

## **INDIAN FINANCIAL SEGMENT: CURRENT SITUATION OVERVIEW**

**Dr. Manisha M. Barad**

**Associate professor Department of Commerce and Management**

**K.S.K.V Kachchh University Bhuj**

### **ABSTRACT**

Throughout the course of the last several decades, the financial sector in India has been confronted with a number of significant problems. Additionally, the country has been suffering with a percentage of credit to GDP that is large and unfavourable ever since the year 2012. In order to explore the influence that cyclical financial conditions have on the growth of GDP, we make use of a method that is referred to as “growth-at-risk (GaR). Using panel regressions at the bank level, we also investigate the relationship between bank balance sheets, loan expansion, and long-term growth for both public and private banks. This is done for both types of banks. Both sorts of banks are subject to this procedure. When seen from a cyclical perspective, the pattern of economic growth distribution exhibits a shift to the left. This movement is observed when we look at the pattern. This shift is the result of adverse impacts on loan availability or an increase in the vulnerability of the macroeconomic system. Consequently, this results in a reduction in the growth that was anticipated, as well as an increase in the likelihood of experiencing significant detrimental impacts. With the passage of time, it has been clearly evident that there is a positive link between increased credit growth, which originates from banks with decreased nonperforming loans and higher capitalization, and improved GDP development. This association is a positive indication of the relationship between the two.

**KEY WORDS:** Finance, Banking, Growth, Economy, Impact.

### **INTRODUCTION**

Following the “Global Financial Crisis (GFC)” and the “proliferation of non-banking financial organizations (NBFCs)” in 2018 & 2019, India's financial industry witnessed a substantial rise in the amount of non-performing assets, which are more popularly known as “non-performing loans (NPLs)”. Since 2012, there has been a considerable and ongoing discrepancy between credit and GDP, which indicates that there has been a sustained period of poor credit expansion. Concerns about a fresh spike in nonperforming loans and corporate defaults throughout the economy were sparked by the unexpected effect of the COVID-19 shock, which occurred at a time when the balance sheets of the banking sector were beginning to show signs of improvement. The real “gross domestic product (GDP)” saw an average growth rate of 6.7% during the years 2011 and 2018. As a consequence of the issue involving “non-bank financial companies (NBFCs)” and the COVID-19 outbreak, the growth rate in 2019 was reduced to 3.7%. When India has fully recovered from the epidemic, it is essential for the country's economy to continue to see strong growth in the near to medium term. Only then will India be able to realize its development objectives. There is a link between India's banking system and the growth of the country's “gross domestic product (GDP)”, and this study

investigates the possible influence that a weak banking sector may have on India's GDP growth. It is possible that the banking industry has a number of affects on the expansion of the GDP, some of which are short-term and others of which are more long-term. The purpose of this study is to provide an overview of two distinct channels that are associated with the question of whether or not the size or structure of the financial system is essential for the expansion of the economy. A "1F2" is the input from the user.

In this research, the "growth-at-risk (GaR)" approach (Adrian et al., 2019) is utilized to investigate the impact that cyclical financial situations have on the expansion of the gross domestic product. In the following step, it evaluates the potential association between the anticipated expansion of the GDP and the current state of the economy, as well as worries over credit. An investigation into the connection between "bank balance sheets, loan expansion, and long-term economic development" is carried out in the next portion of the article. Panel regressions are utilized at the level of individual banks in order to conduct this investigation. The scope of this study includes both public and private banks, which together account for about 85 percent of the total assets held by the banking industry. There are two main points of view that are presented in this study on the connection between the financial sector and the expansion of the economy. Taking a cyclical perspective on the situation is the first thread that will be discussed. "Adrian et al. (2019), Prasad et al. (2019), and the International Monetary Fund (2017)" all use the "GaR methodology", which is a method that makes use of the informational value of financial data, in order to evaluate the possible risks that might affect economic development. Indicators of impending production growth that may be relied upon include asset price indices and credit aggregates, both of which are subject to quick swings. As a means of forecasting the expansion of the gross domestic product, Ang, Piazzesi, and Wei (2006) highlight the relevance of the yield curve, specifically the short rate.

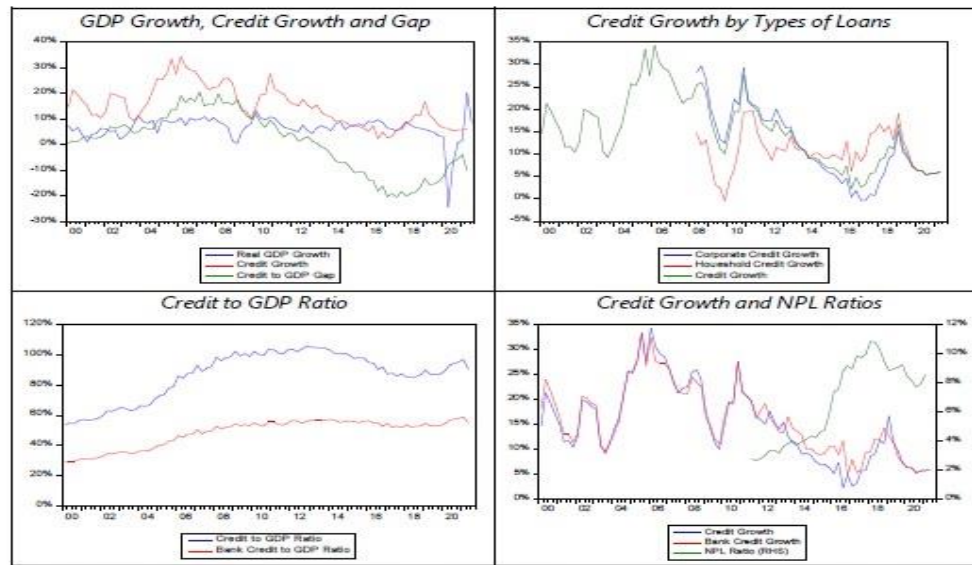
According to the findings of Goodhart and Hofmann (2008), shocks to credit have a major influence on the conduct of economic activity. They carry out an investigation of the relationships that exist between money, credit, property values, and economic activity in seventeen industrialized nations over the course of the past three decades. When compared to conventional recessions, economic downturns that are connected with financial crises have a more harmful and long-lasting impact on the economy (Claessens, Kose & Terrones 2011). It is the objective of the second body of study to investigate the relationship between a robust banking sector and the expansion of real GDP. According to the findings of research carried out by Levine (2005), countries that have major banks that are privately owned are more likely to see rapid economic growth, increased lending to private businesses, and the availability of stock markets that are in good working order. Both Gambacorta and Shin (2016) and Muduli and Behera (2021) present evidence that banks with enough capital experience decreased interest rates on their loans. This data is based on the study of bank balance sheets in a variety of advanced nations. As a consequence of this, yearly credit growth is increased, which ultimately has the potential to have ramifications for the transmission of monetary policy.

According to the findings of the GaR study, there is a positive association between increased lending, decreased nonperforming loans, and GDP growth in the short- and medium-term. A beneficial financial climate is especially important during times of economic crisis since it allows for more opportunities. It is possible for a negative shock to leverage and credit to cause a shift to the left in the overall growth distribution, which can result in a reduction in the predicted growth and an increase in the number of negative tail risks. The findings of the second portion of the study reveal that there is a significant association between the level of capitalization and the growth of loans among private banks which are located in India. This suggests that the correlation is considerably weaker for public banks than it is for private banks. Real GDP in India enjoys quicker growth when banks with greater capital lend more money, provided that these banks do not have an excessive amount of loans that are considered to be nonperforming obligations.

## EVIDENCE AND ARTICULATED DETAILS

In order to collect India's macro-financial data from the first quarter of 2000 to the third quarter of 2021, a database is now being developed at regular intervals of three months. The database takes into account a number of different aspects, consisting of global growth, inflation, policy rate, and bond yields, sovereign spreads, stock prices, credit growth, credit to GDP gap, nonperforming loan ratio, oil prices, currency rates, and world growth. There are many different sources of information that are utilized by the database. Some of these sources include Haver Analytics, the Reserve Bank of India, the Central Statistics Office, the International Monetary Fund, the Bank of International Settlements, the Ministry of Statistics and Programme Implementation, the Bombay Stock Exchange, the Energy Information Administration/Chicago Mercantile Exchange, and Bloomberg. The primary focus of the investigation is on developing a complete definition of credit, which includes both bank credit and debt securities under consideration. The ratio of bank credit to gross domestic product is now at around 55%, but it reached a high of over 106% in 2012 before seeing a decline to over 90% in 2021. After experiencing a period of credit expansion in the double digits, the credit-to-GDP gap<sup>2F</sup> became negative in the year 2012.

Figure 1: Credit and Leverage



*Sources: Haver Analytics, Bank of International Settlements, Central Statistical Office, and International Monetary Fund.*

Figure 1: Credit & Leverage

Since the year 2012, the primary reason for the decline in lending has been the process of lowering debt in the business sector. The expansion of business credit had a more substantial collapse, falling from a peak of nearly thirty percent in 2008 to nearing zero at its lowest point. This is in contrast to the surge that occurred in the housing category. Furthermore, the process of lowering leverage took conducted in both the banking sector and the broader debt finance business. This is due to the fact that the general growth of credit slowed down more dramatically than the rise of bank credit. The percentage of nonperforming loans has dropped to around 8% from a high of over 11% in 2017, when it reached its highest point.

## METHODOLOGY

The process of “GaR analysis” begins with the collection of all of the macro-financial data and the subsequent organization of that data into a number of economically relevant categories that are referred to as "partitions." 1) The policy interest rate, the yield on 10-year Treasury bonds, the spread on sovereign bonds, and fluctuations in stock prices are the elements that have an effect on domestic pricing. 2) The increase of credit, the ratio of credit to GDP, the gap between credit and GDP, and the ratio of nonperforming loans are the factors that influence credit and leverage. 3) Indicators that point to the existence of macroeconomic vulnerabilities include inflation, the ratio of the current account balance to GDP, and the ratio of short-term foreign debt to reserve level. 4) The fluctuation of oil prices and currency rates are two factors that have an impact on external pricing. Five, the rise of the global GDP is a representation of external macro forces. After that, the principal component analysis (PCA) is utilized in order to compute these divisions. This is accomplished by collecting data on patterns that are consistently present across a variety of macro-financial variables.

## RESULTS

This study investigates the influence that a number of macro-financial divisions have on the growth of India's real GDP. Except for the nonperforming loan ratio, which has a negative loading, the first major component 3F<sup>4</sup> has positive loadings for all credit and leverage indicators. The only indication that does not have a positive loading is the nonperforming loan ratio. An increase in the credit and leverage summary indication would indicate that the credit rating has improved or that the credit rating has exceeded the previous level. After reaching its highest point in 2005-2006, the credit and leverage indicator has been steadily declining, which has finally led to a negative credit to GDP gap in 2011-2012.

**Figure 2: Macro-Financial Partitions and Loadings**



Note: the blue lines in the left-hand-side charts refer to the first principal component of each partition.

Source: IMF Staff estimates.

As the first phase in the GaR analysis process, you will collect and classify all of the macro-financial data into specific divisions. These divisions are economically relevant

groupings. There are a number of factors that have an impact on domestic pricing, including the policy interest rate, the yield on 10-year Treasury bonds, the spread between sovereign bonds, and stock prices. The ratio of nonperforming loans, the credit to GDP gap, the credit to GDP ratio, and the credit to growth are the factors that ultimately define leverage and credit. Inflation, the ratio of the current account balance to GDP, and the ratio of short-term foreign debt to reserves are all indicators that represent the degree to which the macro-economy is vulnerable to the possibility of adverse events. The pricing of products and services that are imported from other countries is impacted by fluctuations in the price of oil and currency rates. The increase of the global GDP is a useful indicator for determining the impact of external macroeconomic forces. Following that, these divisions are computed by employing principal component analysis (PCA), which is a technique that gathers information on recurring patterns across a broad variety of macro-financial variables.

The key factor that has an effect on domestic pricing is the positive influence that it has on yields on 10-year Treasury notes, policy interest rates, and sovereign yields. On the other hand, it has a negative effect on changes in stock prices. If the major component of domestic pricing were to increase, this would result in stricter financial constraints that are dependent on price than they already are. A restriction in financial conditions that was based on pricing during the early time was ascribed to the fall in economic expansion that occurred during that beginning period. This is consistent with the idea that there is an inverse relationship between the growth of real GDP and the overall domestic price index. Over the course of the past few years, there has been a steady improvement in the state of the financial system, and the correlation between these circumstances and the advancement of the economy has been less robust. When it comes to the vulnerabilities of the macroeconomic system, the key factor is heavily impacted by inflation and short-term foreign debt, while the current account balance is negatively connected to it. It would be indicative of increased vulnerability in the economy if there was an increase in the major indicator of macroeconomic weaknesses. Based on the data presented in Figure 2, the level of macroeconomic vulnerabilities reached its highest point in the 2012/13 fiscal year and has been steadily reducing ever since.

## CONCLUSION

An investigation of the influence of the expansion of the gross domestic product throughout a variety of time periods, as well as the composition of leverage and credit indicators, is carried out. Quantile regressions were performed at intervals of four, eight, twelve, and sixteen quarters in advance, and the findings of those regressions were incorporated into the present study. The quantile regression is depicted by utilising the credit and leverage partition coefficient, which is represented by Equation (1). Several quantiles, including the 10th, 25th, 50th, 75th, and 90th percentiles of GDP growth, are represented along the x-axis of the graph. The findings suggest that there is a significant relationship between high lending and low nonperforming loans, and that both of these parameters have a significant influence on the expansion of the gross domestic product across all time periods. At lower quantiles, when there is less GDP growth, the impact is substantially bigger than it is at higher quantiles. It is crucial to

have a good credit environment that is typified by increased credit levels and enhanced credit quality while the economy is suffering slow development. This is because elevated credit levels and enhanced credit quality are elements that support economic recovery. In addition, we suggest an alternate method that focuses solely on the ratio of bank credit to GDP and the growth of bank credit as a means of assuring the trustworthiness of our findings. This is done in place of taking into consideration the more general notion of credit. Furthermore, the findings exhibit a high degree of consistency. There would be a further shift to the left in the distribution of GDP growth if there was a negative shock to the credit and leverage division. Rises in the amount of money that banks give out and an improvement in the quality of credit are two factors that are extremely beneficial to the economy during times of relatively slow development. In a manner that is analogous to how we evaluate the expansion of the total GDP, we investigate the effects that a considerable reduction in credit and leverage by two standard deviations might have on investment and consumption. In the aftermath of the negative shock, there would be a shift to the left in the distributions of both the growth of investments and the increase of consumption. It is anticipated that the proposed rate of investment growth for the subsequent four quarters would decline from twenty percent to ten percent. Furthermore, it is anticipated that the investment-at-risk, which is now at -10.9%, would decline even further to -19.2%. A chance of 5% existed before to the shock, which meant that there was a possibility that the growth of investments may fall below 0.9 percent. On the other hand, following the initial shock, there is a 5% chance that growth may drop to -19.2%, which is a far more debilitating event. The growth rate that is anticipated for consumption over the next four quarters is expected to decline from 12.5% to 6.7%, according to the projection! In addition to this, the amount of consumption-at-risk, which is a measure of the probability of a bad result, would increase from 5% to 15.6%. In light of this, there is a significantly increased likelihood of coming across serious hazards.

## REFERENCES

1. <https://www.ibef.org/industry/financial-services-india>
2. <https://byjus.com/govt-exams/indian-financial-system/>
3. <https://www.dfat.gov.au/publications/trade-and-investment/india-economic-strategy/ies/chapter-10.html>
4. <https://www.google.com/search?q=Indian+Financial+Segment%3a+Current+Situation+Overview&Oq=Indian+Financial+Segment%3a+Current+Situation>
5. <https://www.investindia.gov.in/sector/bfsi-FinTech-financial-services>
6. <https://www.bajajfinservsecurities.in/blog/financial-services-sector-in-india/>
7. <https://www.ibef.org/industry/financial-services-presentation>
8. <https://www.forbes.com/advisor/in/banking/indian-financial-sector-changes-you-need-to-look-out-for-in-2022/>
9. [https://loksabhadocs.nic.in/Refinput/New\\_Reference\\_Notes/English/financialsectorinindia.pdf](https://loksabhadocs.nic.in/Refinput/New_Reference_Notes/English/financialsectorinindia.pdf)