

## **RBI releases Report on Trend and Progress of Banking in India, 2005-06**

The Reserve Bank of India today released its Report on Trend and Progress of Banking in India, 2005-06. The Report provides a detailed account of policy developments and performance of commercial banks, co-operative banks and non-banking financial institutions during 2005-06. The Report also presents a detailed analysis of the Indian financial system from the financial stability viewpoint.

The Report has seven chapters. Statistical tables appended to the Report provide information on operations and performance of financial institutions both at individual and aggregate levels.

Financial sector reforms in India have been introduced in a calibrated and well-sequenced manner since the early 1990s. The sustained efforts by the Government, the Reserve Bank and by banks themselves have resulted in a competitive, healthy and resilient financial system. The asset quality and soundness parameters of the Indian banking sector, on the whole, are now comparable with global levels. This has been achieved in the backdrop of gradual alignment of prudential norms with international best standards and in an environment of growing competitive pressures. There is also an evidence of some financial deepening in recent years. Having achieved substantial success in improving the financial health of commercial banks over this period, there is now need to focus on the further expansion and deepening of financial services so as to serve the needs of those who are underprivileged. This would include particular attention being given to the underdeveloped regions of the country. The reform process is also being extended to the improvement of financial health and prudential regulation of urban co-operative banks, regional rural banks, the rural co-operative banking sector and non-banking financial institutions. In view of the dual regulatory control of urban co-operative banks, the strategy of reform is being conducted through a consultative mechanism involving State Governments.

### **Overview**

The first Chapter provides an overview of the macroeconomic developments in the global and the Indian economy during 2005-06, as also the performance of various financial institutions.

### **Policy Developments in Commercial Banking**

This Chapter provides a detailed account of the various policy measures undertaken by the Reserve Bank during 2005-06 and some major developments up to October 31, 2006. These relate to monetary policy, credit delivery, regulation and supervision, customer service, financial inclusion, payments and settlement systems, technological developments and legal reforms. The objective of various policy measures has been to ensure an efficient and stable financial system for sustaining the growth momentum, and to expand banking services to all sections of society. Major policy initiatives

undertaken by the Reserve Bank include allowing banks to raise capital through innovative instruments, advising banks to open 'no frills' accounts with nil or low balances, one-time settlement scheme for SME accounts, guidelines on securitisation of standard assets and sale/purchase of NPAs, and introduction of the national electronic funds transfer (NEFT) system.

### **Operations and Performance of Commercial Banks**

This Chapter profiles the operations and financial performance of scheduled commercial banks, at the aggregate and bank group levels, based on their audited balance sheets. The analysis in this Chapter covers important aspects such as trends in overall bank credit, credit to the priority sector, lending to sensitive sectors, investment portfolio, trends in deposits, structure of interest rates, financial performance and soundness parameters, extent of technology application and regional spread of scheduled commercial banks. The Chapter also covers the operations of scheduled commercial banks in the capital market. An analysis of the balance sheet parameters and financial performance of regional rural banks is presented in the Chapter. Finally, the financial performance of the four local area banks is also covered in this chapter.

The main points emerging from the analysis are:

- Bank credit growth remained robust for the second year in succession.
- Credit growth turned more broad-based even as credit expansion was more pronounced in respect of retail sector, particularly housing and loans to commercial real estate.
- Net accretion to deposits was lower than expansion in credit, with banks having to partially unwind their holdings of Government securities.
- Net profits of scheduled commercial banks, as a group, increased during the year as against the decline in the previous year due mainly to a turnaround in non-interest income.
- Gross NPAs and net NPAs declined significantly during the year and are now comparable with global levels.
- Banks' capital to risk weighted assets ratio remained more or less at the previous year's level, despite application of capital charge for market risk; significant increase in risk-weighted assets and increase in risk-weights for certain sensitive sectors. This, to an extent, was facilitated by large resources raised by banks from the capital market.
- Till October 31, 2006, 137 RRBs were consolidated to form 43 new RRBs, sponsored by 18 banks in 15 States, bringing down the total number of RRBs all over India from 196 at end-March 2005 to 102.

### **Developments in Co-operative Banking**

The Chapter outlines major policy initiatives, and operations and performance of various segments of the co-operative credit institutions in India, *i.e.*, urban co-operative banks (UCBs) and rural co-operative credit

institutions. The data coverage for UCBs has been widened to include complete balance sheet information in respect of both scheduled and non-scheduled UCBs. Besides, the analysis also covers non-scheduled UCBs with deposit size of Rs.100 crore and above. The Chapter also covers, for the first time, information on balance sheet, financial performance and asset quality of State Co-operative Agriculture and Rural Development Banks (SCARDBs) and Primary Co-operative Agriculture and Rural Development Banks (PCARDBs).

The policy initiatives for UCBs during 2005-06 were guided by the 'Vision Document' for revival of UCBs. Eight States have entered into Memoranda of Understanding with the Reserve Bank so far. As envisaged in the 'Vision Document' a differentiated approach to regulation has been adopted with regulatory forbearance for the smaller UCBs while at the same time strengthening their operations. Regulatory measures undertaken during the year related to improving credit delivery mechanism, strengthening prudential norms, improving customer service and enhancing business opportunities.

The major points emerging from the analysis of balance sheet, financial performance and soundness indicators in this Chapter are as follows:

- Assets of urban co-operative banks (both scheduled and non-scheduled) increased moderately during 2005-06.
- Total assets of scheduled urban co-operative banks increased at a higher rate during 2005-06 in comparison with 2004-05.
- Net profits of scheduled UCBs more than doubled during 2005-06 in contrast to a decline in the previous year.
- Asset quality of UCBs improved significantly during 2005-06.
- All segments of the rural co-operative sector were able to expand their business operations during 2004-05. However, their financial performance varied across the institutions.
- Within the short-term structure, while the state co-operative banks (StCBs) earned lower profits, the district central co-operative banks (DCCBs) recorded higher profits. Primary agricultural credit societies (PACS), on the whole, continued to incur overall losses, although a sizable number of them earned profit during 2004-05. In the case of long-term structure, while the SCARDBs continued to incur losses, PCARDBs staged a turnaround during 2004-05.
- Asset quality of short-term structure of rural co-operative banks including StCBs, DCCBs and PACS improved, while that of long-term institutions including SCARDBs and PCARDBs declined.
- The SHG-Bank linkage programme continued with 0.6 million new SHGs having been credit linked by the banking system during 2005-06, benefiting over 32.9 million poor families at end-March 2006.

### **Non-Banking Financial Institutions**

The Chapter analyses business operations, financial performance, and policy developments relating to Financial Institutions (FIs), Non-Banking Financial Companies (NBFCs), and Primary Dealers (PDs). The coverage of

data on NBFCs section has been widened to NBFCs not accepting public deposits, but with asset size of 'Rs.100 crore and above' as against 'Rs.500 crore and above' earlier.

The main points emerging from the analysis in this Chapter are:

- Financial assistance sanctioned and disbursed by FIs registered a significant increase during 2005-06, reversing the trend of the previous year.
- Assets of FIs expanded during 2005-06.
- A shift in asset portfolio of FIs away from investments to fund increased demand for loans and advances was observed during 2005-06.
- Profits of FIs increased significantly during the year. The capital adequacy ratio of FIs continued to be higher than the minimum prescribed. Asset quality of FIs improved during the year.
- Total assets of NBFCs declined marginally during the year as compared with the previous year.
- A sharp increase in expenditure resulted in a sharp decline in profitability of NBFCs. However, asset quality of NBFCs improved significantly.
- Financial performance of Residuary Non-Banking Companies (RNBCs) improved significantly during 2005-06. A sharp rise in their income was reflected in their higher profitability.
- Operations of NBFCs not accepting deposits but with asset size of Rs.100 crore and above expanded. Their gross NPAs registered a significant decline during the year.
- PDs made robust profits in 2005-06 as compared with substantial losses during 2004-05.
- The CRAR of PDs continued to be much in excess of the stipulated minimum of 15 per cent of aggregate risk-weighted assets.

### **Financial Stability**

The Chapter reviews the regulatory and supervisory measures relating to financial institutions, developments in financial markets and technological improvements in financial infrastructure from the financial stability perspective. The Chapter identifies the major sources of risks, viz., (i) risks of inflationary pressure emanating from higher oil prices (although prices have receded in the recent period, they still continue to be volatile); (ii) rising interest rates globally and potential turnaround in the corporate credit cycle; and (iii) global financial imbalances. These risks may impact the Indian financial sector in varying degree and could pose challenges for the financial system in the near future. However, in the overall assessment undertaken in the Chapter, it emerges that the domestic financial system has become resilient and is found to cope with adverse developments as they occur.

The main points that emerge from the analysis in this Chapter are:

- Financial markets remained generally orderly during 2005-06.
- The activity in the money market migrated significantly from the uncollateralised to the collateralised segment during 2005-06.
- Conditions in the foreign exchange markets also remained broadly stable during 2005-06.
- Yields in Government securities market hardened during 2005-06 leading to significant portfolio adjustments.
- The financing conditions for the corporates remained comfortable during 2005-06.
- Huge resources were mobilised by mutual funds, especially under the equity-oriented schemes, reflecting growing investor confidence.
- The stock market remained stable, barring some volatility in May and June 2006. However, even during these episodes there was no spill over of stock market volatility to the other segments of markets and disruption of the payments and settlement system.
- The volume and amount of transactions through RTGS has increased manifold, which has considerably reduced a major source of systemic risk in the payment and settlement system.

### **Perspectives**

The Chapter highlights some of the emerging issues facing the Indian banking system. These include, *inter alia*, credit delivery and pricing, customer service and financial inclusion, implementation of Basel II, NPA management, corporate governance and application of technology in banking.

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