

Beyond HDFC

*Good that private banks are gaining market share.
But plenty of challenges for banking remain*

The amalgamation of HDFC and HDFC Bank, once legal formalities are done, will create a private sector banking behemoth. It will result in a balance sheet size of almost Rs 18 lakh crore, with an emphasis on mortgages and retail loans. At one level, the creation of a large bank through the amalgamation embodies the growing importance of private banks in a financial sector dominated by public sector banks. In September 2021, private banks contributed about 38% of the industry's total credit, up by over 10 percentage points in five years. This, however, is just a part of the story.

India's banking industry has seen two phases over the last two decades. Between 2000-01 and 2009-10, there was growth at breakneck speed. Bank credit as a proportion of GDP increased from 24% to 50%. In the next decade, as imprudent loans of boom years hit home, the credit to GDP ratio stagnated at around 50%. The lost decade was marked by a slow process of first accounting for bad loans and then their clean-up. Among the tools introduced to aid the process was the Insolvency and Bankruptcy Code (IBC) in 2016, the most far-reaching measure thus far.



The report card, however, is mixed. Three broad trends are visible. Public sector banks that were the worst hit by the NPA problem have lost market share over the last decade. Second, risk aversion because of NPAs caused by exposure to industry intensified during the pandemic. For instance, RBI's most recent Financial Stability Report showed that when indexed

to December 2019, loans to agriculture and retail segments led the recovery. Industry and services sector trailed. Third, the level of gross NPAs to total advances has trended downwards to stand at 6.9% at the end of September 2021. However, even before the Omicron wave and Ukraine conflict, RBI's stress test showed that NPAs may rise to 8.1% by September 2022 under a baseline scenario.

India's bank-dominated financial sector remains vulnerable. To illustrate, despite IBC and numerous private asset reconstruction companies, a state-backed bad bank had to be created last year. It's still to stabilise in terms of leadership. Looking ahead, India needs financial intermediation that can handle not just scale but also variety. It's not merely about capital, there's also a need to upgrade skills in the upper echelons of banking. And privatisation of public sector banks can no longer be postponed.