

## **General Studies-3; Topic: Indian economy – growth and development;**

### **Banking Reforms**

#### **1) Introduction**

- To sustain the high growth rate India has achieved, the country should carry out banking sector reforms; continue with fiscal consolidation, simplify and streamline GST; and renew impetus on reforms, the International Monetary Fund said.
- IMF also said India must address the ongoing crisis in its banking sector to support investment and inclusive growth agenda.
- Historically, India's banking sector reforms — especially in the 1990 — focused on enhancing competition, strengthening governance and regulation.
- Future reforms should build upon these areas and draw lessons from past experiences.

#### **2) Present Status**

- India's banking system is characterised by a high share of Public Sector Banks (PSBs), accounting for over 70% of total assets.
- We see a steady deterioration of the banking sector in successive quarters.
- There has been policy inaction on reforming the governance of the banking system to distance it from politics.
- Since the RBI launched the Asset Quality Review (AQR) in 2015, Indian banks have had to progressively reveal the true extent of their NPAs.
- The gross non-performing asset (GNPA) of the Scheduled Commercial Banks (SCBs) has deteriorated from 10.4% in September 2017 to 11.6% in March 2018.
- The deterioration with regards to public sector banks is even sharper: from 13.7% to 15.6%.
- Rising NPAs have also put a strain on the health of the PSBs, reflected in their declining Return on Assets (ROA) and Return on Equity (ROE) ratios.
- The decline in bank's profits is largely due to higher growth in risk provisions; loan write offs and decline in net interest income.
- The stresses on the banking sector have translated into a slowdown in industrial credit.
- They also limit banks' ability to meet international capital requirements.
- Banks are witnessing a surge in wilful defaults, or refusal of repayment obligations by borrowers.

#### **3) Concerns / Challenges**

- Deteriorating profitability and asset quality pose elevated risks to banking sector stability.
- RBI has warned of further worsening of NPA situation.
- Issues like Punjab National Bank fraud raise the concern for banking sector reform in India.
- With growing Internet and mobile banking, cybercrime is becoming a greater threat.
- Rising wilful defaults in PSBs hurt investor confidence.
- Political interference while granting loans.
- More exposure to corporate loans by PSBs while private banks maintain a balance between corporate and retail sector loans.
- India's banks lag behind global counterparts in terms of financial depth or the size of banks.
- India also has low levels of private credit to GDP and credit to deposit ratio, relative to other emerging economies.

- With oil prices rising it is difficult for controlling the fiscal deficit, current account deficit and inflation.

#### 4) **Way Forward**

- Need to build capacity in the PSBs to evaluate lendable projects.
- Urgent need for freeing PSBs from political interference.
- Reducing the government equity below 51%, and attracting some strategic investors.
- It will not only reduce the pressure on government for recapitalization, it will also set the stage for a more commercial orientation for public sector banks.
- Comprehensive approach to improve the capacity, risk management and governance of the PSBs.
- Revive bank credit and enhance the efficiency of credit provision; accelerate the clean-up of bank and corporate balance sheets.
- Wilful default must be recognised early and followed by quick action.
- Ensure balanced exposure to retail and corporate sector lending.
- Amalgamate banks into bigger entities by mergers and acquisitions and ensure capital adequacy as per the Basel norms.
- Developing corporate bond markets to relieve pressure from banks as lending sources.
- Banks need to do forensic audit for ascertaining the end use of funds.
- To build a robust banking system, recapitalization will have to be complemented by lower entry barriers, improved financial supervision, and efficient debt recovery mechanisms.
- Decisive and urgent actions are necessary for not merely ensuring the stability of the banking system, but also to create conditions for sustained accelerated growth.