View: Indian banks clawing out of the woods

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The current fiscal could very well be a watershed for India's banks.

As CRISIL predicted just before the fiscal began, there has been a reversal in two of the biggest challenges — credit offtake and asset quality.

No doubt, the Reserve Bank of India's stringent stressed assets resolution norms, and traction on resolution of a number of large-ticket non-performing assets (NPAs) referred under the Insolvency and Bankruptcy Code (IBC) framework, have been game changers.

On another front, the government's mega recapitalisation plan for public sector banks (PSBs) and the recent bold step towards their consolidation stacks up in favour of strengthening the sector.

We foresee six things happening in the banking sector in the months ahead:

1. Resolution of large-ticket bad loans should progress further by end of this fiscal.

2. Incremental NPAs will decline, as tightening stressed assets recognition norms pays off.

3. Bank credit will grow at about 12% in the current fiscal compared with 8% in the last. It will grow faster for private sector banks, while for public sector banks, there will be some drag though it'd be better than last fiscal.

4. Return on assets for the system as a whole will look up at 0.1% from -0.2% last fiscal.

5. Provisioning coverage of banks will rise.

6.Deferred implementation of the final tranche of capital conservation buffer (CCB) by a year to provide some reprieve to PSBs. However, they will still need to raise Rs 85,000 crore as capital by the end of this fiscal mainly from the government.

ASSET QUALITY PRESSURES TO RECEDE, HOPES PINNED ON BIG-TICKET RESOLUTIONS UNDER IBC

At long last, asset quality concerns are peaking. About Rs 14 lakh crore worth of NPAs have been recognised by banks in the past three years. CRISIL expects the banking sector gross NPAs (aggregate) to drop to under 11% by March 2019 as against 11.6% reported by the end of fiscal 2018. Three key factors at work are — lower incremental slippages to NPAs, drop in SMA-2 (or special mention accounts, where loans are overdue for 60-90 days) levels reflecting significant reduction in quantum of potential stress assets and expected resolution of large-ticket NPA accounts under IBC this year.

HEALTHY CREDIT OFFTAKE WILL PROVE A SPRINGBOARD FOR BANKING RECOVERY

CRISIL expects bank credit to grow at ~12% in the current fiscal compared with 8% in the last fiscal. However, PSBs, especially the ones which continue to face lending constraints due to the prompt corrective action invoked by the RBI and inadequate capital buffer, are expected to grow slower than the system. On the other hand, private banks supported by strong balance sheets and significant presence in the retail segment, are likely to grow at almost twice the rate than the systemic credit growth. As a result, CRISIL estimates private banks' market share in the total system credit to spike to ~40% over the next three years from ~30% currently.

PROFITABILITY IN A LULL, BUT BANKS STRIVE TO BE BETTER PREPARED FOR THE RAINY DAYS

PSBs are expected to continue reeling under the NPA provisioning pressures, given the expected haircuts on resolution of stressed loans and ageing of NPAs. As a result, PSBs will continue to report losses this fiscal too, albeit lower than the previous year. CRISIL expects the banking system as a whole to report ROAs of 0.1% compared with -0.2% in fiscal 2018. Nevertheless, the provisioning coverage of banks is expected to increase to 55-60% this fiscal.

RBI'S EXTENSION OF TIMELINE FOR CCB TRANCHE A BREATHER FOR PSBS

CRISIL believes, the RBI board's recent decision to extend the timeline for implementation of the last tranche of capital conservation buffer (or CCB, 0.625% of the risk weighted assets) under the Basel III regulations could reduce the capital requirement for PSBs to Rs 85,000 crore for the period November 2018 to March 2019. This compares with Rs 1.2 lakh crore estimated earlier for the same period.

CCB is the capital buffer that the banks have to accumulate in normal times to be used for offsetting losses during the period of stress.

However, despite the reduction in capital requirement, it is clear the government will need to infuse the bulk of Rs 85,000 crore needed by March 2019, as PSBs have little ability to raise capital from market owing to higher NPAs and weak financial performance.