Loan Default: A Critical Assessment of the Impact on Banks in India

Prologue

- India's retail credit sector grew steadily in Q2 2023, driven by consumption-led demand. Credit supply (originations) increased by 15% year-on-year (y-o-y) compared to the same quarter a year ago, but loan delinquencies remained relatively unchanged.

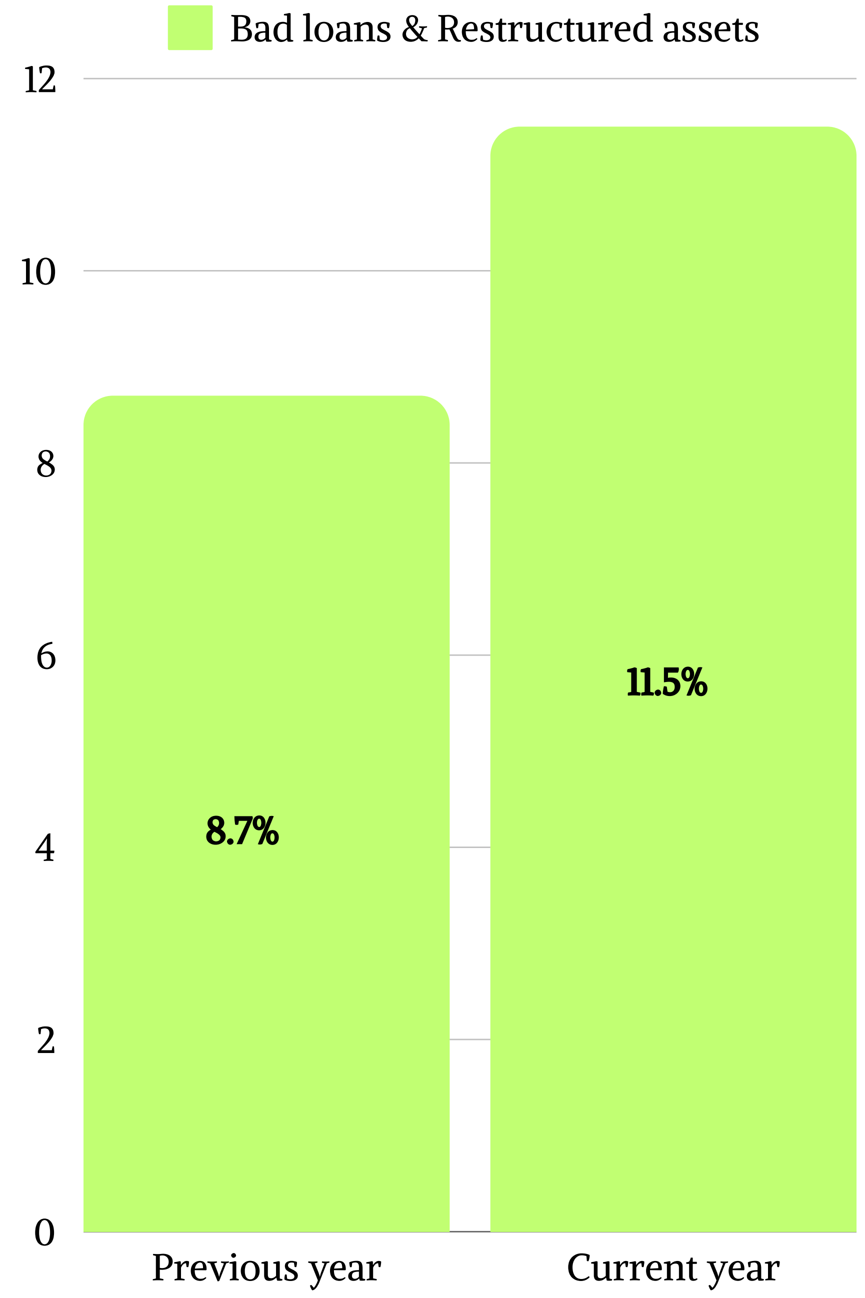
Loan Default: A glimpse

As financial intermediaries, commercial banks rely heavily on the performance of their loans as a key source of revenue. Because of increased loan defaults, the ratio of non-performing advances has risen significantly in recent years, reducing their profitability.

NPAs are assets for which principle or interest payments are past due for more than 90 days. The growing frequency of non-performing advances or loans may have a negative influence on bank performance by squeezing earnings and diminishing profitability.

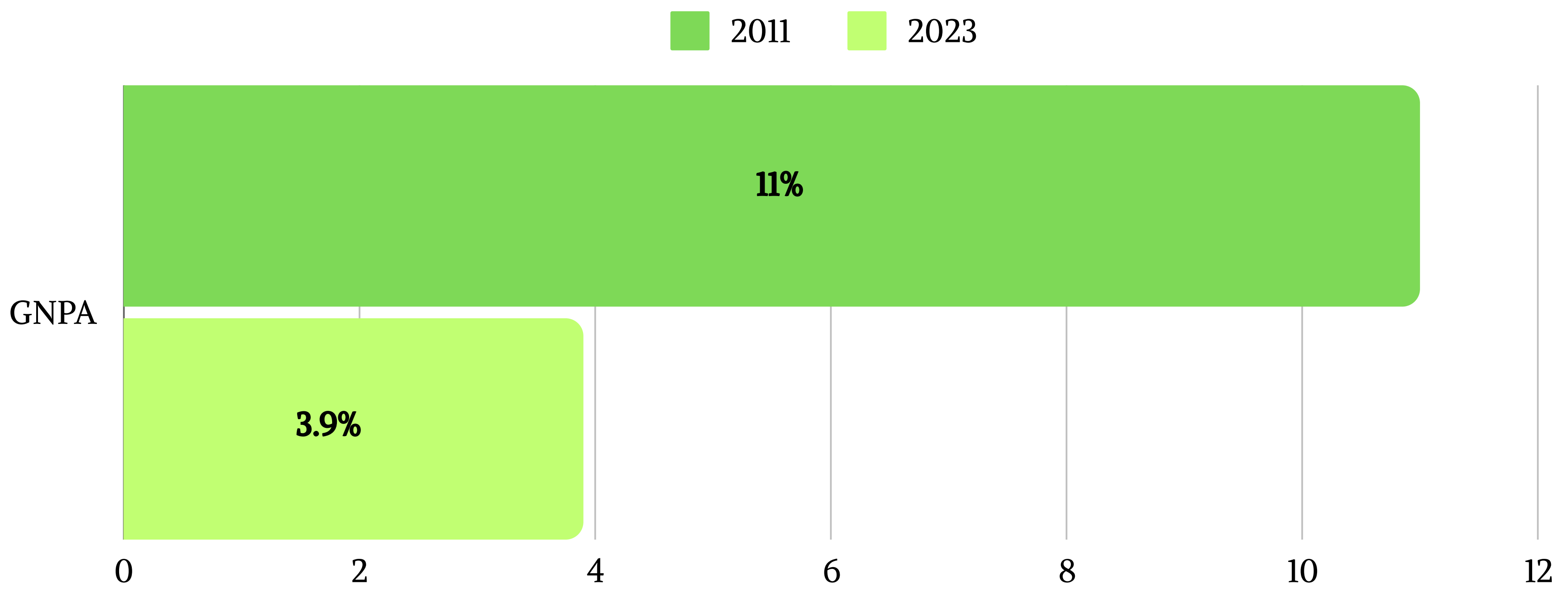
Non-perfoming assets in India

Standard & Poor's Global Rating expects the ratio of bad loans and restructured assets to rise in this fiscal year.



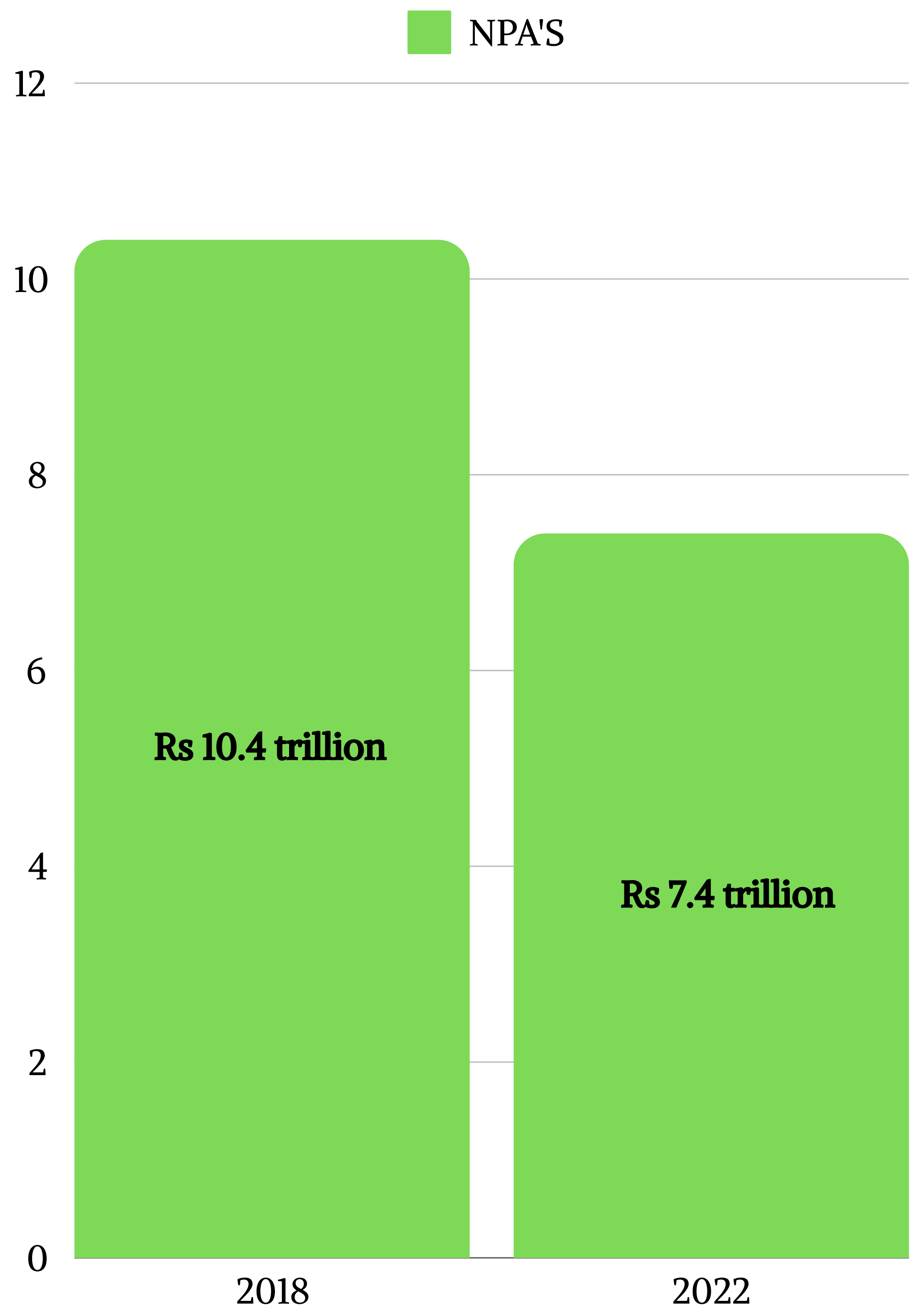
Trend of the gross non-performing assets

Industry surveys and expert projections show a possible small reduction in GNPAs for the first half of 2023-24.



Relation of NPA'S with banks

NPAs of SCBs have dropped to a 7-year low of 5% in September 2022. The net NPAs were at a 10-year low of 1.3%



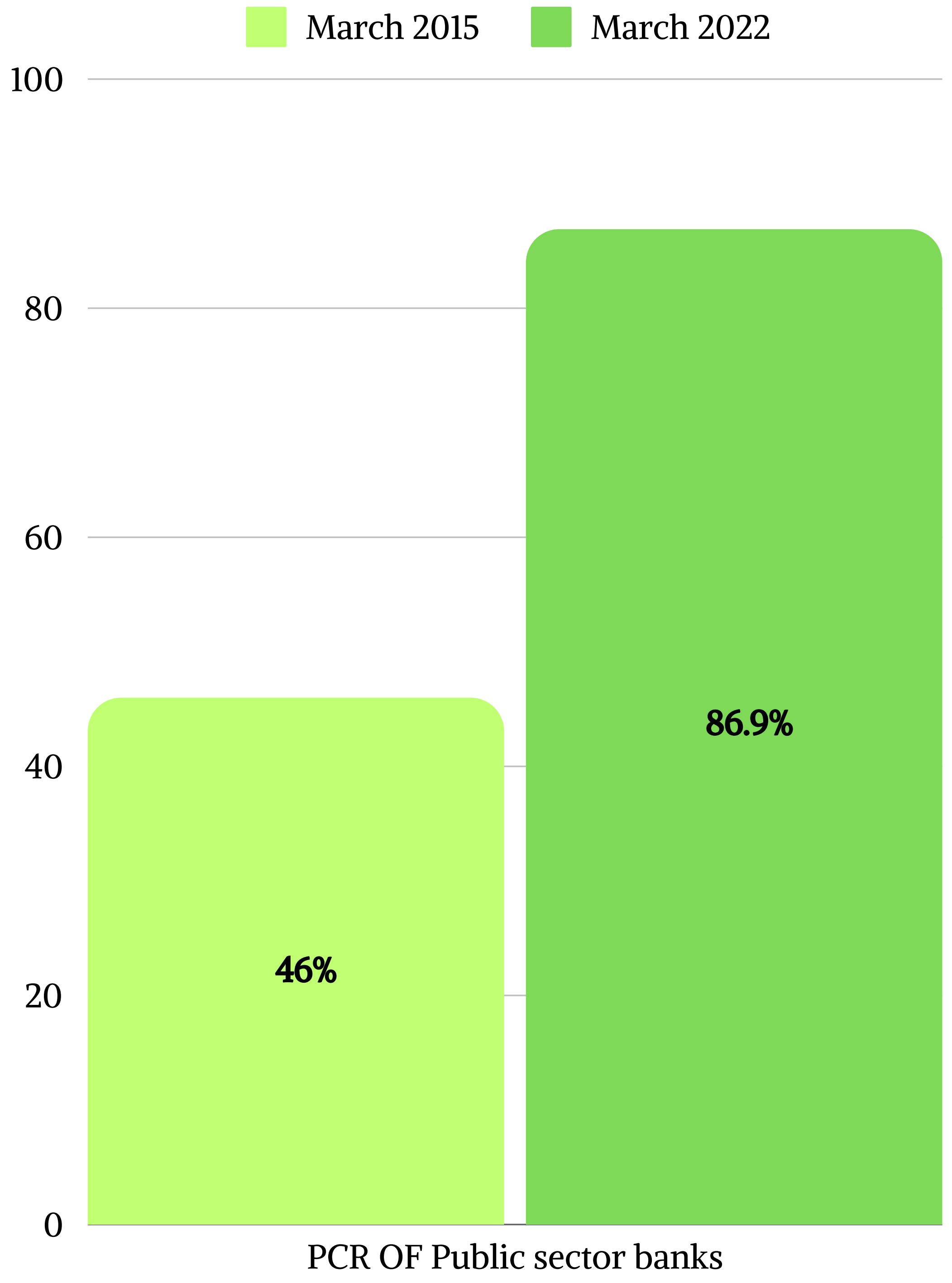
The quarterly slippage ratio increased beginning December 2021, but stabilized in September 2022. Public sector banks demonstrated significant improvement.

Borrower's asset quality and shares in SCB'S

The top 100 borrowers improved their asset quality, resulting in a lower share of SCBs' Gross NPAs.

Provision coverage ratio of banks

Banks' provision coverage ratio (PCR) is steadily increasing since March 2021, reaching 71.5% in September 2022.

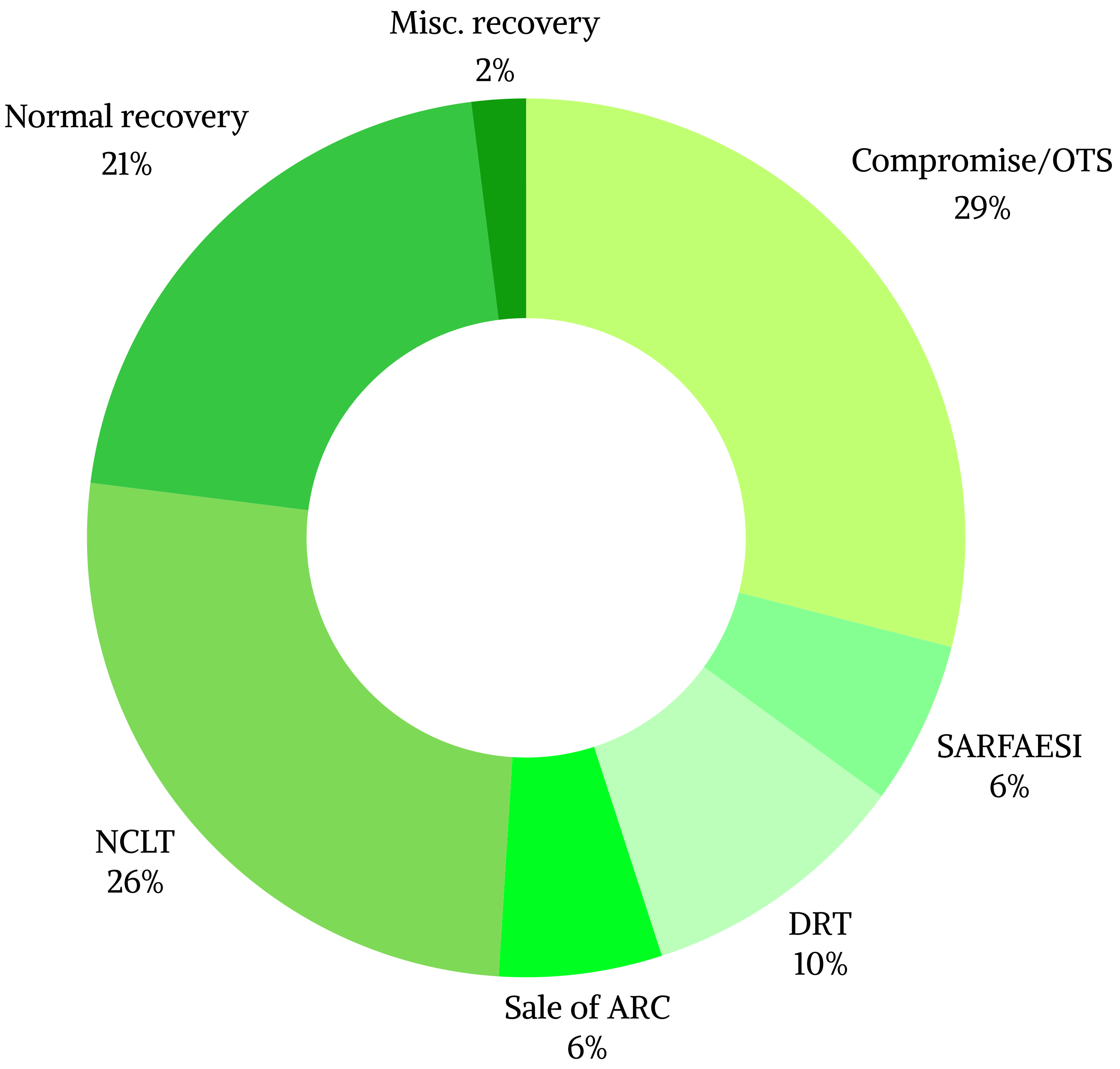


Recapitalisation of PSB'S

Bank recapitalization involves injecting new capital into banks to meet RBI-mandated capital adequacy standards.

During FY17-FY21, the government injected Rs 3.11 lakh crore to recapitalize PSBs, with Rs 0.35 lakh crore coming from budgetary allocations and Rs 2.76 lakh crore via recapitalization bonds issued to these banks.

Example- SBI'S NPA recovery structure



Conclusion

Loan defaults have a substantial negative influence on the profitability of public sector banks in India. To address rising NPAs, banks should retain bigger provisions. Higher NPAs lead to poorer bank profitability due to increasing provisioning costs.

Increasing NPAs have been a serious concern for public sector banks in India. But, there has been a declining trend in NPAs recent years due to efficient regulatory measures taken by the RBI.

The high level of NPAs due to loan defaults has affected the net interest income, capital adequacy ratio, and provisioning requirements of PSBs, leading to a decline in profitability. But effective regulatory measures have been taken to address the crucial issue of NPAs to ensure sustained growth and stability of the Indian banking sector.

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