**Financial Express**
**20th Sep. 2024**
**Page No.8**

# Financing growth

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INDIA'S RECOVERY FROM the pandemic has been stellar. GDP growth rate has averaged no less than 8.3% in the last three years, with 8.2% in 2023-24 alone. And as borne out by the fresh update last week by the Reserve Bank of India (RBI), the flow of financial resources to the commercial sector matched the real economy. In relation to nominal GDP, these reflect a steady increase from the single-digit lows to which they had fallen even before the pandemic (FY20). At ~12% of GDP last year, the total financial resource flows maintain the trend, although remaining below the FY18-FY19 levels (see table).

Underneath the aggregate pick-up however, the shifting sources of financing within the sub-components elicit some discomfort. As the table shows, the dependency upon bank financing has grown rapidly in the post-pandemic years. At 63.4% of overall financial resource flow in the economy last year, the share of bank credit flow expanded exceptionally relative to its historical trend — 16 percentage points above the pre-pandemic average, 47.2%. It was also a further increase from the preceding year's 59%, which too was a significant (14.5 percentage points) jump in one year (2022-23).

The sharp growth in bank credit shares reflects a devolvement of the growing deficit in non-bank resource flows, especially foreign. The data show that these sharp increases occur in the context of a severe drop in the share of external resource flows. Again, this trend continues from last year, FY23. However, the deficit deepened considerably in FY24, with foreign resource flow falling to ₹2 lakh crore net, the lowest since 2007-08 when the data begins. At a 5.8% share in total financial flows, it was just a quarter of the pre-pandemic average (FY08-FY20, 20.8%). Note that the long-term average before the pandemic masks a significant reduction in foreign flow share during FY14-FY19 to 16%. It's difficult to say if these represent a trend or short cycles because the FY20-FY22 period witnessed a remarkable bounce in foreign resource flow shares led by foreign direct investments (FDIs). FDI resource flows have fallen back steeply from 2022-23.

In this while, the share of non-bank domestic resource flows has progressed rather slowly. Net of bank credit, these remain below their average pre-pandemic proportion of 32%. Within the latter however, loans and advances by the non-banking financial corporations (NBFCs) (minus bank credit) grew 67% in FY24 to ₹4.4 lakh crore, again an exceptional increase.

It is evident that the widening shortfall in non-bank financial flows, especially external sources, is being met by the banks who are bearing the growing burden. From a macroeconomic perspective, the overburdening of the banking system is to be noted. There could be implications of these compounding pressures that are yet to become clear. Some features and concurrent developments indicate so.

For one, the increasing pressure on banks for financing much of the commercial sector, ~ two-thirds in FY24, coincides with decelerating growth in deposits, a prudent belt-tightening imposed by the central bank to improve the assets-liabilities' balance of the banking system, and discernible concerns about financial instability risks. The horizon over which these imbalances are straightened out remains to be seen and are uncertain, therefore. Then too, as the banks seek to increase the right kind of deposits to align with their advances, there's accompanying impact on interest rates due to higher marginal costs of funds. Further, because banks must lend afresh on the repo rate-linked benchmark, the probable offset to shield the net interest margins may be a rise in the loan premium — the outcome could be adverse for riskier, albeit smaller, borrowers.

Two, it is doubtful if the NBFCs' lending pace in the current year can match or exceed last year's surge in loan growth in light of the above and increased checks by the RBI.

Three, the financing pressures are also coincident with a decreased share of household financial savings in relation to gross national disposable income. Potential macroeconomic consequences for the equilibrium real interest rate, which is impacted by the movements in savings and balances against investment demand, are uncertain at this point.

Relative to nominal GDP — this is predicted by the RBI to grow marginally slower at 11.7% in FY25 than the 11.9% last year — the advancement in total financial flows acquires significance ahead. We do not know whether bank credit will continue to maintain the growing dominance as a source of financing for the commercial sector this year as well. Neither do we know the intensity of the fallout of these pressures on credit growth. If a credit slowdown lies ahead consequently is difficult to say, therefore. The caution is of a hidden constraint, that of financing, which could feed back to the real economy. Financing growth could then be constrained.

**Flows of resources to commercial sector: Bank credit & foreign flows**

| | Total flow | Bank credit | Foreign flow | Total flow | Bank credit | Foreign flow |
|---|---|---|---|---|---|---|
| | (₹ lakh crore) | | | % GDP | %, total flow | |
| 2007-08 | 10.2 | 4.6 | 3.1 | 20.8 | 44.8 | 30.1 |
| 2008-09 | 9.3 | 4.2 | 2.1 | 16.9 | 45.4 | 22.8 |
| 2009-10 | 10.5 | 4.8 | 2.2 | 16.5 | 45.6 | 21.0 |
| 2010-11 | 12.9 | 7.3 | 2.5 | 16.9 | 56.4 | 19.4 |
| 2011-12 | 12.0 | 6.7 | 2.3 | 13.8 | 55.3 | 19.1 |
| 2012-13 | 14.4 | 7.0 | 3.1 | 14.4 | 48.6 | 21.7 |
| 2013-14 | 13.8 | 7.6 | 2.2 | 12.3 | 55.3 | 16.0 |
| 2014-15 | 13.6 | 5.8 | 2.3 | 10.9 | 42.9 | 16.6 |
| 2015-16 | 15.2 | 7.8 | 2.5 | 11.0 | 51.0 | 16.2 |
| 2016-17 | 13.8 | 5.0 | 2.8 | 9.0 | 35.9 | 20.0 |
| 2017-18 | 21.4 | 9.2 | 3.4 | 12.5 | 42.7 | 15.8 |
| 2018-19 | 23.7 | 12.3 | 3.9 | 12.5 | 51.9 | 16.3 |
| 2019-20 | 15.4 | 5.8 | 5.4 | 7.7 | 37.7 | 35.3 |
| 2020-21 | 16.6 | 4.6 | 3.8 | 8.4 | 27.9 | 22.7 |
| 2021-22 | 22.9 | 10.4 | 6.2 | 9.7 | 45.7 | 27.3 |
| 2022-23 | 29.6 | 17.5 | 3.5 | 11.0 | **59.2** | **12.0** |
| 2023-24 | 35.1 | 22.3 | 2.0 | 11.9 | **63.4** | **5.8** |

Source: RBI, CSO & author's calculations. Note: Bank credit excludes impact of bank-non-bank merger for comparison