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Banking Sector Outlook
- Asset quality whirlwind to dent banks' credit profiles

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Key Messages

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- **Banking system weak assets to rise to 8.9% by Mar-17**
  - Outlook for key investment led sectors which banks are exposed to remains weak
  - Nearly Rs.2.1 lakh crore (5.5%) of large corporate exposures to slip to NPAs by Mar-17
- **Provisioning costs surge to subsume profits of PSBs**
  - Impact of slippages, MCLR, UDAY scheme to reduce NIMs by 10bps
  - Revenue diversity and lower exposure to vulnerable sectors mitigants for private banks
- **Capital requirements to remain a challenge for PSBs**
  - Need to raise Rs.1.7 lakh crore Tier I capital upto Mar-19 (earlier estimate Rs.1.3 lakh crore)
  - Capital commitment by government under Indradhanush plan not sufficient
- **Banking system adequately placed to meet credit demand in 2016-17**
  - Credit growth to see only a slight pick up in 2016-17 to 11% vs 8% for 2015-16
  - Private banks will grow faster at over 20% and gain market share
- **Weakening PSB credit profiles have resulted in rating actions by CRISIL**
  - Rating downgrades on 9 banks and outlook revision to negative on 6 banks
  - Corporate credit rating threshold lowered to A+ from AA-

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Asset quality challenge to continue to impinge banks' credit profile

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Slippages from large corporate exposures to be high

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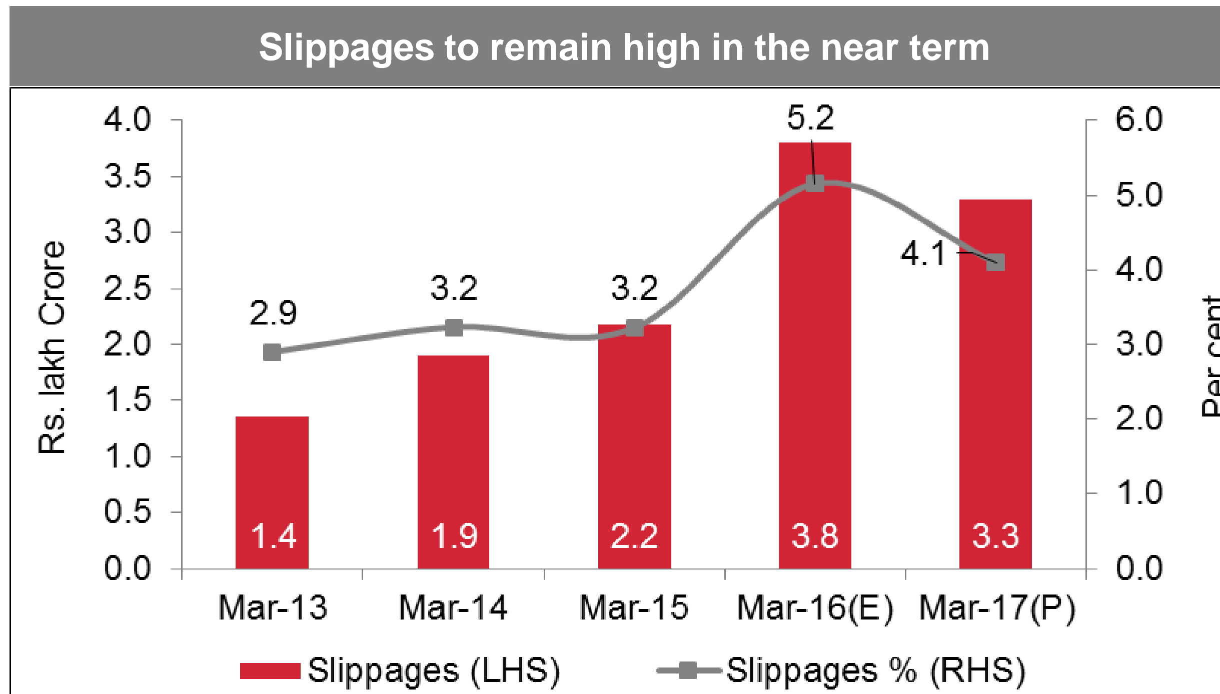
- **Rs.2.1 lakh crore of large corporate loans could slip to NPAs in near term**
  - Constitutes nearly 5.5% of overall corporate sector advances
- **Slippages will be mainly from 3 different categories:**
  - Loans which have been recognized as NPA in some banks but not in other banks
  - Stressed assets in top 100 corporate loans which could potentially slip to NPAs
  - Stressed assets in the restructured standard assets that could slip to NPAs



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Weak Assets* to touch a high of 8.9% by March-17

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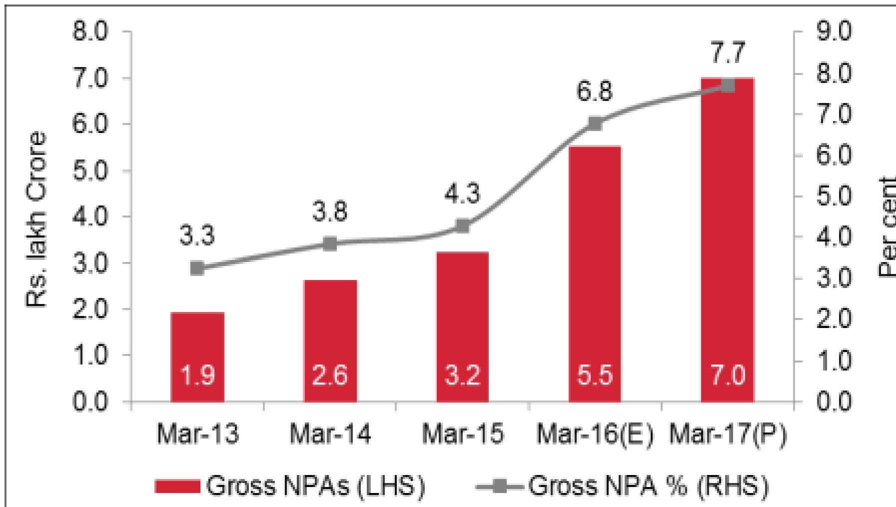
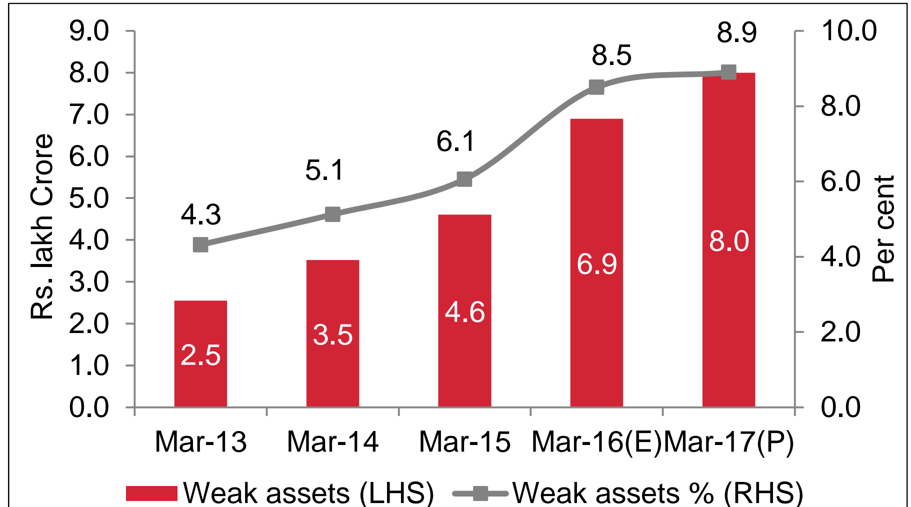
Gross NPAs to rise to Rs.7.0 lakh crore



Weak assets to reach ~Rs.8.0 lakh crore



- **CRISIL revises definition of weak assets to factor in**
  - Continued high slippages from restructured assets (40% v/s earlier expectation of 35%)
- **NPAs to converge towards weak assets by March 2017**
  - A large proportion of stressed assets expected to be recognized bad in coming quarters
- **Banks have limited ability to recover from large NPAs in current environment**
  - Reductions to be low at ~33% in 2016-17 as against 50% in 2014-15

** Weak Assets = Reported gross NPA + 40% of outstanding restructured advances (excluding State Power Utilities) + 75% of investments in security receipts + 15% of loans structured under the 5/25 scheme*

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High provisioning costs to weaken banks earning profile

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NIMs of PSBs to decline by 10 bps in FY17 due to

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- **Application of Marginal cost of funds based lending rate (MCLR) from Apr-16**
- **~7% of loan book slipping to NPAs in 2015-17 will cease to generate income**
- **Conversion of SEB loans to lower yielding bonds under UDAY scheme**
  - However, it will be majorly offset by reversal of provisions on SEB loans
- **However, the impact will be partially offset by a lower deposit costs as they re-price**

- **NIMs of Private Sector Banks to be less impacted in 2016-17 supported by**
  - Higher proportion of higher yielding retail loan portfolio
  - Higher proportion of low cost CASA deposits

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Provisioning costs to equal pre-provisioning profits for PSBs

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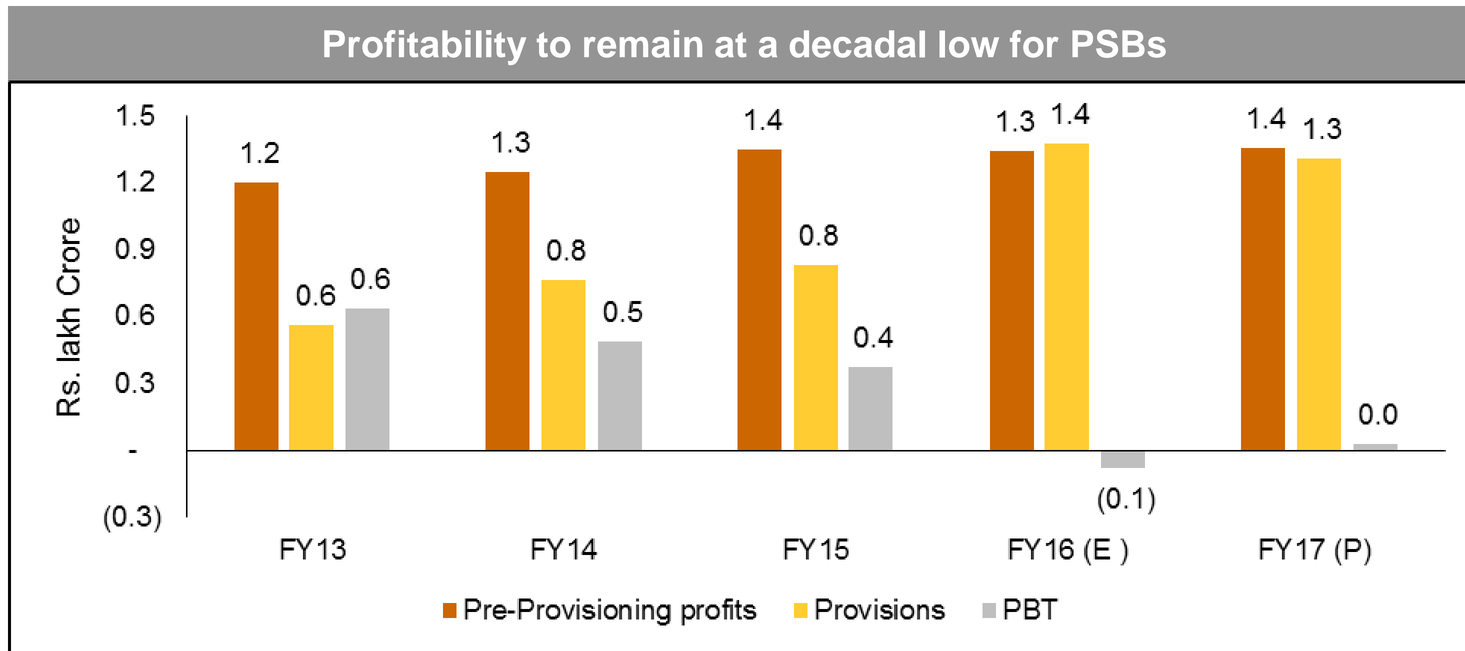

- **Provisions as proportion of total assets to touch a high of 1.4% in 2015-16**
- **To remain at elevated levels in 2016-17 due to**
  - Continued high levels of slippages,
  - Ageing of stock of NPAs
- **Of 26 PSBs, 9-10 PSBs may report losses in FY16 and FY17**

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Lower impact on private banks due to revenue diversity

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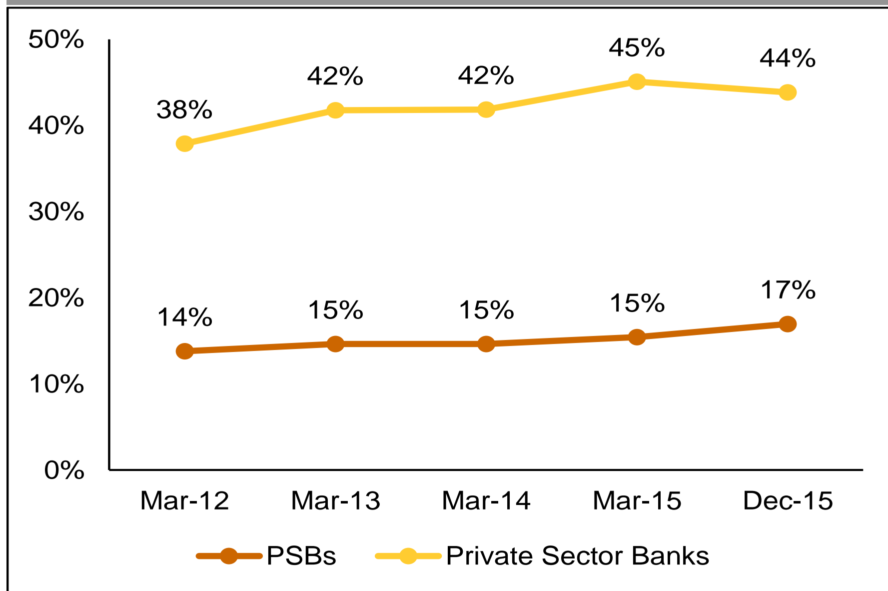
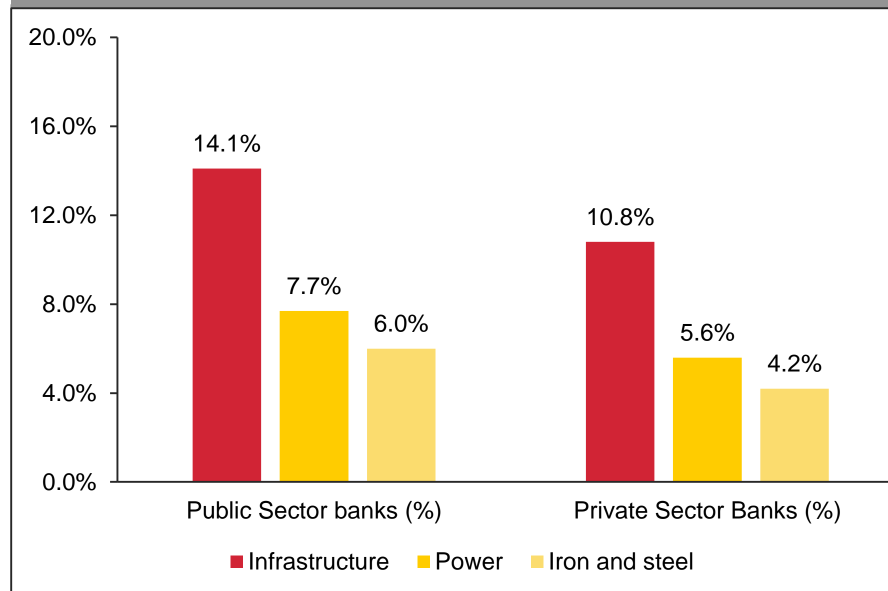
High share of retail advances



Lower exposure to vulnerable sectors



- **Private banks have a much higher share of the granular retail segment**
  - Forms ~44% of overall advances as on Dec-15 (as against ~17% for PSBs)
- **Private banks have lower exposure to cyclical and vulnerable sectors**
  - Stringent credit-appraisal practices with focus on strong collateral cover
  - Preference on taking shorter-term non-fund based exposures to such sectors
- **Fee Income forms 28% of total income of private banks (18% for PSBs)**

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Earnings of private banks to remain healthy in 2016-17

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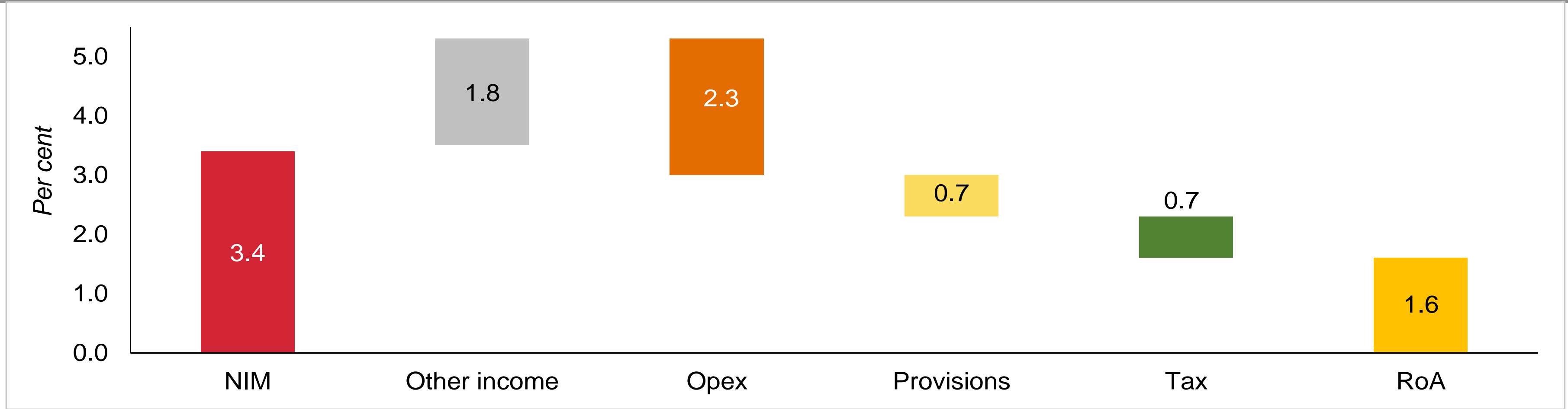
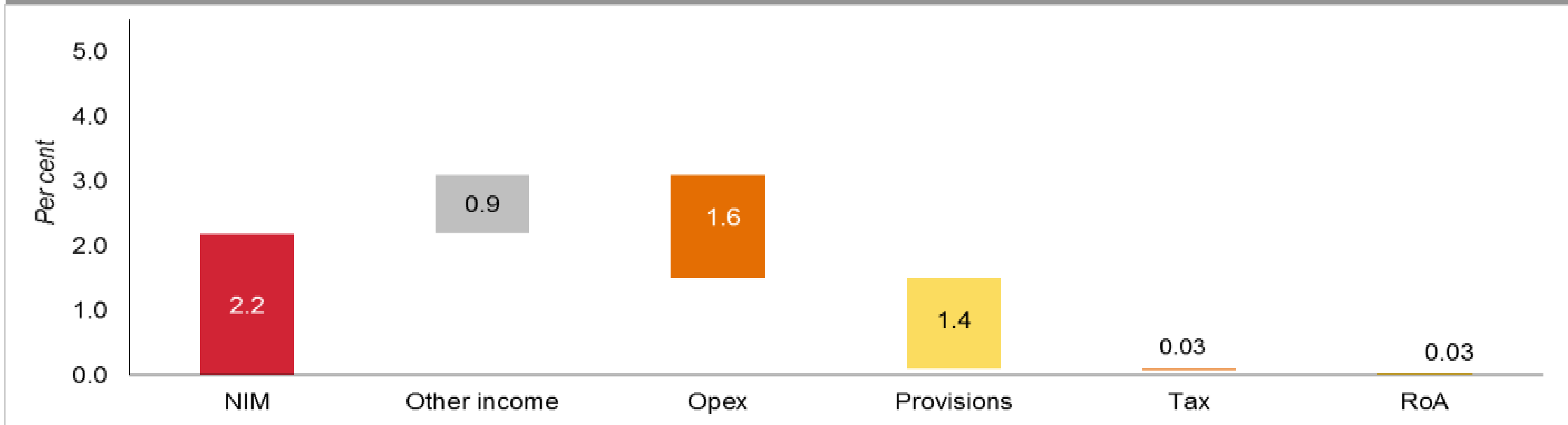
Private banks benefits from higher NIMs and stronger fee income



PSB's to report negligible profits due to lower NIMs and higher provisions



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Capital raising remains a challenge for PSBs

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PSBs need to raise Rs. 1.7 lakh crore Tier I capital upto 2019

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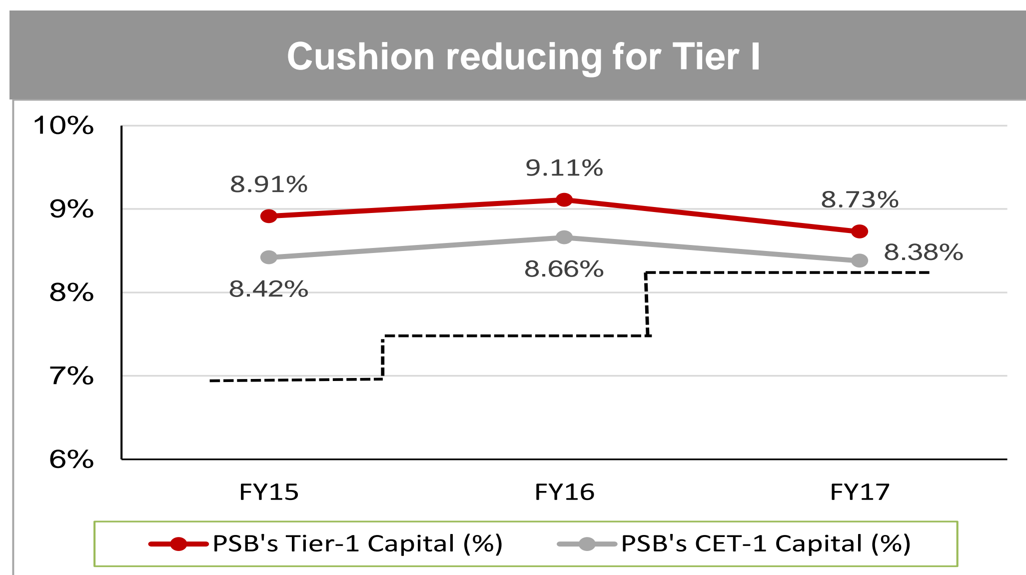
- **Tier I capital raising requirement has increased from earlier estimate of Rs.1.3 lakh cr**
  - Sharp fall in profitability has diminished capital generation from internal accruals
- **Ability to raise capital from external sources severely impaired due to poor performance and low valuations**
- **Market for inherently risker AT1 instruments is low**
- **Rs.70,000 crore capital commitment from government not sufficient**



- **Low cushion over regulatory minimum make PSBs vulnerable to external shocks**
- **Hence, corporate credit rating threshold lowered to “A+” from “AA-”**

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Banking system to meet credit requirements in 2016-17

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Banking system adequately poised to meet credit demand in 2016-17

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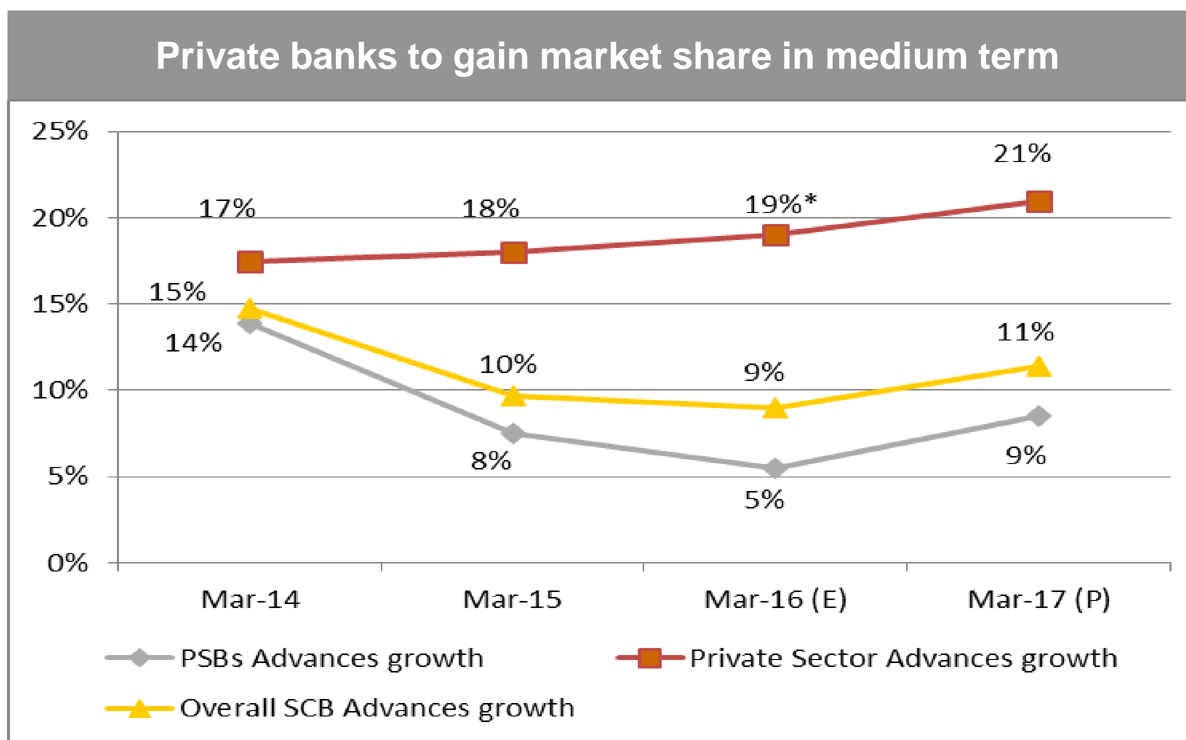
- **Investment growth to witness only a slight pickup in 2016-17**
- **No significant credit demand growth expected**
- **Private banks well placed to lead credit growth supported by strong capitalization**



Advances growth including new banks was around 22% during FY16

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Rating Actions by CRISIL

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Recent rating action on PSBs

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- Credit alert issued in February on increasing asset quality problems in PSBs
- Recent rating actions: Rating downgrades of 9 banks and revision in outlooks to “Negative from “Stable” for 6 banks
- Rating of most PSBs for now continue to remain in high safety category

Transition in Ratings

Earlier Rating \ Current Rating	AAA/Stable	AAA/Negative	AA+/Negative	AA/Negative	AA-/Negative	A+/Negative
AAA/Stable	6	4				
AAA/Negative		1	1			
AA+/Stable			1	2*		
AA+/Negative				3	1	
AA/Stable				1		
AA/Negative				1	1	
AA-/Negative					1	1

** Rating on one bank on Watch negative*

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Rating transition for Tier I bonds (Under Basel III) have been sharper

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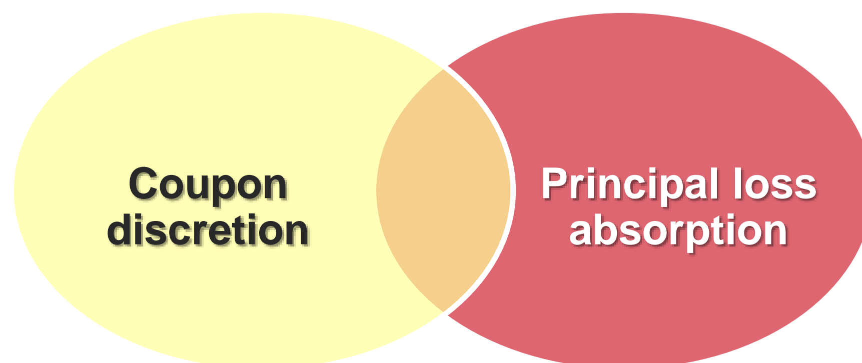
- **Higher notch-down of ratings from corporate credit rating/Tier II Bonds rating**
- **Sharper rating transitions on Tier I bonds in line with earlier articulation in CRISIL's rating rationales**
- **Reflect inherent risks in Tier I bonds**
  - Existence of full coupon discretion
  - High capital threshold for likely coupon non-payment
  - Principal write-down on breach of a pre-specified trigger on capitalisation



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