

Stability of banks has worsened significantly

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Stress tests for credit risk show that gross non-performing advances may rise by March 2017

Mumbai, June 28:

The RBI's Financial Stability Report has warned that the stability conditions in the banking sector, which started deteriorating in mid-2010, have now worsened significantly.

This observation is based on a trend analysis of the banking stability indicator, which maps the five dimensions of soundness, asset quality, profitability, liquidity, and efficiency.

The factors contributing to an increase in risks during the half-year ended March 2016 are deteriorating asset quality and low profitability.

Macro stress test

According to the FSR, macro stress tests for credit risk suggest that under the baseline scenario, the gross non-performing advances (GNPA) ratio may rise to 8.5 per cent by March 2017 from 7.6 per cent in March 2016.

The RBI cautioned that if the macro scenarios deteriorate in future, the GNPA ratio may further increase to 9.3 per cent by March 2017 under a severe stress scenario.

Under such a severe stress scenario, the system level capital to risk weighted assets ratio (CRAR) of scheduled commercial banks (SCBs) may decline to 11.5 per cent by March 2017 from 13.2 per cent as of March 2016.

Among the bank-groups, public sector banks (PSBs) may continue to register the highest GNPA ratio, the report said. Under the baseline scenario, their GNPA ratio may go up to 10.1 per cent by March 2017 from 9.6 per cent as of March 2016. However, under a severe stress scenario, it may increase to 11 per cent by March 2017.

Under the baseline scenario, the GNPA ratio of private sector banks may increase to 3.1 per cent by March 2017 from 2.7 per cent as of March 2016, which could further increase to 4.2 per cent under a severe stress scenario.

Under a severe stress scenario, PSBs may record the lowest CRAR of around 10.3 per cent by March 2017 as against 11.6 per cent as of March 2016.

CRAR is arrived at by dividing the capital of the bank with aggregated risk weighted assets for credit risk, market risk and operational risk. The higher the CRAR of a bank the better capitalised it is. A risk-weighted asset is the notional amount of asset multiplied by the risk weight assigned to it to arrive at the risk weighted asset number.

Sector-wise stress

A macro stress test of sectoral credit risk revealed that in a severe stress scenario, among the select seven sectors, iron and steel industry (which had the highest GNPA ratio at 30.4 per cent as of March 2016) could see its GNPA ratio moving up to 33.6 per cent by March 2017 followed by engineering (to 15.9 per cent from 10.9 per cent) and infrastructure (to 13.4 per cent from 7.1 per cent).

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