RBI's Concerns on Slow Deposit Growth

Why in news?

The Governor, Deputy Governor and other officials of the Reserve Bank of India (RBI), met MD and CEOs of public and certain private sector banks.

What was the meeting about?

- The Governor acknowledged the role played by private commercial banks in supporting economic growth during the pandemic and in the ongoing financial market turmoil.
- Also, he advised the banks to remain watchful of the evolving macroeconomic situation, including global spillovers.
- Discussion points included the **lagging growth in deposits** in relation to credit growth, asset quality and adoption of new-age technology solutions among other things.

Why have banks been asked to remain "watchful"?

- Global headwinds at present are emanating from three sources;
  1. Russian actions in Ukraine impacting energy supplies and prices (especially in Europe),
  2. Economic slowdown in China because of frequent lockdowns due to its zero-COVID policy, and
  3. Increased cost-of-living because of resulting inflationary pressures.
- Thus, monetary policies across the globe, especially of advanced economies, are being tightened, spurring concerns about financial stability risk in emerging and developing economies.
- The 'drag' occurs in two broad ways.
  1. Lower external demand drives down export demand obligating economic growth to be solely driven by domestic demand which might not be sufficiently strong.
  2. Higher global inflation and interest rates impact the flow of capital into the economy, putting downward pressure on domestic currency and in certain circumstances, higher imported inflation.
- To this effect, the RBI's bulletin of November 2022 states that the domestic macroeconomic outlook can be best characterised as resilient but sensitive to formidable global headwinds.

What about deposit growth vis-a-vis credit growth?

- The credit-disbursing bandwidth of the banks is determined by its in-house reserves.
- And, demand for credit increases with greater economic activity.
- As per the RBI bulletin, aggregate demand domestically bears an "uneven profile" at

present.
    1. Urban demand appears robust and
    2. Rural demand which was muted has also started acquiring some strength recently.
- Commercial bank credit growth too has been surging, led by services, personal loans, agriculture and industry, in that order.
- This reflects the growing preference for bank credit for meeting working capital requirements.

What is the place of deposits and credit growth?

- According to the RBI's data for scheduled commercial banks,
    1. Aggregate deposits have grown 8.2% in comparison to 14% on a year-over-year (YoY) basis whereas
    2. Credit off-take has jumped 17% in comparison to a 7.1% increase on a YoY basis.
- It is not that deposit growth has fallen materially, but that credit growth has risen in the last few quarters.
- During the pandemic, owing to lower economic activity credit growth was on a lower trajectory.
- Now with economic activity returning to normalcy, the credit growth has picked up - especially in the first three quarters of year 2022.
- Deposit rates not going up is another reason for slower deposit growth.
- While banks passed on higher rates through loan portfolios, most of which were at floating rates, the approach was much measured with respect to deposit rates.
- Though this helped banks' net interest margins, it did not bolster their bandwidth to disburse further credit.

What about banks' asset quality?

- The RBI's November bulletin informed that gross non-performing assets (GNPAs) have consistently declined, with net NPAs sliding down to 1% of total assets.
- Liquidity cover is robust and profitability is shored up.
- However, market participants have raised concerns with respect to corporates in light of the macroeconomic situation.
- Asset quality can be expected to improve on the corporate loan book.
- The reason is the de-leveraging that has happened in corporate India over the years wherein most corporates have been able to cut down on their debt level and improve their credit profiles.
- The setting up of the National Asset Reconstruction Company Ltd is expected to take over some of the legacy corporate loan NPAs which are still with banks.
- So, the corporate NPAs are expected to come down in the current and upcoming fiscals. However, MSME NPAs would go up.
- Irrespective, **overall NPAs for banks is still expected to come down** in the near to medium term as the corporate segment driving the downward run.

    MSME NPAs account for about 15% of the banks' loan books.

Corporate NPAs account for about 45% of the banks' loan books.

Reference

1. The Hindu | Explained | RBI's concerns on slow deposit growth