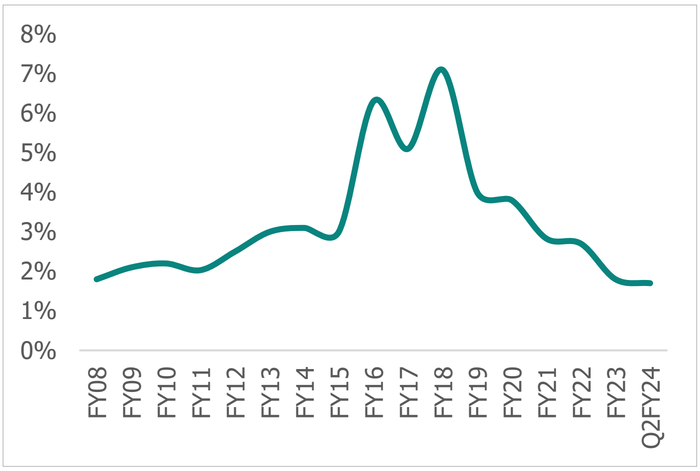
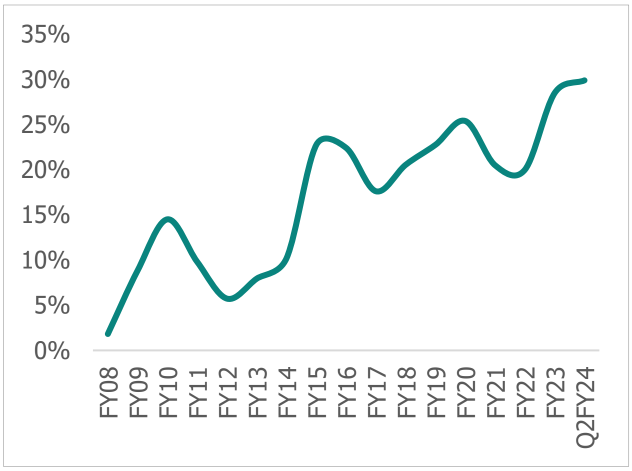


Figure 3: Write-offs as a % of GNPAs

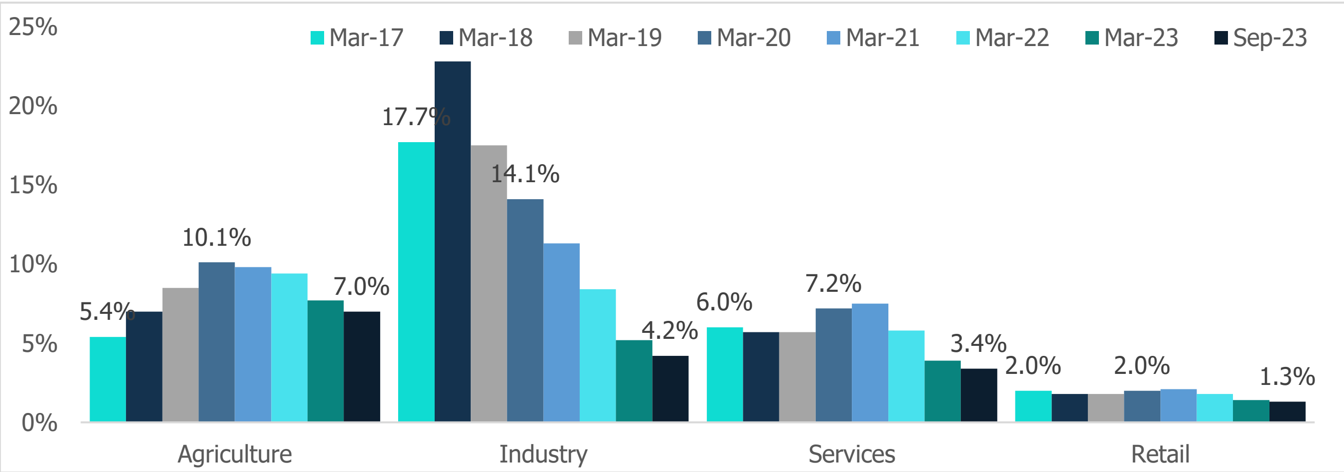


Source: RBI

The figure above shows lower accretion of GNPAs which along with elevated write-offs (figure 3) which have continued apace have played a significant part in the reduction of headline GNPAs. Apart from write-offs and recovery through multiple resolution mechanisms, SCBs also cleaned up their balance sheets through sale of NPAs to ARCs. Sales to ARCs including the NARCL increased in FY23. During FY23, 9.7% of the previous year's stock of SCBs' GNPAs was sold to ARCs as compared with 3.2% in FY22.

Sectoral Asset Quality: Industry logs significant improvement

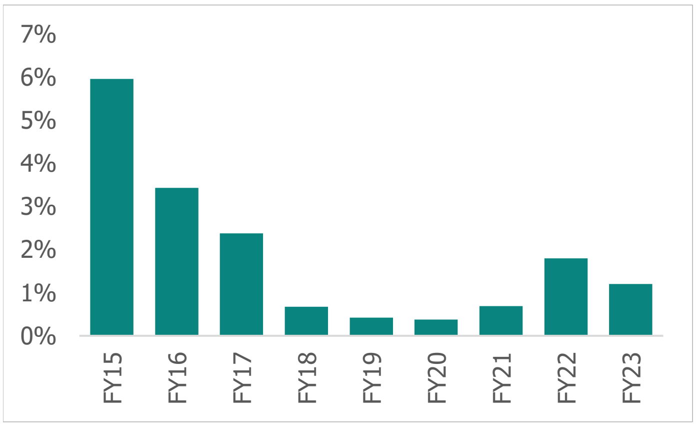
Figure 4: Sector-wise GNPA Ratio



Source: RBI

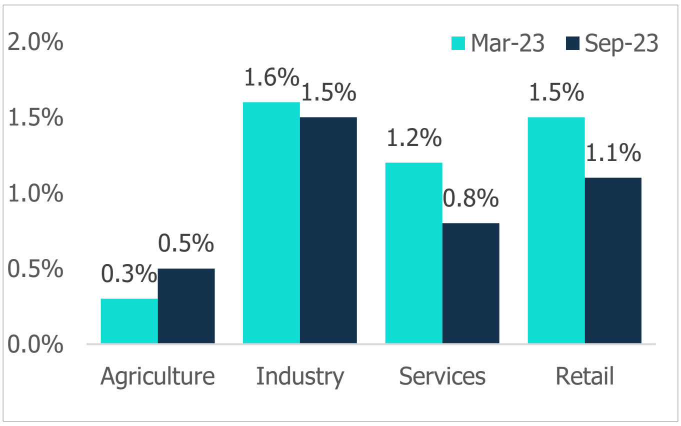
Looking at sectoral GNPA, the agriculture sector GNPA ratio reduced to 7.0% in September 2023 compared to 10.1% reported in March 2020. The industrial sector reported a 4.2% GNPA ratio in September 2023 as compared with a 14.1% GNPA ratio in March 2020 and 22.8% in March 2018 given the corporate deleveraging, resolutions, and write-offs. The March 2018 levels were high primarily on account of the AQR induced recognition. Among major sub-sectors within the industry, there was a broad-based improvement in the GNPA ratio. However, it continues to remain elevated for gems and jewellery and construction sub-sectors. The services and retail sectors reported 3.4% and 1.3% GNPA in September 2023 as compared with 7.2% and 2.0% reported in March 2020, respectively. Retail NPAs can largely be attributed to stress on unsecured loans, education, and credit card receivables.

Figure 5: Reduction in Restructured Std Adv to Gross Advances (%)



Source: RBI

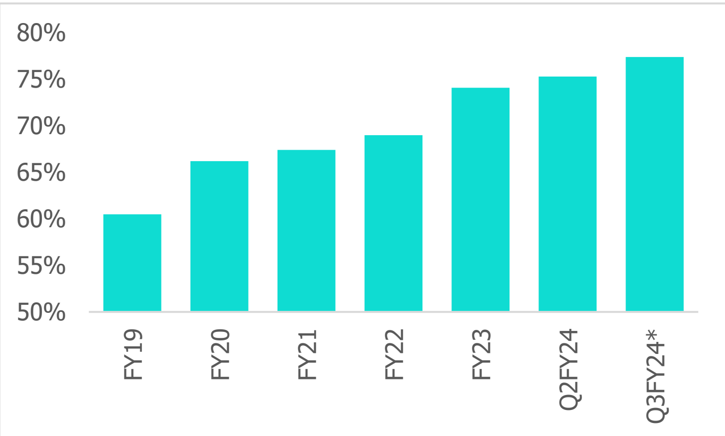
Figure 6: Sector-wise Restructured Std Adv



Source: RBI

The AQR resulted in a reclassification of standard restructured accounts enabling the steady downtrend. However, due to covid and the associated business disruptions have led to an increase in Restructured Standard Assets over FY21 and FY22. Further, as slippages coming largely under control, banks have been reporting significant improvement in the restructured assets, with a gradual rundown of these assets which started in FY23 and has continued in FY24.

Figure 7: Movement in Provision Coverage Ratio (PCR)



Source: RBI, Banking Presentations, CareEdge Estimates; Note: Q3FY24 includes 30 SCBs

Provisioning buffers have been designed to provide a cushion against possible credit impairment. With the stock of GNPA coming down, the requirement of provisions also reduced; however, active provisioning reflected in the improved provisioning coverage ratio across the board.

International – India in Alignment with Other Countries

The asset quality of banks has remained healthy across advanced economies. Non-performing loans have remained low in advanced economies due to continued deleveraging, and institutional and government intervention along with active market/practices to deal with delinquent assets. In the EU, delinquencies reached their lowest levels since the global financial crisis, though the GNPA ratio remained relatively elevated in Russia. Despite a declining GNPA trend, loss assets in India continue to be at comparatively higher levels vs. other countries. Indian banks'

GNPA usually operated at 2.5% plus levels prior to the AQR and is now close to reaching this level again. Hence the NPA levels are likely to come even closer to other countries.

Figure 8: Country-wise - Bank nonperforming loans to gross loans (%)

Country	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
US	3.32	2.45	1.85	1.47	1.32	1.13	0.91	0.86	1.07	0.81	0.72
UK	3.59	3.11	1.65	1.01	1.69	1.36	1.10	1.02	0.98	0.97	0.97
Malaysia	2.02	1.85	1.65	1.61	1.61	1.55	1.47	1.52	1.57	1.68	1.72
China	0.95	1.00	1.25	1.67	1.74	1.74	1.83	1.86	1.84	1.73	
Spain	5.71	7.12	6.38	5.09	4.72	4.46	3.69	3.15	2.85	2.92	3.06
Russia	6.06	6.02	6.81	8.38	9.24	9.66	9.75	8.83	8.26	6.72	6.10
India	3.10	3.20	3.80	4.30	7.50	8.60	11.20	9.10	8.20	7.33	5.80

Source: World Bank; RBI, Note: India: FYE March

CareEdge View

The SCB GNPA ratio is projected to improve from the expected 2.5%-2.7% in FY24 to 2.1%-2.4% by FY25 end driven by moderation in slippages, elevated PCR levels resulting in lower incremental credit costs, corporate deleveraging leading to improved financials, some level of slippage from the retail book, a declining trend in the stock of GNPAs and sustained retail GNPA levels in spite of high levels of unsecured loans. At these levels, GNPA figures would have reached the long-term levels prior to the pre-AQR levels. The performance of unsecured personal loans and restructured accounts continues to be monitorable. Additionally, credit costs are estimated to remain benign. However, downside risks include any material weakening of asset quality due to elevated interest rates, impact of regulatory changes, a tighter liquidity environment and global issues.

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