Press Release

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Bank NPAs to shrink 350 bps to ~8% by March 2020

Driven by resolution of large ticket stressed assets and slowing pace of fresh accretion to NPAs

Asset quality of banks should witness a decisive turnaround this fiscal with gross non-performing assets (NPAs) reducing by 350 basis points (bps) over two years to ~8% by March 2020 compared with a peak of ~11.5% in March 2018 and 9.3% in March 2019. This will be driven by a combination of reduction in fresh accretions to NPA as well as stepped up recoveries from existing NPA accounts.

Significantly, public sector banks (PSBs), which account for over 80% of the NPAs in the system, should see their gross NPAs climb down over 400 bps to ~10.6% by March 2020 from a peak of 14.6% in March 2018.

To be sure, slippages have been on the wane since last fiscal. The rate of accretion of fresh NPAs halved in fiscal 2019 to 3.7% compared with 7.4% the previous fiscal and is expected to drop to ~3.2% in fiscal 2020 *(refer Chart 1)*. This is mainly because banks have already recognised ~Rs 17 lakh crore of stressed loans as NPAs since fiscal 2016, led by accelerated NPA recognition following the Reserve Bank of India's (RBI's) stringent norms and asset quality reviews. CRISIL estimates for fiscal 2020 also factor in slippages from the stress being witnessed in a few large corporate and financial sector entities.

What, however, will help reduce the stockpile significantly this fiscal is a pickup in recoveries and resolutions from large NPA accounts, especially under the Insolvency and Bankruptcy Code (IBC) and pick up in credit growth. This is assuming bulk of the pending cases in the National Company Law Tribunal (NCLT) would be resolved with higher recovery rates and faster resolution times than that hitherto seen in the country.

According to Krishnan Sitaraman, Senior Director, CRISIL Ratings, "In fiscal 2019, write-offs, coupled with recoveries under IBC in key large stressed assets, played a critical role in reduction of NPAs. Further, after a gap of six years, the pace of NPA reduction is estimated to have overtaken that of fresh slippages for the banking system in fiscal 2019. Private banks, which have had fewer asset quality issues, should also witness an improvement in portfolio performance."

The improvement would be driven by two major factors which should result in corporate loans exhibiting a substantial reduction in NPA levels:

First, the resolution of some large NPA accounts under NCLT-1[1] and NCLT-2 is expected to fructify by the end of this fiscal. This could account for almost half of the total reductions in gross NPAs of the banking system by March 2020. Recapitalisation has ensured that a number of PSBs have the balance sheet strength to provide for reasonable haircuts on resolution of stressed assets.

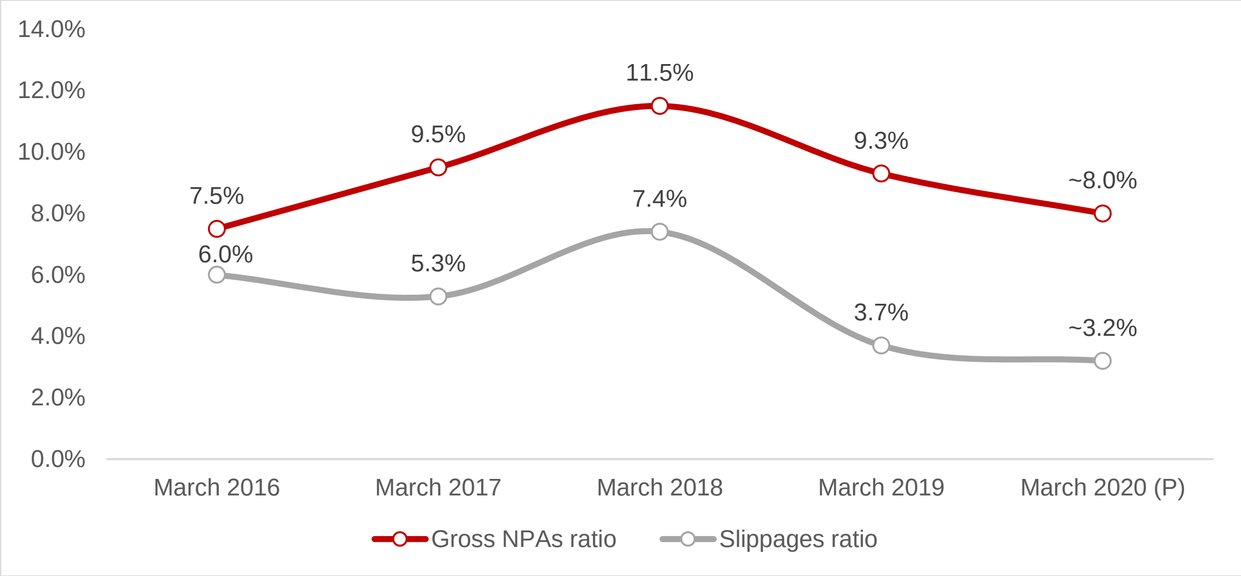
Second, trends in corporate credit quality are supportive at an aggregate level. CRISIL's credit ratio – number of upgrades to downgrades – increased to 1.81% in H2 of FY2019 compared with 1.67% in fiscal 2018. Though the credit ratio could moderate going forward, steady domestic growth and benign interest rates should continue to support credit profiles in the corporate sector.

Although delinquencies have inched up marginally in the retail segment and portfolios are yet to fully season given strong growth in the past few years, the granular nature of these loans should ensure diversification and support against material deterioration going forward. Also, given the RBI's stance on restructuring of loans to small and medium enterprises (SME) till the end of fiscal 2020, the overall NPA position of banks should continue to witness an improving trend.

According to Vydianathan Ramaswamy, Associate Director, CRISIL Ratings, "We believe the seasoning of retail loans and performance of SME loans post the restructuring period will shape the asset quality trends for the banking sector, especially PSBs, over the medium-to-long term. Nevertheless, with the improvement in the corporate stressed assets situation, overall NPAs in the banking system should continue their downward trend over the medium term."

[1] *NCLT-1 and NCLT-2 refer to the two tranches of 12 and 28 large NPA accounts respectively referred for resolution to the NCLT under the IBC.*

Chart 1: Trend in gross NPAs ratio and slippages ratio for banking sector



Source: CRISIL Estimates

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