What slow credit growth says about economic recovery

PREMIUM With signs of a probable V-shaped recovery, credit growth in the second quarter of FY21 did see an uptick at 6.2%; however, with the onslaught of the second wave, things might take another gloomy turn*2 min read* . Updated: 26 Apr 2021, 06:05 AM IST

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India was not spared by the sweep of pandemic. The government and the central bank took several steps to give the requisite boost to the economy. But India's credit growth rate slowed further in 2020-21, while deposit growth rate continued to rise. Mint explores

1. The trend in credit and deposit growth rates

As per the Financial Stability Report of January 2021, year-on-year (y-o-y) credit growth of scheduled commercial banks was slowing down even before the pandemic. Credit growth rate in March 2020 was at 5.7%, which fell further to 5.0% by September 2020. On the other hand, deposit growth remained healthy at 10.3%, thanks to precautionary savings by people influenced by the virus-induced uncertainty. With signs of a probable V-shaped recovery, credit growth in the second quarter of FY21 did see an uptick at 6.2%; however, with the onslaught of the second wave, things might take another gloomy turn.

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2. What does falling credit growth suggest?

Slowing credit growth rate was based on low demand for credit. With business confidence dipping (65.5 in Q2 2021 and 84.8 in Q3FY21 as per the NCAER), business sentiments relative to the previous year were still negative at -23.7% on a y-o-y basis relative to Q3FY20. Despite credit offtake in Q3FY21 and financial institutions largely cushioned by plentiful liquidity, overall capacity utilization was still lower at 72.8% as the investment climate in general was not encouraging. Growth in new loans in Q2FY21 was seen mainly in agriculture, while new loans availed by the industry and services sectors were still negative.

3. What does increasing deposit growth rate mean?

Uncertainty about future economic prospects has resulted in increased precautionary savings leading to deposit growth rate outpacing bank credit growth rate. Even with CPI inflation rising to 5.52% in March 2021 and bank deposit rates in the range of 5.0-5.75%, the fear of uncertainty looming large has resulted in individuals parking their money in banks.

4. The sectoral credit deployment picture

Though non-food bank credit growth rate at 6.5% in February 2021 was up from 5.7% in January 2021, it reflected discouraging credit disbursal when compared with the 7.3% growth in February 2020. Credit disbursal to the agriculture sector continued rising, while that to industry contracted. Within the industry sector, credit to food processing, beverages and tobacco, textiles, gems and jewellery, glass and glassware registered accelerated growth in February 2021 compared to February 2020.

5. The implication on macroeconomy

India Inc. perhaps started relying more on alternative sources of funds such as debt instruments or has probably put capex on hold. For banks, it would mean reduced opportunity to recover cost of banking operations and earn profits. Falling credit-deposit ratio may lead to the development of a situation soon where Indian business units may look for a competitive interest rate regime. It is also time for the RBI to focus on cost of loans rather than liquidity.

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