Press Release

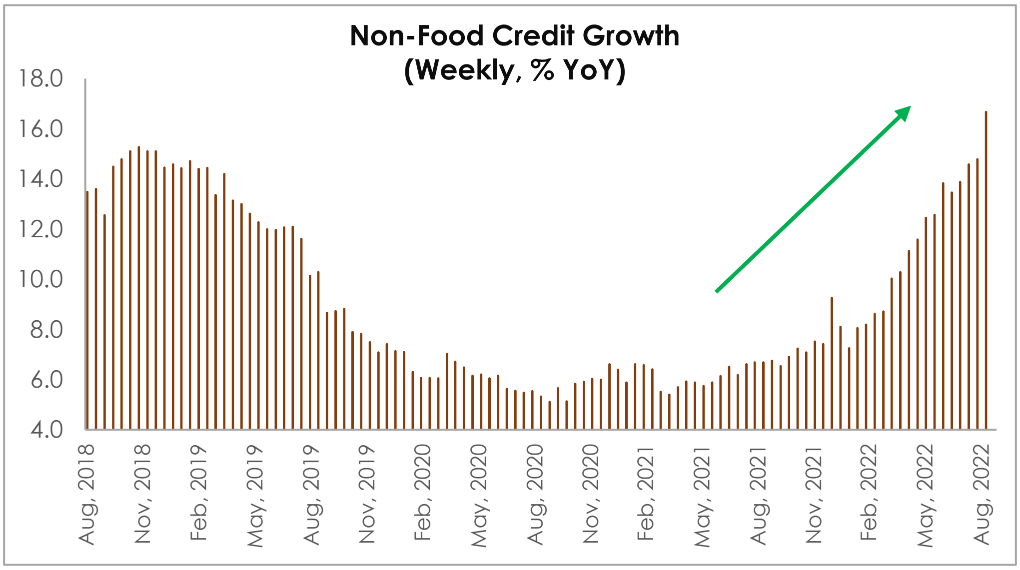
Credit growth back at its pre-pandemic levels

Gradual economic recovery to keep credit growth in the range of 14-15% in FY23

26-Sep-2022

Credit growth in India's banking sector which had remain muted in single digits since the last two and a half years, has clearly started manifesting signs of a revival in H1FY23. Since early Apr-22, non-food credit growth has climbed to double digits and has been above 14% in Aug-Sep'22 (16.7% as on Sep 9, 2022). The significant turnaround in credit growth has been led by a gradual demand pick-up in the economy after the pandemic, a revival in retail loan disbursements, some support from favourable base and increased working capital requirements due to higher commodity prices in both SME and large corporates. Overall, non-food credit has seen a sustained increase since the begging of 2022, despite the RBI front-loading the policy repo rate hike by 140 bps to 5.40% in FY23 so far. While 43.6% of the banking system loans that are linked to the external benchmark, i.e. repo rate and 91/182 T-bills, have recorded a rise in interest rates, MCLR hike (~49.2% of banking system loans are linked to MCLR) has not yet been very significant leading to many large corporates to resort to the banking sector for their additional funding requirements vis-à-vis the bond market where yields have increased sharply.

Chart 1: Non-food credit growth has seen a turnaround in H1FY23



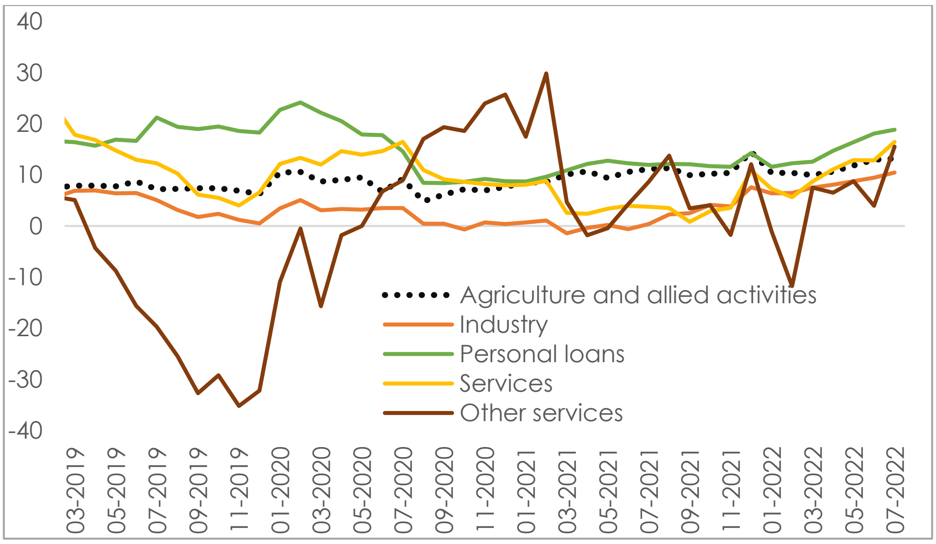
As per the monthly granular data released by the RBI, retail loan segment (comprising of 30% of total non-food credit) continued to remain the bright spot with credit growth in this segment accelerating to 18.8% YoY in Jul-22. Notably, while the retail loan segment had seen some slowdown during Covid amid lacklustre in consumption demand, it was relatively better placed than the other categories such as services, agriculture and industry segment. Within retail segment, while housing loans have recorded a steady increase of 16.2% YoY in Jul-22, consumer durables followed by credit cards and vehicle loans have been the key drivers. Going forward, recovery in urban demand is likely to power ahead with the onset of festivities and lingering pent-up demand, which is further expected to buoy the retail loan growth.

Services sector after a dismal performance during the pandemic, has recouped at a relatively faster pace with the credit growth of 16.5% YoY in Jul-22 primarily led by NBFCs along with retail and wholesale trade segment. Despite higher inflation and rising interest rates, the deployment of credit to the NBFCs has remained robust in FY23 so far with a high growth of 27.4%. Going forward, the overall outlook for credit demand for NBFCs remains optimistic, taking into account, prospects of normal monsoon and and an expected improvement in rural demand which is also likely to be aided by the upcoming festive season from the latter half of Q2 FY23.

On the other hand, credit growth in the industry segment appears to be relatively muted at 10.5% YoY in Jul-22. However, looking at the sub-sectors, the credit to micro, small and medium enterprises which were significantly impacted during the pandemic have registered a strong growth of 35% YoY in the last one year backed by support from the Emergency Credit Line Guarantee Scheme (ECLGS) scheme announced by the Government in May-20. According to the RBI's Financial Stability Report, loans amounting to Rs 3.32 tn were sanctioned under ECLGS till April 30, 2022, of which Rs 2.54 tn were disbursed. The sanctioned amount had jumped to Rs 3.48 tn loans till Jun-22 end. Looking at the granular data, some of the industries such as food processing, drugs & pharmaceuticals, rubber & plastic products and electronics that have driven credit growth, have a large number of MSMEs as a part of their value chain.

Agriculture credit growth remained broadly resilient amid a healthy monsoon and good crop sowing in both the kharif and the rabi season during FY22. However, at the current juncture, rural economy is performing below par with agricultural wages still somewhat weak, higher rural inflation, and the terms of trade against the farmers. Additionally, the fiscal support extended by the government during the pandemic has now moderated that has partly impacted consumption demand. However, prospect of a good monsoon performance after a sluggish start could keep the agriculture credit growth stable in the coming months.

Chart 2: Credit growth driven by retail loan segment while services sector catch-up

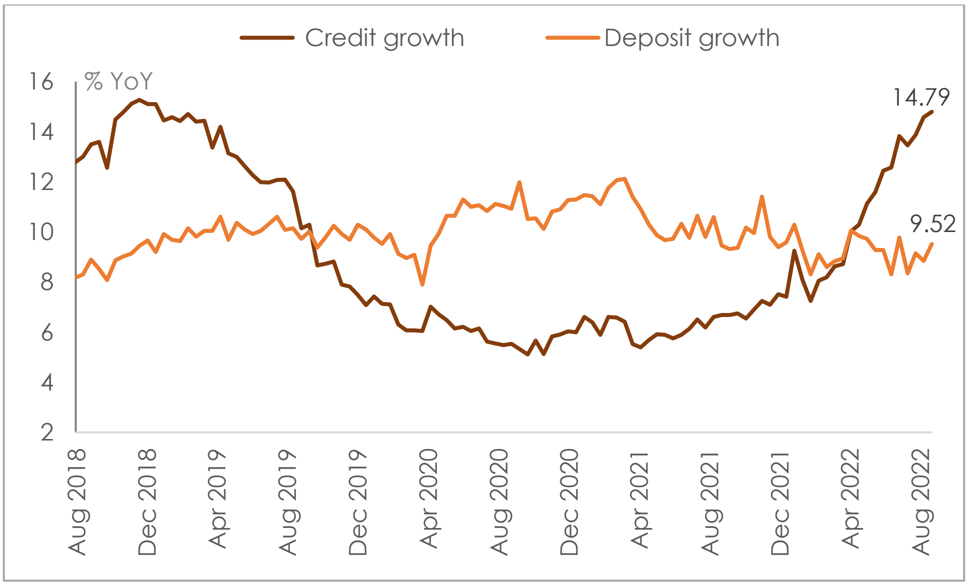


Given India's resilience towards global headwinds in the form of weakening global growth and external demand, persistent inflationary pressures, and accelerated monetary tightening across economies, the medium-term prospects for India's credit cycle appears to be promising on the back of:

1) normalization of economic activities, 2) pick-up in urban consumption growth, 3) a revival in the real estate sector 4) manufacturing capacity-utilization back at their pre-pandemic levels 5) government's continuing thrust on capital expenditure and 5) implementation of PLI scheme and the extension of ECLGS scheme. Additionally, an improvement in banks' overall asset quality and a reduction in the systemic risk aversion is also expected to aid the buoyancy in bank credit growth.

While we expect average credit growth in the range of 14-15% in FY23, some downside risks to credit growth cycle could emerge from the widening gap between deposit and credit growth, which could lead to supply-side constraints. As per the latest data, the aggregate deposits have registered a growth rate of 9.5% YoY as of Sep 9, 2022 thereby trailing the aggregate credit growth. In our view, with incremental credit-deposit ratio at 107.13%, the banks are set to increase the deposit rates further in the next 2 quarters with a view to garner more durable liquidity, which may lead to a rise in the MCLR in the system.

Chart 3: Wedge between credit and deposit growth widens



Says Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research "Despite the strong global headwinds, the high frequency indicators indicate a healthy momentum in the domestic economy and this is reflected in our Acuité Macroeconomic Performance index (AMEP) for Aug-22 that has continued to record a double-digit growth rate for the fifth consecutive month. The pickup in credit growth to mid teens after more than 2 years is one of the indicators of that momentum and reinforces our belief a GDP growth of over 7.0% is likely in FY23."

About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 9,200 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Kanjurmarg, Mumbai.

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