Banking Sector: A Pillar of India’s Economic Growth

For Prelims: **Scheduled Commercial Banks**, **Non-Performing Assets**, **Unified Payments Interface**, **Initial Public Offerings**, **FREE-AI**

For Mains: Role of banking sector in inclusive growth and economic development, Role of banks in implementing welfare schemes

Source: TH

Why in News?

President Droupadi Murmu highlighted **India’s banking sector** role in fostering economic growth, supporting **Micro, Small, and Medium Enterprises**, boosting the rural economy, and driving financial inclusion.

What is the Contribution of India's Banking System to its Economic Growth?

- **Credit Growth & Economic Activity: Bank credit disbursal by** Scheduled Commercial Banks (SCBs) **reached Rs 164.3 lakh crore by March 2024, up 20.2% YoY (compared to 15% in FY23).**
    - Agricultural credit grew from Rs 13.3 lakh crore in FY21 to Rs 20.7 lakh crore in FY24, supported by over 7.4 crore operative Kisan Credit Card accounts.
    - Banks channel credit strategically to sectors driving economic growth and job creation.
- **Financial Stability & Asset Quality: Gross** Non-Performing Assets (GNPA) **of SCBs fell to a 12-year low of 2.8% in March 2024 from 11.2% in FY18, reflecting improved borrower selection and recovery mechanisms.**
    - Top 10 Indian banks have loans constituting over 50% of total assets, ensuring resilience to rising interest rates.
- **MSMEs & Entrepreneurship Support:** Banks act as enablers of entrepreneurship and inclusive development. Banks facilitated low-cost credit to MSMEs and industrial sectors, boosting employment, innovation, and industrial growth.
    - India has the second-largest market globally, after China, in terms of borrowing customers.
    - Industrial credit growth accelerated to 8.5% in FY24 from 5.2% (FY23).
- **Digital Transformation & Financial Inclusion:** Over 77% of adults now have accounts in formal financial institutions, reducing the income and gender access gap.
    - Unified Payments Interface (UPI) transactions surged from Rs 0.07 lakh crore in FY17 to Rs 200 lakh crore in FY24.
    - India has 116.5 crore smartphone subscribers as of March 2024, facilitating digital banking access.
- **Capital Market Development:** Primary market fund mobilisation reached Rs 10.9 lakh crore in FY24. Initial Public Offerings (IPOs) increased from 164 in FY23 to 272 in FY24. Corporate bond issuances rose to Rs 8.6 lakh crore in FY24, the highest so far.

- Banks link capital markets and investors, supporting corporate funding and long-term growth.
- **Social & Welfare Programs Implementation:** Pradhan Mantri Jan-Dhan Yojana (PMJDY) **accounts exceed 56 crore, with 67% in rural/semi-urban areas and 56% held by women.**
  - Ayushman Bharat-Pradhan Mantri Jan Arogya Yojana generated 34.2 crore health cards, 49.3% held by females.
  - National Pension System and Atal Pension Yojana saw 735.6 lakh total subscribers, up 18% YoY, with female participation rising to 48.5%.

What are the Key Challenges Facing India's Banking Sector?

- **Credit-Deposit Balance and Liquidity Risks: Credit growth has outpaced deposit mobilisation, creating potential structural liquidity pressures.**
  - Households are increasingly moving savings to mutual funds, insurance, and pension schemes, reducing banks' traditional low-cost deposit base.
  - Banks are bridging this gap via short-term borrowings and Certificates of Deposit, increasing sensitivity to interest rate fluctuations.
- **Cybersecurity and Third-Party Risks:** Growing digitalisation has increased exposure to cyber attacks, system failures, and risks from outsourced operations.
  - Weak management in these areas can lead to operational disruption, financial losses, and reputational damage.
  - Rise in social engineering attacks and use of mule accounts exposes banks to financial and reputational risks.
- Retail Credit and Unsecured Lending: Rapid expansion of retail, unsecured, and private credit increases exposure to defaults, leverage risks, and systemic vulnerabilities, requiring banks to strengthen risk assessment, monitoring, and governance frameworks.

What Measures can Strengthen India's Banking Sector to Drive Economic Growth?

- **Strengthening Capital and Risk Management: India must align with** Basel III guidelines **and Narasimham Committee recommendations (1991) by ensuring adequate capital buffers and strengthening risk management.**
  - Banks should adopt advanced risk-based assessment models for retail and unsecured lending to enhance capital adequacy and reduce delinquencies. These measures will foster a more resilient and sustainable banking sector.
- **Digital Transformation and Cybersecurity:** In line with Reserve Bank of India (RBI) Framework for Responsible and Ethical Enablement of Artificial Intelligence (FREE-AI), banks should encourage fintech partnerships, and AI-driven risk analytics to boost reach and efficiency.
  - Initiatives like the MuleHunter AI, and Account Aggregator framework foster innovation while ensuring security and compliance.
- **Governance and Fair Conduct:** Enforcing consumer protection norms, transparent loan contracts, and fair pricing mechanisms especially in microfinance can build trust.
- **Promoting Financial Inclusion and Deepening Credit:** Expansion of priority sector lending, co-lending models, and innovative digital credit platforms can bring underserved populations into the formal financial system.
  - Schemes like PMJDY, PM-Surya Ghar, and PM-KUSUM integrate banking with social and infrastructure development, boosting inclusive growth.
- **Climate and Transition Financing:** Integrating sustainability and climate risk assessment into lending is crucial for long-term financial stability.
  - Initiatives like Sovereign Green Bonds, green deposits, and the RBI draft climate disclosure framework encourage banks to provide transition financing while mitigating greenwashing risks.
- **Regulatory and Policy Measures:** Strengthening regulatory frameworks through prompt corrective action (PCA), enhanced supervision, and risk-based audits improves resilience.

Narasimham Committee

- Dr Manmohan Singh set up the **Narasimham Committee in 1991** to analyse India's banking sector and recommend reforms. It was followed by the **1998 Committee which is known as the Narasimham Committee II.**

Narasimham Committee- I Recommendations:

- A 4-tier hierarchy for the Indian banking system with 3 or 4 major public sector banks at the top and rural development banks for agricultural activities at the bottom.
- A quasi-autonomous body under RBI for supervising banks and financial institutions.
- Reduction in **statutory liquidity ratio**
- Reaching of 8% **capital adequacy ratio**
- Setting up **Asset Reconstruction fund**

Narasimham Committee- II Recommendations:

- The Committee recommended the merger of major public sector banks to boost international trade. However, the Committee warned against merging stronger banks with weaker banks.
- The Committee also recommended reforms in the role of the RBI in the banking sector. The Committee felt that RBI being the regulator, should not have ownership in any bank.
- It also recommended the formation of Asset Reconstruction Funds or **Asset Reconstruction Companies.**

Conclusion

By adopting **transition financing, climate-aware lending, and digital credit expansion** , banks can simultaneously promote sustainability and economic growth. The sector's stability also boosts **investor confidence, domestic savings mobilization**, and integration with global financial markets.

Drishti Mains Question:

Q. Analyse the role of India's banking sector in driving credit growth and financial inclusion while maintaining financial stability.

UPSC Civil Services Examination, Previous Year Question (PYQ)

Prelims:

Q1. With reference to 'Urban Cooperative Banks' in India, consider the following statements: (2021)

1. They are supervised and regulated by local boards set up by the State Governments.
2. They can issue equity shares and preference shares.
3. They were brought under the purview of the Banking Regulation Act, 1949 through an Amendment in 1966.

Which of the statements given above is/are correct?

(a) 1 only
(b) 2 and 3 only
(c) 1 and 3 only
(d) 1, 2 and 3

Ans: (b)

Q. Which one of the following links all the ATMs in India? (2018)

(a) Indian Banks' Association
(b) National Securities Depository Limited
(c) National Payments Corporation of India
(d) Reserve Bank of India

Ans: (c)

Mains:

Q. Pradhan Mantri Jan Dhan Yojana (PMJDY) is necessary for bringing unbanked to the institutional finance fold. Do you agree with this for financial inclusion of the poorer section of the Indian society? Give arguments to justify your opinion. **(2016)**