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THE SMOKESCREEN OF DECLINING CREDIT FLOW TO COMMERCIAL SECTOR

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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 hullaballoo 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.

DECLINE IN RESOURCE FLOW

- 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. A detailed analysis of the major parameters will give an insight and understanding on this changing matrix.

DELEVERAGING

- First, the hullaballoo 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, the 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, such 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.

LARGE EXPOSURE FRAMEWORK

- Another important factor that has gone unnoticed is the importance of Large Exposure Framework (LEF). As per the RBI norms, the sum of all the exposure values of a bank to a single counterparty must not be higher than 20 percent of the bank's available eligible capital base at all times. In exceptional cases, Board of Banks may allow an additional 5 percent exposure of the bank's available eligible capital base. Further, the sum of all the exposure values of a bank to a group of connected counterparties (must not be higher than 25 percent of the bank's available eligible capital base at all times.

Flow of Funds to the Commercial Sector (Rs billion)

	H1FY19	H1FY20	Growth (%)
A. Flow from banks	1,851	-1,288	-170
1. Non-food credit	**1,652**	**-937**	**-157**
*of which credit to NBFCs**	-62	392	-
*credit to Industry**	-372	-1,206	-
2. Non-SLR investment by SCBS	199	-351	-276
B. Flow from non-banks (B1+B2)	**5,510**	**2,198**	**-60**
B1. Domestic source	4,447	136	-97
1. Public issues by non-financial entities *	63	583	833
2. Gross private placement by non-financial entities*	474	625	32
3. Net issuance of CPs subscribed by non-banks	2,537	191	-92
4. Net credit by housing finance companies $	522	-60	-112
5. Total accommodation by 4 RBI regulated AIFIs	400	-48	-112
6. NBFCs-ND-SI and NBFCs-D (net of bank credit)	412	-1,256	-405
7. LIC's net investment ^	40	100	151
B2. Foreign sources	1,063	2,062	94
1. ECB /FCCB	-6.5	541	-
2. FDI to India^	1,070	1,521	42
C. Total flow from banks and non-banks (A+B)	**7,361**	**910**	**-88**
Memo			
Change in Repo Rate	+50 bps	-60 bps	-
Change in 1-Yr MCLR	+30 bps	-30 bps	-

Source: SBI Research, RBI $: Up to Jun ^: Up to Jul *: Up to Aug

Top10 Sector - Change in Total Debt

Sector	Total Debt (Rs. In Crore)		
	as on March'18	as on March'19	Change in Debt
Steel	267286	213036	-54250
Infrastructure Developers & Operators	102942	71055	-31887
Textiles	109110	77375	-31734
Consumer Durables	31985	4176	-27808
Miscellaneous	36837	12693	-24144
Construction	55439	40857	-14582
Auto Ancillaries	30067	19161	-10907
Air Transport Service	12440	3779	-8660
Edible Oil	9885	1384	-8501
Capital Goods - Electrical Equipment	23748	16557	-7191

Source: CLIne; data are from around 4000 listed entities; SBI Research

- 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 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.

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).

NBFCS-ND-SI AND NBFCS-D (NET OF BANK CREDIT)

- Net flow 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 (upto 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.

Deployment of Funds in CP by Mutual Fund (Rs. billion)

Period	O/s	Net flow
H1FY19		
March'18	3061	1088
Sept'18	4149	
H1FY20 (upto Aug'19)		
March'19	3548	208
Aug'19	3756	

Source: SEBI; SBI Research

CP Issuance and redemption in H1FY20 (upto Aug'19) (Rs. In Billion)

Month	Issuance	Redemption	O/s
April	2004	1406	5429
May	2084	1993	5520
June	2156	2636	5039
July	2009	1955	5094
Aug	2013	2136	4972
Total	**10267**	**10126**	

Source: RBI; SBI Research

Top 10 Sectors - ECB/FCCB raised during H1FY20 (upto Aug'19)

Economic Sector of the borrower	Rs. Billion
Financial Service Activities, Except Insurance And Pension Funding	632
Warehousing and support activities for transportation	183
Manufacture of coke and refined petroleum products	116
Manufacture of basic metals	95
Electricity, gas, steam and air conditioning supply	81
Telecommunications	36
Extraction of crude petroleum and natural gas	33
Manufacture of computer, electronic and optical products	29
Manufacture of machinery and equipment n.e.c.	29
Manufacture of chemicals and chemical products	28

Source: RBI * Based on applications for ECB/Foreign Currency Convertible Bonds (FCCBs) which have been allotted loan registration number during the period.; SBI Research

ECB/FCCB raised durig H1FY20 (upto Aug'19)

Purpose	Rs. Billion
On-lending/Sub-lending.	547
Rupee Expenditure Loc CG	247
Modernisation	108
Import of Capital Goods	86
Refinancing of earlier ECB	82
Working Capital	80
Refinancing of Rupee loans	71
New Project	65
Infrastructure development	40
Other	36
Others	35
Overseas Acquisition	14
Micro Finance	2
General Corporate Purpose	1
Total	**1414**

Source: RBI * Based on applications for ECB/Foreign Currency Convertible Bonds (FCCBs) which have been allotted loan registration number during the period.; SBI Research

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