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Golden Years Of Indian Banking Sector Banking Outlook For FY 2023-24

Aashish Bansal
Chief Manager
ULA Corporate & Treasury,
Union Bank of India, Gurgaon, India

Abstract: The strong fundamentals of Indian economy are pushing all the sectors to perform and contribute significantly in the growth of GDP. Among all the sectors, the banking sector is going through its golden years where all the major financial parameters like credit deployment, profitability, asset quality, capital adequacy etc. indicate that the performance of banks are at best of all times. Currently, India is having "twin balance sheet advantage" i.e. strong balance sheets of corporates and public sector banks.
The private sector banks are having strong fundamentals and presently growing at very fast pace, taking market share from public sector banks. However, now PSBs are well placed, which is evident from the PSB's performance in FY 2022-23 i.e. "PSBs earned a record aggregate net profit of around INR 1.05 lakh crore", "high capital adequacy(CRAR) of 15.53%", "gross NPA at 4.97%", net NPA at 1.24%, healthy provision coverage of 90.68% etc.
Fundamentally stronger PSBs along with private sector banks are ready not only to earn for their shareholders/promoters but also to contribute in the growth of country. The strong fundamentals and government support is putting banking industry in its best era and it is right to say that next few years shall be golden years for Indian banking industry.

Keywords: Banking,

I. Introduction

"Banks" in terms of their primary activity can be defined as:
Banks are financial institutions which accept deposits from cash surplus entities and lend these accepted deposits to cash deficit entities. By acting as intermediary, banks' play an important role for each stake holder like depositor gets the interest income on deposit, borrower gets the fund for production or consumption activity and banks earn the net interest income i.e. "interest earned on lending" minus "interest paid to depositor". By its primary activity, Banking sector enables different industries & sectors to flourish and grow to its maximum potential and in turn contributes significantly to each country's GDP.

In India, the Indian banking system consists of 12 public sector banks, 22 private sector banks, 46 foreign banks, 56 regional rural banks, 1485 urban cooperative banks and 96,000 rural cooperative banks in addition to cooperative credit institutions.

The Indian banks are in a very healthy state both in terms of the book as well as the capital base. The various factors contributing to it are strong GDP growth, robust credit demand with low NPAs, strong corporate balance sheet, high domestic demand, government capex, normal monsoon etc. All these factors show great prospects for Indian banking industry in near future terms.

Considering the importance of banking sector in the economy, this paper tries to evaluate and project the future prospects of Indian banking industry.

II. Data Collection

The data for the research is collected from RBI website, individual bank's website and Crisil database.

III. Data Analysis & Findings

A. The three most important factors contributing to the growth of banking industry are India's Macroeconomic factors, recapitalization of public sector banks and various government initiatives. These factors are analyzed and its effect on banking industry is described as below:

a) GDP & Macroeconomic Factors

Indian real GDP growth is continuously improving from 5.8% in fiscal 2021, 9.1% in fiscal 2022 and 7.2% in fiscal 2023. The GDP data is presented below through a graph fig 1.

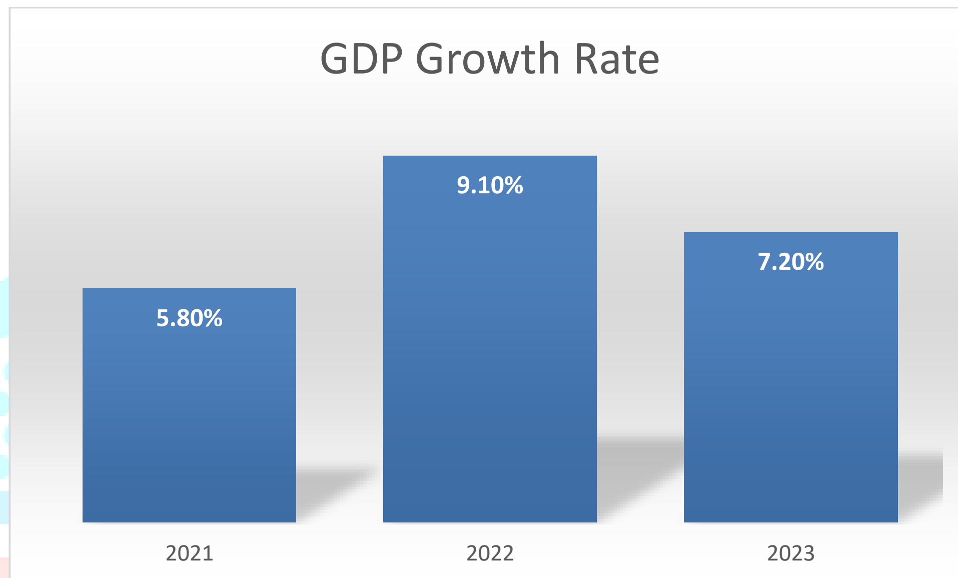


Fig 1: GDP Growth Rate (Source: MOSPI)

The various factors like Russia-Ukraine war, inflationary pressure, rising interest rates, rising commodity prices and slowdown in global growth is negatively impacting the India's exports and industrial activity. However, domestic demand, contact-based services, government capital expenditure (capex), strong financial conditions, and normal monsoon for the fourth time in a row are catalyzing the growth potential of India. The GDP growth projection for FY 2023-24 by different organizations are as below:

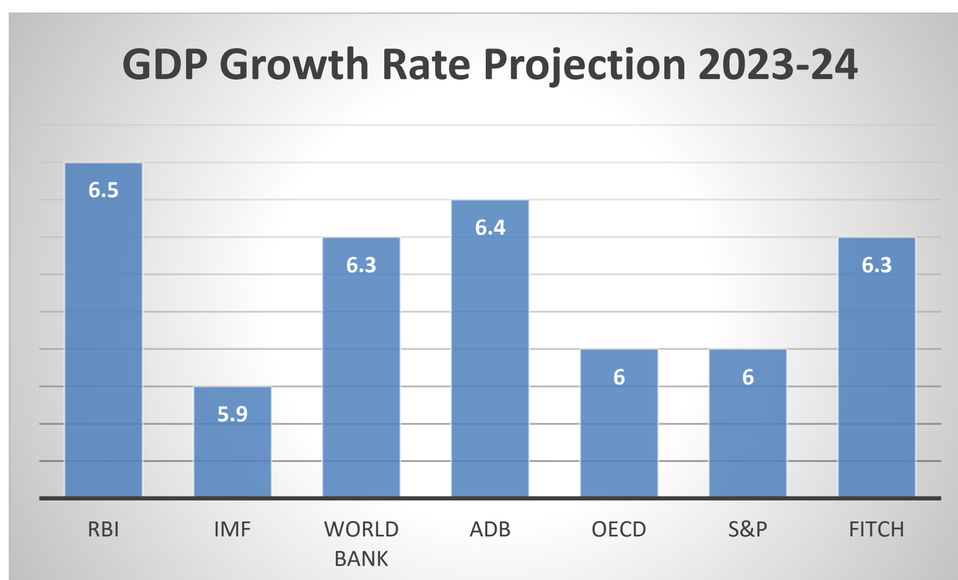


Fig 2: GDP Growth Rate Projections

From the above chart, we could conclude that our GDP may grow between 5.9% - 6.5%. However, all the major economies across the globe are experiencing a decline in growth. This GDP growth shall lead to higher production capability along with strong consumption in turn strong credit demand for production and consumption activities.

b) Recapitalization of PSU Banks

Over past 7 years, government has infused over Rs 3.4 trillion in Indian Banking system primarily public sector banks. Recapitalization provision for public sector banks (PSBs) has been revised to Rs 15,000 crore compared with the budgetary allocation of Rs 20,000 crore for fiscal 2022. With improving profitability and asset quality of banks along with adequate capitalization for both public and private sector banks, no further need of capitalization is expected. Further, three banks i.e., UCO Bank, Indian Overseas Bank and Central Bank of India were put under the Prompt Corrective Action (PCA) framework and subsequently were taken out during fiscal 2022 and fiscal 2023 post compliance of relevant ratios. The average capital to risk assets (CRAR) ratio for PSBs increased from 12.90% as of March 2020 to 15.53% as of March 2023.

Further, the asset quality of PSBs has improved significantly with gross NPAs at 4.97% and net NPAs at 1.24% in March 2023. During FY 2022-23, PSBs earned a record aggregate net profit of around INR 1.05 lakh Crore, almost triple from net profits earned in FY 2013-14.

Strengthened by high capital adequacy, clean balance sheets supported by a healthy provision coverage (90.68%) and strong profitability, PSBs are well positioned to support the credit needs of the productive sectors of the growing economy.

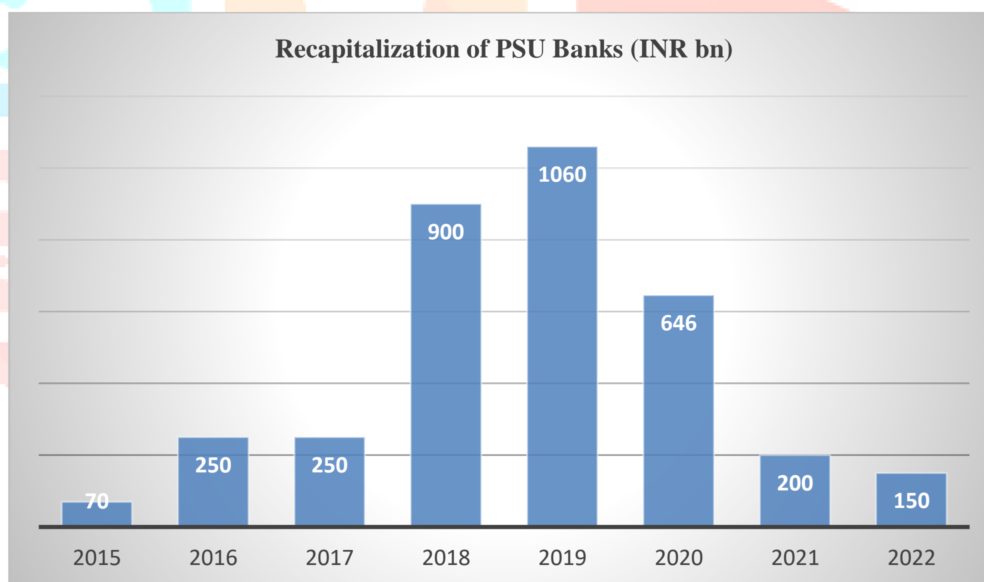


Fig 3: Recapitalization of PSU Banks (Source: MOF)

c) Government's Initiatives

The government's various initiatives and scheme are giving opportunity to banks to grow themselves along with contribution in the nation's building.

i. Production Linked Incentive (PLI) schemes for 14 sectors for enhancing India's manufacturing capabilities and enhancing exports.
ii. Government focus and spending on Infrastructure Development.
iii. The government is improving the ease of doing business in India by implementing regulatory reforms, simplifying processes, and reducing bureaucratic hurdles.
iv. "Foreign Direct Investment" act as catalyst for faster economic development. Therefore, GOI have increased FDI limit in various sectors.
v. Various Schemes like PMFME scheme (to support setting up of 2 lakh micro food processing enterprises through credit linked subsidy), Semicon India Program (with an incentive outlay of ~USD 10 Bn was launched with the vision to develop a sustainable semiconductor and

display ecosystem), creation of National Bank for Financing Infrastructure and Development (NaBFID) to fund infrastructure projects in India, Smart City Mission (100 cities are expected to improve quality of life through modernized/ technology driven urban planning), PM Awas Yojana, Urban Infrastructure Development Fund, UDAN Scheme (to augment the airport infrastructure the government aims to develop 100 airports by 2024, National Monetization Pipeline (NMP), FAME, 'Dekho Apna Desh' initiative, Vibrant Villages Program (at border villages for developing tourism infrastructure), unity malls (to be set up in State Capitals or prominent tourist centres), Bharat Mala Pariyojana, Incentive scheme for green hydrogen production, Sagar Mala Program (with the vision of port-led development and growth of logistics-intensive industries), JAM Trinity, Digital India initiative(the Govt. mandated an open API policy, known as India Stack), Gift-IFSC, Azadi Ka Amrit Mahotsav Mahila Samman Bachat Patra, Pradhan Mantri Ji-VAN Yojana, Sustainable Alternative Towards Affordable Transportation (SATAT) Scheme, obtaining capital goods from the indigenous market through the revised Defence Acquisition Procedure (DAP)-2020, Launching of Innovations for Defence Excellence (iDEX) scheme, Launch of an indigenization portal like SRIJAN to promote Make in India by Indian Industry together with MSME, Restructuring of Ordnance Factory Board into seven new Defense Companies and many more.

B. The current state of banking industry and projection for financial year 2024 is analysed and described as below:

a) Credit:

FY	Credit Outstanding (INR bn)	Credit Growth Rate (Y-o-Y)
2018	85751	7%
2019	96241	12%
2020	102144	6%
2021	106744	5%
2022	118913	11%
2023P	135000	13-15%
2024 P	152000	12-14%

Table 1: Credit Outstanding, growth rate & projection (Source: RBI & Crisil)

In fiscal 2021, the Indian economy contracted, due to the onset of the pandemic and imposition of a nationwide lockdown. To help deal with the impact of the pandemic, the government and the RBI took several initiatives to provide relief to borrowers. The revival led to moderate credit growth of 4.6% in fiscal 2021. The most significant initiatives included the Rs 3 trillion (revised upwards to Rs 5 trillion) Emergency Credit Line Guarantee Scheme (ECLGS); provision of loan moratorium; and option of restructuring loans to corporates, micro, small and medium enterprises (MSMEs), and individual borrowers under the restructuring framework (One-time restructuring - OTR 1.0 and 2.0).

In the first half of fiscal 2022, the second wave of the pandemic forced both borrowers and lenders to tread cautiously, leading to muted growth in bank credit. Growth picked up in the third quarter of fiscal 2022, and with a mild third wave, the momentum continued in the fourth quarter supported by pent-up and festive season demand. Further, the amount sanctioned under the ECLGS aggregated to Rs 3.58 trillion and disbursement aggregated to Rs 2.86 trillion as of November 2022. The scheme has primarily aided the MSMEs to obtain credit from the banking sector and revive business activities.

During fiscal 2023, rating agency CRISIL expects bank credit to grow 13-15%, with a large part of this growth spurred by the retail segment, primarily owing to rising demand for home and vehicle loans and supported by recovery in service segment, with pent up demand in NBFCs and trade segment. On the industry side, additional working capital requirement due to high inflation and move from the bond markets to bank loans, given the interest rate movements, are driving growth. Going ahead with the continued momentum in retail and services segments banking credit is expected to grow at 12-14% during fiscal 2024.

The segment wise credit contribution to total loan outstanding of banks could be categorized as per below mentioned table.

Segment	% of total loan Outstanding		
	FY'22	Fy'23(P)	Fy'24(P)
Retail	28%	29%	30%
Agriculture	12%	12%	12%
Industries	27%	25%	25%
Services	25%	26%	26%
International	7%	7%	7%

Table 2: Segment wise contribution to total loan portfolio (Source: RBI & Crisil)

As per CRISIL, Retail contribution to total loan outstanding of banks shall increase in FY'23 and FY'24 and Business loan contribution to overall loan portfolio shall decline to 25%. The primary reason for that is strong retail loan demand vis-a-vis industrial credit demand.

Each segment outstanding and growth rate is analyzed and described as below:

i. **Industry Credit growth Rate**

Industrial credit holds one of the biggest chunks in overall credit portfolio of any bank. In bigger commercial banks it is around 50% of total credit portfolio. The industrial Credit and its growth rate are shown in the tabular form as below:

Years	Industrial Credit (INR bn)	Growth Rate (Y-O-Y)
2018	27246	1%
2019	29128	7%
2020	29387	1%
2021	29277	0%
2022	31561	8%
2023P	34189	7-9%
2024P	37633	9-11%

Table 3: Industrial Credit Outstanding, Projections and Growth Rate (Source: RBI & Crisil)

Due to asset quality concerns, the industrial credit grew at 2% CAGR between fiscals 2015 and 2020. But it rose sharply in fiscal 2019, led by lending to the infrastructure segment.

In fiscal 2021, pandemic posed demand challenges to sectors like chemicals, engineering, and construction therefore credit growth weakened and credit outstanding in several sectors declined by 6-8% on-year.

In fiscal 2022, industry credit grew by around 8% supported by the textile, engineering and food processing segments and partially offset by de-growth in the basic metals and metal products segment on account of an increase in metal prices, which helped companies generate higher revenues and, in turn, deleverage balance sheets during the last two fiscals.

In fiscal 2023, the industrial credit is expected to grow in range of 7-9%, primarily supported by:

- Healthy double-digit credit growth witnessed in segments such as basic metal and metal products (which deleveraged in the past fiscals), chemical and chem products and partially off-set by segment such as textile on account of impact on export.
- Additional working capital requirement due to high inflation.
- Move from the bond markets to bank loans due to increasing interest rate.
- Government initiatives like production-linked incentive scheme, which is a concerted push to drive manufacturing with greater focus on large employment-generating and export-oriented sectors, is a positive for industry and to aid growth in medium term.
- Strong domestic demand leading to industrial capital expenditure.

As per rating agency CRISIL, the industrial credit shall continue to grow in a range of 9-11% during fiscals 2024.

ii. Retail Credit growth

FY	Retail Loans (INR bn)	Growth Rate (Y-o-Y)
2018	20537	18%
2019	23897	16%
2020	26903	13%
2021	29768	11%
2022	33817	14%
2023P	39550	17-19%
2024P	45487	15-17%

Table 4: Retail Credit Outstanding, Projections and Growth Rate (Source: RBI & Crisil)

The retail segment recorded 14% CAGR between fiscals 2017 and 2022. However, pandemic negatively affected retail loan exposure (housing & auto segments) of banks during the first half of fiscal 2021. During the second half of FY2021, RBI's and government initiatives like cuts in interest rates and stamp duty led to post healthy credit growth of around 11% by fiscal 2021-end.

During fiscal 2022, RBI's further decreasing of policy rates helped bank's retail segment to grow at around 14% on year. The RBI's policy rates hike was challenging in fiscal 2023, however CRISIL expects credit to the overall retail segment will grow at 17-19% during fiscals 2023 and 15-17% during 2024. The growth would be primarily driven by demand in housing segment, pent up demand in vehicle loans segment with visible growth in the sale of underlying passenger vehicles also supported by healthy growth consumer durable, gold and other personal loans segments.

iii. Agriculture Credit Growth

FY	Agri Loans (INR bn)	Growth Rate (Y-O-Y)
2018	10771	4%
2019	11618	8%
2020	12085	4%
2021	13349	10%
2022	14617	10%
2023P	16517	12-14%
2024P	18665	12-14%

Table 5: Agriculture Credit Outstanding, Projections and Growth Rate (Source: RBI & Crisil)

Loans outstanding for agriculture and allied activities (collectively Agri-loans) in India logged 7% CAGR between fiscals 2017 and 2022, supported by a good monsoon and higher banking penetration. In fiscal 2018, though, farm loan waiver by many states led to a deceleration in growth to 4% on-year. But, in fiscal 2019, the pace picked up again to 8% over a low base amid banks' priority sector lending (PSL) targets and a normal monsoon.

In fiscal 2022, due to higher food-grain and horticulture production, elevated prices of crops such as cotton, and support from the agriculture fund, Agri-credit grew around 10%, with loans outstanding of banks at Rs 14,617 billion. As per CRISIL, Agri-credit to grow 12-14% during fiscal 2023 and fiscal 2024, supported by PSL targets, expected higher food-grain production, an increase in commodity prices, and an increase in the Agri-credit target from Rs 16.5 trillion during fiscal 2023 to Rs 18 trillion in fiscal 2024. Further, continued government focus on Agri-allied sectors via schemes such as the Agri-infrastructure fund and linking KCC to animal husbandry and fisheries will also support credit growth.

iv. Service Credit Growth

FY	Services Loans (INR bn)	Growth Rate (Y-o-Y)
2018	19801	14%
2019	23327	18%
2020	25530	9%
2021	26300	3%
2022	30173	15%
2023	35035	15-17%
2024	39972	13-15%

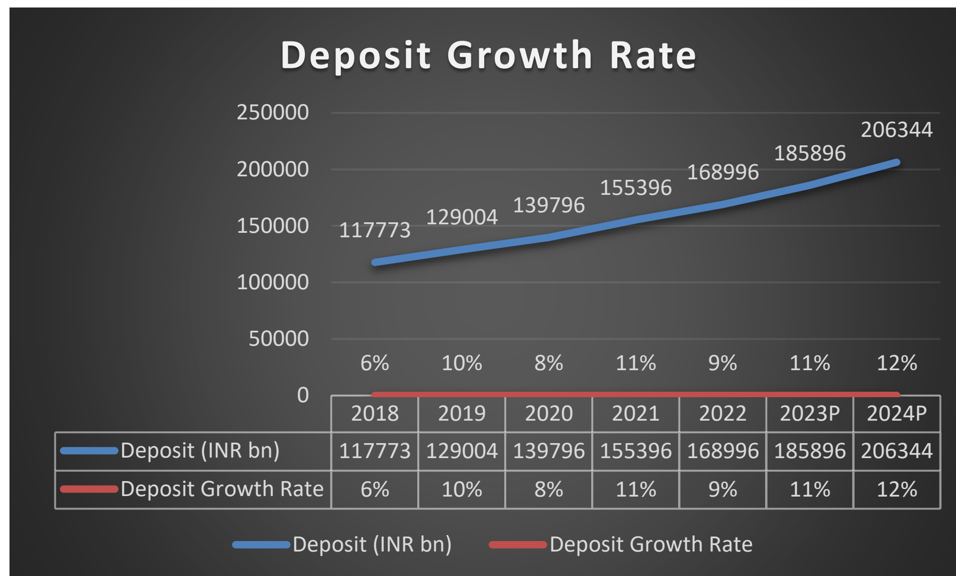
Table 6: Service Credit Outstanding, Projections and Growth Rate (Source: RBI & Crisil)

Credit to the services segment logged 10% CAGR between fiscals 2017-22, driven by lending to NBFCs which registered 18% CAGR. Credit growth to the NBFC segment was muted during fiscal 2021 due to the onset of the pandemic, which affected the country's economy, and halted the credit flow from NBFCs to end borrowers in certain segments.

Further, during fiscal 2022, with the off take in credit demand banking sector lending to NBFCs picked up and posted high double-digit growth in fiscal 2022. This trend continued in fiscal 2023 with NBFCs expected to lead the growth in service segment followed trade and commercial real estate segment.

Further, in fiscal 2023, with RBI increasing the repo rate at an aggressive pace (by 250 bps until February 2023, taking repo rate to 6.50%) the accessibility to debt market reduced for NBFCs and the loan demand diverted to banks. As per CRISIL, service sector credit to grow at 15-17% during fiscal 2023 followed by 13-15% growth during fiscal 2024.

b) Deposit Growth Rate



	2018	2019	2020	2021	2022	2023P	2024P
Deposit (INR bn)	117773	129004	139796	155396	168996	185896	206344
Deposit Growth Rate	6%	10%	8%	11%	9%	11%	12%

Fig 4: Deposit Growth Rate (Source: RBI, Crisil)

Between fiscals 2015 and 2020, the banking sector enjoyed a healthy deposit compound annual growth rate (CAGR) of around 10%. In fiscal 2021, with the outbreak of COVID 19, conserving money became a priority and households reduced their private consumption, leading to 11% deposit growth in the fiscal. Further, the weighted-average domestic term deposit rate declined 80 basis points (bps) from 6.07% in April 2020 to 5.28% in March 2021.

With the RBI keeping it stance accommodative and policy rates unchanged for the entire fiscal 2022, the weighted-average term deposit rate declined a further 25 bps to 5.03% as of March 2022. During the monetary policy meeting in April 2022, the RBI started the interest rate hike with 40 bps in May 2022, followed by 50 bps each in June, August and September 2022, 35 bps in December 2022 and 25 bps in February 2023 taking repo rates to 6.50%. With this the weighted-average term deposit rate moved upwards to 5.90% as of January 2023. Further, the incremental credit to deposit ratio rose to more than 100% during the second quarter of fiscal 2023 and deposit growth continued to lag credit growth.

To support credit growth, increased competition and people investing in alternate asset classes like mutual funds/equity, there is expectation that the deposits rate to inch up to attract depositors. As per CRISIL, the deposits are expected to grow at 10-11% during fiscal 2023 followed by 11-12% growth in fiscal 2024.

c) **Gross NPA**

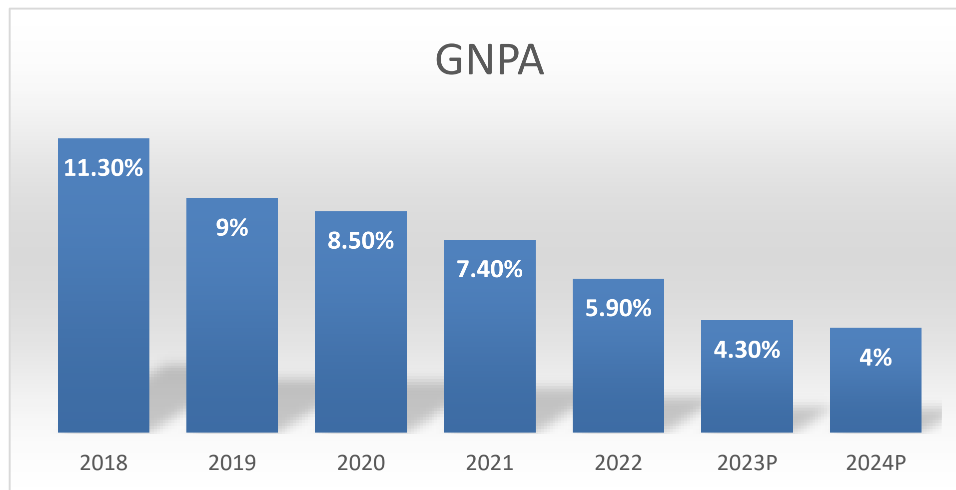


Fig 5: Gross Non-Performing Asset (Source: RBI, Crisil)

The various industries like Airlines, hospitality, travel, gems and jewelry, auto dealers, and real estate were hit hard due to pandemic, given the discretionary nature of these sectors. The first half of fiscal 2021, both collections and disbursements were impacted significantly. However, government and RBI had taken various measures assisting in containing the deterioration in asset quality, overall GNPA ended the fiscal at 7.4%.

The various measures taken by RBI are enhancement of liquidity, ease financial market conditions, address cash flow concerns, and improve market sentiment following a near-halt in economic activity. The measures such as loan repayment moratorium provided relief to borrowers until August 2020 and loan restructuring framework helped customers who were financially impacted by the pandemic in the rest of fiscal 2021. These relief measures helped contain asset quality deterioration.

As of March 2021, about 0.9% of the total credit outstanding was restructured under the one-time restructuring framework (OTR 1.0), which was significantly lower than earlier estimates. In the case of public banks, the majority of the restructuring came from the corporate sector. In the case of large and mid-size private sector banks, the proportion of retail assets in total restructuring (invoked + implemented) was relatively high.

The RBI announced the restructuring framework (OTR 2.0) in May 2021, during the second wave of the pandemic. This framework saw better response from corporate borrowers - the window for application ended on September 30, 2021 (with the last date to implement the restructuring for banks being December 31, 2021). One estimate is that the overall restructuring (OTR 1.0 and 2.0) at around1.4% of the loans outstanding as of March 2023.

Given the restructuring took place in fiscals 2021 and 2022 and the estimated tenure of the restructuring is around two years, the behavior of such portfolios may be clear after fiscal 2023. GNPA of both private and public banks improved in fiscal 2022 on account of reduction in fresh slippages and improvement in upgrades and recoveries. GNPA of scheduled commercial banks stood at a ~6% as of March 2022. As per CRISIL, the bank's asset quality to improve further to 4.1-4.3% in fiscal 2023, primarily on account of lower slippages, higher recoveries, upgrades and expectation of recoveries via the NCLT and National Asset Reconstruction Company Ltd (NARCL) route.

The segment wise NPA could be understood from following facts:

- **Agri GNPA:**
  GNPA of agri-loans was 9.4% in FY22 and it may improve further in fiscal 2023/2024. The Primary reason is OTS and collection efficiency.

- **Industry GNPA**
  GNPA for industrial credit declined in fiscal 2021 from 14.5% (in FY20) to 11.3%(in FY21) , due to the resolution of stressed assets via NCLT, the restructuring frameworks, lower slippages from large corporate accounts, higher recovery or write-offs, and lower credit costs alongside traction being witnessed in NARCL deals during fiscal 2023. The industry GNPA was 8.4% in FY'22 and may reduce to 4.8% in FY'23.

- **Services GNPA**
  The Covid-19 disruption, lockdowns and sluggish economic activity significantly affected the services sectors, such as transport operators, tourism, hospitality, and trade. Since the government provided one-time restructuring schemes 1.0 and 2.0 in August 2020 and May 2021, respectively, ECLGS to MSMEs, this helped improve the asset-quality in fiscal 2022 to 5.8%. The services sector GNPA may further come down to 4.2-4.4% in fiscal 2023 and 3.9-4.1% in fiscal 2024 supported by improved collection and higher credit growth for services segment.

- **Retail GNPA**
  GNPA of retail loans was at 1.8% in fiscal 2020. Because of the Covid-19 fallout and deterioration in asset quality in the segment, GNPA increased to 2.1% as of March 2021. GNPA spiked further in the first quarter of fiscal 2022 due to the second wave. However, loan restructuring under the one-time restructuring 2.0 announced by the RBI in May 2021 contained further deterioration. Improvement in economic activities and the mild third wave in the fourth quarter also helped, pushing the GNPA back to pre-Covid levels at 1.8% as of fiscal 2022. Going further, the retail GNPA to remain range bound at 1.6-1.7% during fiscal 2023 and 1.7-1.8% during fiscal 2024

d) Banks' Profitability

The banks' profitability could be understood from two important factors

1. Net Interest income and
2. Return on Asset.

The net interest income of banks is shown below through table and graph:

Year	Net interest income on total asset	Interest income on total assets	Interest Expense on total assets
2018	2.50%	6.90%	4.40%
2019	2.70%	7.10%	4.50%
2020	2.70%	7.00%	4.30%
2021	2.90%	6.60%	3.70%
2022	2.90%	6.10%	3.20%
2023P	3.30%	6.90%	3.60%
2024P	3.80%	7.90%	4.10%

Table 7: Net interest income on total asset, Interest income on total assets, Interest expense on total assets (Source: RBI & Crisil)

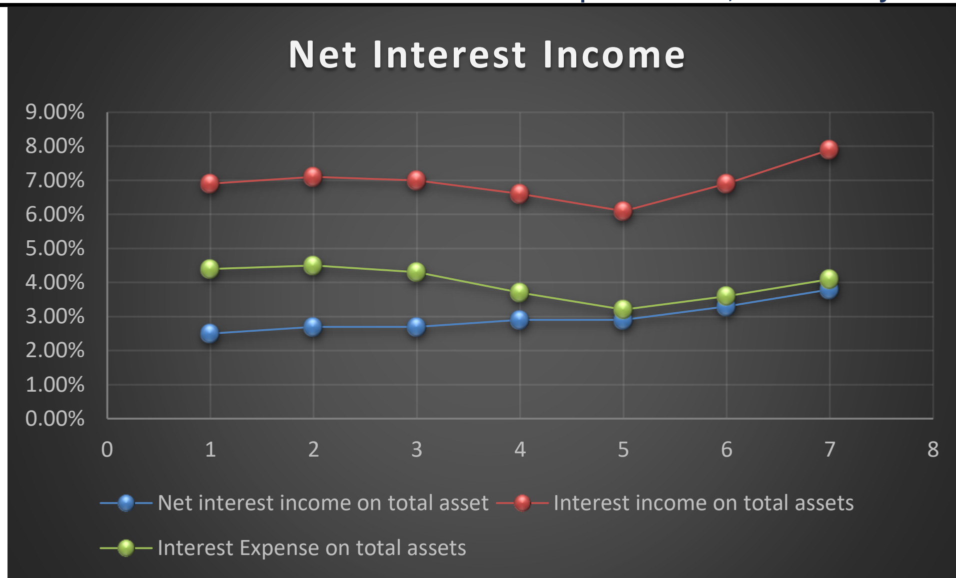


Fig 6: Net Interest Income trendline

RBI introduced new guidelines on external benchmark lending rates (EBLR; linked to repo rate), mandating banks to link all new personal or retail floating rate loans, and micro, small and medium enterprises floating rate loans to the external benchmark effective October 1, 2019.

In fiscal 2023, to tackle inflation RBI started increasing policy repo rating by 40 bps in May 2022 and 50 bps in June, August and September 2022, 35 bps in December 2022 and 25 bps in February 2023, taking policy repo rate to 6.50%. With faster increase in repo rates the yield on loans are expected rise quicker as compared to historical trend due to implementation of new guidelines on EBLR linking of loans and cost of deposits to rise at a slower pace since banks will be benefitted by lower cost of funds during last two fiscals.

During fiscal 2023, it is expected that interest income as % of total assets to rise by 80 bps and interest expense as % of total assets to rise by 40%, resulting in improvement in net interest income to total assets at 3.3%.

Further, our second parameter for profitability, “Return on asset” for banks continues to improve from 0.9% in fiscal 2022 and cross the 1% mark to 1.2% in fiscal 2023 with better credit cost and stable operating expenditure.

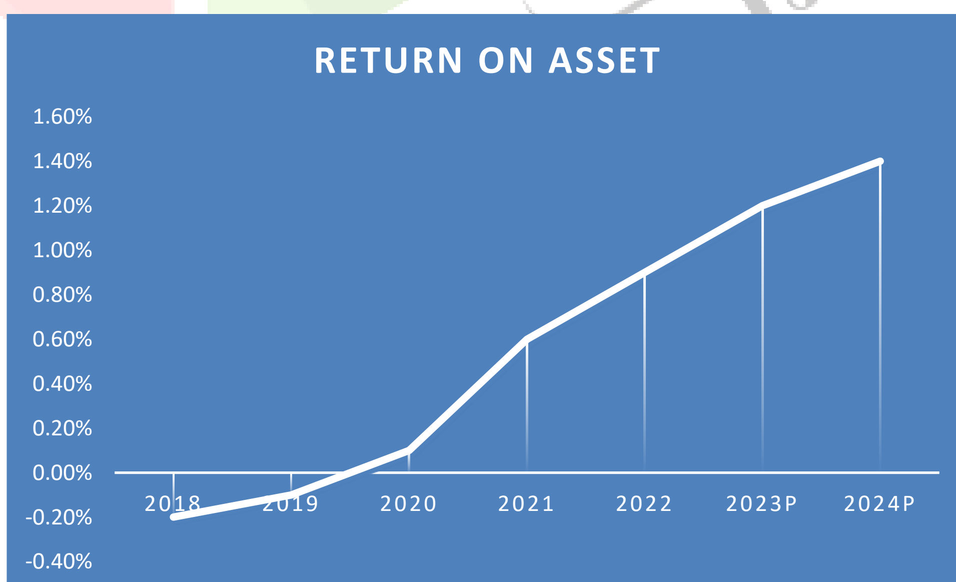


Fig 7: Return on Asset trendline (Source: RBI, CRISIL)

IV. Conclusion

The two major activities of banks are deposit mobilization and lending. Due to inflation, RBI increased policy repo rates by an aggregate 250 bps until February 2023, taking repo rate to 6.50%. However, the credit and deposit growth are expected to be robust in FY 2024, the major contributor to this credit growth shall be retail demand especially housing and auto and service segment demand (mostly NBFC). Moreover, the major contributor to the growth of deposit shall be increase in term deposit rates due to competition among banks and strong credit demand.

We can conclude with the growth projections of different segments of credit portfolio for FY-2024 with factors contributing to that growth.

<table>
<tr><th>Segment</th><th>Credit Growth Estimate (FY24)</th><th>Factors</th></tr>
<tr><td>Agriculture</td><td>12-14%</td><td>Higher commodity prices
Collection efficiency
Asset quality stable/ improvement</td></tr>
<tr><td>Industry</td><td>Fiscal 2024 -9-11%</td><td>High Inflation leads to higher working capital requirement.
Rising regulatory rates, move from the bond markets to bank loans.
Revival in industrial capex.</td></tr>
<tr><td>Services</td><td>Fiscal 2024 – 13-15%</td><td>Demand recovery amongst NBFCs and trade segments</td></tr>
<tr><td>Retail</td><td>Fiscal 2024 – 15-17%</td><td>Housing and Vehicle segments posting healthy growth</td></tr>
<tr><td colspan="3">Other Factors impacting overall banks' credit growth are strong domestic demand, government capex push, PLI scheme, increasing FDI flow, healthy corporate balance sheet, low NPA and well capitalized banking sector.</td></tr>
</table>