RBI troubled by loan quality of banks

Warns of deterioration if slowdown persists; blames non-priority sector

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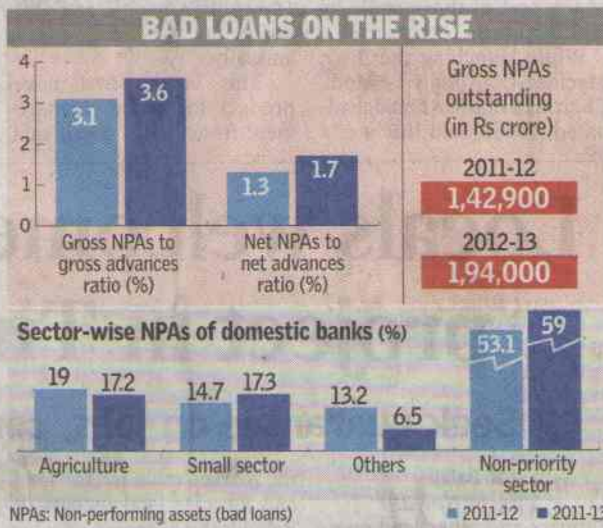
The pressure on the loan quality of banks remains a major challenge in the short term, the Reserve Bank of India has warned.

The central bank said stress tests indicate that if the current macroeconomic conditions persist, the credit quality of commercial banks could deteriorate. To mitigate the problems of rising bad loans, the RBI wants banks to strengthen their due diligence, credit appraisal, and post-sanction loan monitoring.

In its report, *Trend and Progress of Banking in India, 2012-13*, released on Thursday, the RBI observed that the banking system's loan quality, primarily in the industrial and infrastructure sectors, has deteriorated significantly during the year and there was an increase in total stressed assets.

The banking system's total stressed assets (bad loans plus restructured standard loans) rose to 9.2 per cent of total advances as on March-end 2013 against 7.6 per cent as on March-end 2012.



SAGE ADVICE

- Improve credit appraisal, due diligence and post-sanction loan monitoring
- Accelerate the working of debt-recovery tribunals, asset reconstruction companies
- Strengthen information-sharing mechanism among lenders

KEY FACTORS

While the primary driver of the deteriorating loan quality was the domestic economic slowdown, other factors such as delays in obtaining statutory and other approvals as well as lax credit appraisal/monitoring by banks were also significant. Further, higher credit concentration in certain sectors and higher leverage among corporates also increased the stress on loan quality.

The report cautioned that "in recent years there has also been a sharp increase in the amount of debt restructured under the corporate debt restructuring mechanism... this has implications for banks' already stressed loan quality in the period ahead." The deterioration in asset quality was most perceptible for the SBI group with its NPA ratio reaching a high of 5 per cent at end March 2013. "Deterioration in asset quality in 2012-13 was primarily on account of the non-priority sector," the RBI said. FY13 was marked by a slowdown in the growth of credit to all productive sectors – agriculture, industry and services. The slowdown was the sharpest for agriculture and allied activities which grew a mere 7.6 per cent at Rs 5,89,900 crore.

Within industry, there was a slowdown in the growth of credit to the infrastructure sector. But bank credit to the sensitive sectors almost doubled to Rs 10,20,600 crore in 2012-13, primarily due to credit to the real estate sector. The retail loans portfolio continued to grow in double digits, as in the previous year.

IMPROVE RECOVERY

The RBI said there is a need to improve the effectiveness of the recovery system. It flagged the urgent need to accelerate the working of Debt Recovery Tribunals and Asset Reconstruction Companies. Recovery should be focused on efficiency and fairness – preserving the value of the underlying assets and jobs where possible, even while redeploying unviable assets to new uses and compensating employees fairly.

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