



COVID 19 CRISIS AND ITS IMPACT ON NON-PERFORMING ASSETS IN INDIAN BANKING SECTOR

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Abstract — Non-performing asset is a serious problem faced by the banking sector in India. Both the public sector and private sector banks in India are suffering from this problem. The amounts of gross and net non-performing asset of the banks (both public sector and private sector) are mounting in recent times in India. In spite of adopting various efforts by Government of India and Reserve Bank of India for reducing and recovering of loans of the banks, the results are not satisfactory at all. This paper is an attempt to analyse the non-performing assets and its impact due to Covid 19

Introduction

A Non –Performing Asset according to RBI is an asset whose repayment of principal and interest of their own has not been received more than 90 days. That is, the person failed to make regular payments even after the notice issued by the banks to correct default in payments. NPAs are alternatively called as bad loans. Nonperforming assets are listed on the balance sheet of a bank or other financial institution. After a prolonged period of non-payment, the lender will force the borrower to liquidate any assets that were pledged as part of the debt agreement. If no assets were pledged, the lender might write-off the asset as a bad debt and then sell it at a discount to a collection agency.

In most cases, debt is classified as nonperforming when loan payments have not been made for a period of 90 days. While 90 days is the standard, the amount of elapsed time may be shorter or longer depending on the terms and conditions of each individual loan. A loan can be classified as a nonperforming asset at any point during the term of the loan or at its maturity.

The deteriorating asset quality of the banking sector emerged as a major concern, with the gross NPAs of banks registering an increase in the last few years. Carrying nonperforming assets, also referred to as nonperforming loans, on the balance sheet places significant burden on the lender. The non payment of interest or principal reduces the lender's cash flow, which can disrupt budgets and decrease earnings. Loan loss provisions, which are set aside to cover potential losses, reduce the capital available to provide subsequent loans to other borrowers. Once the actual losses from defaulted loans are determined, they are written off against earnings. Carrying a significant amount of NPAs on the balance sheet over a period of time is an indicator to regulators that the financial health of the bank is at risk.

Hinting at the need for higher provisioning and the need to adopt loan restructuring to deal with the stressed asset situation, the RBI said, "Globally, banks bracing up for the incidence of bad assets have generally increased their provisions, as a prudential measure."

Bad loans weren't an alarming word in the banking system until half a decade ago. Bank CEOs kept repeating to analysts that things are under control. All those talks changed in 2014-2015. A massive clean-up process of bad loans initiated by the Reserve Bank of India (RBI) in 2015 under former governor Raghuram Rajan kicked off a painful phase for banks.

They were forced to declare sticky loans hidden thus far in the balance sheets over the next few years. This came at a cost, though. Banks had to significantly increase provisions (money set aside to cover bad loans) subsequently impacting their profitability. The gross non-performing assets in the system skyrocketed to around Rs 9 lakh crore from about Rs 2-3 lakh crore in just five years. With that, bankers thought the pain is over. It was only the beginning.

Indian banks may now be at the beginning of a new NPA cycle. Warning signals are already visible. The COVID-19 impact on the Indian economy, coupled with some of the schemes launched by the government to contain the problem may actually cause another wave of bad loans in the Indian banking system.

The Reserve Bank of India (RBI) has said the problem of bad loans plaguing the Indian banking sector could worsen towards the end of the ongoing fiscal year. The central bank said the gross non-performing assets (GNPA) ratio of the country's scheduled commercial banks (SCBs) may increase from 8.5 percent in March 2020 to 12.5 percent by the same period next year, under the baseline scenario. This ratio could, however, soar to 14.7 percent under severe economic stress.

In its Financial Stability Report, the RBI highlighted that the gross NPA ratio fell from 9.3 percent in September 2019 to 8.5 percent by the end of FY20. However, the COVID-19 pandemic and the economic and financial disruption that followed halted the slow improvement that had been achieved in reducing the overhang of stressed assets.

Further, public sector banks (PSBs) may see their GNPA ratio of 11.3 percent in March 2020 increase to 15.2 percent by March 2021 under the baseline scenario. The gross NPA ratios in respect of construction and gems and jewellery sectors swelled up in March 2020 while the quality of bank loans to the services sector also worsened during this period. While the financial system “remains sound”, gross non-performing asset (NPA) ratio of all commercial banks is likely to increase from 8.5 per cent in March 2020 to 12.5 per cent by March 2021 under the baseline scenario in the wake of the disruption caused by the Covid-19 pandemic. If the macroeconomic environment worsens further, the NPA ratio may escalate to 14.7 per cent under the very severely stressed scenario.

According to the RBI, nearly 50 per cent of the customers, accounting for around half of outstanding bank loans, opted to avail the benefit of the relief measures — loan moratorium to tackle the lockdown impact. RBI Governor Shaktikanta Das said “the financial system in India remains sound”. Nonetheless, in the current environment, the need for financial intermediaries to proactively augment capital and improve their resilience has acquired top priority. “In the evolving milieu, while risk management has to be prudent, extreme risk aversion would have adverse outcomes for all,”

Among the bank groups, GNPA ratio of public sector banks may increase from 11.3 per cent in March 2020 to 15.2 per cent by March 2021 under the baseline scenario. “Bank-level stress test results show that 23 banks¹⁶ with a share of 64.5 per cent in banks total assets might fail to maintain the required CRAR under the scenario of 3 SD shock to the GNPA ratio, the RBI’s FSR said. In such an extreme shock scenario, the CRAR of all the 18 PSBs is likely to go down to 9 per cent.

Given the fact that impact of moratorium is still uncertain and evolving, the exact nature of how the same will play out on the quality of banking assets is difficult to ascertain accurately. Sectorally, the quality of bank loans to services sector worsened in March 2020. The GNPA ratio of the retail loan sector also edged up. Among major sub-sectors within industry, NPA ratios in respect of construction and gems and jewellery sectors swelled up in March 2020. On the other hand, the infrastructure sector (with a share of 36.2 per cent in bank credit to the industrial sector), basic metals (11.3 per cent) and electricity (17.5 per cent) have shown a perceptible decline in NPA ratios. This has implications for aggregate asset quality of the banking sector, the RBI said. “The pandemic has the potential to amplify financial vulnerabilities, including corporate and household debt burdens in the case of severe economic contraction,” it said.

The RBI said central government finances are likely to suffer some deterioration in 2020-21, with fiscal revenues badly hit by Covid-19-related disruptions even as expenditures come under strain on account of the fiscal stimulus. For State finances, the additional burden of lower federal transfers may accentuate downside risks to the outlook.

According to India Ratings, COVID-19 may drive total slippages of banks by up to Rs 5.5 lakh crore in this round. To be sure, COVID-19 is only the latest reason. The second round of bad loan build-up had already begun in the sector even before the pandemic hit the economy. Falling revenues were making it difficult for companies to generate enough cash flows to pay back their lenders.

The onset of COVID-19 was the final nail in the coffin. The banking system is already burdened with Rs 8 lakh crore worth of NPAs. According to India Ratings, banks have faced elevated provisions resulting from the corporate stress cycle over FY16-FY20. Banks had largely provided for the existing corporate stress and were progressing towards a more moderated credit cost cycle. But, COVID-19 has changed all calculations.

In the present context, there are primarily a few reasons that will cause a new NPA cycle.

COVID-19 lockdown

The nationwide lockdown began on March 25. Till now, the lockdown is largely in effect in most parts of the country (with some relaxations beginning now). This prolonged closure has paralysed businesses and resulted in large-scale job losses. According to the Centre for Monitoring Indian Economy, unemployment spiked to 23 percent in April. This will impact the repayment ability of the borrowers and demand for fresh loans. The economic impact of COVID-19 on India is still a big source of uncertainty for policymakers. The impact will be large and can potentially push down GDP growth to a negative zone. This will have a corresponding impact on the bank NPAs. According to BofA Securities, government-owned banks' NPAs could go up by 2-4 percent of the credit in the present economic environment. This, BofA says, will result in a recapitalisation requirement of \$7-15 billion (Rs 1.14 lakh crore at the upper end). All this would mean that banks are up for a major shock in the post-COVID world.

Govt's loan push could lead to NPAs

As part of the COVID-19 economic package, the Narendra Modi-led government has announced a series of loan schemes, some backed by government guarantees to small industrial units and non-banking finance companies (NBFCs). These include a Rs 3 lakh crore economic package for micro, small and medium enterprises (MSMEs), Rs 75,000 crore of loans to NBFCs (of which Rs30,000 crore is a three-month loan scheme fully backed by the government), Rs5,000 crore for street vendors and Rs2 lakh crore concessional credit to farmers. Of the Rs20 lakh crore package, the direct spending is only about one percentage of GDP, the rest include loans through various banking channels and development institutions.

Demand revival key

If one takes a closer look at the economic package, the government has failed to do much to revive the demand scenario. Without demand creation, merely pushing additional credit to the industry will likely add to the bad loan burden of banks. Companies are mostly using this money to pay up their existing obligations, not for extra lending, according to senior bankers who spoke on condition of anonymity.

Based on India Ratings' vulnerability framework and corporate stress analysis of 30,000 corporates, the total corporate standard-but-stressed corporate pool may increase from 3.8 percent of the total bank credit as of December (pre-COVID-19 levels) 2019 to up to 6.6 percent post-COVID.

The incremental stress is mainly from sectors including power, infrastructure, constructions, hospitality, iron and steel, telecom and realty. Out of this, the agency estimates corporates exposures of up to 3.2 percent of total bank credit are at a high risk of slippage.

NBFC loans at risk?

Shadow banks are an additional risk to the banking sector. Banks are the major lending sources to NBFCs. Indian banks have a loan outstanding of Rs 8 lakh crore to NBFCs till May end. Much of this money is lent by the non-banks to real estate, mortgage financing and other consumption-related loans. If these loans are not paid back to NBFCs, banks may see further stress from this portfolio. The fundamental question is when the demand situation will revive on the ground.

The government's Rs 20 lakh crore economic package is only a liquidity relief given through banking channels. It has arguably failed to do something meaningful to give a push to demand. Ultimately, loans are not free money; companies have to repay these loans. If they don't, this money will add to the bad loan book of banks. The build-up of fresh stock of bad loans in the banking sector is entirely dependent on how soon the economy recovers from the COVID-19 lockdown shock. An early resumption in industrial activities and revival in consumer spending are key. There are no green shoots yet.

CONCLUSION

The mounting NPA of banking sector of India become a serious problem for the economy. Though, the concept of non-performing asset is associated only with the banking sector, the negative effects of its spread out to the whole economy in the long run. Non-performing asset results decrease in profitability and liquidity position of banks and thus worsen the banking environment of the country. It further negatively affects the economy. Therefore, to smooth functioning of the banking sector government and reserve bank should take adequate policy measures that reduce and recover the non-performing asset. It will increase the effectiveness of banking sector, which is most important for smooth functioning of the economy

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