Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Prelims and Mains focus: About the RBI report and its significance; concerns raised by the report

News: In its Report on Trend and Progress of Banking in India 2018-19, released on Tuesday, the central bank said banks need to restart lending to industries in order to stimulate the capex and investment cycle.

- The Reserve Bank of India (RBI) wants banks to resume lending to large industries instead of restricting themselves to the low-risk retail sector.
- According to RBI, there has been a shift of focus toward retail loans due to subdued profitability of corporates, low interest coverage ratio, and deleveraging by corporates along with risk aversion of banks.

Background

The latest in a series of bad news came earlier last month as India’s economic growth fell to 4.5% in the September quarter. Moreover, the core sector, comprising eight infrastructure industries, contracted 5.8% in October, the second consecutive month of contraction.

Figures supporting RBI’s argument

- Outstanding bank loans to industries increased 5.6% year-on-year (y-o-y) to ₹33.04 trillion in FY19, but declined 3.95% between March and September 2019. At the end of September, it stood at ₹31.74 trillion. Retail loans, on the other hand, grew 18.5% y-o-y to ₹23.02 trillion in FY19 and 18.1% between March and September 2019 to ₹24.64 trillion, albeit on a smaller base. ‘The need of the hour is to kick-start industrial credit and use the impetus therefrom to regenerate a virtuous cycle of capex, investment and growth,’ said RBI.

Concerns raised in the RBI report
The central bank’s report said while diversifying from industrial loans to retail acts as a risk mitigation tool, it has its own limitations. For instance, the slowdown in consumption and overall economic growth, RBI said, may affect the demand for and the quality of retail loans. Moreover, household leverage and indebtedness need to be kept in focus in the context of overall financial stability.

The regulator also cautioned that banks must follow proper risk pricing so that the health of the banking sector is not compromised, while ensuring adequate credit to these sectors.

On capital raising, RBI said in the coming years the financial health of public sector banks (PSBs) should increasingly be assessed by their ability to access capital markets instead of the tendency to depend excessively on the government.

The central bank also raised the issue of corporate governance practices in banks and other financial institutions. Without naming them, it said the recent governance failures in some financial entities have highlighted the impact of the quality of corporate governance on efficiency in allocation of resources as well as on financial stability. RBI said it is in the process of issuing draft guidelines on corporate governance for regulated entities and the objective is to align the current regulatory framework with global best practices.

Status of Banks

- RBI said PSBs led the recovery in capital ratios for the banking sector in FY19. They were recapitalized with ₹90,000 crore in FY18 and another ₹1.06 trillion in FY19. This bolstered their capital position, even as they battled with the overhang of impaired assets.
- Private banks and foreign banks remained well-capitalized and above the regulatory minimum of 10.875% of risk-weighted assets in March 2019. However, private banks experienced a marginal decline in capital adequacy ratio in FY19 after the reclassification of IDBI Bank as a private bank.