The Demise of Bank Credit*

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In most market economies, the disbursal of bank credit is usually a relatively reliable indicator of the extent of dynamism, of both expectations and actual economic expansion. So much so that it is often viewed by analysts as a better guide to the current state of the aggregate economy than quick estimates of GDP that are based on many assumptions and guesses.

This is true of India as it is of many other countries. The Prime Minister of China, Li Keqiang, was distrustful of his own country's GDP data, and famously remarked to a diplomat in 2007 that he tended to use a combination of credit extended by banks, electricity consumption and railway freight volumes to gauge the state of the economy – and this speedily became known as the "Li Keqiang Index" to monitor real economic growth.

In India, we know that commercial banks (especially the publicly held commercial banks) have been in difficulties for some time because of the large Non-Performing Loans in their portfolios, and it is commonly believed that this is what has recently constrained their lending. It is true that until recapitalisation of banks is fully implemented NPAs are likely to have some effect on aggregate credit. Even so, this may not explain the full story.

Chart 1: Bank credit slowed sharply from 2014

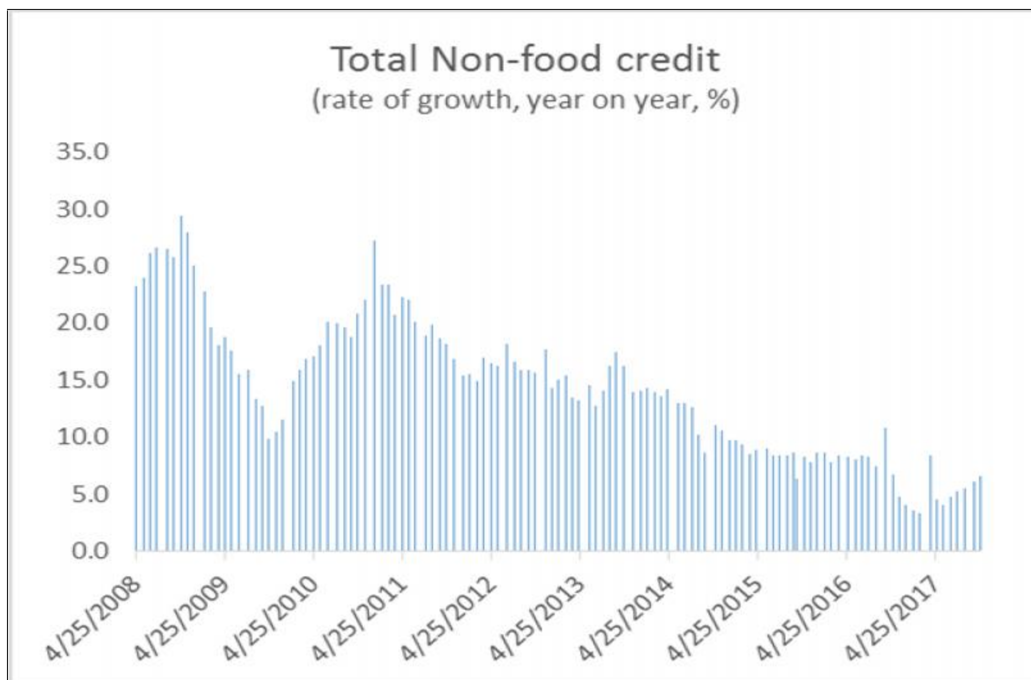


Chart 1 provides data from the RBI on total non-food credit deployed by commercial banks in India. It shows the year-on-year rate of change of the total stock of credit by month since April 2008. For most of the period of economic boom in India from 2003 to late 2008, bank credit was growing at a very fast clip, at around 20-30 per cent per

annum. The Global Financial Crisis and its fallout in India put a brake on that expansion, so that the rate of growth fell at the peak of the crisis (in October 2009) to just under 10 per cent. However, it revived thereafter, and even though the expansion slowed somewhat, until late 2013 bank credit continued to expand at a healthy pace, generally at annual rates of more than 15 per cent.

But from early 2014, a prolonged deceleration set in, with continued slowing down of credit deployment. This slowdown clearly preceded the demonetisation, but that bizarre move hardly helped: credit that had expanded by nearly 11 per cent in September 2016 fell to rates of growth of only 4 per cent in December, 3.5 per cent in January and 3.3 per cent in February 2017. A recovery to 8 per cent growth in March 2017 did not stave off the longer-term decline. The latest months' data suggest that credit is still barely growing at around 5 per cent annual rate, but this is largely due to more retail lending for personal consumption.

This surely sits uneasily with the image of an economy that is doing well and growing at around 7 per cent (according to official data), although it fits in with other evidence such as the falling investment rate and evidently stagnant employment opportunities. But the sectoral disaggregation of the bank credit brings more bad news.

Chart 2: Credit to industry has been the worst affected

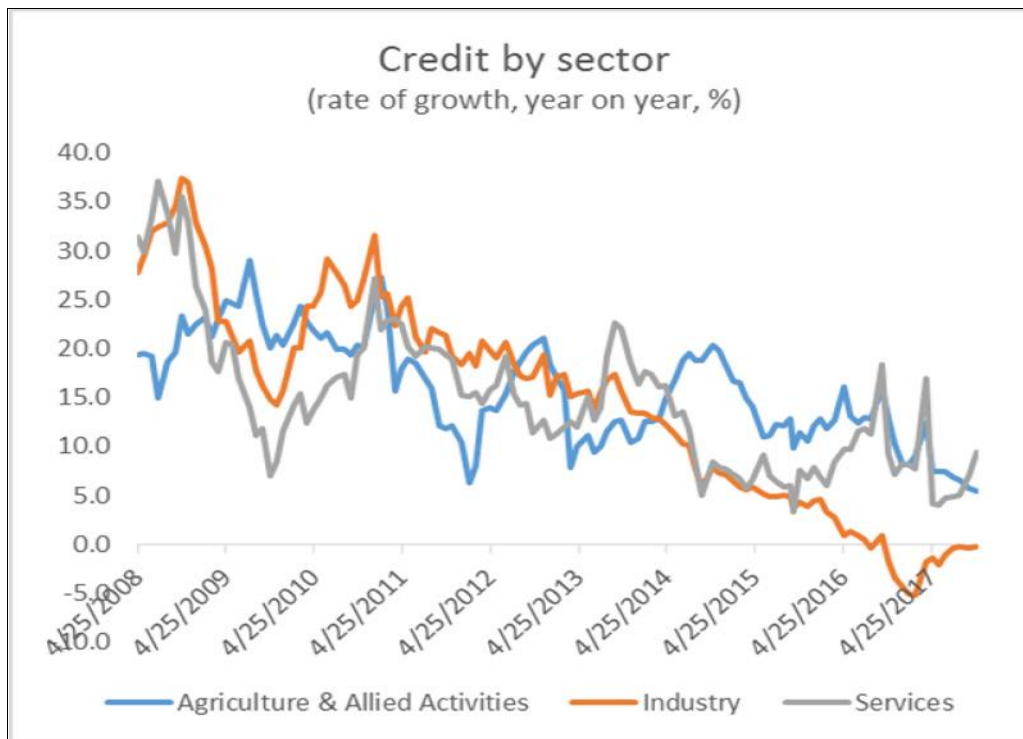


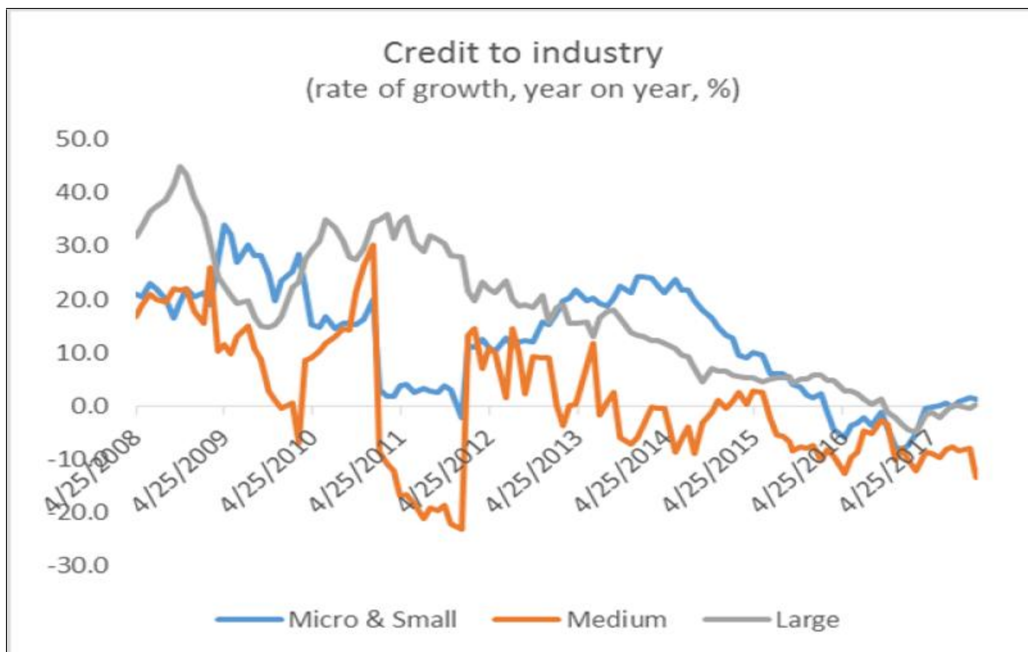
Chart 2 describes the change in bank credit outstanding by major sector – and what is particularly striking is the slowdown in credit to industry. Credit to the services sectors has been volatile and with less evidence of a clear downward trend, while the deceleration of bank credit directed to agriculture has been more evident since April 2017.So the declining rate of growth of aggregate credit was largely driven by industry.

Credit to industry had recovered strongly after the shock of 2008-09, such that it was growing at annual rates of 20-30 per cent in the period 2010-12. Annual growth rates of less than 15 per cent were first evident in November 2013, but thereafter the decline was marked and even precipitous. By mid 2016, credit to industry was flat or slightly negative, and the decline became more pronounced with demonetisation, with declines of more than 5 per cent year-on-year in the first two months of 2017, and absolute annual declines in every month since then.

Chart 3 describes the changes in stock of credit by size of enterprise within industry. Medium sized enterprises have been very volatile in terms of the bank credit received, and have faced declining credit for more than two years, since mid 2015. But they account for less than 4 per cent of total credit to industry. The share of micro and small enterprises is greater at just under 14 per cent, and such enterprises also experienced absolute declines in bank credit from February 2016.

The Micro-Units Development and Refinance Agency (MUDRA) scheme, which seeks to reach credit to small entrepreneurs aiming to establish or expand small businesses has not been successful either. The scheme offers refinancing to banks and MFIs against credit provided to MSMEs. There are no interest rate concessions associated with loans under the Pradhan Mantri Mudra Yojana (PMMY), with interest rates on the loans ranging between 9 and 12 per cent. The real benefits they offer are the six month moratorium on interest and amortization payments and the fact that no collalteral is demanded, rescuing borrowers from the clutches of money lenders from whom they would have otherwise borrowed. Despite this, in 2016-17, the second year of implementation of the scheme, loan disbursements under the PMMY amounted to only around Rs. 1.75 trillion as compared with the target of Rs. 2.44 trillion set by the government. Things are not very much better this financial year, with disbursements till December 22, 2017 amounting to Rs. 1.24 billion.

Chart 3: Recently, bank credit to every segment of industry has stagnated or declined



Large enterprises receive more than 82 per cent of total bank credit to industry. It is for this sub-sector that the deceleration of growth followed by absolute decline is the clearest. From an annual rate of growth of 18 per cent in September 2013, bank credit to such enterprises decelerated continuously, to stagnate at rates of around 5 per cent for much of 2015 and 2016, then fell further to near zero expansion in August and September 2016. It turned negative the following month, fell sharply in January and February 2017 and has been negative since. In other words, for all the months of the past year, large industry has received smaller amounts of bank credit relative to the same months of the previous year.

Such a decline in bank credit would be unusual even if actual economic growth were lower than suggested by the GDP figures. This must be a combination of investors' unwillingness to borrow and banks' reluctance to lend, but either reason points to very severe problems in the economy. This should be sending off alarm bells in policy circles -but unfortunately those at the helm of government at present seem more concerned about perceptions about the economy than the actual behaviour of the economy and its immediate prospects.

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