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संचार विभाग, केंद्रीय कार्यालय, एस.बी.एस.मार्ग, मुंबई 400001
DEPARTMENT OF COMMUNICATION, Central Office, S.B.S. Marg, Mumbai 400001
फोन/Phone: 91 22 2266 0502 फैक्स/Fax: 91 22 2270 3279

वेबसाइट : www.rbi.org.in/hindi
Website : www.rbi.org.in
इ-मेल email: helpdoc@rbi.org.in

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RBI releases Report on Trend and Progress of Banking in India 2009-10

The Reserve Bank of India today released its statutory Report on Trend and Progress of Banking in India, 2009-10. This yearly Report provides a detailed account of policy developments relating to as well as the performance of commercial banks, cooperative banks, and non-banking financial institutions for the year 2009-10. While retaining the essential analytical rigor and maintaining continuity in crucial data, the size of the current Report has been rationalised to enhance readability.

Notwithstanding some knock-on effects of the global financial crisis, the Report indicates that the Indian banking sector remained largely resilient in 2009-10. While some slippages in profitability and asset quality were evident during the year, robust capital adequacy of banks provides enough cushion for absorption of future losses. The Indian approach to regulation, which is geared to forward looking assessment and preparedness of financial institutions, has allowed calibrated financial sector reforms without disruption. The Indian economy, which has managed quick recovery post-crisis, is poised to reach higher growth trajectory. Going forward, banking sector needs to support the growth momentum in the economy, while maintaining asset quality, prudent provisioning and asset liability management to balance emerging returns and risks. In the long-run, banks need to leverage on scale-neutral technology to step up efforts towards financial inclusion and boost economic growth with equity.

The Report has six chapters: (i) Perspectives, (ii) Global Banking Developments, (iii) Policy Environment, (iv) Operation and Performance of Commercial Banks, (v) Developments in Cooperative Banking, and (vi) Non-Banking Financial Institutions. The statistical appendices provide data on various indicators of performance of the financial sector.[1]

Key findings of the Report are set out below:

Perspectives

- The global financial crisis brought a number of lessons to fore, viz., (i) the need for financial regulation to stay ahead of innovations, (ii) the importance of inter-agency coordination to ensure financial stability, (iii) an in-depth understanding of the implications of large scale bail-outs on financial and fiscal health, and (iv) a closer analysis of complex derivative products *(para 1.1; page 1)*.

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[1] The detailed bank-wise data on the banking sector will be provided in *Statistical Tables Relating to Banks in India*, 2009-10.

- In the aftermath of the financial crisis, multipronged initiatives have been taken by standard setting bodies, such as the Basel Committee on Banking Supervision (BCBS) and national authorities to address weaknesses of the extant financial architecture – notably in the areas of re-calibration of capital and enhancement of regulatory perimeter *(para 1.9; pages 3-4*).
- The sovereign debt crisis that emerged in early 2010 highlighted the exposure of banks to sovereign debts and the adverse feedback loop between public finances and the financial system. This has underscored the need for credible fiscal reforms and implementation of prudent macroeconomic policies to prevent overheating *(para 1.27; page 8).*
- The enhanced Basel II capital and liquidity norms are not likely to have immediate effect on Indian banks given their already existing higher levels of capital adequacy and the limited leveraging of balance sheets. However, going forward, banks need to make efforts to further shore up their capital base *(para 1.34 and 1.35; pages 9 to 10).*
- The Reserve Bank has introduced the Base Rate system from July 2010, which would improve transparency and pricing of credit, and thus increase the efficacy of the interest rate channel of monetary policy transmission *(para 1.43; pages 11 to 12).*
- Indian banks need to support long term financing without running into ALM mismatches. This would be facilitated by the use of innovative credit enhancement mechanisms such as credit default swaps (CDS) for which draft guidelines were issued by the Reserve Bank in August 2010 *(para 1.37 to 1.39; pages 10 to 11).*
- Financial inclusion is accorded top priority by the Reserve Bank. These efforts need to be carried forward using innovative technological solutions, and explicit and implicit incentives *(para 1.47 to 1.49; page 13).*

Global Banking Developments

- The global economy, after contracting in 2009, witnessed a significant recovery during the first half of 2010. Further, emerging and developing economies are projected to grow at a faster rate than the advanced economies *(para 2.6; page 16).*
- The performance of the global banking industry showed some improvements during 2009-10, after witnessing a tumultuous period of large income losses and write downs in the wake of global crisis in 2008-09. A positive development in the aftermath of the global crisis was that during the first three months of 2010, the international claims of global banking industry rose for the first time since the third quarter of 2008 *(para 2.16; page 22).*
- Though the large scale monetary and fiscal stimulus measures led to economic recovery, various concerns over downside risks to the global banking industry remained, especially those regarding the quality of banks' assets and profitability. Going forward, banks would have to address challenges arising from the need to refinance large portions of their liabilities and ending their dependence on emergency support measures from the public sector *(para 2.1; page 15).*
- Keeping in view the higher capital charge proposal under the enhanced Basel II framework, the global banking industry in some regions like the Euro area is

bound to witness further challenges to recapitalisation as private sector funding matures and extraordinary public support is withdrawn *(para 2.33; page 27).*

Policy Environment

- The year 2009-10 witnessed a gradual shift in policy focus of the Reserve Bank from crisis management to that of recovery management. On the credit delivery front, new developments included the introduction of the Base Rate and waiver of security/margin norms for agricultural loans, among others.
- Apart from measures to ease the flow of credit particularly to small and marginal farmers, and micro and small enterprises to increase self employment, initiatives for improving financial literacy and inclusion in seven focus States formed an important part of the policy agenda in 2009-10 *(para 3.15-3.21; pages 32-33).*
- The Securities and Insurance Laws (Amendment and Validation) Bill, passed by the Parliament to provide a joint mechanism to resolve inter-regulatory differences in opinion is among the important legislative measures unveiled during 2009-10 *(para 3.149; page 56).*
- The supervisory practices in respect of concerns relating to banking frauds, overseas operations, financial conglomerates, electronic banking and technology risk received attention in 2009-10. Focused attention was also placed on improving customer service and the efficiency of payments and settlement system *(para 3.53-3.59 pages 39-40).*
- In 2009-10, the Reserve Bank undertook a number of initiatives for improving IT infrastructure facilities, implementing new applications and initiating steps for further adoption of technology in the financial sector *(para 3.144-3.150; pages 56-58).*

Operation and Performance of Commercial Banks

- The year 2009-10 experienced a relatively subdued performance of the Indian banking sector with deceleration in the growth of consolidated balance sheet of scheduled commercial banks (SCBs) contributed mainly by slowdown in deposits growth *(para 4.3; page 60).*
- The composition of deposits changed in favour of Current and Saving Accounts (CASA) with CASA accounting for 35.4 per cent of total deposits at end-March 2010 as compared to 33.2 per cent in the previous year *(para 4.6; page 62).*
- In line with the deceleration in deposits growth, there was a slowdown in the growth of bank credit of SCBs in 2009-10. However, on an intra-year basis, there were signs of a pick up in bank credit after November 2009, as economic recovery became more broad-based *(para 4.8; page 62).*
- Another concern was the decline in the growth of profits of SCBs. At the aggregate level, the growth in net profits, which was on a steady rise during the four years up to 2007-08, posted a decline in 2008-09, which was repeated in 2009-10 *(para 4.22, page 69).*
- Return on Assets (RoA) of SCBs declined from 1.13 per cent in 2008-09 to 1.05 per cent in 2009-10 (para 4.22-4.25; page 69-71). Further, there was a decline in all other indicators too at the aggregate level, such as Return on Equity, net interest margin and spread (defined as the difference between return on and cost of funds) in 2009-10 *(para 4.26; page 72).*

- The other emerging concern was with respect to asset quality of banks. The gross Non-Performing Assets (NPAs) ratio showed an increase from 2.25 per cent in 2008-09 to 2.39 per cent in 2009-10. Moreover, there was an increase in the proportion of doubtful and loss assets in 2009-10. The increase in gross NPA ratio coupled with a decline in the (outstanding) provisions to gross NPA ratio in 2009-10 at the aggregate level, underlined the need for further strengthening of provisions by banks *(para 4.35 to 4.42, pages 74 to 79).*
- However, even against the backdrop of an increase in NPA ratio, there was a rise in the Capital to Risk Weighted Assets Ratio (CRAR) of SCBs, which stood at 14.5 per cent at end-March 2010, far above the stipulated minimum ratio of 9 per cent under the Basel II framework indicating the robust capital adequacy of banks in India *(para 4.30; page 73).*
- As regards financial inclusion, a welcome development in the recent years has been the steady increase in the penetration of bank branches and ATMs (reflected in a decline in population per bank branch/ATM). The increased penetration of both branches and ATMs could be seen across rural India.
- As regards technological advancement in banks, an important development was the near completion of computerisation and an increase in the extent of adoption of Core Banking Solutions (CBS) in public sector banks in 2009-10.

Developments in Cooperative Banking

- An outcome of the on-going consolidation of the urban cooperative banking (UCB) sector was the further decline in the number of UCBs in 2009-10. However, there were also signs of increasing concentration of banking business within the UCB sector with the share of banking business in the larger asset-size categories and business-size categories showing an increase *(para 5.5 to 5.7; pages 104 to 106).*
- Unlike SCBs, the consolidated balance sheet of UCBs expanded at a higher rate in 2009-10 attributable to the growth in deposits on the liability side, and a growth in both investments, and loans and advances on the asset side *(para 5.12; page 108).*
- There were emerging concerns with respect to profitability of the UCB sector as net profits posted a decline in 2009-10, due to the decline in the operating profits. Consequently, the RoA of the UCB sector registered a fall from 0.8 per cent in 2008-09 to 0.7 per cent in 2009-10 *(para 5.17; page 110).*
- There was an improvement in the asset quality of the UCB sector with a decline in the gross NPA ratio from 13.0 per cent at end-March 2009 to 11.8 per cent at end-March 2010 *(para 5.20; page 111).*
- More importantly, the capital adequacy of UCBs was reasonable, with 86.3 per cent of UCBs complying with the minimum CRAR norm of 9 per cent at end-March 2010 *(para 5.22; page 112).*
- In line with their role in financial inclusion, about 65 per cent of total advances of UCBs was made towards priority sectors with more than 16 per cent of the total advances being provided to weaker sections in 2009-10 *(para 5.27; page 115).*
- While State Cooperative Banks, District Central Cooperative Banks and State Cooperative Agriculture and Rural Development Banks earned net profits, the ground level institutions, viz., Primary Agricultural Credit Societies, and Primary

Cooperative Agriculture and Rural Development Banks reported net losses in 2008-09 *(para 5.32; page 116).*

- Despite the improved financial performance, the asset quality of rural cooperative credit institutions witnessed deterioration with the short-term rural cooperative credit institutions accounting for the major share of non-performing loans at end-March 2009 *(para 5.32; page 116).*

Non-Banking Financial Institutions

- The financial performance of the Financial Institutions (FIs) sector improved during 2009-10 as compared with 2008-09 mainly on account of substantial increase in interest income, notwithstanding the decline in non-interest income *(para 6.19; page 140).*
- At the aggregate level, there was an increase in the amount of net NPAs for FIs in 2009-10 attributable only to SIDBI. The capital adequacy of FIs, however, was robust with the CRAR remaining above the stipulated minimum of 9 per cent for all FIs *(para 6.20 to 6.23; pages 142 to 143).*
- There was an improvement in the asset quality of NBFCs-D with a decline in their gross NPA ratio from 2.0 per cent at end-March 2009 to 1.3 per cent at end-March 2010. There was an improvement in their capital adequacy too, with only 3 out of 216 NBFCs-D having CRAR below 9 per cent as at end-March 2010 *(para 6.41 to 6.44; pages 150 to 152).*

Alpana Killawala
Chief General Manager

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