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Credit Growth in Indian Banks

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Abstract

The purpose of present study has been to obtain a deep insight and full familiarity with the credit growth of the banking industry in general and public sector banks and private sector banks in specific. The present study is based on the data released by the RBI on Bank group wise and Occupation wise Credit for the period from Mar'14 to Sep'16. Credit growth of the Banking Industry for the study has been analyzed with the help of compound Annual Growth rate (CAGR) and Market Share of the Banking Groups and sectors.

The lending activities in the economy depends upon various factors such Demand for Credit which reflects the growth in the economic activity, Interest Rate scenario, other source of the finance. GDP growth and Repo Rate have been taken as key indicator to measure economic activity and inters rate scenarios. Further, other factors such as Profitability, Asset Quality of the Banking Industry have also impacted the Credit Growth. This paper was done in 2017, as a project report of internship at Punjab National Bank.

Introduction

Growth of banks credit have fell down to 5.1 (date), which is multi –decade low .Data released by RBI shows that in December 23, 2016. As recorded by SBI Chief Economist Soumya Kanti Ghosh this was actually the lowest growth in 60 years since 1954-55, when it had slowed to 1.7 Percent. The year on year growth (YOY) growth momentum slowed in retail and service sector, agriculture sector. Retail loan saw a slowdown to 12.9 percent year on year versus 13.5 percent in December 2016 and 14.8 percent in November 2016.thus,we can say that recently the credit growth have declined a lot due to so many reasons which I will analyze in this project.

India's leading corporate have too much debt on their balance sheets; this keeps them from making fresh investment. Banks are undergoing the problem of bad loans. This is coming in way to credit growth, twin balance sheet impacts growth and affect both demand supply of credit. Since, banking credit growth is struggling in India and a decelerating trend is seen continuously .It becomes important to understand the reason behind this slow growth.

Objective

Objectives of the paper are to find out the reasons for low credit growth in Indian banking system during the study period.

Data and Analysis

Data is taken from Reserve Bank of India

Date	credit growth rate	GDP growth rate	Repo Rate	CPI	WPI
Mar-14	12.9	7.26	8	8.25	6
Dec-14	10.1	7.91	8	4.48	-0.5
Mar-15	9.80	7.75	7.75	5.25	-2.33
Jun-15	8.60	7.50	7.25	5.4	-2.13
Sep-15	8.90	8.44	7.75	4.411	-4.59
Dec-15	10.9	7.42	7.25	5.61	-1.06
Mar-16	9.30	6.90	7.25	4.38	-0.45
Jun-16	9.00	6.69	6.5	5.77	2.12
Sep-16	7.80	6.61	6.8	4.39	3.8

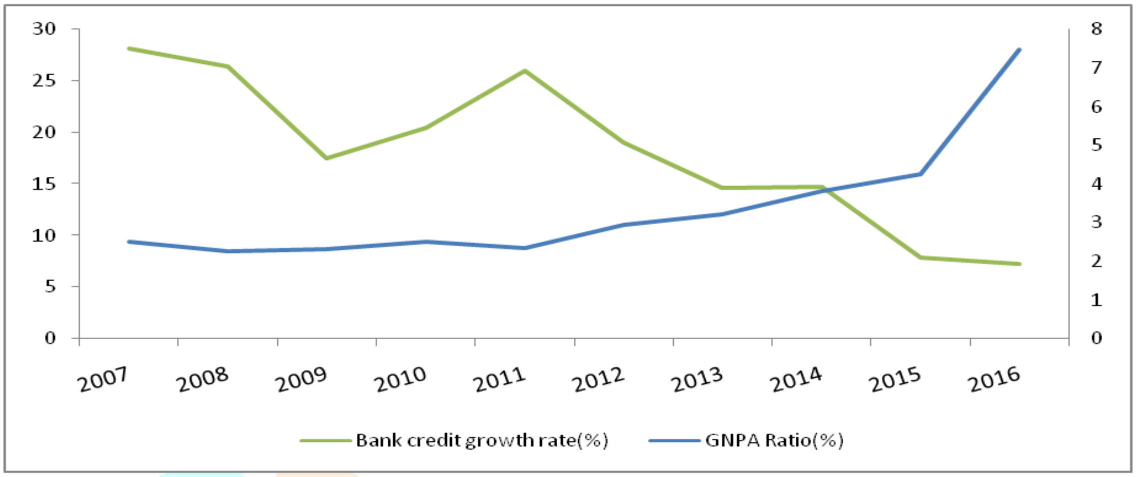
The problem of less credit growth have lead us to think in other aspects and factors that affect the credit growth of any economy in general. The credit growth is recorded as a six-decade low of 5.08 per cent in the financial year 2016-17 against 10.7 per cent a year ago, according to the Reserve Bank of India data. The numbers are surprising as the economy has grown at around 7 per cent during the year.

Banks play an important the role in an economy by mobilization of savings and then channeling it to investments in an economy by accepting deposits and converting them into loans and investment. the lending activities of any bank depends on various factors such as GDP growth rate, inflation (CPI and WPI) ,Repo rate, profitability and asset quality of banks, some external shocks affecting demand (recently it was demonetization). These various factors can be classified into internal and external ones. India has been facing problems rooted in Banks and corporate balance sheets, or Twin Balance Sheet problem. The reason is a mix of distressed and over leveraged company's along with increasing NPAs in the banks' balance sheets. These two problems can be defined as all the root cause of all the stress and slow credit growth.

Leverage can be defined as amount of debt used to finance assets. Since companies are suffering already pending leverages they are not willing to lend more.

Non Performing Asset (NPA)-

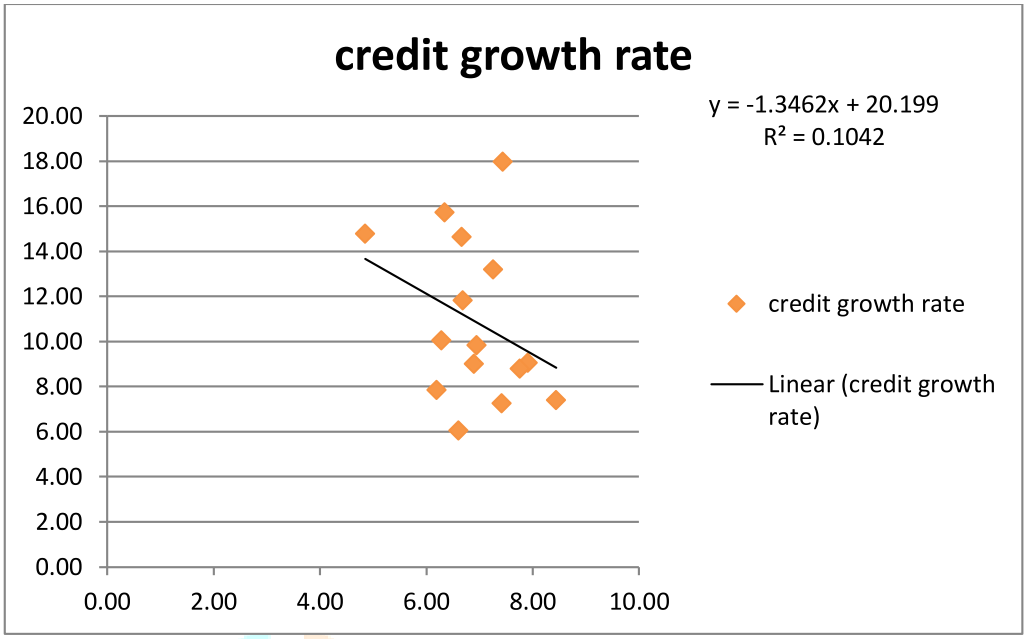
Asset Quality of Banks: Declining asset quality of banks is reflected in increasing GNPA ratio (Gross NPAs/ Gross Advances). As asset quality is falling, so is the credit growth rate. If we look at the data The GNPA of public sector banks was Rs.5,02,068 crore at the end of 2015-2016 and it rose by more than 1 lakh crore in December 2016,when it was Rs.6,06,911 crore. For private sector banks, gross NPAs grew to Rs.70, 321 crore by December 2016, from 48,380 crore on March 2016. This shows that banks because of high level of NPAs resulting into declining profitability might be constrained in lending to corporate and therefore, looking for avenues in small-ticket retail segment which has lower risk weight and less concentration .



Source: ANNUAL RBI REPORT

All these mix up of problems are creating so much distress and stress on both public sector and private sector banks and economy as well. Firms are busy cutting back investment, partly due to lack of growth, already persisting leverages. Even if money was available, they would not want to borrow. In fact, banks were forced to cut their lending rates recently due to surge in deposits, denting their profit margins further.

Gross Domestic Product: Gross Domestic Product (GDP) is a primary indicator of countries economy.GDP is monetary value of all the finished goods and services produced within the country in particular time period. Here to support my study I have plotted a graph between GDP growth rate and Banks credit growth rate of past data from 2013-2014 to 2016-17. Here I have taken gross domestic product growth rate as independent variable and credit growth rate as dependent variable.

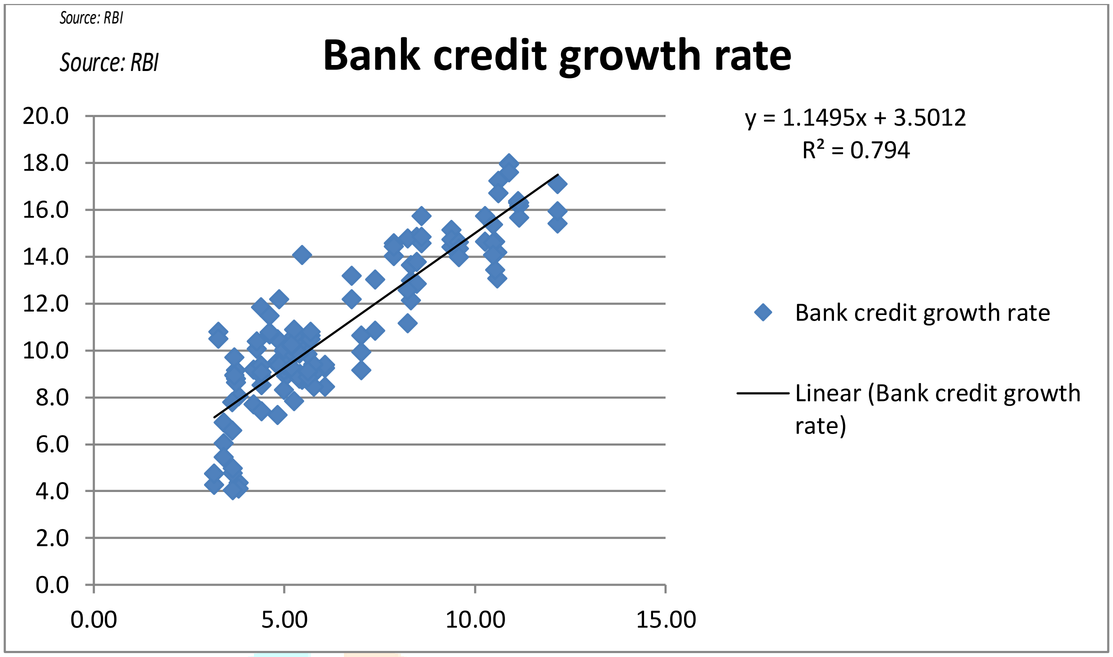


Source: RBI

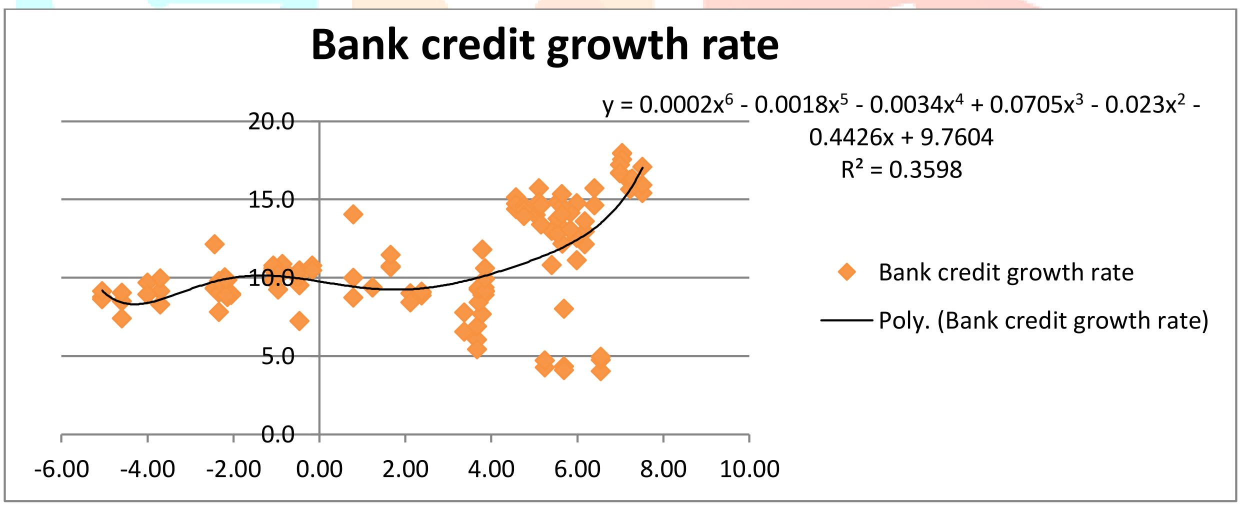
Thus value of R^2=.104 which shows poor correlation between the two and correlation coefficient comes out around .32. Under normal circumstances, a positive correlation is found between credit growth rate and GDP growth rate. However, the strength of the relationship between the two has been weakening from some time. This is partly the result of alternative sources of finance for the corporate and their unwillingness to go for capes due to slowdown in global economy and high leverage on their balance sheets. In a developing economy like India under better economic environment, investment demand and GDP growth are positively correlated which in turn creates demand for credit and vice-versa. Here the reason of poor correlation might be because there are many more factors including GDP which affect credit growth, GDP is not complete indicator.

Repo Rate- Repo rate is a rate at which central bank of a country lends money to commercial banks in the event of any shortfall of funds. Repo rate is used by monetary authorities to control inflation. According to theory, the correlation between interest rates and credit growth must be negative. However, the data suggests it to be positive. As repo rate is continuously declining, so is the credit growth. This suggests that falling interest rates is not increasing credit growth rate. Here I have taken repo rate as independent variable and credit growth as dependent variable. In this case also it can be considered that repo rate is not complete indicator to affect credit growth.

Inflation- Consumer Price Index, here I have taken CPI as independent variable and Credit growth rate as dependent variables. Then regression is shown below, which shows credit growth rate depends on CPI .CPI could be considered as good indicator to depict banks credit growth since R^2 value is .794. Thus, the trend followed here is as inflation increases credit growth also increases.

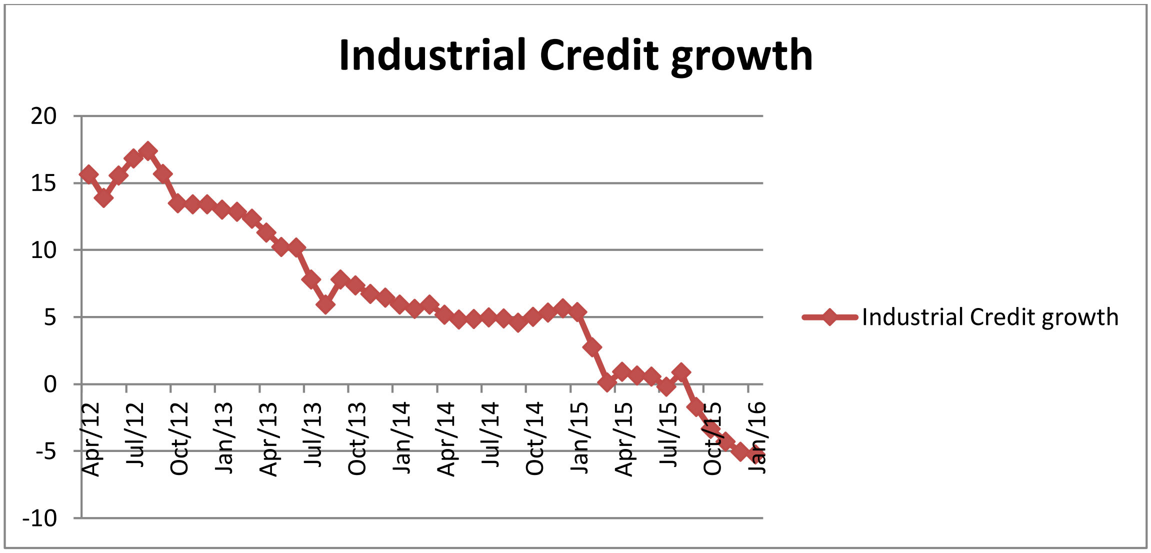


Whole Price Index (WPI)-here I have shown relationship between banks credit growth and WPI.there are so many variations and according to data it the correlation coefficient between WPI and credit growth is .599.



Source: RBI

Industrial Credit Growth- This reflects changes in the volume of production of industrial goods. The index is indicative of investment demand and a low IIP explains slowdown in production and industrial credit growth. Industrial credit growth affects the Industrial output with a lag i.e. Industrial production is a lagged result of industrial credit growth.



Source: RBI

As shown by above diagram we can see the trend followed by industrial credit growth, which is declining trend. After analyzing the occupational sector wise data of each sectors like Finance, industry, Transport Operator , Agriculture, Personal Loans, Trade, Professional and other services etc, the regular trend was visible that public sector banks are not doing well in case of Finance, Industry, Transport Operator and even in agriculture sector their share has been decreased. Over all if we look at bank lending to agriculture, home loans, consumption loans, car loans etc which can maximum constitute 40% of its portfolio. So there is need to lend more credit to manufacturing sector or Industry sector.

Conclusion

It is known fact that growth may not always show along as predicted. Initially the high predicted growth was due to Indian being a fastest growing economy. Since, India was one among fastest growing economy which was shown to be completely turned unrealistic as domestic demand slowed down. Also one of the important truths which we tend to ignore is that even the sensible lending will result in default. And also weak monitoring of the many projects was reason of default. Banks may have expected the growth and complete returns, but this did not always happen. If we go for reasons why bad loans are made we can see that many of these loans were made in 2007-2008. Economic growth was strong at that time with lot of opportunities. Deposit growth in public sector banks was high, and many of infrastructure projects such as power plants were completed on time and within the budget. But, the things did not turned out as expected because of global slowdown.

So, it can be concluded that low credit growth was not from the result of increase in interest rate but, rather it was due to low economic activities in the country, which led to low public and private spending. This resulted in poor recovery of bank loans and which led to increased NPAs. Thus, again lack of investments and credit created a vicious cycle which further slowed down the economy. The way forward for this distress is cleaning up the problem of twin balance sheet, creating a monitoring body for bad loans. The Reserve Bank of India and Government are working in this direction and helping banks to overcome with the problem of NPAs.

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