It is now well known that resource flow to commercial sector has declined by a sharp 88% in first half of current fiscal. We believe though the sharp decline in credit flow to commercial sector do indicate heightened risk aversion in the system, beneath the surface are some interesting trends that has escaped the attention of the market players. What are those unexplained myths that explain such significant slowdown in credit apart from risk aversion?

First, the hullabaloo over the decline in bank credit at Rs 1.3 lakh crores (vis-à-vis Rs 1.8 lakh crores expansion like period last year). **However, most recent trend is showing an pick-up in credit growth.** The decline in credit is driven almost by degrowth in credit to industry, even as credit to NBFCs expanded by a sharp Rs 39,200 crores. However, there are 2 hidden myths in such a large decline in credit to industry. One, the credit data is disbursements net of repayments that continues to be buoyant reflecting the extent of deleveraging by corporates. For example for FY19, the reduction in debt for top 10 corporates were around Rs 2.20 lakh crores, a large part of which could have been used to repay the banks. If we adjust for such deleveraging the credit numbers could portray a different story. Clearly, repayments has far outstripped disbursements resulting in negative credit expansion.

Second, the Large Corporate Framework effective from April 1’2019 that limits a banks aggregate exposure to a group of connected counterparties at 25% of Tier 1 capital may be acting as a constraining factor in bank lending to such entities and hence these are tapping the ECB route that has seen a significant jump in H1FY20. For the record, ECB/FCCB records with RBI (based on loan account numbers generated) were Rs 1.4 lakh crores. Specifically, recent stake sales of Government of India as a part of disinvestment programme has resulted in some CPSUs become a part of a connected counterparties and hence there might be little headroom for bank lending to the singular CPSUs. In fact, even if such lending were to happen it would result in additional bank capital or higher risk weights resulting in elevated rates. No wonder some of these entities are tapping the ECB route more vigorously given such constraints.

As far as NBFC sector is concerned, though the banks expanded their lending in H1FY20, the markets seemed to have lost appetite in funding of NBFCs, even the CPs. Subsequently, a large part of NBFCs are tapping the ECB route mostly for on lending by NBFCs, that jumped around 80% as compared to previous year. Our estimates show that nearly 45% of the ECB raised during H1FY20 were NBFCs, while 20% were accounted by corporate entities, including some CPSE conglomerates.

**Clearly, there is an emerging story behind the recent decline in credit flow that hitherto has got unnoticed.** Additionally, delay in resolution through NCLT due to various litigation and interpretation of law are dragging down credit demand from the industry.
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The eligible capital base for this purpose is the effective amount of Tier 1 capital fulfilling the criteria defined in Master Circular on Basel III – Capital Regulation.

Further, as per RBI guidelines on Enhancing Credit Supply for Large Borrowers through Market Mechanism, the primary objective of this RBI guideline was to restrict incremental exposure of all banks to single large borrowers thereby mitigating concentration risk apart from broad basing and encouraging resource raising from corporate bond market. Under this framework, the normally permitted lending limit (NPLL) for the specified borrower would be 50% of the incremental funds raised by the borrower over and above the ASCL.

A specified borrower is one having an aggregate fund-based credit limit (ASCL) of more than

- Rs.25,000 crore at any time during FY 2017-18;
- Rs.15,000 crore at any time during FY 2018-19;
- Rs.10,000 crore at any time from April 1, 2019 onwards

As per LEF, banks would have to make higher capital provisioning for lending to these specified borrowers i.e. Standard Asset Provision of 3% on the incremental exposure of the banking system more than NPLL and Additional Risk weight of 75% over and above the applicable risk weight for the exposure to the specified borrower. This would not only make credit costly but also will consume additional capital which is already scarce in nature. This could be one of the reasons which is keeping the borrowers away from the banking system.

Specifically, recent stake sales of Government of India as a part of disinvestment programme has resulted in some CPSUs become a part of a connected counterparty and hence there might be little headroom for bank lending to the singular CPSUs. In fact, even if such lending were to happen it would result in additional bank capital or higher risk weights resulting in elevated rates. No wonder some of these entities are tapping the ECB route more vigorously given such constraints.

Resolution Delay

Delay in resolution through NCLT due to various litigation and interpretation of law is also one of the dragging factor in boosting credit demand from the industry. Though the government has been quick in amendments, it would be an enabler if the bidders are assured of time bound resolution ringfenced from any litigation.

Net Issuances by CP Subscribed by Non-Banks

CP issuance during Apr-Aug 2019 declined by around 10% to Rs.10267 billion as compared to Rs.11343 billion during the same period previous year. Net CP issuance during the period is only Rs.141 billion as compared to Rs.2597 billion last year. Mutual funds also reduced their exposure to CP, by Rs.393 billion, from an outstanding of Rs.4149 billion as on Sept’18 to Rs.3756 billion as on Aug’19, resulting decline in net flow from Rs.1088 billion (H1FY19) to Rs.208 billion (H1FY20, up to Aug’19).

Netflow reduced mainly because of liquidity issue in the sector post which many a company had stop/reduced disbursements and also because of portfolio sell-out by NBFCs to Banks to meet their liquidity needs and stay afloat. Securitisation in H1FY20 estimated to be increased to around Rs.1 lakh crore from Rs.70000 crore in H1FY19.

ECB/FCCB

ECB/FCCB raised during H1FY20 (up to Aug’19) increased by 25% from H1FY19 to Rs.1414 billion. Major ECB raised are seen for on lending by NBFCs, which increased by around 80% as compared to previous year.

Our estimates show that nearly 45% of the ECB raised during H1FY20 were NBFCs, while 20% were accounted by corporate entities, including some CPSE conglomerates.

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