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RBI releases Report on Trend and Progress of Banking in India: 2004-05

The Reserve Bank of India has today released its Report on Trend and Progress of Banking in India, 2004-05. The Report gives a detailed account of the policy developments and performance of commercial banks, co-operative banks and non-banking financial institutions during 2004-05. The Report is divided into seven chapters and contains detailed statistical tables on several parameters relating to the operations and performance of various financial institutions.

Overview

The first chapter entitled 'Overview' provides a synoptic view of the macroeconomic developments in the global and the Indian economy, as also the performance of various financial institutions during 2004-05.

Policy Developments in Commercial Banking

The second chapter on 'Policy Developments in Commercial Banking' provides a detailed account of the policy initiatives undertaken in the banking sector during 2004-05. These relate to credit delivery, regulatory and supervisory measures, technological developments, payments and settlement systems and legal reforms. The Reserve Bank continued to strengthen the supervisory framework consistent with the increasing market orientation of the economy with a view to enhancing efficiency and financial stability. The policy measures have been primarily guided by the objectives of increasing operational efficiency of monetary policy, strengthening the credit delivery mechanism, prudential norms and risk management systems with particular reference to the adoption of Basel II norms, and enhancing accounting standards and corporate governance. This was reinforced by several initiatives to develop technological and institutional infrastructure. The issue of financial inclusion has been engaging the attention of the Reserve Bank and increasing emphasis has been placed on the facilitation of transactions and access to the banking system for the common person.

Operations and Performance of Commercial Banks

This Chapter analyses the performance of the commercial banks during the year, based on their audited financial results. The focus of the Chapter is on analysis of diversification of banks' portfolio. The shifting pattern of banks' revenue and performance patterns have also been analysed at the aggregated level as well as major bank group-wise. The analysis covers important financial indicators, such as, income, expenditure, profits, spread, non-performing assets and capital to risk-weighted assets ratio, apart from a detailed disaggregated picture of balance sheets of commercial banks.

The coverage of the Chapter has been expanded in this year's Report by including new sections on 'Banks' Operations in the Capital Market', 'Technological Progress in Banks' and 'Customer Service in Banks'. The section on capital market operations of banks covers banks' operations in both primary and secondary

markets and shareholding pattern of banks in a comprehensive manner. The section on technological progress in banks covers branches and ATMs of banks, and computerisation of banks.

The major points emerging from the analysis are set out below:

- Reversing the decelerating trends of the previous years, bank credit exhibited robust growth during the year.
- The credit offtake was also broad-based with agriculture and industry joining the housing and retail segments in driving up the demand for credit.
- Growth of deposits slowed down, *albeit* marginally.
- In order to meet the increased demand for credit, banks increased recourse to non-deposit resources and restricted fresh investment in Government securities.
- Banks, in general, were successful in weathering the impact of an upturn in the interest rate cycle supported by a sharp increase in net-interest income.
- Asset quality of Scheduled Commercial Banks improved further during 2004-05 as reflected in the decline in gross non-performing assets in absolute terms for the third year in succession despite the switch over to the 90-day delinquency norm with effect from March 2004.
- Banks' capital base kept pace with the sharp increase in risk-weighted assets.
- Improved business and financial performance was reflected in a sharp rise in prices of most of the bank stocks.

Developments in Co-operative Banking

The Chapter outlines major policy initiatives during the year. These include issuance of the Vision Document and Medium-term Framework for Urban Co-operative Banks, revival plans for weak banks and framework for mergers/amalgamations for the sector. The recommendations of the Task Force on Rural Co-operative banks have also been covered. The performance of urban co-operative banks and issues relating to the short-term and long-term structure of the rural co-operative banks are discussed separately alongwith a discussion on the regional spread and performance of each segment of the co-operative banking. Detailed information on operations and financial performance of Primary Agricultural Credit Societies (PACS) has been included for the first time in the Report as a part of the analysis pertaining to the rural co-operatives. The discussion on micro-finance includes the different models emerging in the area. The role played by National Bank for Agriculture and Rural Development (NABARD) in financing and monitoring the rural co-operative banking sector, besides administering various development schemes in the agricultural and rural sector has been discussed in a separate section.

The major points emerging from the Chapter are set out below:

- Business operations and financial performance of co-operative credit institutions during the year showed divergent trends.
- Assets of scheduled Urban Co-operative Banks (UCBs) and State co-operative banks expanded during 2004-05.
- Despite an improvement in net interest income, profitability of scheduled UCBs declined, due mainly to a sharp decline in non-interest income. The profitability of State co-operative banks declined during the year, while that of CCBs improved.

- The overall business of PACS continued to expand, despite decline in deposits. Although the asset quality of PACS improved during the year, overdues continued to remain high.
- Assets of long-term rural co-operatives, *i.e.*, the State Co-operative Agricultural and Rural Development Banks (SCARDBs) and Primary Co-operative Agricultural and Rural Development Banks (PCARDBs), witnessed a moderate growth. However, their financial performance worsened as they continued to incur significant overall losses during the year.
- Asset quality of UCBs did not record any noticeable change. The asset quality of all the layers of rural co-operative banks, other than PACS, deteriorated.
- A significant development during the year was a sharp increase in the Self Help Group (SHG)-Bank linkage programme and financial assistance extended to micro-finance institutions (MFIs) by both commercial and co-operative banks.

Non-Banking Financial Institutions

This new Chapter combines the erstwhile Chapters on 'Financial Institutions' (Chapter V) and 'Non-Banking Financial Companies' (Chapter VI) of the previous year's Report. The new Chapter analyses three sets of institutions, *viz.*, financial institutions, non-banking financial companies and primary dealers. The policy developments, business operations and financial performance for each category have been discussed separately. The section on NBFCs has been structured into three sub-sections. These are: (i) NBFCs (Excluding Residuary Non-banking Companies (RNBCs)), (ii) Residuary Non-banking Companies (RNBCs), and (iii) NBFCs not accepting Public Deposits and with Assets Size of Rs.500 crore and above. In addition to data for the year 2003-04, the current Report contains updated information for 2004-05. The direction of policies continued to focus on the specific set of institutions with emphasis on prudential regulations for financial institutions and NBFCs, directed investments for RNBCs and institutional and market development measure for the PDs.

The major points emerging from the analysis are set out below:

- Business operations of FIs expanded during 2004-05, reversing the trend of the previous year.
- Financial performance of FIs also improved, resulting from an increase in net interest income.
- Significant improvement was also observed in the asset quality of FIs, in general. The capital adequacy ratio of FIs continued to remain at a high level, notwithstanding some decline during the year.
- Business operations of NBFCs, which contracted sharply during 2003-04 reflecting mainly the impact of decline in resource mobilisation, expanded marginally during 2004-05.
- Profitability of NBFCs improved in 2003-04 and 2004-05 mainly on account of containment of expenditure.
- While gross NPAs of NBFCs, as a group, declined during 2003-04 and 2004-05, net NPAs after declining marginally during 2003-04, increased significantly during 2004-05.
- Although capital adequacy of NBFCs continued to be comfortable, on the whole, there was increase in the number of NBFCs with CRAR less than 12 per cent and decline in NBFCs with CRAR above 30 per cent.
- The business of large NBFCs not accepting public deposits, but with asset size of Rs.500 crore and above, continued to expand. These NBFCs earned substantial profits and improved their asset quality during the year.

- PDs, as a group, incurred net losses during the year, mainly due to large trading losses as against trading profits in the previous year. Notwithstanding the losses, PDs continued to maintain high capital adequacy ratios.

Financial Stability

The purpose of the financial stability Chapter, in general, is to identify at an early stage any trends of vulnerability that may be seen as likely to emerge in the financial system. This Chapter reviews the stability of the financial system in India in terms of financial institutions, financial markets and financial infrastructure. The Chapter on financial stability focuses on the significance of the policy actions of the Reserve Bank as well as the key developments during 2004-05 from the financial stability perspective. As financial markets in the financial stability chapter are being introduced for the first time, the key developments during 2004-05 have been assessed somewhat in historical perspective.

The following main points emerge from the analysis in the Chapter:

- The performance indicators of the Indian banking system are increasingly converging to international benchmarks.
- Various segments of financial markets have deepened and widened over the years which have enhanced the stability of the system.
- The perception of money market participants about counter party credit risk remained stable during 2004-05.
- Conditions in the foreign exchange markets also remained broadly stable during the year.
- The hardening of yield in the Government securities market led to significant portfolio adjustments.
- The financing conditions for the corporates improved significantly during 2004-05.
- The reliance of the corporate sector on the banking system is declining.
- Volatility in the stock markets has reduced over the years.
- With the introduction of RTGS, the systemic risk in the system has reduced considerably.
- The RTGS has been functioning satisfactorily and it stood the test of business continuity planning during heavy rains on July 26 and 27, 2005.

The Chapter attempts to identify the main sources of risks and vulnerability that could pose challenges for the financial system in the near future. The overall assessment of the financial system as summarized at the end of this Chapter states that while the overall quality of the banking system has improved significantly over the years, banks could now face some uncertainties in respect of market risk.

Perspectives

The final Chapter on 'Perspectives' highlights some of the emerging issues facing the Indian banking system. These include, inter alia, credit delivery and pricing, customer service and financial inclusion competition and consolidation.

The Report is available on the RBI website (www.rbi.org.in).

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