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As NBFCs struggle, banks set to reclaim lost ground after NPA worries take a backseat

BY [JOEL REBELLO](#), ET CONTRIBUTORS | UPDATED: OCT 31, 2018, 12.09 PM IST

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In this din over liquidity squeeze faced by mutual funds and [non-banking finance companies \(NBFCs\)](#), a subtle but significant change underneath the surface is being lost – the rebirth of the banking industry.

After plunging in its key activity – credit growth – to a six-decade low in FY17, banks have managed to expand loans at 14.5% year-on-year, the highest growth recorded in four years.

Inability of the shadow banking system to lend, rising interest rates, the tapering off of bad loans, betterment of technology and continued faith of depositors are all aiding high-street banks to put their struggles behind and look ahead to the future with promise.

The end of cheap money from mutual funds and the disappearance of easy money from NBFCs are driving borrowers to the age-old banking system, which after years appears to be a better option than competitors.

“Banks have liquidity,” says V Srinivasan, deputy managing director at Axis Bank. “The [mutual fund](#) market is almost kind of frozen. So even the big corporates are now turning to banks for funding.”

Total loans by scheduled commercial banks have grown to Rs 89.93 lakh crore in the fortnight ended October 12, 2018 from Rs 78.64 lakh crore a year earlier, driven by loans to individuals, services and micro credit, data from the Reserve Bank of India show. By

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contrast, mutual funds witnessed an outflow of Rs 2.30 lakh crore, the highest since the start of the year, data from Association of Mutual Funds in India (AMFI) showed.

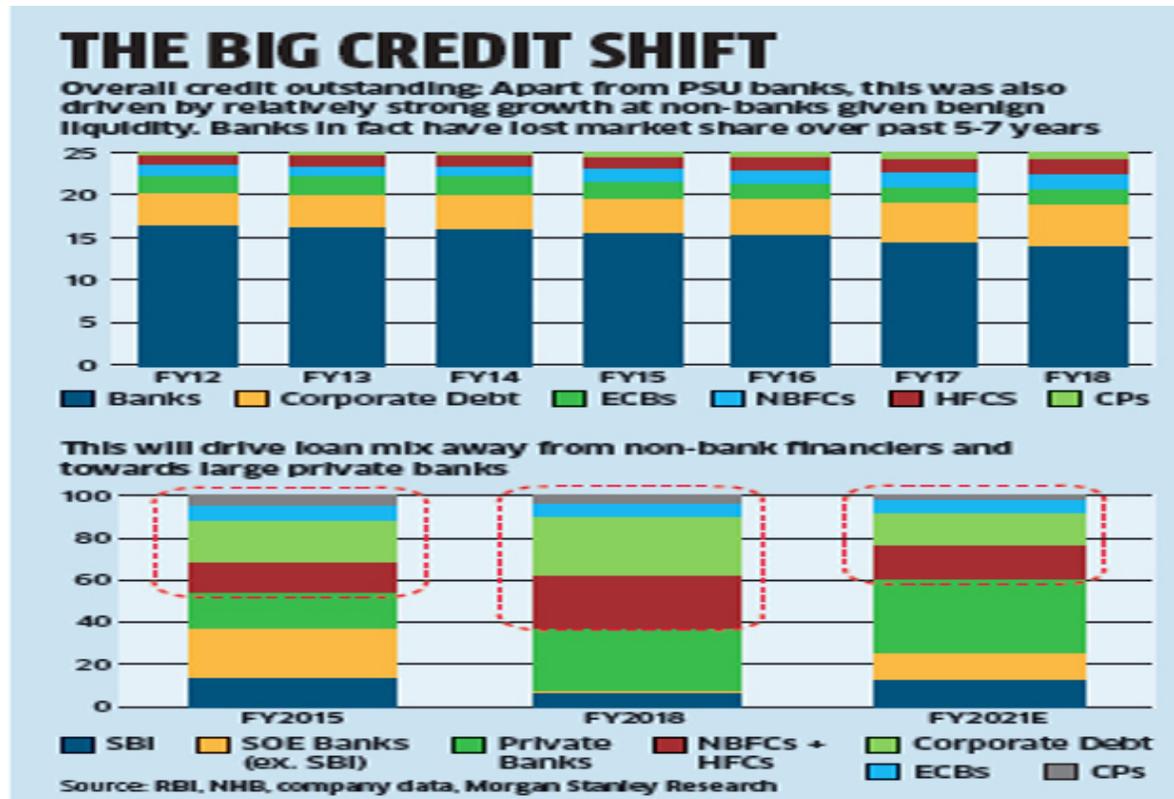


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CHANGING FORTUNES

Banks suddenly appear to be a better place to borrow from, thanks to their loyal individual depositors. Bank deposits have grown 30% CAGR in the past three years even as their lending was constrained due to bad loans.

“We do not have the liquidity problems that NBFCs have, we are hence in a better position. We can also partner with NBFCs and originate loans together,” said Nagesh Srivastava, head-corporate and institutional relationship, Bank of Baroda.

Market interest rates have spiked in the past six months in line with global interest rates and a squeeze in domestic liquidity as the Reserve Bank of India’s currency management through sale of US dollars sucked out rupees from the market. So, the current fiscal could be favourable to banks.

“In FY19, we see a likelihood that domestic banks will reemerge as a primary source of funding to the commercial sector, over bond markets and non-bank entities,” says Radhika Rao, economist at DBS Bank. “Most of these funding options are susceptible to market volatility, borrowing cost movements, liquidity squeeze and tweaks to banks’ lending controls and credit reviews.”

Mutual funds, key lenders to NBFCs, have turned cautious after the Infrastructure Leasing & Financial Services defaulted on its loans. Because of the aversion, NBFCs are finding it difficult to roll over their short-term loans, forcing them to compromise lending for liquidity.

JM Financial and IIFL Holdings, the two NBFCs for whom mutual funds are a crucial part of their total borrowings, prepaid their commercial papers to infuse confidence in the market.

“This NBFC liquidity squeeze could alter the lending market in many ways,” says KVS Manian, head- corporate, institutional and investment banking at [Kotak Mahindra Bank](#). “NBFCs made up a huge 23% of total credit in the system, so we should expect some shifts. Some of these loans will come to banks, especially in the retail and SME space, which was heavily occupied by NBFCs.”

LOST GROUND

Although banks have historically been the backbone of Indian industry, they fell behind in the past five years due to a combination of bad loans and capital erosion.

Stressed assets, the aggregate of bad loans and restructured loans, rose to 24.8% of the total in FY18, from 9.8% in FY14. These were mostly loans to power, telecom and steel industries, which faced headwinds in the shape of lower prices and regulatory changes.

During this period, banks shrank their growth rates and state-run banks that constitute about three fourths of the total industry were also crippled due to lack of capital.

As the lenders were setting their house in order, NBFCs which were less regulated than banks took advantage and began lending to consumers and small businessmen. As interest rates remained lower and liquidity was plenty, funding for NBFCs was easier as mutual funds chased customers.

In the process, the share of NBFCs, including housing finance companies, in overall loans to the commercial sector rose to 24% in FY18 from 14% in FY15, according to estimates from [Morgan Stanley](#).

“During that period, non-bank financial institutions have taken up a greater role in lending activities,” says Rao of DBS. “This translated into a drop in the domestic banks’ share in the total flow of funds to the commercial sector to 34% in FY17 from 55% in FY16.”

BANKS’ SWOT

Flush with liquidity and technology, banks are preparing to reclaim their share.

On September 25, a consortium of public sector banks led by State Bank of India and the Small Industries Development Bank of India launched a new internet platform that will process SME data within minutes, helping sanction loans in less than an hour.

“There is a time for everything,” said Narayanan Sadanandan, chief general manager at SBI. “Now is the time for banks. This is an opportunity we want to capitalise on.”

With the implementation of Goods and Services Tax, banks will have authentic accounts of even small businesses which they did not have earlier.

But the gains in market share would not be for all. The big banks and the well capitalised ones would benefit while smaller ones continue to struggle with poor human resources and funds.

“The rising rate environment will shift bargaining power in favour of the large banks, which have relatively higher retail funding bases – and given that CASA (Current Account Savings Account) deposits don’t reprice, loan growth acceleration at these banks will be accompanied by rising spreads,” says Morgan Stanley.

State Bank of India, ICICI Bank, Axis Bank, HDFC Bank, Kotak Mahindra Bank and Bank of Baroda may be among the winners because of their strong low-cost deposits and improving bad loans position.

SBI's CASA is at 45.07%, while for ICICI it is at 50.8%. HDFC Bank and Kotak will reap the benefits of low bad loans.

But weak banks like Allahabad Bank, UCO Bank and IDBI Bank risk being left behind in the revival.

Allahabad's stressed assets are at 16.7% while capital adequacy is at 6.88%. For IDBI Bank, gross NPAs are at 30.78% and capital adequacy is at 8.18%.

"While the preoccupation may have come down with regards to bad loans and resolutions etc., you still need capital to grow, and I don't think that the question has been fully addressed as yet in terms of how you recapitalise the banks in a manner where they can go out and lend," says Ravneet Gill, CEO, [Deutsche Bank](#), India.

While the opportunities for banks may be opening again, it would be the well capitalised and the ones with big franchises that would be the winners.

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