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RBI releases Report on Trend and Progress of Banking in India, 2006-07

The Reserve Bank of India today released its Report on Trend and Progress of Banking in India, 2006-07. This Statutory Report provides a detailed account of policy developments and performance of commercial banks, co-operative banks and non-banking financial institutions during 2006-07. 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 banks/financial institutions both at individual and aggregate levels.

The Report highlights that the major challenge for banks in India in current times is to mobilise enough resources for meeting the demands of a growing economy. Most of business of banks in India is still concentrated in a few urban centres. To mitigate this problem, since 2006, opening of new branches for any bank is approved by the Reserve Bank only on condition that at least half of such new branches are opened in under-banked areas as notified by the Reserve Bank. Many banks now find that the branches in semi-urban and rural areas are also commercially viable. The Report records that there are some States where the credit-deposit ratio is observed to be low. Already some area-specific action plans for accelerated financial deepening have been drawn up with full participation of the State Governments, banks and other local development agencies. The Reserve Bank would continue to play the role of a catalyst as well as a coordinator in these initiatives of growing cooperation between the States and the banking system. The Report further notes that there remains huge potential for growth in small centres and States with low credit-deposit ratios. The challenge going forward is to increase banking penetration further. Banks, therefore, need to expand their outreach to hitherto under-banked areas/States by re-focussing their strategies and using appropriate technology and delivery channels. Information technology is critical to minimising transaction costs. At policy level, the Reserve Bank, in recent years, has also focussed on democratisation of the financial sector with the aim of ensuring hundred per cent financial inclusion. The Reserve Bank has also made a beginning to enhance financial literacy and impart financial education to enable vast numbers of new entrants into employment and higher incomes to better manage their finances in a rapidly marketising financial sector.

As noted in the Report, there is also a need for the banking sector to increase the flow of credit to agriculture and small scale industries. To address this issue, the Reserve Bank has at policy level already modified the definition of the priority sector in April 2007. Priority sector is now restricted to advances to highly employment intensive sectors such as agriculture, small industry, educational loans for students and low cost housing.

The Report observes that to raise capital from the market continuously to sustain their operations in a fast growing economy is a challenge for banks. They also need to be vigilant about maintaining their profitability in future. Banks' net interest margins have come under pressure in recent years. This is the outcome of increased competition and reflects an improvement in the efficiency of the banking sector. However, the impact of reduced margins on the profitability of banks has been disguised by strong volume growth in the last few years. In order to maintain their profitability in future, therefore, banks would have to contain operating costs, apart from searching for non-interest sources of income.

In an increasingly global and competitive financial world, a major challenge for banks is to institute appropriate risk management systems to manage such risks and for the Reserve Bank to understand the changing forms of risk and adapt its regulatory and supervisory responsibilities appropriately while maintaining financial stability.

Operations and Performance of Commercial Banks

The main points emerging from the analysis presented in the Chapter entitled 'Operations and Performance of Commercial Banks' are:

- Bank credit growth remained robust for the third year in succession, although there was some moderation. Deposit growth of commercial banks accelerated due mainly to term deposits. Higher net accretion in deposits than expansion in credit, resulted in moderate growth of investment portfolio as well (Para 3.16) (Page 71).
- Net profits of scheduled commercial banks increased on the back of rise in interest income and containment of operating expenses (Para 3.73) (Page 89).
- Non-performing assets ratio, both on a gross and net basis, declined further (Para 3.77) (Page 91).
- The capital to risk-weighted ratio of SCBs was sustained at the previous year's level despite strong growth increase in risk-weighted assets emanating largely from credit expansion (Para 3.87) (Page 95).
- Consequent upon the amalgamation of 147 RRBs into 46 new RRBs, sponsored by 19 banks in 17 States, the total number of RRBs declined from 196 to 95 as at August 31, 2007 (Para 3.129) (Page 113) .

Developments in Co-operative Banking

The major points emerging from the analysis of balance sheets, financial performance and soundness indicators of co-operatives in the Chapter titled, 'Developments in Co-operative Banking' are:

- Assets of urban co-operative banks (both scheduled and non-scheduled) increased moderately during 2006-07 (Para 4.77) (Page 133).
- Net profits of scheduled UCBs declined during 2006-07 in contrast to an increase in the previous year mainly on account of increase in provisions, contingencies and taxes (Para 4.84) (Page 135).
- Asset quality of UCBs improved significantly during 2006-07 (Para 4.81) (Page 135).

- In the short-term structure of rural co-operative banks, while the operating profits of StCBs declined during 2005-06, their net profits increased significantly mainly on account of substantial decline in provisioning. The balance sheets of DCCBs expanded moderately. Their profits witnessed a sharp decline. During 2005-06, total profits earned by profit-making PACS increased, while the losses made by loss making PACS declined (Paras 4.104-4.121) (Pages 142-147).
- In the case of long-term structure, the operating profits of state co-operative agriculture and rural development banks (SCARDBs) registered a sharp rise (Para. 4.124) (Page 149).
- Asset quality of StCBs, DCCBs and SCARDBs declined, while that of PCARDBs improved significantly (Paras 4.106, 4.112, 4.125 and 4.130) (Pages 142, 145, 149 and 151).
- The SHG-Bank linkage programme continued to make significant progress as 0.6 million new SHGs were credit linked by the banking system during 2006-07 taking the cumulative number of SHGs credit linked to 2.86 million (Para 4.136) (Page 153).

Non-Banking Financial Institutions

The Chapter outlines major policy developments and analyses the business operations and financial performance of financial institutions (FIs), non-banking financial companies (NBFCs), and primary dealers (PDs).

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

- Financial assistance sanctioned and disbursed by FIs continued to expand during 2006-07. While sanctions grew at a lower rate as compared with previous year, disbursements witnessed a sharp rise (Para 5.16) (Page 166).
- The combined balance sheets of FIs during 2006-07 expanded at a high rate as compared with the previous year. On the asset side, loans and advances continued to expand, *albeit* with some moderation (Para 5.18) (Page 167).
- While non-interest income of FIs increased significantly during 2006-07, the operating expenses of FIs registered a decline, resulting in a sharp rise in operating profits (Para 5.26) (Page 170).
- The capital adequacy ratio of FIs continued to be significantly higher than the minimum prescribed. Asset quality of FIs improved during the year (Para 5.29) (Page 170).
- Total assets of NBFCs (excluding RNBCs) expanded at a higher rate during 2006-07 as compared to 2005-06 (Para 5.63) (Page 178).
- Financial performance of NBFCs turned around during 2006-07. This was entirely on account of sharp rise in fund based income, which offset the sharp increase in operating expenditure and financial expenditure (Para 5.76) (Page 185).
- Asset quality of various types of NBFCs as reflected in the various categories of NPAs (sub-standard, doubtful, loss) remained broadly at the previous year's level (Para 5.80) (Page 186).
- The increase in income of RNBCs during 2006-07 was more than the increase in the expenditure, as a result of which the operating profit of RNBCs increased (Para 5.85) (Page 189).

- The liabilities/ assets of non-deposit taking systemically important non-banking finance companies (with asset size of Rs. 100 crore and above) (NBFCs-ND-SI) increased during the year ended March 2007 over the previous year (Para 5.89) (Page 190).
- The gross NPAs to total assets ratio of NBFCs-ND-SI declined during the year ended March 2007 (Para 5.93) (Page 191).
- As a result of sharp increase in expenditure, net profits of PDs declined during 2006-07 (Para 5.104) (Page 195).
- The CRAR of PDs continued to be much in excess of the stipulated minimum of 15 per cent of aggregate risk-weighted assets (Para 5.98) (Page 193) .

Financial Stability

The main points that emerge from the analysis of Chapter on Financial Stability are:

- Financial markets remained orderly during 2006-07, barring some occasions when the money market turned volatile mainly due to large capital inflows and movements in Government cash balances. However, orderly conditions were restored (Para 6.75) (Page 217).
- The activity in the money market has witnessed further significant migration from the uncollateralised to the collateralised segment during 2006-07 (Para 6.86) (Page 220).
- Foreign exchange markets showed a two-way movement during 2006-07 (Para 6.91) (Page 221).
- Yields in Government securities market hardened during the latter part of 2006-07 and the first half of 2007-08, reflecting domestic developments as well as global events (Para 6.102) (Page 224) .
- The net mobilisation of resources by mutual funds under equity oriented schemes during 2006-07 declined, reflecting the risk aversion tendency among investors particularly in view of the stock market touching record peaks (Para 6.107) (Page 226) .
- The stock markets registered large gains with occasional bouts of volatility due mainly to global developments (Para 6.111) (Page 228).
- Continuing the upward trend during 2007-08, the BSE Sensex closed at an all-time high level of 19976 on November 2, 2007 (Para 6.110) (Page 228).
- The volume and value of transactions through RTGS increased manifold (Para 6.116) (Page 229).

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