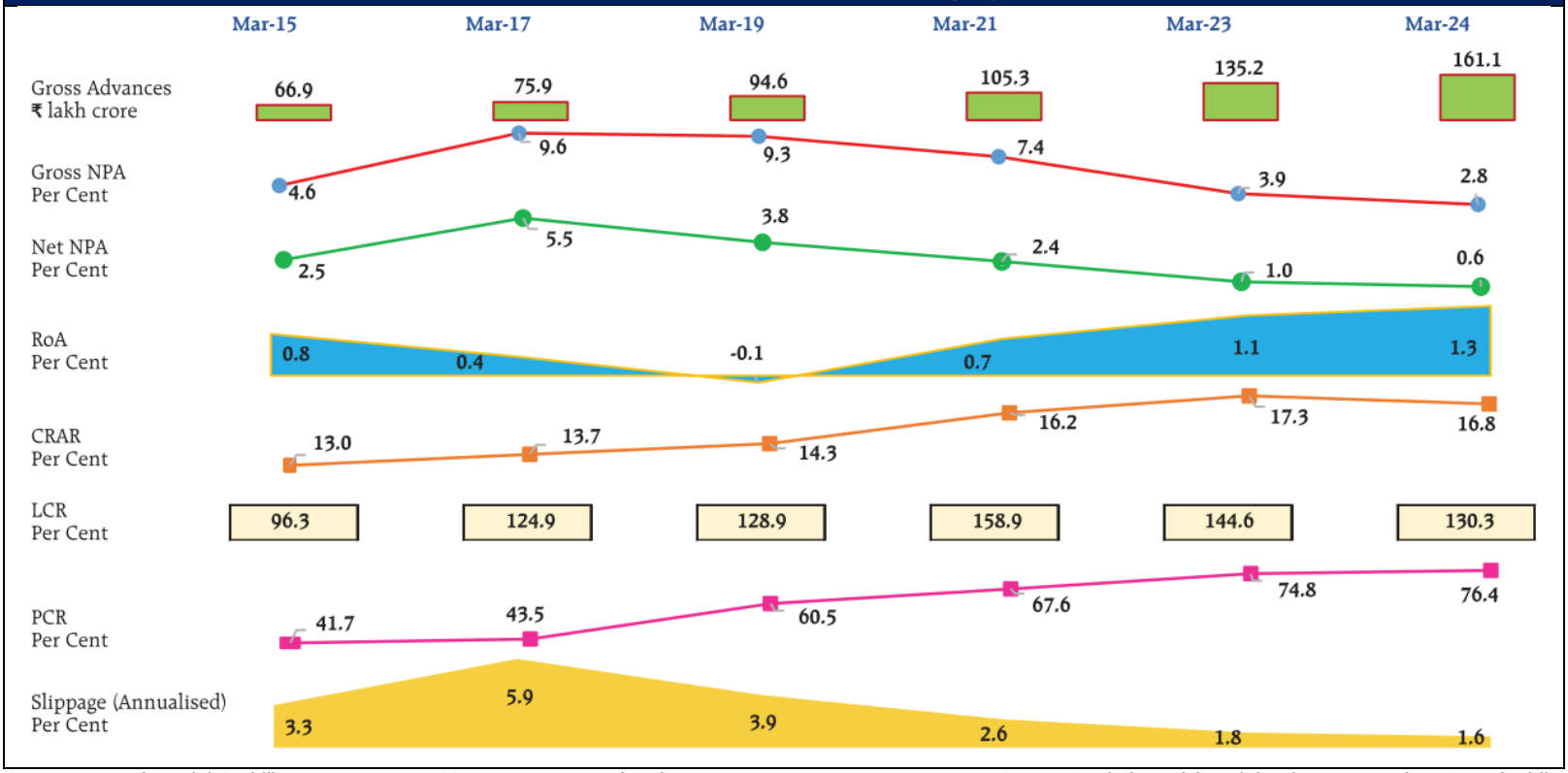
July 02, 2024

Financial Stability in an Environment of Macroeconomic Stability!

What's the Point? (A Brief Summary)

In its latest Financial Stability Report, the Reserve Bank of India (RBI) affirmed its assessments of Indian macroeconomic and financial stability and resilience against global risks. The banking system has reported decadal lows in Gross Non-Performing Assets (GNPA) ratio (2.8%) and Net Non-Performing Assets (NNPA) Ratio (0.6%). India's robust economic growth, lowering inflation (core CPI (Consumer Price Index) at multi-year low), government capex, strong external sector (low CAD (Current Account Deficit), high forex reserves, FDI (Foreign Direct Investment) and FPI (Foreign Portfolio Investor) inflows, moderation in external debt as a % of GDP) provide cushions against shocks. On the domestic front, key risks highlighted were higher delinquencies in the <₹50,000 personal loan bracket, and growth in lending at Non-Bank Financial Companies (NBFCs) with relatively low capital buffers. RBI also highlighted certain global macroeconomic risks such as elevated global public and private debt, stretched valuations, and geopolitical risks. Overall, India's strong macroeconomic fundamentals and financial system soundness augur well for sustaining the growth momentum and withstanding global shocks.

Improving Health of India's Banking System



Source: RBI Financial Stability Report, June 2024. NPA: Non-Performing Assets; RoA: Return on Assets; CRAR: Capital to Risk-weighted Assets Ratio; LCR: Liquidity Coverage Ratio; PCR: Provisioning Coverage Ratio.

Some Highlights

- **Banking Sector Gross NPAs** improved to a 20-year low of 2.8% from high in 2017/18. As per RBI's estimates, this is expected to further drop to 2.5% by March 2025. Other asset quality metrics, such as Net NPAs, slippages also seem to be trending lower (improving). However, Private banks witnessed rise in retail (ex-housing) slippages which formed ~40% of total slippages for them in FY24 (advances share of 21%).
- **Stress in Unsecured Segment has started to wane**, with GNPA ratio dropping to 1.5% compared to 1.6% a year ago. Higher weights for unsecured consumer lending (Refer our note dated November 21, 2023) have had an impact: the rate of growth in balances of consumer credit saw moderation vs the past year, even as

inquiry volumes remained high. Due to higher risk weights, capital requirements increased at a higher rate for private banks, as they had higher share of these loans. This resulted in some drop in the Capital to Risk (Weighted) Assets Ratio (CRAR) as well.

- **Personal Loans below ₹50,000** are posing a concern, with higher delinquencies (with NBFC-Fintech seeing delinquency levels of 6% plus), high vintage delinquencies (NPAs from loans issued in past 12 months) in personal loans at 8% plus and overleveraging in the segment (>50% of borrowers have 3 loans at origination).
- **Banking Sector is well capitalised:** The Banking sector is well capitalised, with the overall CRAR and Common-Equity Tier 1 (CET-1) ratio remaining well above the regulatory minimum, despite higher risk weights during the year. In fact, as per RBI's stress tests, system level CRAR in a 'severe stress' environment would still stay above the minimum capital requirement of 9% - in fact, no individual bank is expected to breach this either.

Conclusion

India is placed relatively comfortably in a volatile and uncertain world. High economic growth led by investments picking up across sectors bodes well for the economy. With corporate and bank balance sheets being resilient, India can continue to grow at a higher pace for a reasonably long period of time in *Amrit Kaal*.

The Banking sector in India has seen a recovery from the corporate asset quality issues seen in the past decade, and balance sheets both in the banking sector and the corporate sector today stand strong and resilient. Continuous deleveraging and higher profitability have contributed to this. Proactive measures to counter emerging sources of risk have the potential to lengthen the period of upcycle in the sector and the economy.

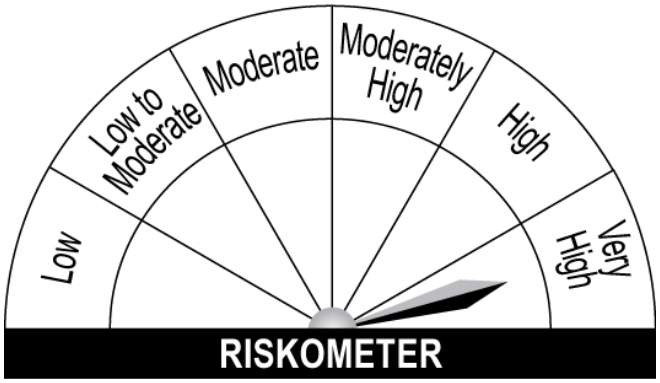
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Sources: RBI and other publicly available information

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HDFC Banking & Financial Services Fund (is suitable for investors who are seeking*: • To generate long-term capital appreciation / income • Investment predominantly in equity & equity related instruments of banking and financial services companies *Investors should consult their financial advisers, if in doubt about whether the product is suitable for them. #For latest Riskometer, investors may refer to the monthly portfolios disclosed on the website of the fund viz. www.hdfcfund.com	**Riskometer#**  Investors understand that their principal will be at very high risk

@The Scheme being sectoral in nature carries higher risks versus diversified equity mutual funds on account of concentration and sector specific risks.

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