Trends and Progress of Banking report

Why in news?

- The RBI has recently released its annual *Trends and Progress of Banking* report
- It finds that banks have been resilient to the pandemic that disrupted credit off take, pressuring rates and putting borrowers in a tight corner.

How did banks manage to survive during pandemic?

The report mentions three trends that supported banks finances while the economy was in a difficult situation.

Trend 1

- **Increases in Savings -** The Covid prompted the households and private businesses to raise their savings and hoard cash in order to avert risks.
- As a result deposit base of banks increased from ₹140-lakh crore to ₹156- lakh crore in FY21.
- **Banks investing in low risk gilts -** Banks preferred to deploy much of the incremental funds in gilts
- They have stepped up credit disbursals just from ₹103-lakh crore to ₹108-lakh crore.
- Scissor effect refers to non availability of money for private investment due to increased savings, coupled with low lending by banks associated with the pandemic.
- The RBI suggests that it is this 'scissor effect (risk aversion by both borrowers and lenders) that is now causing a lag in economic growth.

Gilt funds are low-yield investments that carry very low risk.

Trend 2

- MPC prompted a step cut in lending rate
- Despite this banks actually improved their spreads by booking hefty treasury profits and slashing deposit rates faster than lending rates.
- This suggests that the Centre is going to have a tough task reviving credit flow to the economy once the pandemic winds down, as banks appear to have found a cosy comfort zone in sourcing cheap deposits and lending to the government.

Bank spread is the difference between the interest rate that a bank charges a borrower and the interest rate a bank pays a depositor.

Trend 3

- Contrary to spike in loan defaults, banks have improved their asset quality position in FY21.

- This is reflected in the NPA and CAR values.
- Their gross and net NPAs decreased to 7.3% and 2.4% respectively when compared to 8.2% and 2.8% in FY20.
- They also raised their capital adequacy ratios from 14.8% to 16.3%.
- While this may be partly attributed to special dispensations such as the loan moratorium, NPA recognition standstill and leeway to restructure loans, the first two measures have already been wound down with no material change in the picture.

How did NBFCs and the Government act during the pandemic?

- While banks played it safe during the pandemic, NBFCs have taken up the slack in lending
- NBFCs have stepped up credit flow to MSMEs
- They experimented new co-lending and digital lending models on retail loans.
- While NBFCs also improved their capital buffers and asset quality in FY21, there seems to be a worry about hidden stress in recent retail loans.
- The report also repeatedly credits the Centre and the RBI for their timely fiscal and monetary interventions (pegged at 14.6% of GDP) that ensured financial stability through Covid.

What needs to be done?

- Banks and the regulator need to remain vigilant about restructured assets at 1.8% of advances and the rise in Special Mention Accounts.
- Banks have to restart lending.
- Savers have to receive their due.
- Industry has to regain its animal spirits post-pandemic.
- Above mentioned trends needs to be withdrawn.

Special Mention Account (SMA) mentions borrowers defaulting timely payment of his debt obligations, though the account has not yet been classified as NPA as per the extant RBI guidelines.

Loans vs. Advances

- **Money provided by the bank to entities** for fulfilling their short term requirements is known as Advances.
- Loans can be secured or unsecured whereas Advances are secured by an asset or by a guarantee from a surety.

Reference

1. https://www.thehindubusinessline.com/opinion/editorial/resilient-show/article3807281ece