Economy & Banking during COVID-19 pandemic and way forward

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Economic Impact

The spread of the COVID pandemic across the globe brought in a lot of uncertainties and implications on all aspects of business. Despite implementation of work-from-home measures, loss of employment and earnings deficit was anticipated. The extended lock-down resulted in waterfall moment as far as jobs are concerned though a revival is seen from June 2020 onward when economic activities resumed gradually. Though Government announced first relief package amounting to Rs. 170,000 crore, yet a large section of populace faced hardships. Additionally, State Governments, NGO, Self-help groups and Corporate enhanced the aid coverage, including daily distribution of free food. Although corporate earnings announced so far have been better than anticipated, yet the overall impact would be discernible only in the coming quarters. Another indicator of economic revival is GST collection, which has crossed Rs. 1 lakh crore in October 2020. Other economic indicators like Forex reserves have reached all time high of US$ 561 billion on the back of unabated FDI and FPI inflows. Retail inflation linked to Consumer Price Index was at 6.58 in February 2020 i.e. before commencement of pandemic, which has inched up to 7.34 in September 2020. Debt-GDP ratio of the Indian economy was around 66% at the end of FY19-20, which is likely to surpass 85% by the end of FY20-21.

There was an old saying about non-existence of black swans, until one appeared from nowhere. Black swan events are characterized as rare, impactful, of large magnitude and consequence, hard-to-predict, etc. Such events derail the financial markets including banking industry. Corporate and commercial banks would be playing a catalyst role to bring back economy on the revival path during the pandemic, and in facilitating an economic revival thereafter. One of the indicators of the major impact was contraction of US economy by a whopping 32.9% annual rate in April-June 2020 quarter followed by a strong recovery of 33.1% annual rate in July-September 2020 quarter, albeit, on a lower base. Indian GDP contracted for Q1FY20-21 at historic low of 23.9% YoY basis. Q2 FY2020-21 GDP data released on 27th November 2020 reflects a contraction by 7.5%. The economy has clawed back faster than expected. However, the economy has entered into a technical recession with two consecutive quarters of negative growth though reasons are obvious.

RBI is expecting GDP to contract by 9.5% in the current financial year whereas World Bank has predicted Indian economy to contract by 9.6%. Besides rise in unemployment, the other pain points would be supply chain stress, fall in tax collections, collapse of tourism and hospitality industry, gap in supply and consumer demand, and reduced fuel consumption. Subsequently, second relief package worth Rs. 2,000,000 crore announced, which was equivalent to 10% of India's GDP, with focus on self-reliant India mission. CLSA, capital markets and investment group, expects India's real GDP to contract by 15% whereas S&P, global rating agency, prediction revolves around 9.0% contraction. The GDP contraction estimates differ from institution to institution due to uncertain times ahead.

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Agriculture Sector

According to the published data, 44% of India's workforce is employed in agriculture and it is source of livelihood for 58% of country's population. Agriculture continues to be main pillar of Indian economy, which serves food consumption need of the entire country.

The set of challenges faced by the sector could be divided into two categories viz. labour scarcity and exports. The labour problem surfaced due to mass exodus of migrant labour to rural hometowns that has also affected supporting infrastructures in the form of storage units (go-downs, cold-storage, warehouses, etc.) and milk processing plants. The other challenge pertains to transportation of agriculture produce from one part of the country to other besides export challenges getting unfolded. Government announced relief package, part of overall package, amounting to Rs. 163,000 crores for agriculture and allied sectors with emphasis on strengthening infrastructure, logistics and capacity building.

MSME Sector

Many MSMEs had temporarily shut down their activities due to prevailing pandemic, according to a survey. The temporary closure was prominent among metro-cities and those in manufacturing and retail verticals. MSMEs have asked for tax discounts or exemptions or interest free/cheaper rates loans to tide over the crisis. Almost one-thirds of MSMEs have migrated to digital mode of business, enabling themselves with e-commerce functionality. Some of the MSMEs adopted video-conferencing and WhatsApp tools in an attempt to keep business running during these turbulent times. According to the survey, MSMEs often take assistance of web professionals to create website and take plunge into digital mode of transactions.

According to annual report of Department of MSME, there are 6.34 crore MSMEs in the country, out of which 55% are located in rural India, employing almost 11 crore people. Micro enterprises constitute 99.5% of the total MSMEs equally distributed in rural and urban areas. Since majority of micro enterprises are not registered, as they are just too small, leading to constraints in getting government aid. Majority of the MSME funding comes from informal sources, as lending institutions cater to one-thirds of their credit requirement. The total lock-down had raised a question mark on the survival of MSMEs due to scarcity of cash to wither out crisis. Another challenge was in the form of labour unavailability to resume operations though migrant labourers have resumed work gradually.

Government has announced 6 measures to support MSMEs for revival – Rs. 300,000 crore collateral free loans; Subordinate debt to the extent of Rs. 20,000 crores; Equity infusion to the tune of Rs. 50,000 crores; MSME definition revised to enhance coverage; Global tenders to the extent of Rs. 200 crore disallowed to foreign firms; pending payments to MSMEs released within 45 days, by Government. The latest report suggests that commercial banks have sanctioned Rs. 187,579 crores to approximately 50.7 lakh MSMEs, with disbursements reaching a level of Rs. 136,140 crore by first week of October 2020.

Banking Sector

Indian Banks have proactively formulated short term as well as medium term strategies to cope up with the ongoing health crisis, impacting banking industry. The foremost might be capital requirement - stronger public sector banks would be in a position to raise capital from market subject to Government holding not falling below 51% as per extant regulations. RBI asked all commercial banks not to declare dividend for the FY19-20, rightfully so, to conserve capital, in the first fortnight of April 2020, subject to review post 2nd quarter performance of all commercial banks during FY20-21. New generation private sector banks would find easier to access capital markets for raising capital whenever needed. The 6 months moratorium option availed on loans and advances by borrowers might result in surge of delinquent assets, requiring additional bad loan provisions though banks' are already keeping aside COVID-19 provision. Recently, Government of India (GoI) has announced waiver of compound interest to select categories namely, MSME loans, Education loans, Housing loans, Consumer durable loans, Vehicle loans and Credit Card dues, Personal loans to professionals, Consumption loans, and allowed ex-gratia payment to the borrower accounts, those availed moratorium, which were standard assets as on 29th February 2020. The ex-gratia payment is allowed to the borrowers having sanctioned limits and outstanding amount not exceeding Rs. 2 crore in aggregate, who also continued regular payment of EMIs during moratorium period. If a borrower has liquidated outstanding loan during moratorium period then pro-rata relief amount to be credited in the account of the borrower. Rating agency CRISIL has predicted rise of bad loans to 11.5% level by March 2021. The Financial Stability Report of the regulator has estimated delinquent assets to reach a range of 12.5% and 14.7% by the end of FY20-21. RBI has accepted the recommendations of Kamath Committee for onetime restructuring of loans for medium and large Corporates, covering 26 worst affected sectors for advances of Rs. 25 crores and above, basis five mandatory financial ratios.

The other major factors impacting banking industry are **liquidity** and **risk** management. Though enough of liquidity has been released by RBI (Rs. 5.66 lakh crore till May 2020) yet, the primary focus of the central bank revolved around liquidity measures. The risk factors which need careful assessment include credit risks, operational and liquidity risks. Liquidity is key element of business continuity or going concern capacity of lending institutions during pandemic period. The Q1FY20-21 results announced by private sector as well as public sector banks have been better than expectations. The Q2FY20-21 results announced during October/November 2020, by leading new generation private sector banks have exceeded expectations so far. However, the real impact would be visible by the end of the year when moratorium payments become due.

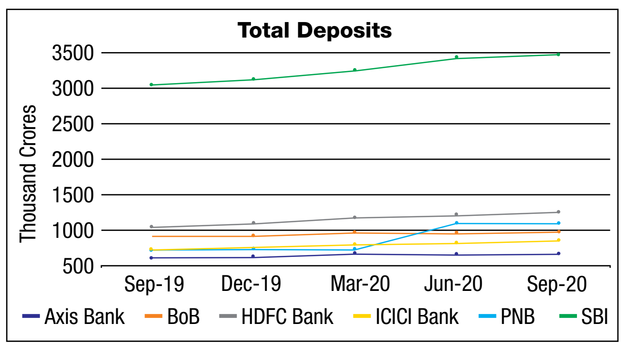
The drop in consumer lending demand is likely to affect retail loan growth during this year whereas MSME lending could witness a normal growth due to guaranteed MSME relief package of Rs. 300,000 crore announced by the Government. Banks are negotiating for reduction in rentals of existing leased premises to bring down operating expenditure; dwindling interest rates are likely to squeeze net interest margins; credit costs would surge on account of additional provisioning; demand for non-loan banking services would recoup gradually; customer trust might have shifted to renowned and trusted brands; consolidation/privatization of weaker banks; deposit and advances interest rates have touched new lows; branch, expansion exercise has slowed down; and last but not the least banks started exploring adoption of modern technology to enhance digitalization process. While banking sector is likely to go through unprecedented uncertainty about the economic outlook, the present environment continues to encounter, in particular, challenges and disruption, which could impact banking industry as a whole.

Table I - TOTAL DEPOSITS (Rs. in Crore)

Bank Name	Sept 2019	Dec 2019	March 2020	June 2020	Sept 2020
Axis Bank	583958	591676	640105	628150	635454
BoB	*894130	896162	945984	934461	954340
HDFC Bank	1021615	1067433	1147502	1189387	1229310
ICICI Bank	696273	716345	770969	801622	832936
PNB	695782	708544	703846	**1074917	1069747
SBI	3033396	3111229	3241621	3419363	3470462

***Vijaya Bank and Dena Bank merger with Bank of Baroda (BoB) became effective from 1st April 2019**

****Amalgamated figures with United Bank and OBC effective 1st April 2020**



On an analysis of deposit growth pattern during last 12 months, it is observed that growth of top 6 banks - 3 from public sector and 3 from new generation private sector – from October 2019 to September 2020 has been in the range of 9% and 20% except PNB where figures are not comparable due to merger of 2 banks with it effective 1st April 2020. If deposit growth during pandemic period is considered, then

SBI, HDFC Bank and ICICI Bank have grown by 7% approximately. BoB has registered deposit growth of 1% whereas Axis Bank recorded de-growth of 1%. In terms of total deposits, SBI is far ahead of all other banks as depicted in graph.

Table II - TOTAL ADVANCES (Rs. in Crore)

Bank Name	Sept 2019	Dec 2019	March 2020	June 2020	Sept 2020
Axis Bank	521594	550138	571424	561341	576372
BoB	*637340	654465	690120	686672	669851
HDFC Bank	896984	936030	993703	1003299	1038335
ICICI Bank	613359	635654	645290	631215	652608
PNB	427903	471356	471828	**721695	716924
SBI	2248313	2301669	2422845	2385639	2383624

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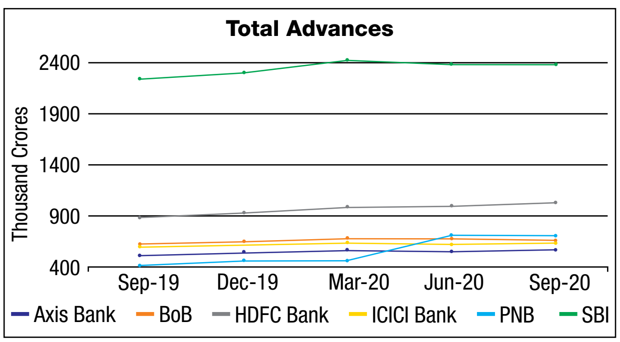
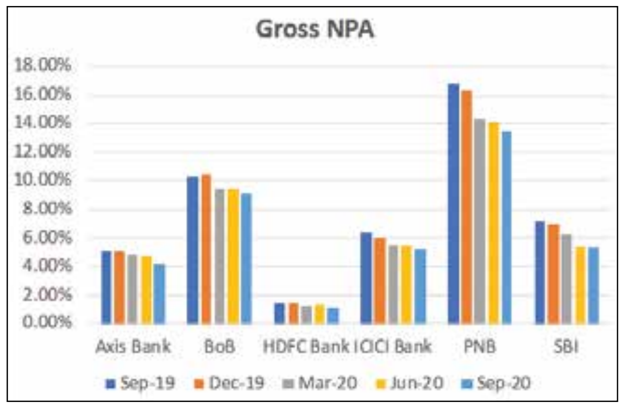
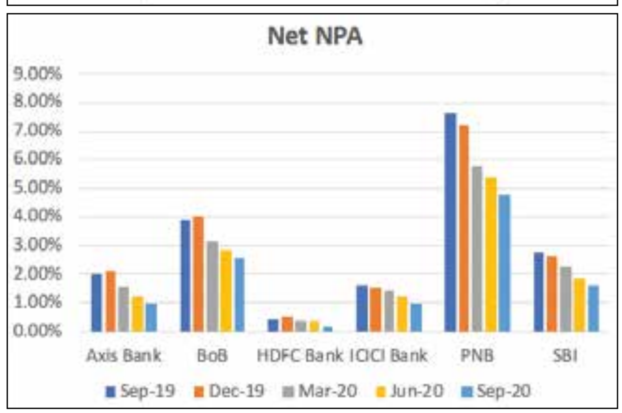


On a closer look at credit growth during last 12 months, it is noticed that growth has been in the range of 5% and 16%, with HDFC Bank emerging as leader in this segment. PNB figures are not comparable due to amalgamation of 2 banks with it effective 1st April 2020. During pandemic period, HDFC Bank comes out as leader with around 5% growth whereas Axis Bank and ICICI Bank registered credit growth of barely 1%. BoB and SBI recorded de-growth in advances level. Lower credit growth or de-growth during pandemic period could be attributed to poor or no demand for funds from retail as well as corporate sector due to lockdown, enhanced unemployment and temporary suspension of manufacturing activities. SBI is much better placed when it comes to total advances as compared to all other banks.

Table III - GNPA & NNPA QUALITY (Unit is percent)

Bank Name	Sept 2019	Dec 2019	March 2020	June 2020	Sept 2020
Axis Bank	5.03 1.99	5.00 2.09	4.86 1.56	4.72 1.23	4.18 0.98
BoB	10.25 3.91	10.43 4.05	9.40 3.13	9.39 2.83	9.14 2.51
HDFC Bank	1.38 0.40	1.42 0.48	1.26 0.36	1.36 0.33	1.08 0.17
ICICI Bank	6.37 1.60	5.95 1.49	5.53 1.41	5.46 1.23	5.17 1.00
PNB	16.76 7.65	16.30 7.18	14.21 5.78	14.11 5.39	13.43 4.75
SBI	7.19 2.79	6.94 2.65	6.15 2.23	5.44 1.86	5.28 1.59



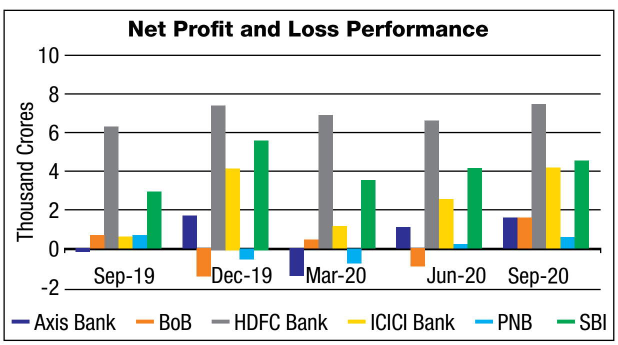


Asset quality of all the top 6 banks has improved significantly during last 12 months due to full disclosure of delinquent assets and adequate provisioning for non-performing assets. These banks have also made additional Covid-19 provisioning to take care of additional delinquent assets arising out of moratorium period of 6 months offered to the borrowers. Since honourable SC has banned declaring assets as

NPA from 1st April 2020 onwards, the asset quality improvement during pandemic period is obvious. RBI has approached honourable SC for lifting NPA declaration prohibition. On 3rd September, 2020, the apex court has issued an interim order against declaring an account NPA which was categorised as Standard as on 31st August 2020 (the date when moratorium period ended). Since we are already in the third quarter FY'21, there is a fear that all the new NPAs may be pushed to the fourth quarter FY'21. The bad loan recovery has dropped to one-thirds in the June quarter with hardly any progress in IBC cases and sale of bad loans to ARCs has dried up due to uncertainty. Banks' will have to ensure that standard loans don't slip into sub-standard category as far as possible.

Table IV - NET PROFIT/LOSS PERFORMANCE (Rs. in Crore)

Bank Name	Sept 2019	Dec 2019	March 2020	June 2020	Sept 2020
Axis Bank	-112	1757	-1388	1112	1683
BoB	737	-1407	507	-864	1679
HDFC Bank	6345	7417	6928	6659	7513
ICICI Bank	655	4146	1221	2599	4251
PNB	757	-492	-697	308	621
SBI	3012	5583	3581	4189	4574



Net profit figures of HDFC Bank, ICICI Bank and SBI have been consistent during last 5 quarter by recording surplus every quarter whereas Axis Bank, BoB and PNB profitability has been erratic during last 5 quarters where it suffered losses during 2 of the 5 quarters perhaps on account of provisioning on delinquent assets. It is quite heartening to note that all these 6 banks have registered profits during last quarter, which is a good sign of revival during pandemic period. Unlike IT companies, Banks' doesn't post sequential rise in net profit, rather YoY growth is seen as a measure of profitability performance.

Capital & Operating Expenditure

In the absence of usual branch outlet expansion, Banks' would be in the process of finding out innovative ways to extend customer services through branch channel, enhancing semi-urban and rural coverage, payments processing and upgrading digital migration. Relationship Managers and Customer Interfacing Officials should manage customer relationships virtually besides promoting subsidiary businesses. Therefore, judicial investment in technology, artificial intelligence, robo-advisory and paperless or less paper banking may be resorted to. Since business hours of the banks functioning during pandemic period stand reduced to 4 hours, call centre volume might witness a spike leading to additional costs. Customer handling costs are likely to go up in the short run as operating expenditure viz. employee costs, rent, electricity, stationery, etc. are likely to remain unchanged. The enhanced expenditure is going to be partially offset by variable sales and marketing costs. Enhanced digitalization would result in surging cyber security issues. Well-designed training programs would provide practical input to the customer interfacing officials. Banks are likely to offset increased costs by enhancing locket rents, service charges, transaction charge, cash deposit charges, and penal charges.

Upgrading Technology

Dynamic customer/consumer preferences and digital platform promotion initiatives taken by the GoI have opened up doors for technical giants namely, Amazon, Facebook, Apple and Google to firm up their footsteps into the Indian Financial Sector, thereby launching innovative products/services benefiting customers/consumers. Payment platforms like Amazon Pay, Google Pay (facilitator only), Apple Pay and proposed WhatsApp payment services would pose a greater threat to the Banks in that field. More than 200 million Indians are already using WhatsApp messaging services, which will make it a prominent player in the Payment space. Usage of big data in analysing consumer behaviour patterns could aid these tech giants to work on vital aspects of consumer delight, uniform customer experiences and financial inclusion. When adopting modern technology, banks will have to ensure simultaneously mitigation of risks associated with cyber security, operations, business continuity and data management. Another opportunity during pandemic would be to move towards paperless banking for account opening, loan applications, appraisal, documentation and investment advisory. Indian Banks' have to prepare a contingency plan - using artificial intelligence, block-chain technology, chatbots, business intelligence, promoting Fin-tech start-ups and advanced machine learning when Fin-tech giants namely, Amazon, Apple, Google and Facebook firm up their plans to enter Financial Sector in India.

Coronavirus, a black swan event, has devastated the economies across the globe, resulting in contraction of GDP during 1st and 2nd quarter of the FY 20-21. As a consequence, the financial markets got derailed where a large gap is witnessed in demand and supply of goods and services in certain sectors though IT services, Pharma Companies, FMCG sector continued to do well. The deposit and advances growth of Banks have slowed down and profitability has been erratic during the last 5 quarters yet NPA levels have seen an improvement, albeit, moratorium has contributed to a certain extent. Banks have been making additional NPA provisioning for last 3 quarters yet full impact of pandemic will be known when the true picture gets revealed post March 2021. Government has allocated sizeable funds for revival of Agriculture and MSME sectors where Banks have been provided guarantee for lending to MSME sector. Considering slowdown on the branch expansion front, banks will do well to adopt modern technology for rendering efficient services to the customers.

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