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CHANGING PROFILE OF HOUSEHOLD SECTOR CREDIT AND DEPOSITS IN INDIAN BANKING SYSTEM

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CHANGING PROFILE OF HOUSEHOLD SECTOR CREDIT AND DEPOSITS IN INDIAN BANKING SYSTEM

Deepak Mathur[1]

1. Introduction

1.1 In the background of rapidly changing global financial market scenario post the recent credit crisis, it is being intensively examined in which direction banking industry would move. While debate is going on some of the key issues like how to oversee the big financial conglomerates which are "too big to fail" or the Basel norms on capital issues and credit scores to measure borrowers' risk, they do not address the liquidity issues that were the cause of crisis. The core issue remains very much puzzling about how to use an assiduously built up buffer to stimulate the economy in the rainy days. In the overall, between the ups and downs of de-regulations during the boom time and now the re-regulation being contemplated to make the banking business a 'boring one' by resorting to basics, the acceptable model seems to be moving from the product-push type to a customer-centric one.

1.2 It is now recognized that structure of banking and finance depends very much on the time and phase condition of the community-fix in which it operates. The 'know-your-customer' banking model is being perceived as an effective bulwark against incipient risk profile because it helps articulate risk management model with an in-built automaticity; it is also easier to manage. Presently banking commissions in the developed economies and some South American countries are looking into how universal banking model[2] matters in terms of protecting the economy better where the financial systems operate. For example, very recently Venezuela has tabled draft reform bill on Banking Sector Institutions by envisaging that the Banks will have to adapt to socialist plans; it ought to be declared as public utility. According to the bill, commercial banking will have to undergo a forward looking change. To become a full-service universal banking, they shall meet new requirements, such as the increase of share capital. According to this draft bill, there would be only universal banking, microfinance banking and money exchange offices and there should not be any other banks, thrifts and credit unions, mortgage banks and investment banks. Similarly, in case of Indian banking business, a conscious shift was initiated towards universal banking since the financial liberalization process started in the early 1990s. It was, however, calibrated differently with a commercial banking perspective having an in-built socialistic pattern of public utility content from the very beginning.

1.3 Since the early 1990s, structural changes of profound magnitude have been witnessed in global banking systems. Large scale mergers, amalgamations and acquisitions between the banks and financial institutions resulted in the growth in size and competitive strengths of the merged entities. There emerged

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[1] The author is an Assistant Adviser in Department of Statistics & Information Management, Reserve Bank of India. The views expressed here are those of the author and not of the organisation to which he belongs.

[2] Issues relating to universal banking have been analyzed in an working paper from Swiss National Bank's Study Centre, namely 'The Performance of Universal Banks: Evidence from Switzerland' by Bertrand Rime and Kevin J. Stiroh, May 2001; the study suggests only a 'few obvious benefits from the trend toward larger universal banks'.

new financial conglomerates that could maximize economies of scale and scope by building the production of financial services organization, which are now being called as universal banking. On this score it may be mentioned that Indian banking system remained fairly regulated and did not allow much of specialized banking activities like investment banking, retail banking on a standalone kind of business entity. A lot many regulatory prudential norms were prescribed to ensure more of local banks than foreign banks and protect the market that they operated in. This is now being proclaimed as auguring so well for Asia. Like the Indian system, most of the Asian banks are leverage players in the economy and better-off managing their customers. Indian financial system is getting accolades across the world because of maintaining a relatively stable financial system through the past few major crises. Historically, the Indian financial system has been a bank dominated one with a customer centric model of doing banking business. While banking sector accounts for nearly 70 per cent of the total assets of all the financial institutions in India, it has not grown disproportionately as a percentage of GDP.

1.4 Thus, Indian banks have formed an intrinsically stable link to the Indian economy and they are doing well in following their customers abroad and leverage the accelerating pace of a growing economy in a sustained manner. Given the rich demographic dividends that would accrue out of adult population accounting for over 55 per cent of the total population, with an average age of 28-29 years, populating about 675 thousand habitats, having a high saving rate of about 38 per cent, the scope of leveraged banking with an increased customer base through a proactive plan for financial inclusion is enormous in India. As seen from Indian perspective, the central theme is to serve the community to the funding requirements and allow the economy grow in an accelerating pace. While regulatory ambience is needed to make sure that banking business should grow in line with the economy, and not grow outside the economy, there are several challenges set for Indian banking system namely 'deepening financial inclusion, financing infrastructure, strengthening infrastructure, upgrading risk management architecture and improving efficiency by way of reducing cost and passing on the benefits to both the depositors and lenders' (2009).[3]

1.5 Commercial banks in India play a critical role in the economy. They pool and absorb risks for depositors and provide a stable source of investment and working capital funds to various sectors of the economy. In addition, they provide a smooth functioning payment system that allows financial and real resources to flow relatively freely to their highest return uses. They are also a back up source of liquidity for any sector in the economy in temporary difficulty. Banks are a particularly important source of funds for small borrowers who often have limited access to other sources of external finance. Indian banking system has evolved out in a very sustained and resilient manner to serve these three main interrelated functions of banking namely holding of deposits; creating credit through lending and investment activities; and providing a mechanism for payments and transfers of funds for various productive activities.

1.6 Against this challenging backdrop of Indian banking, it is very much necessary to understand the dynamics of household saving made with the banks and credit availed by them as they form the very basis of banks' balance sheet which otherwise could undertake leveraged business of lending and investment in the productive segment of the economy. As regards credit extension and corresponding share of assets formation in relation to GDP, the following Table would show how this did not outpace GDP in relation to other countries, even after the post liberalization period of the 1990s:

3 Keynote speech of RBI Governor addressed at the International Finance and Banking Conference on 'Banking – Crisis and Beyond', RBI Bulletin, December 2009.

Credit-GDP Ratio of the Banking Sector – Select Countries

Country	1981-85	1986-90*	1991-95	1996-00	2001-06
India	**18.3**	**20.1**	**19.9**	**21.2**	**33.5@**
World	**108.3**	**132.6**	**142.8**	**155.4**	**163.3**
China	60.2	81.2	92.6	109.2	138.6
Brazil	50.7	156.5	110.2	68.1	75.0
United Kingdom	48.4	98.8	117.2	126.4	156.5
United States	126.5	150.4	163.6	195.3	216.1
Japan	212.8	251.6	274.7	298.6	300.1
France	110.3	94.6	101.4	102.2	107.6

Note: Data relate to calendar years. In case of India data relate to end-March.
@: 57 per cent for 2009-10.
Source: World Bank Online Database.

With the countries having very low saving rates, particularly for the developed economics like the United States, credit extension outpacing GDP backed by flourishing financial market mechanism and aided by household asset market bubbles got the banking completely decoupled from world economic growth. Against this backdrop, it would be pertinent to peruse following analysis to understand the evolving pattern of household sector deposits and credit in the Indian banking system

2 Banking system in India

2.1. The banking system in India comprises of commercial and co-operative banks, of which the former accounts for more than 90 per cent of the banking system's assets. The commercial banks include the public sector banks (whose major equity holding is with the Government), domestic private sector banks and branches of foreign banks. These banks together with regional rural banks constitute the scheduled commercial banks. Other banks being co-operatives (rural and urban) banks, local area banks and specialized banks like land development banks. The 166 scheduled commercial banks have wide spread branch network of about 85,000 branches which are located at about 35,000 of about 675,000 inhabited centres (villages/towns) across the country. These banks are having deposit base of about Rs. 48 trillion and loans and advances of Rs. 35 trillion and maintained 660 million deposit accounts and 110 million loan accounts as at the end of March 2009.

2.2. The Basic Statistical Returns or BSR system relates to spatial distribution of credit and deposits in India. This system has been in vogue for four decades, and was introduced after nationalization of major commercial banks in 1969. The system covers a wealth of information at disaggregated level through 7 prescribed returns on deposits, credit, employment and investments, *etc*. of different frequency, and finds immense utility in planning and policy formulation. On the credit side, annual BSR-1 return captures account level information on several characteristics of borrower accounts, like purpose of loan, organization of borrower, interest rate, type of loan account, secured/unsecured nature of loan account, asset classification, *etc*., besides data on credit limit and amount outstanding on reference date, for large accounts (credit limit above Rs. 200,000 or more). Such accounts, though only about 10 per cent of all loan accounts, cover over 90 per cent of outstanding loans and advances. In the case of other (small) loan accounts branch level consolidated data are obtained from all the branches of banks. Such information is supplemented by periodic sample surveys of small accounts. On the deposits side, branch level data are collected by type of deposit (current, savings and term deposits) and broad ownership category (individuals and others), and on maturity and interest rate of term deposits on annual basis. An annual sample survey of ownership of deposits supplements these data to provide a detailed profile of ownership and composition of deposits with banks. The survey captures branch level data on ownership of deposits, classified according to broad institutional sectors and sub-sectors for each type of deposit, *viz*., current, savings and term, including inter-bank deposits. The major institutional sectors are 'Household', 'Government', 'Private Corporate (Non-Financial)', 'Financial' and 'Foreign' sectors. A Stratified sampling design is used for selection of branches of banks for this survey. The branch-wise data on outstanding aggregate deposits as on the reference date of the survey forms the base for construction of the frame. State/Union Territory, population group of the centre where bank branch is located, and bank group to which the branch belongs are used as the stratification criteria. Besides this, the information on branch-size (in terms of outstanding deposits) is used for selection of sample. The estimates are derived using a ratio estimator and generated at different levels of aggregation. The results of this survey form an important input in estimation of household sector financial savings. Other BSR returns include quarterly return on branch level deposits and credit, debits to deposit and credit accounts (to compute turnover rates) and investment profile of banks. The BSR system is able to provide detailed spatial distribution of credit and deposits according to various classificatory characteristics based on the data collected therein and utilizing the database on location and business details of bank branches, as maintained in the Reserve Bank.

2.3. The household sector, in general, is covered under two segments, *viz*., the individuals and the unincorporated bodies (like, proprietary and partnership firms, trusts, associations, NGOs, *etc*.), in the BSR system. Using these data for the last two decades, since 1991, the profile of credit and deposits of household sector in Indian banking system is discussed below.

3.1 Share of household sector in credit and deposits of banks

The household sector is the single largest constituent of banks' deposit holders, although its share has declined over the years. The total deposits with the banks grew at annual compound rate of 18.2 per cent during the past two decades (1991-2009), the growth in the second decade (2001-2009) being higher at 19.4 per cent. The growth of household sector's deposits was lower than that of total deposits by about 2 percentage points. Correspondingly, the household sector which accounted for over four-fifths (80.5 per cent) of the deposits (Rs. 2 trillion) with the banks in 1991 witnessed steady decline in its share thereafter and its share stood at two-thirds (67.2 per cent) in 2001, and is hovering around 58 per cent in recent years. In 2009 this sector held 58.3 per cent of Rs. 40.4 trillion deposits with the banks. Individuals sub-sector of the household sector accounted for major share of household sector deposits. Individuals held 91 per cent of household sector deposits in 1996, which however declined thereafter, and had a lower share of about 80 per cent in 2009 (Tables 1 and 2),

As stated earlier, detailed account-wise information on credit is available for accounts having credit limit above a cut-off, that is, for large accounts. The small accounts are enormous in number, with a small share in total outstanding credit of banks. These small credit accounts belong mainly to household sector, particularly to individuals. Based on the results of periodic sample surveys of small accounts, 95 per cent of such accounts are considered as those of the household sector. In 1991, the household sector held 58.9 million credit accounts out of the 61.9 million credit accounts with banks; the corresponding numbers were 104.2 million and 110.1 million in 2009. The credit growth during 1991-2009, for credit to the household sector was lower at 16.6 per cent compared to 19.0 per cent growth in respect of total credit. The differential between the two rates was, however narrower during 2001-2009. The household sector accounted for 56.3 per cent of total credit (Rs.1.2 trillion) in 1991. Similar to deposits, the share of the household sector in total credit has also been declining over the years. It was about 47 per cent in 2006-2007 and the sector had a lower share of 39.1 per cent in 2009 (Rs. 28.5 trillion) (Tables 1 and 2).

The household sector has been a net provider of funds to the banking system as reflected by the credit-deposit ratio; the ratio for the household sector has been consistently higher than that at the aggregate level for the banks, the differential being in the range of 13-23 percentage points. The sector had 43.4 per cent C-D ratio in 1991, and although the ratio increased to about 57-60 per cent in 2006-2007, it was lower at 47.3 per cent in 2009 (Table 2).

Table 1: Growth rate in outstanding deposits and credit with banks-sector-wise
(Compound annual rates in per cent)

Period	Deposits		Credit	
	Household sector	Total-all sectors	Household sector	Total-all sectors
1991-2009	16.1	18.2	16.6	19.0
1991-2001	15.1	17.2	12.9	15.8
2001-2009	17.3	19.4	21.5	23.1

Table 2: Share of household sector in outstanding deposits and credit with banks
(per cent to total)

As on March 31	1991	1996	2001	2006	2007	2008	2009
Deposits @	80.5	69.2	67.2	58.5	57.4	58.1	58.3
	(91.0)	(77.5)	(83.5)	(80.2)	(77.6)	(77.6)	(79.5)
Credit	56.3	50.4	43.5	47.5	47.1	44.2	39.1
Credit-Deposit ratio (per cent) @@	43.4	42.3	35.7	56.9	59.2	55.4	47.3
	(62.1)	(58.1)	(55.1)	(70.1)	(72.1)	(72.8)	(70.5)

@: Figures in brackets indicate share of individuals in household sector deposits.
@@: Figures in brackets relate to total (all sectors).

3.2 Characteristics of bank credit to Household sector

The following discussion on household sector credit relates mainly to large accounts as comparable detailed data are not available for the small accounts. However, wherever available, data based on surveys of small accounts have been presented. As bulk of small loan accounts pertains to household sector, may be considered as proxy for the household sector.

3.2.1 Purpose of credit

The credit to household sector is broadly classified as that for personal loans (comprising housing loans, loans for purchase of consumer durables and other personal loans) and the remaining for productive purposes. The annual growth of credit for personal loans, during 1991-2009 at 25.5 per cent was substantially higher than 17.3 per cent growth in total credit to the household sector. The decade 2001-09 witnessed even wider difference between the two growth rates (39.5 per cent and 24.7 per cent). The number of personal loan accounts increased at annual rate of 37.6 per cent during this period. The share of personal loans in amount of outstanding credit, which was 12.9 per cent in 1991 increased more than three folds and accounted for about 43 per cent of the credit to the sector; the growth was more pronounced after 2001, particularly in 2006-2007 and the share peaked in 2007 (43.3 per cent). In 2009, 65.3 per cent of the loan accounts of the household sector pertained to personal loans (Table 3).

Viewing individual borrowers segment among the household sector, it is observed that credit for personal loans had annual growth of 25.5 per cent during 1991-2009, as against 21.1 per cent growth in total credit. The share of personal loans in total credit doubled from 35.8 per cent in 1991 to 72.5 per cent in 2006, and was slightly lower at 67.3 per cent in 2009. In terms of number of accounts over 70 per cent of accounts of individuals pertain to credit for personal loans.

Table 3: Share of personal loans in outstanding bank credit to household sector
(per cent)

As on March 31	1991	1996	2001	2006	2007	2008	2009
Number of accounts	27.3	37.7	39.0	62.9	61.8	62.6	65.3
Amount outstanding	12.9	16.2	17.7	42.9	43.3	39.7	43.2

The distribution of outstanding credit to household sector according to major purposes is presented in Table 4 for recent years. Credit to agriculture accounted for over one-tenth of the credit in 1996, and though its share was marginally lower in subsequent years, it accounted for 11.4 per cent share in 2009. The share of credit to industry sector has witnessed a steady decline from 35.8 per cent in 1996 to 19.2 per cent in 2009. The combined share of credit to transport operators and professional services has hovered around 10 per cent of total credit. Credit for retail trade accounted for about 10 per cent of outstanding credit in 2009. Within the personal loans segment, share of credit for housing has grown four-fold between 1996 and 2009 and stood at 24.4 per cent of outstanding credit to household sector in 2009.

Table 4: Distribution of outstanding bank credit to Household sector by purpose
(per cent)

As on March 31/ Purpose of credit	**1996**	**2001**	**2006**	**2009**
Agriculture	10.8	7.2	8.6	11.4
Industry	35.8	34.9	21.5	19.2
Transport operators	3.5	2.0	1.7	2.1
Professional and other services	6.1	5.9	7.7	7.1
Personal loans	16.2	17.7	42.9	43.2
of which Housing loans	*6.2*	*8.9*	*25.5*	*24.4*
Retail trade	6.6	11.0	7.5	10.2
All purposes (including others)	100.0	100.0	100.0	100.0

Data based on surveys of small accounts indicated that about 30 per cent of the credit outstanding in small loan accounts was for agriculture (29.1 per cent-32.1 per cent range as per results for 2001, 2004 and 2006 surveys). The share of industry was low at about 4 per cent in 2004 and 2006. In case of personal loans, the share in total credit to small loan accounts (42.8 per cent in 2006) was similar to that of large accounts.

3.2.2 Cost of credit

The weighted average interest rate on outstanding credit has been computed using the amount outstanding as the weight, both for credit to household sector and total credit. As instead of account level data, the published data containing frequency distributions have been utilized, the mid points of the available interest rate ranges are used for computation purpose. Table 5 presents weighed average interest rates.

Though, the interest rates on total credit and on credit to household sector have steadily declined since 1996 to 2009, the data do not reveal any relationship between the rates on total credit and credit to household sector. It is observed that while in 1996 and 2006 the interest rate on loans to household sector was lower than that on total credit, in other periods the position was reverse. The absolute difference in the interest rates has been in the range of 50 to 80 basis points.

Table 5: Weighted average interest rate on outstanding bank credit
(per cent)

as on March 31	1996	2001	2006	2009
Household sector	16.3	14.9	11.4	11.3
Total credit (All Sectors)	17.0	14.3	12.2	10.8

Based on the results of the surveys of small borrowal accounts, the interest rates on small loans for the years 2004 and 2006 are presented in Table 6. Small loans for agriculture and housing were at rates lower than those for all small loans.

Table 6: Weighted average interest rate on outstanding bank credit-small loans
(per cent)

As on March 31/ Purpose of credit	**2004**	**2006**
Agriculture	10.5	9.1
Industry	10.9	10.1
Transport operators	13.9	11.2
Professional and other services	12.7	11.2
Personal loans	11.0	13.1
of which Housing loans	*8.9*	*8.0*
Retail trade	11.5	11.4
All purposes	**10.9**	**11.4**

3.2.3 Average size of credit account

The average size of credit account, that is, the average amount outstanding per account for credit accounts of household sector was about 34 per cent of the average outstanding per account for all credit accounts, both in 2001 and 2009.

3.2.4 Type of credit account

The types of credit accounts of household sector have been grouped into two major groups, *viz*., short term accounts including cash credits, overdrafts and demand loans, and the long term accounts which include medium term and long term loans. It is observed that the relative share of short term credit, both in terms of number of credit accounts and amount outstanding, has declined and that of the long term accounts increased. The share of amount outstanding in long term accounts for credit to household sector which was 42.2 per cent in 1996, which increased to 63.2 per cent in 2006 and to 67.0 per cent in 2009. The share of long term credit accounts of households, in terms of number of accounts also increased from 69.2 per cent in 1996 to 77.0 per cent in 2009 (Table 7). In the case of total credit, long term accounts accounted for about 30 per cent credit in 1996 and 59 per cent of the credit in 2009.

Table 7: Distribution of outstanding credit to household sector by type of account
(per cent)

As on March 31	Number of accounts				Amount outstanding			
	1996	2001	2006	2009	1996	2001	2006	2009
Short term accounts	29.2	36.3	23.3	22.5	41.6	48.9	30.3	29.7
Long term accounts	69.2	61.0	75.9	77.0	42.2	36.2	63.2	67.0
Total (including others)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

3.3 Characteristics of bank deposits of Household sector

3.3.1 Type of deposits

The deposits with banks are grouped into Demand deposits comprising current deposits and savings deposits (CASA) and the Term deposits, having fixed maturity and can generally not be withdrawn on demand. The term deposits with banks registered 18.9 per cent annual growth during 1991-2009, while in the case of deposits of household sector, the growth rate was lower at 15.7 per cent, and in the case of Individuals sub-sector the growth rate was even lower at 14.7 per cent.

A major part of deposits with banks is held in the form of term deposits, the remaining as balances in current accounts and savings accounts (CASA). In case of household sector, the share of term deposits which was 60.7 per cent in 1991, declined to 50.7 per cent in 2001. The share improved thereafter and was 57.6 per cent in 2009. A similar trend is observed for the Individuals sub-sector. On the other hand, for the total (all sectors) deposits, the share of term deposits has increased between 1991 and 2009. Data for recent years indicate that the household sector is maintaining higher proportion of its deposits under CASA as compared to other sectors (Table 8).

Table 8: Share of term deposits in outstanding deposits with banks-sector-wise
(per cent to total)

As on March 31	1991	1996	2001	2006	2007	2008	2009
Household sector	60.7	59.7	60.3	50.7	52.3	55.7	57.6
Out of which Individuals	62.7	60.7	61.3	49.5	51.0	54.4	57.6
Total-all sectors	58.3	61.8	63.5	60.4	62.7	62.8	64.7

The share of household sector deposits in total outstanding deposits is presented in Table 9. The sector owned the bulk of savings deposits (84-86 per cent). As regards, current deposits, its share which was 48.2 per cent in 2005, declined to 43.7 per cent in 2009, while its share in term deposits remained around one-half.

Table 9: Share of Household sector deposits in outstanding deposits with banks-Type of deposit-wise
(per cent to total)

As on March 31	2005	2006	2007	2008	2009
Current deposits	48.2	45.4	47.9	40.7	43.7
Savings deposits	86.1	86.4	86.2	85.4	83.6
Term deposits	52.2	49.1	47.9	51.1	51.9

3.3.2 Maturity of term deposits

The data on maturity (original or contracted) of term deposits is available for deposits of individuals' sub-sector of the household sector. This sub-sector accounts for more than 80 per cent of the household sector's deposits. The Individuals held about two-thirds of their term deposits for less than 3 years maturity. In 1996, 67.7 per cent of deposits of individuals had maturity within 3 years, while in respect of all deposits 71.4 per cent of deposits had maturity within 3 years and the corresponding shares in 2009 were 69.9 per cent and 79.9 per cent. The share of term deposits with maturity less than one year which was in 24-30 per cent range for individuals, during 1996-2006 declined to below 15 per cent in 2009. In 2009 the deposits of 1-3 years maturity accounted for about 55 per cent of term deposits of individuals. The share of deposits with above 3 years maturity in total term deposits for individuals at 30.1 per cent in 2009 was higher than corresponding share of 20.2 per cent for all sectors' deposits. This indicates preference of individuals in recent years to lock in their funds in term deposits for relatively longer period.

The average maturity of term deposits has been computed using the amount outstanding in a particular maturity bracket as the weights and mid-point of the maturity bracket as the maturity period. The average maturity of term deposits of individuals was 2.4 years in 1996 and 2001, 2.3 years in 2006 and 2.4 years in 2009. This was higher than the average maturity of all sectors term deposits which was 2.2 years in 1996 and 2001 and lower at 1.9 years in 2006 and 2009. This indicates that individual depositors preferred deposits with higher maturity compared to all depositors (Table 10).

Table 10: Distribution of term deposits with banks according to maturity
(per cent to total)

Maturity bracket / As on March 31	Individuals				Total (all sectors)			
	1996	2001	2006	2009	1996	2001	2006	2009
Less than 1 year	23.4	26.6	29.3	14.8	28.6	31.1	39.6	27.8
1-3 years	44.3	38.0	37.6	55.1	42.8	37.2	36.0	52.1
Above 3 years	32.3	35.4	33.1	30.1	28.6	31.7	24.4	20.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Average maturity (in years)	2.4	2.4	2.3	2,4	2.2	2.2	1.9	1.9

4. Concluding Observations

With the Indian economy expecting to grow at 8-9 per cent, and population base of about 1.25 billion growing at 1.6 per cent, the per capita income ought to grow manifold. Given high saving rate of about 38 per cent and comparatively younger population of average age at 28-29 years, the Indian banking system in poised to grow manifold. Challenges are not so much to repair Indian banking system or the excessive growth of financial sector unrelated to growth of the real sector. So far the banking system's asset-liability could operate in a healthy synergy as against household sector assets and liabilities creation capability. But the level of banking penetration in India is presently low with only 35,000 habitations out of about 675,000 habitations being banked. The challenges of extending banking services in tandem with the country's growth expectations, that too in present day crisis ridden globalised and competitive environment are quite arduous.