

## Credit Alert: Heightened asset quality stress to dent PSB credit profiles

*A Credit Alert is CRISIL's opinion on a sharp and specific development. It conveys that CRISIL will revert shortly on the impact of the development on the ratings of those affected.*

CRISIL believes intensifying asset quality problems at public sector banks (PSBs) have the potential to impair their credit risk profiles and necessitate significantly higher capitalisation of PSBs either through government infusion or relaxation of regulatory capital norms.

Over the past 18 months, CRISIL has either downgraded or revised its outlook to 'Negative' on nine out of the 25 PSBs that it rates on the back of expectations of worsening asset quality.

As much as 85% of banking system weak assets<sup>1</sup> are in the books of PSBs. Increasing stress is also visible in the quantum of strategic debt restructuring and 5/25 structuring being carried out by banks.

CRISIL, in May 2015, had estimated weak assets in banks to rise to a high of around Rs.5.3 lakh crore or 6.3% of total advances by March 2016. However, the deterioration in asset quality in the first nine months of the current fiscal has been faster than expected for various reasons such as the severe downturn in global commodity prices, inability of the leveraged players to sell assets, and the proactive identification of stressed assets as part of Reserve Bank of India's asset quality review.

As a result, we believe the provisioning requirement of PSBs will increase further and render their pre-provisioning profits inadequate, leading to a significant deterioration in earnings profiles.

We believe the government will have to step in and provide more capital than what was committed under the Indradhanush plan and we will be looking out for government announcements for such measures, including in the upcoming Union Budget. If that doesn't happen, CRISIL's threshold of 'high safety category' for PSBs could get lowered.

CRISIL is undertaking a detailed analysis of the impact on credit risk profile of banks it rates. We will factor in the deterioration in standalone credit profile and also any developments on the capital front for PSBs in our rating or outlook changes to be announced subsequently.

<sup>1</sup> Weak assets is CRISIL's measure for assessing banks' asset quality. Weak Assets = Gross NPAs + 35% of outstanding restructured standard advances (excluding state power utilities)+ 75% of Security Receipts received against sale of assets to asset reconstruction companies + 15% of assets structured under the 5/25 scheme.

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