Research Report on NBFC Industry

December 2022

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1. Economic Outlook

1.1 Global Economy

As per the International Monetary Fund ("**IMF**")'s World Economic Outlook growth projections released in October 2022, the world economy grew by 6% in the calendar year ("**CY**") 2021 ("**CY21**"), majorly due to economic recovery and the lower base. For CY 2022 ("**CY22**"), the IMF slashed its projection for global economic growth to 3.2%, citing disruptions due to the Russia-Ukraine war and higher-than-expected inflation worldwide. The IMF projects real gross domestic product ("**GDP**") to slow down further to 2.7% in CY 2023 ("**CY23**"), mainly due to tightening global financial conditions, expectations of steeper interest rate hikes by major central banks to fight inflation, a sharper slowdown in China and spill over effects from the war in Ukraine with gas supplies from Russia to Europe tightening. The IMF projects world economy growth of between 2.6%-3.3% on a year-on-year ("**Y-o-Y**") basis for next five years.

IMF revises the GDP growth outlook considering uncertainties relating to global inflation

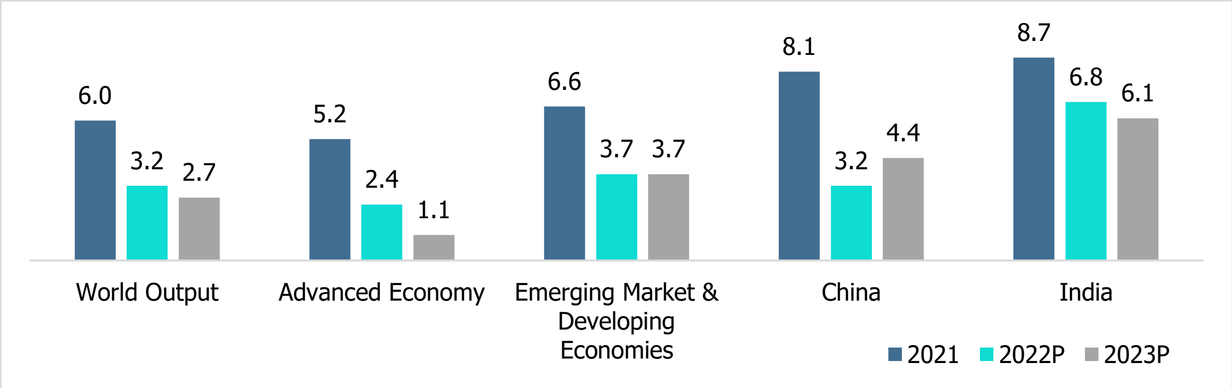
Advanced Economies Group

For the major Advanced economies group, which includes the United States, the GDP growth is projected to be lower at 2.4% in CY22 and 1.1% in CY23.

The baseline growth for the United States is revised down by 0.7 percentage points to 1.6% for CY22 and remains unchanged for CY23 at 1%. This is reflective of declining real disposable income impacting consumer demand with higher interest rates taking toll on spending.

The growth in the Euro Area is comparatively less pronounced than that in the United States. Recovery in tourism related services and industrial production in Italy and Spain, Russian gas supply cuts, tighter financial conditions, with rapidly rising policy rate, reflects an upward revision of 0.5 percentage point in CY22 to 3.1% and a downward revision 0.7 percentage point to 0.5% in CY23.

Chart 1: Global Growth Outlook Projections (Real GDP, Y-o-Y change in %)



Notes: P-Projection
*For India, data and forecasts are presented on a fiscal year basis and GDP from 2011 onward is based on GDP at market prices with fiscal year 2011/12 as a base year.
Source: IMF – World Economic Outlook, October-2022

Emerging market and developing economies group

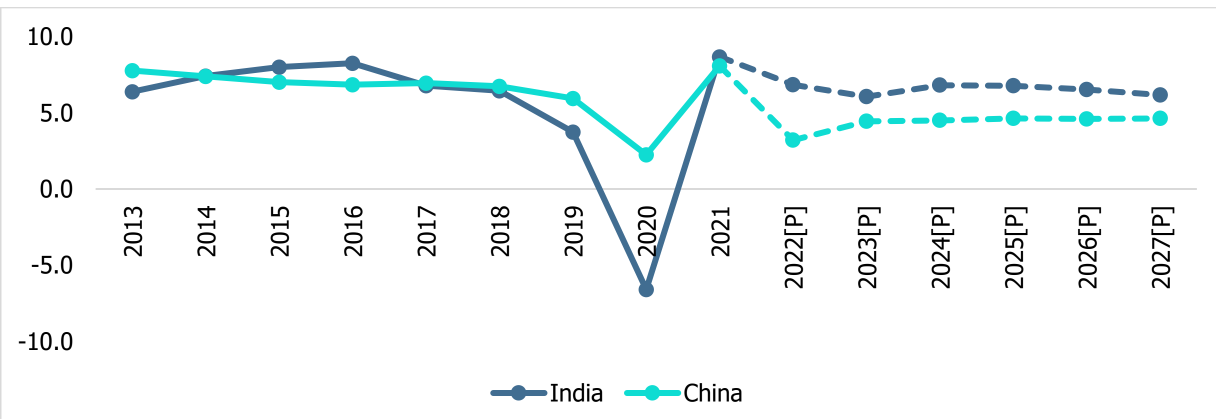
For the Emerging market and developing economies group, GDP growth is expected to decline to 3.7% in CY22 and sustain at that level in CY23. This downgrade is primarily a reflection of the sharp slowdown of China's economy and the moderation in India's economic growth. China's GDP growth is expected to slow down to 3.2% in CY22 and then pick-up to 4.4% in CY23. This is the lowest growth in more than four decades, excluding the initial COVID-19 crisis in CY20. Shanghai, a major global supply chain hub, entered a strict lockdown in April 2022 due to worrisome surge in COVID-19 cases, forcing citywide economic activity to halt for about eight weeks. The worsening crisis in China's property sector is also dragging down sales and real estate investment. Furthermore, COVID-19 pandemic related intermittent lockdowns continue to adversely impact economic growth.

The estimates for India's GDP growth have been downgraded to 6.8% in CY22 and 6.1% in CY23. This downgrade is majorly reflection of weaker-than-expected outturn in the second quarter and more subdued global demand.

India to remain fastest growing economy transcending China

Despite of the turmoil in last two-three years, India bears good tidings for becoming a USD 5 trillion economy by CY 2027 ("**CY27**"). According to the IMF dataset on Gross Domestic Product (GDP) at current prices for India, the current GDP is estimated to be USD 3.5 trillion for CY22 and projected to be USD 5.5 trillion by CY27. The expected GDP growth rate of India for coming years is almost double as that of the world economy.

Chart 2: GDP growth trend comparison - India and China (Real GDP, Y-o-Y change in %)



P- Projections; Source: IMF, World Economic Outlook Database (October 2022)

India stands out as the fastest growing economy amongst the major economies. Outshining the growth rate of China, the Indian economy is projected to grow at more than 6% in the period CY23-CY27.

The Indian economy is paving its way towards becoming the largest economy in the world. Currently, India is the third largest economy globally in terms of Purchasing Power Parity ("**PPP**") with ~7% share in global economy with China (~18%) on the top and United states (~15%) being second. Purchasing Power Parity is an economy performance indicator denoting the price of an average basket of goods and services that a household needs for livelihood in each country. In spite of the pandemic and the geo-political tensions in Europe, India has been one of the major contributors to world economic growth.

1.2 Indian Economy Outlook

1.2.1 GDP growth and Outlook

Resilience to external shocks remains critical for near-term outlook

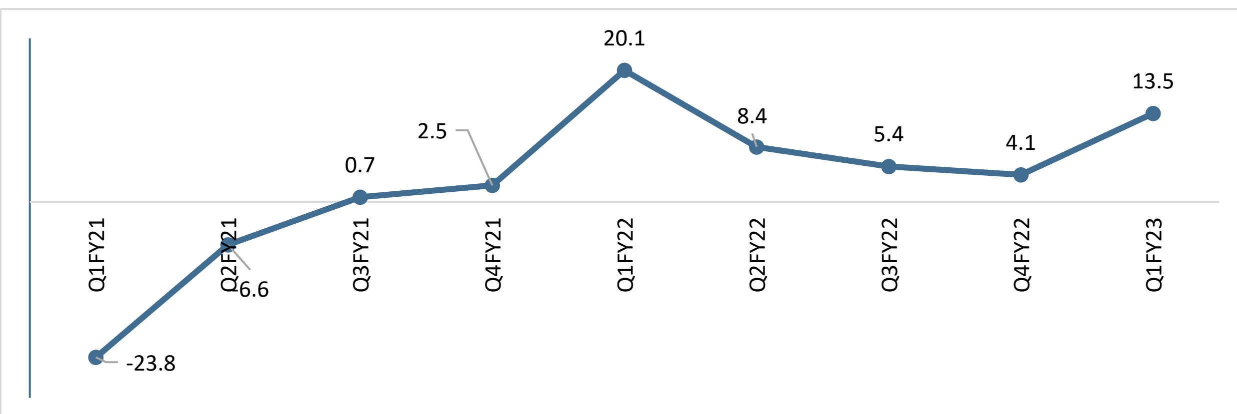
The year ended 31 March ("**FY**") 2021 ("**FY21**") started with the country being hit by the COVID-19 pandemic, which saw lockdowns and restrictions being imposed across states. This impeded economic output in the first quarter ("**Q1**") of FY21 and led to a year-on-year decline of 23.8% in GDP. By the end of the fourth quarter ("**Q4**") of FY21, the economy began to recover. In a broader sense, the pandemic resulted in 6.6% negative growth for the Indian economy in FY21.

The Indian economy bounced back strongly in Q1 of FY 2022 ("**FY22**") with 20.1% Y-o-Y growth due to the lower base effect. The easing of lockdowns and restrictions across states since June 2021 coupled with the decline in COVID-19 cases and higher vaccination rate facilitated higher economic activity, as reflected in the GDP for the Q2FY22, which grew annually by 8.4%. The dip in the third quarter ("**Q3**") of FY22 of 5.4% can be attributed to the fading base effect. India's economy recorded modest growth of 4.1% in the fourth quarter ("**Q4**") of FY22 due to the hit on the economy caused by the third wave of COVID-19 as well as global supply bottlenecks due to the Russia-Ukraine war and higher input costs. Overall, India witnessed 8.7% growth in FY22.

In Q1 of FY 2023 ("**FY23**"), India recorded 13.5% growth in GDP, which can largely be attributed better performance by agriculture and services sectors. Prospectively for FY23, the announcements in the Union Budget 2022-23 on boosting public infrastructure through enhanced capital expenditure is expected to augment growth and crowd in private investment through large multiplier effects. However, heightened inflationary pressures and resultant policy tightening may pose risks to the growth potential.

GDP growth outlook

Chart 3: Growth in GDP at constant prices (Y-o-Y in %)



Source: Ministry of Statistics and Programme Implementation ("MOSPI")

As the economy was getting back on its feet, global supply bottlenecks due to the Russia-Ukraine war and higher input costs slowed the pace of recovery again. The contraction in the manufacturing sector, which struggled with supply bottlenecks and high input prices, in the last quarter of Fiscal 2022 is a cause for concern. The other worrying aspect is the decline in consumption to GDP ratio in Q4 of Fiscal 2022, even when the investment to GDP ratio has bounced back. The slowest quarterly growth in Fiscal 2022 was also partly because of the unfavourable base effect. The economic growth picked-up with 13.5% growth registered in Q1 of Fiscal 2023 on a lower base of Q1 of Fiscal 2022 and better performance of agriculture and services sector.

Apart from this, the announcements in the Union Budget for Fiscal 2023 on boosting public infrastructure through enhanced capital expenditure are expected to augment growth and boost-in private investment through large multiplier effects.

Table 1: RBI's GDP Growth Outlook (Y-o-Y %)

Q2FY23	Q3FY23	Q4FY23	Q1FY24
6.3	4.6	4.6	7.2

Source: RBI press release dated October 14, 2022

With improvement in demand for contact-intensive sectors as well as positive business and consumer sentiment, the discretionary spending and urban consumption is expected to bolster economic growth. Along with increasing government support and push towards capex, the investment activities are expected to stay upright through improving bank credit and rising capacity utilization. On the other hand, headwinds from geopolitical tensions, tightening global financial conditions and the slowing external demand pose downside risks to net exports and hence to India's GDP outlook.

Taking all these factors into consideration, the real GDP projected growth for FY23 is pared down to 7% by RBI for the October 2022 Outlook from the projected figure of 7.8% in RBI's February 2022 Outlook.

1.2.2 Gross Value Added (GVA)

Gross value added (GVA) is the measure of the value of goods and services produced in an economy. GVA gives a picture of supply side whereas GDP represents consumption.

Industry and Services sector leading the recovery charge

• The gap between GDP and GVA growth has turned positive in FY22 (after a gap of two years) as a result of robust tax collections. Of the three major sector heads, service sector has been fastest growing sector in the last five years.

• **Agriculture sector** was holding a growth momentum till FY18. In FY19, the acreage for rabi crop was marginally lower than previous year, which affected the agricultural performance. FY20 witnessed growth on account of improved production. During the pandemic impacted period of FY21, the agriculture sector was largely insulated as timely and proactive exemptions from COVID-19-induced lockdowns to the sector facilitated uninterrupted harvesting of rabi crops and sowing of kharif crops. However, supply chain disruptions impacted the flow of agricultural goods leading to high food inflation and adverse initial impact on some major agricultural exports. However, performance remained steady in FY22.

The Q1FY23 recorded a growth of 4.5%. Due to uneven rains in this financial year, the production of some major Kharif crops such as rice and pulses was adversely impacted thereby impacting agriculture sector's output growth. Going forward, high prices for agri products and subsidy support from the government, is expected to bode well for the sector.

• **Industrial sector** witnessed CAGR of 4.7% for the period FY16 to FY19. From the March 2020 month onwards, nation-wide lockdown due to the pandemic had a significant impact on industrial activity. In FY20, this sector felt mild turbulence and recorded downfall of 1.4%. FY21 witnessed 3.3% decline on account of adverse impact of covid-19 pandemic. With the opening up of economy and resumption of industrial activity, FY22 registered 10.3% growth, which also has a lower base effect.

The industrial output in Q1FY23 jumped 8.6% on Y-o-Y basis. However, sequentially the sector witnessed a sharp contraction due to lower output across mining, manufacturing and construction sectors. In the coming quarters, easing of commodity price pressures and prospects of improvement in consumption demand are potential attributes to support growth in the manufacturing sector.

• **Services sector** recorded CAGR of 7.1% for the period FY16 to FY20, which was led by trade, hotels, transport, communication and services related to broadcasting and finance, real estate & professional service. This sector had been hardest hit by the pandemic and registered 7.8% of decline in FY21. The easing of restrictions aided a fast rebound in this sector, with 8.4% growth witnessed in FY22.

In Q1FY23, this sector registered growth of 17.6%, on a lower base of Q1FY22. While the output in the sectors related to trade, hotels, transport, communication and broadcasting recorded a good growth of 25.7% on Y-o-Y basis, it was still 15.5% lower compared with the pre-pandemic level.

Table 2: Sectoral Growth (Y-o-Y % Growth) - at Constant Prices

At constant Prices	FY17	FY18	FY19	FY20	FY21	FY22	Q1FY23
Agriculture, forestry & fishing	**6.8**	**6.6**	**2.1**	**5.5**	**3.3**	**3.0**	**4.5**
Industry	**7.7**	**5.9**	**5.3**	**-1.4**	**-3.3**	**10.3**	**8.6**
Mining & quarrying	9.8	-5.6	-0.8	-1.5	-8.6	11.5	6.5
Manufacturing	7.9	7.5	5.4	-2.9	-0.6	9.9	4.8
Electricity, gas, water supply & other utility services	10.0	10.6	7.9	2.2	-3.6	7.5	14.7
Construction	5.9	5.2	6.5	1.2	-7.3	11.5	16.8
Services	**8.5**	**6.3**	**7.2**	**6.3**	**-7.8**	**8.4**	**17.6**
Trade, hotels, transport, communication & broadcasting	7.7	10.3	7.2	5.9	-20.2	11.1	25.7
Financial, real estate & professional services	8.6	1.8	7.0	6.7	2.2	4.2	9.2
Public administration, defence and other services	9.3	8.3	7.5	6.3	-5.5	12.6	26.3
GVA at Basic Price	**8.0**	**6.2**	**5.8**	**3.8**	**-4.8**	**8.1**	**12.7**

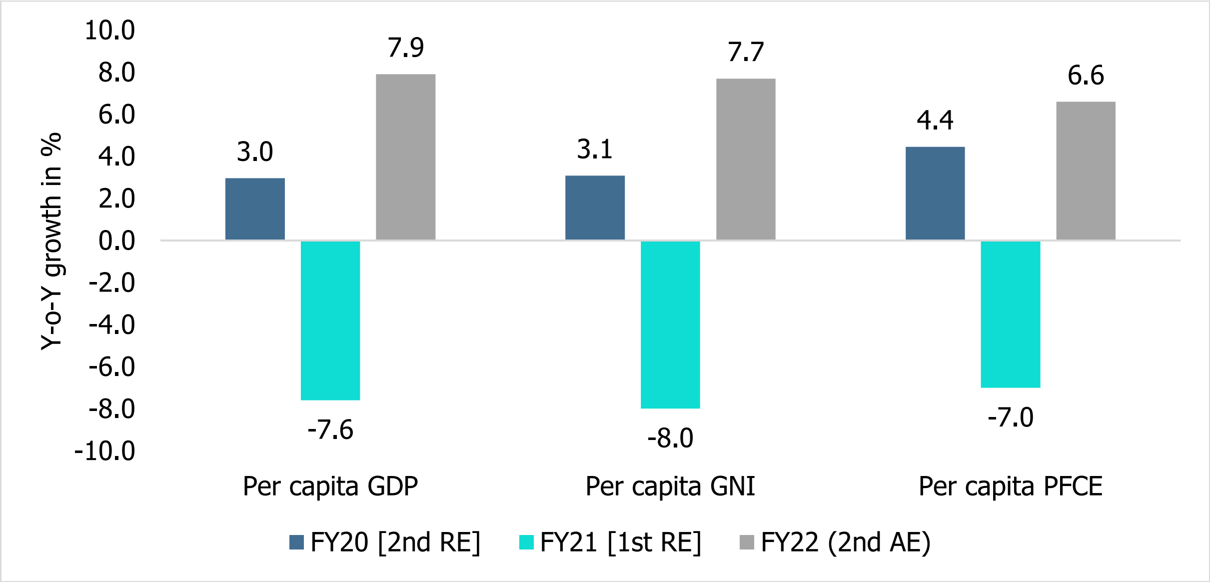
Source: MOSPI

Per Capita GDP, Income and Final Consumption

India has a population of about 1.3 billion with a young demographic profile. (Source: MOSPI). The advantages associated with this demographic profile are better economic growth, rapid industrialization and urbanization.

GDP per capita is a measure of a country's economic output per person. Fiscal 2021 witnessed a significant slowdown due to the pandemic. However, in Fiscal 2022 the economy is on a path of recovery and the per capita GDP is estimated to grow by 7.9%. The Gross National Income ("**GNI**") is also estimated to increase by 7.7% in Fiscal 2022. The per capita private final consumption expenditure ("**PFCE**"), that represents consumer spending, is likely to increase by 6.6% in Fiscal 2022. Majorly, the Fiscal 2022 reflects per capita growth due to a lower base.

Chart 4: Growth in Per Capita GDP, Income and Final Consumption (Y-o-Y growth in %)

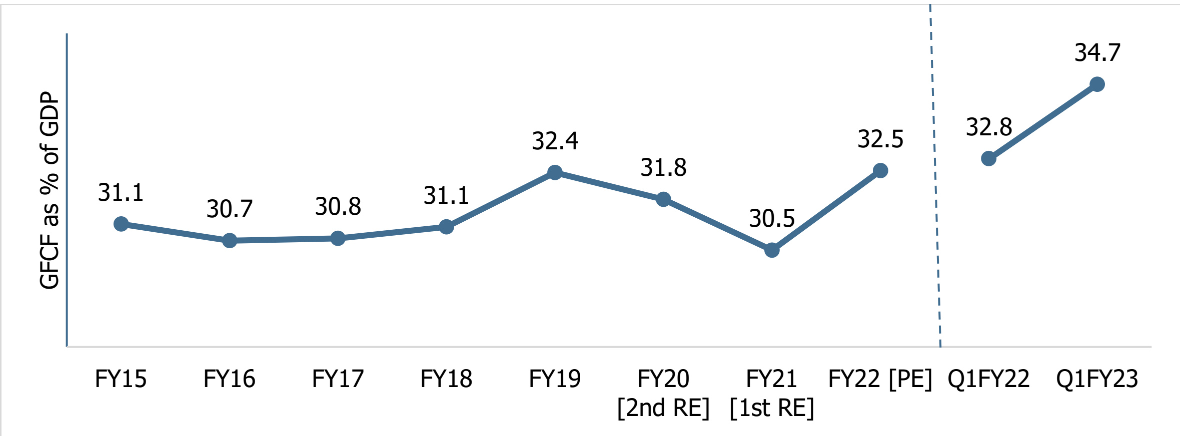


Source: MOSPI; RE – Revised Estimates; AE – Advanced Estimates

1.2.3 Investment Trend in infrastructure:

Gross Fixed Capital Formation ("**GFCF**"), which is a measure of the net increase in physical asset, is estimated to have made an improvement in FY22. As a proportion of GDP, it is estimated to be at 32.5%, which is the second highest level in seven years (since FY15).

Chart 5: Gross Fixed Capital Formation (GFCF) as % of GDP (At constant prices):



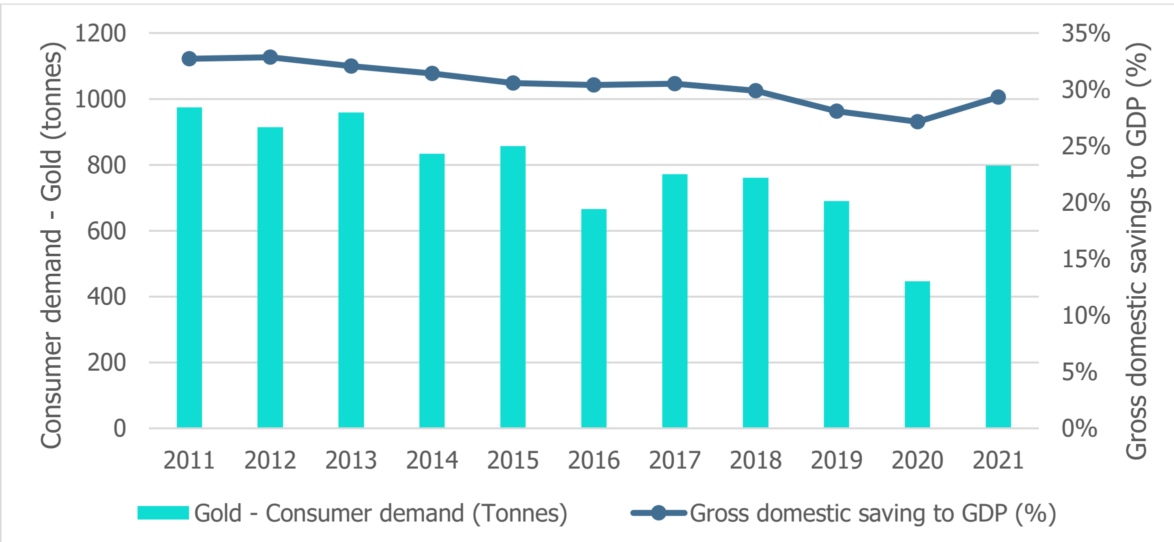
PE: Provisional Estimates, AE: Advanced Estimate; Source: MOSPI

Overall, support of public investment in infrastructure is likely to gain traction from the ethos of Atmanirbhar Bharat.

1.2.4 Consumption trend in gold

India is the second largest gold consumer after China. Wherein rising income is the powerful growth driver for gold consumption. India has been preserving gold as a means of wealth historically. However, with change in consumer spending and growing financial inclusion along with financial literacy have provided various investment avenues for investors which are other than gold (like equities, mutual fund etc). Furthermore, the savings to GDP ratio (%) have also witnessed decline due to change in the spending behaviour. Despite of these challenges, in coming years, the Indian Gold Market is expected to benefit from rising income along with the positive economic growth, demographic and socio-economic changes.

Chart 6: Consumption trend in gold



Source: World Bank Database; World Gold Council

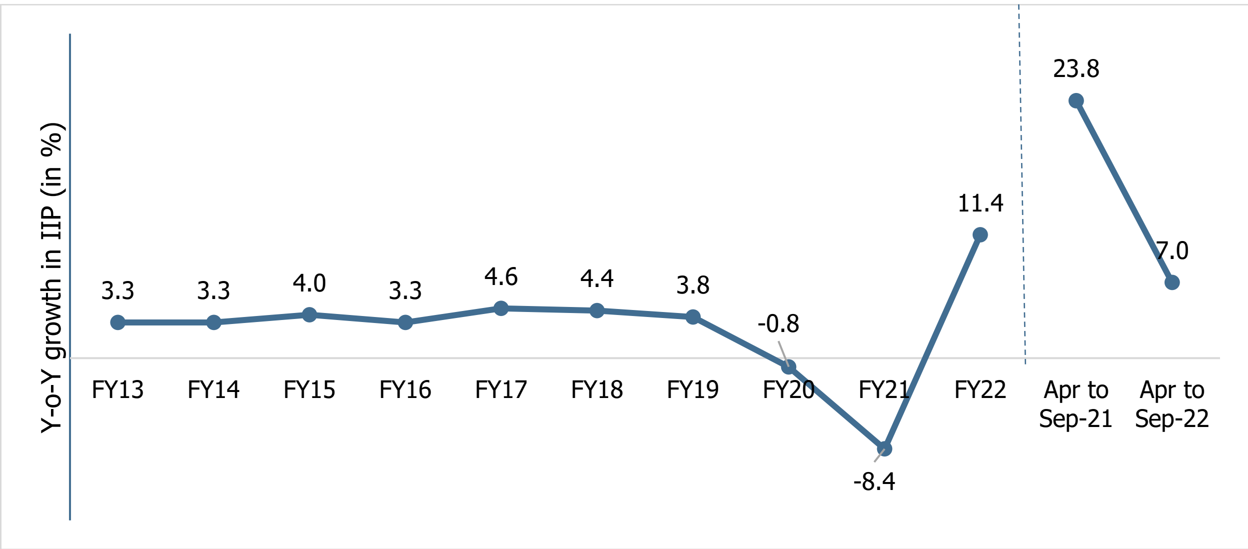
1.2.5 Industrial Growth

Improved core sector and capital goods sector helps in IIP pickup

Index of Industrial production (IIP) is an index to track manufacturing activity in an economy. On a cumulative basis, IIP grew by 11.4% in FY22. However, this high growth is mainly backed by a low base of FY21. FY22 IIP was higher by 2.0% when compared with the pre-pandemic level of FY20, indicating that while economic recovery is underway, it is still very nascent.

India’s industrial production moved to the expansion zone recording growth of 3.1% in September 2022 from -0.7% in August 2022. Rebound in IIP was led by expansion in manufacturing (1.8%), mining (4.6%) and electricity (11.6%). Here, improved performance in core sectors and capital goods sector helped in improving industrial output performance from negative to positive territory.

Chart 7: Y-o-Y growth in IIP (in %)



Source: MOSPI

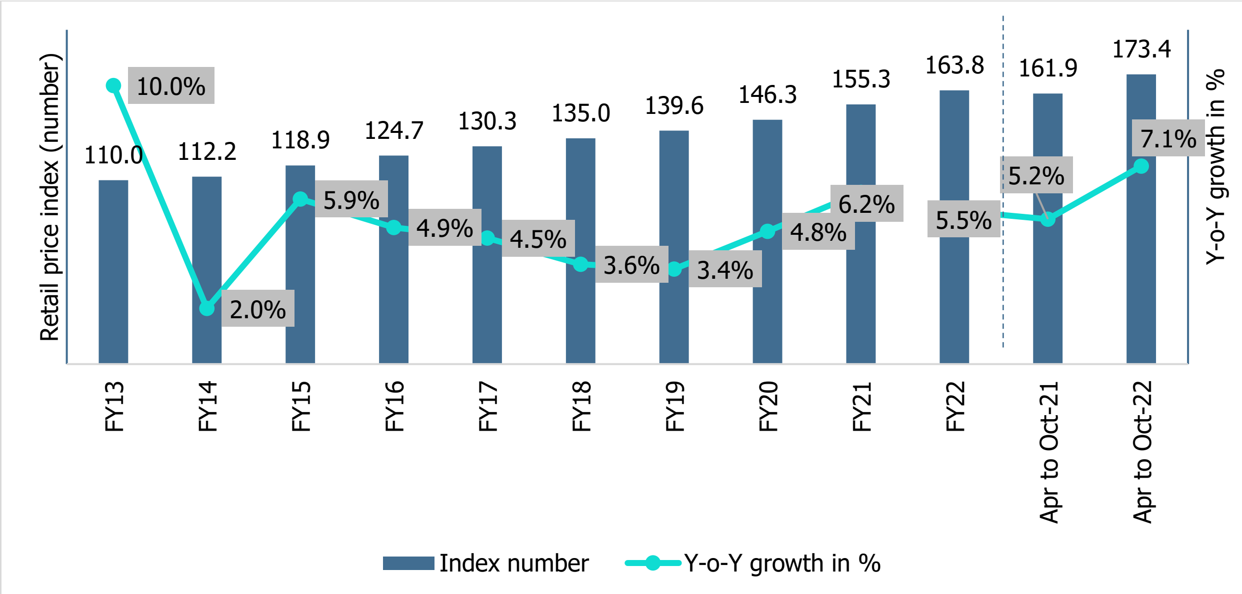
Going ahead, the consumption growth with commencement of festive and wedding season would be a key driver for industrial growth. However, elevated domestic inflation, volatility in commodity prices and global economic slowdown could be the major challenges.

1.2.6 Consumer Price Index

CPI continues to remain uncomfortably high

Inflation has reappeared as a global issue in both advanced and emerging economies. India's retail price inflation stood at 5.5% in FY22, which is within the RBI's targeted tolerance band of 6%. The consumer inflation started to upswing from October 2021. As per the monthly numbers, the inflation rate reached the tolerance level of 6% per annum in January 2022. Following this, the month of March 2022 registered an inflation rate of 6.9% per annum.

Chart 8: Retail Price Inflation in terms of index numbers and Y-o-Y Growth in % (Base: 2011-12=100)



Source: MOSPI

Consecutively, during the cumulative period of April 2022 – Oct 2022, the inflation rate remained above the RBI's tolerance level, surpassing even the band of 7.1%. The retail inflation eased to a three months low of 6.8% in October 2022.

The CPI is primarily factored in by RBI while prepapring its bi-monthly monetory policy. At the bi-monthly meeting held in October 2022, the RBI projected inflation to be at 6.7% for FY23. For the Q2FY23 projections were made at to 7.1%, for Q3FY23 at 6.5% and Q4FY23 at 5.8%. Entering into FY24, CPI inflation for Q1FY24 is projected at 5%.

Table 3: Component wise retail inflation (Y-o-Y growth in %)

	Food and Beverages	Pan, tobacco and intoxicants	Clothing & footwear	Housing	Fuel & light	Miscellaneous
Weight	**45.9**	**2.4**	**6.5**	**10.1**	**6.8**	**28.3**
May-21	5.2	10.0	5.3	3.9	11.6	7.5
Jun-21	5.6	4.0	6.2	3.8	12.7	7.3
Jul-21	4.5	4.7	6.5	3.9	12.4	6.7
Aug-21	3.8	4.0	6.8	3.9	13.0	6.4
Sep-21	1.6	4.2	7.2	3.6	13.6	6.4
Oct-21	1.8	4.3	7.5	3.5	14.4	6.8
Nov-21	2.6	4.1	7.9	3.7	13.4	6.8
Dec-21	4.5	3.2	8.3	3.6	11.0	6.7
Jan-22	5.6	2.5	8.8	3.5	9.3	6.5
Feb-22	5.9	2.4	8.9	3.6	8.7	6.5
Mar-22	7.4	2.9	9.4	3.3	7.5	7.0
Apr-22	8.1	2.7	9.9	3.4	10.8	8.0
May-22	7.8	1.2	8.9	3.7	9.5	6.8
June-22	7.6	1.8	9.5	3.9	10.4	6.3
July-22	6.7	1.8	9.9	3.9	11.8	6.7
August-22	7.6	1.7	9.9	4.1	10.8	7.0

Source: MOSPI

- **Food** continues to be the main driver of total inflation, contributing to 50% of total inflation. At 7.60% in August 2022, food inflation continued to remain high. The food prices gained momentum on account of rising price pressures for items such as cereals and vegetables.

- **Cereals** inflation rose to 9.6% in August 2022, primarily due to a sharp rise in wheat and rice prices. Wheat prices increased due to lower domestic production with heat waves in major wheat producing states. Retail wheat prices have increased because of production shortfall due to heatwaves in the country, while rice prices have also increased mirroring the increase in wheat price on solid demand.

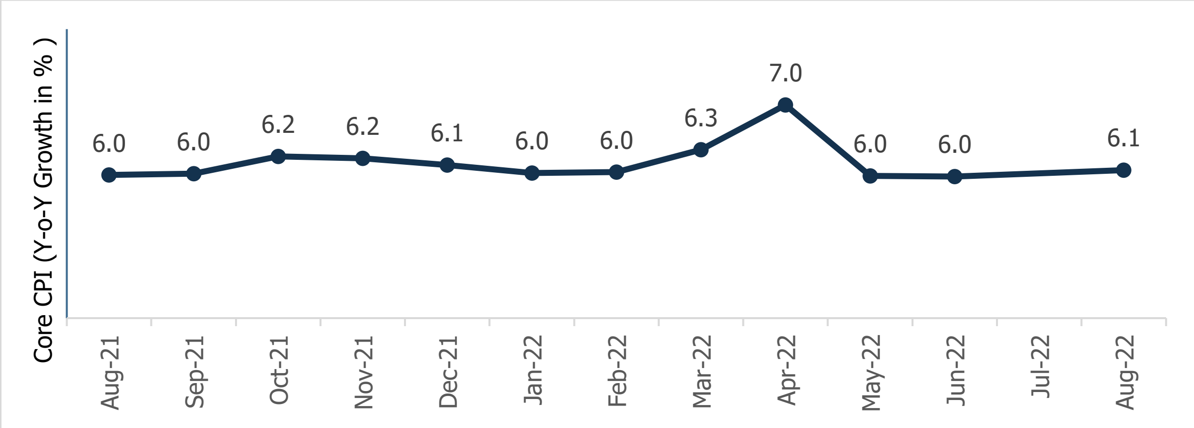
- **Vegetable inflation** remained in double digit at 11.8% in August 2022. Among key vegetables, tomato prices rose sharply in May owing to lower production due to the heatwaves prevailing in key supplier states and high fuel prices. Potato prices also hardened in May. Prices of meat and dairy rose, which was driven by higher feed costs. Going ahead, the normal monsoon and the recent supply-side measures taken by the Government may help to ease the food price pressures to some extent.

- **Fuel and light inflation** remained high at 10.78% in August 2022 as a result of a hike in LPG cylinder prices (domestic: Rs. 53.5/cylinder; commercial: Rs. 102.5/cylinder) in the current fiscal and electricity tariff revisions by many states. Coal and natural gas prices have also skyrocketed in the past few months and have prompted domestic players to raise prices to maintain their margins. Rising fuel inflation had a cascading effect on inflation as it feeds into input costs due to higher transportation and logistics costs.

Core CPI

Core inflation (which excludes volatile components, such as food and energy prices) eased out but was still close to the 6.1% mark, indicating that inflation has become broad-based.

Chart 9: Core CPI (Y-o-Y Growth in %)



Source: MOSPI and CareEdge Research

RBI tightening the monetary policy to tame the inflation

RBI hiked its policy repo rate by 50 basis points ("**bps**") to 5.90% in a meeting held between 28-30 September 2022. This was the another policy rate action after a hike of 50 bps thrice in August, June and May 2022 respectively. RBI maintained the liquidity adjustment facility ("**LAF**") corridor by adjusting the standing deposit facility ("**SDF**") rate at 5.65% as the floor and the marginal standing facility ("**MSF**") at the upper end of the band at 6.15%.

The RBI continued to maintain its stance as accommodative.

The consecutive rate hike by the RBI has come against the backdrop of intensifying inflationary pressures in the global and domestic economies. With the US dollar index appreciation to a two decade high in July 2022, both advanced and emerging economies witnessed weakening of their currencies against the US dollar. The RBI foresees this could lead to imported inflationary pressure. With domestic economic activities gaining traction, The RBI has shifted gear to prioritize controlling inflation. The RBI continues to remain focused on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

1.2.7 Concluding Remarks

Despite the global growth uncertainties, Indian economy is relatively better placed. The major headwinds to economic growth are escalating geopolitical tensions, volatility in global commodity prices and shortages of key inputs. However, the bright spots for the economy are continued healthy demand, support from government capital expenditure and improving business confidence. Various high-frequency growth indicators including purchasing managers index, auto sales, bank credit, GST collections have shown improvement in the first few months of FY23.

Despite high food and fuel inflation pressure, the normalizing employment situation after the opening up of economy is expected to improve and provide support to consumption expenditure.

Public investment is expected to exhibit healthy growth as the government has budgeted for strong capital expenditure in FY23. The private sector’s intent to invest is also showing improvement as per the data on new investment projects announced. However, the volatility in commodity prices and the economic uncertainties emanating from global turbulence is likely to slow down the pick-up in the private capex and investment cycle.

Among sectors, the industrial segment is expected to be negatively impacted due to high input prices. Nonetheless, with flagship programmes like ‘Make in India’ and the Production Linked Incentive (PLI) schemes, the government is continuing to provide the support to boost the industrial sector. Service sector are expected to see a bounce back in FY23 with good economic revival and growth. However, in the services sector, some segments like Information Technology would feel the pinch of slowdown in the US and European economy.

2 NBFCs Credit Growth

2.1 Introduction to NBFCs

The Indian banking industry is classified into scheduled and non-scheduled banks. Banks that are included in the Second Schedule to the Reserve Bank of India Act, 1934 are called scheduled banks. These banks are then further classified into scheduled commercial banks ("**SCBs"**) and scheduled co-operative banks. SCBs are banks that are permitted to conduct the normal business of banking, which entails collecting deposits, sanctioning loans and offering other banking services. SCBs are further divided into Public Sector Banks ("**PSBs**"), Private Banks ("**PVBs**"), Foreign Banks and Regional Rural Banks ("**RRBs**").

Apart from SCBs, there are non-banking financial companies ("**NBFCs**") that also play an important role in the Indian financial system by complementing and competing with banks, and by promoting efficiency and diversity into financial intermediation. NBFCs have evolved considerably in terms of operations, heterogeneity, asset quality and profitability, and regulatory architecture.

NBFCs can be classified on the basis of a) asset/liability structures; b) systemic importance; and c) the activities they undertake, according to the RBI. In terms of liability structures, NBFCs are subdivided into deposit-taking NBFCs ("**NBFCs-D**") - which accept and hold public deposits - and non-deposit taking NBFCs ("**NBFCs-ND**") - which source their funding from markets and banks. Among NBFCs-ND, those with asset size of Rs. 5 billion or more are classified as non-deposit taking systemically important NBFCs ("**NBFCs- ND-SI**"). As on July 31, 2022, there were 49 NBFCs-D and 415 NBFCs-ND-SI, according to RBI.

Since NBFCs cater to niche areas, they are also categorised on the basis of activities they undertake. Up until February 21, 2019, NBFCs were divided into 12 categories. Thereafter, these categories were harmonized by the RBI in order to provide NBFCs with greater operational flexibility. As a result, asset finance companies ("**AFCs**"), loan companies ("**LCs**") and investment companies ("**ICs**") were merged into a new category called Investment and Credit Companies ("**NBFC-ICC**"). Additionally, account aggregators has been added as category of NBFCs. At present, there are 12 categories of NBFCs in the activity- based classification.

Table 4: Types of NBFCs

Type of NBFC	Nature of activity / Principal business
Investment and Credit Company (ICC)	Lending and investments.
Infrastructure Finance Company (IFC)	Providing loans for infrastructure development.
Infrastructure Debt Fund (IDF)	Facilitate flow of long-term debt to infrastructure projects.
Core Investment Company (CIC)	Investment in equity shares, preference shares, debt, or loans of group companies.
NBFC- Micro Finance Institution (NBFC-MFI)	Collateral free loans and advances to small borrowers.
NBFC – Factor	Factoring business i.e., financing of receivables.

Type of NBFC	Nature of activity / Principal business
Non-Operative Financial Holding Company (NOFHC)	For setting up new banks in private sector through its promoter/promoter groups.
Mortgage Guarantee Company (MGC)	Providing mortgage guarantees for loans.
Asset Reconstruction Company (ARC)	Acquiring and dealing in financial assets sold by banks and financial institutions.
Peer-to-Peer Lending platform (P2P)	Providing an online platform to bring lenders and borrowers together to help mobilise funds.
Account Aggregator (AA)	Collecting and providing information about a customer's financial assets in a consolidated, organised and retrievable manner to the customer or others as specified by the customer.
Housing Finance Company (HFC)	Financing for housing.

Source: RBI, CareEdge Research

In October 2021, RBI decided to classify NBFCs based on size and risk perception using Scale Based Approach – The Filtering Process by segregating NBFCs into four categories namely NBFC Base Layer (BL), NBFC Middle Layer (ML), NBFC Upper Layer (UL), and NBFC Top Layer (TL).

Classification of NBFCs

NBFC BL	NBFCs with asset size of not more than Rs. 10 billion, Type 1 NBFC, Peer to Peer (P2P), Account Aggregator (AA), and Non-Operative Financial Holding Company (NOFHC)
NBFC ML	NBFC-ND that are systematically important (SI) having an asset size of less than Rs. 10 billion and also NBFC-HFCs, IFCs, IDFs, CICs, and Standalone Primary Dealers irrespective of their asset size
NBFC UL	Top NBFCs to be filtered based on their size & leverage, inter-connectedness, complexity, and superior inputs (including group structure, liability mix, and segment penetration).
NBFC TL	Top Layer will remain empty unless RBI takes a view on specific NBFCs in the Upper Layer

Source: RBI, CareEdge Research

Additionally, Investment and Credit Companies (NBFC-ICC), Micro Finance Institution (NBFC-MFI), NBFC-Factors and Mortgage Guarantee Companies (NBFC-MGC) that can be classified under any layer of the regulatory structure depending on the parameters of the scale based regulatory framework. Government owned NBFCs can only be classified under base layer or middle layer.

Further, as per RBIs notification as on October 11, 2022 titled "Multiple NBFCs in a Group: Classification in Middle Layer". NBFCs that are part of a common Group or are floated by a common set of promoters are required to be viewed on a consolidated basis. For the consolidation of assets of the NBFCs in a Group, the total assets of all the NBFCs in a Group shall be consolidated to determine the threshold for their classification in the Middle Layer.

Recognition of NBFCs in Upper Layer:

NBFC categorization is based on an annual review. The paper recognizes two parameters; quantitative and qualitative:

- The quantitative parameters will have 70% weightage.
- The qualitative parameters will have 30% weightage.

The table below represents quantitative and qualitative parameters as proposed:

Parameter	Sub-parameter	Sub weight	Weights
Quantitative Parameters (70%)			
Size & Leverage	Size: Total exposure (on-and off-balance sheet) Leverage: total debt to total equity	20+15	35
Interconnectedness	i) Intra-financial system assets: – Lending to FIs – Securities of other FIs – Mark to market REPO – OTC derivatives ii) Intra-financial system liabilities –Borrowings from FIs – Marketable securities issued by the finance company to FI – Mark to market OTC derivative with FIs iii) Securities outstanding (issued by NBFC)	10 10 5	25
Complexity	i) Notional amount of OTC derivatives – CCP centrally – Bilateral OTC ii) Trading and available for sale securities	5 5	10
Qualitative Parameters/Supervisory inputs (30%)			
Nature and type of liabilities	– Degree of reliance on short term funding – Liquid asset ratios – Callable debts – Asset-backed funding Vs. other funding – Asset liability duration and gap analysis – Borrowing split (secured debt, CCPS, CPs, unsecured debt)	10	30
Group Structure	– Total number of entities – Total number of layers – Total intra-group exposure	10	
Segment Penetration	Importance of NBFC as a source of credit in a specific segment or area	10	

Source: RBI, CareEdge Research

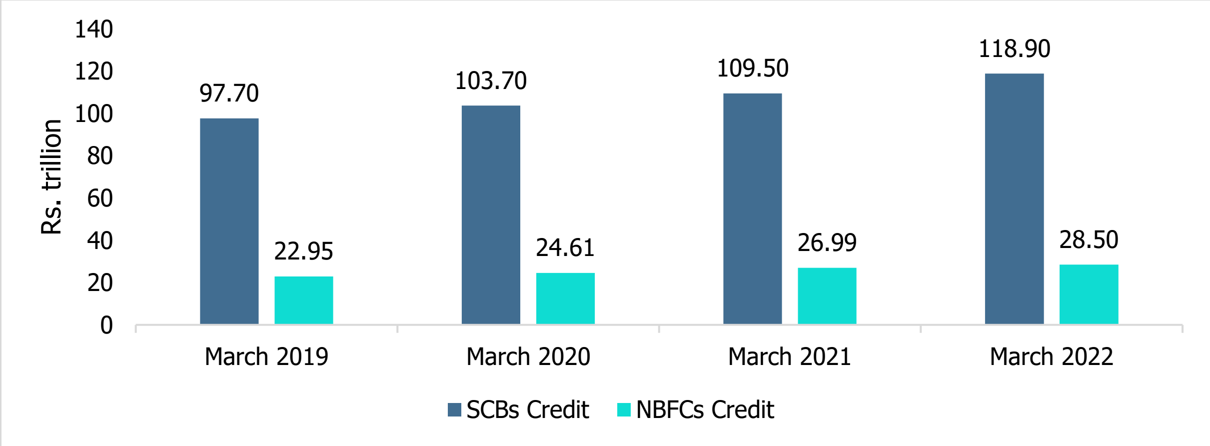
Further, as per RBI's notification as on June 06, 2022 titled "Provisioning for Standard assets by Non-Banking Financial Company – Upper Layer". NBFCs classified as NBFC-UL shall maintain provisions in respect of 'standard' assets at the following rates for the funded amount outstanding:

Category of Assets	Rate of Provision
Individual housing loans and loans to Small and Micro Enterprises (SMEs)	0.25%
Housing loans extended at teaser rates	2%, which will decrease to 0.4% after 1 year from the date on which the rates are reset at higher rates (if the accounts remain 'standard')
Advances to Commercial Real Estate – Residential Housing (CRE - RH) Sector	0.75%
Advances to Commercial Real Estate (CRE) Sector (other than CRE-RH)	1%
Restructured advances	As stipulated in the applicable prudential norms for restructuring of advances
All other loans and advances not included above, including loans to Medium Enterprises	0.4%

2.2 Credit growth of SCBs and NBFCs

Credit disbursed by SCBs and NBFCs is broadly classified into two parts – food and non-food credit. Food credit accounts for a fraction of total credit disbursed. Non-food credit makes up close to 99% of total credit extended by SCBs and NBFCs and the movement in overall credit growth therefore hinges on the movement in non-food credit growth.

Chart 10: SCBs' and NBFCs' Credit Deployed

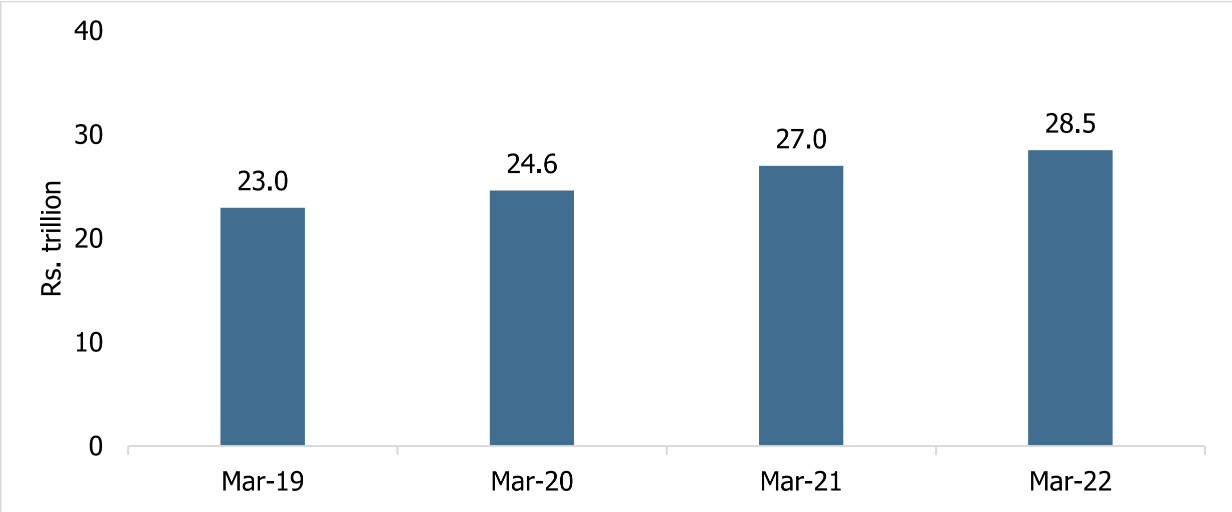


Source: CMIE, RBI, CareEdge Research, Data are provisional

Bank credit growth, including food and non-food credit growth, witnessed a slowdown in Fiscal 2020 on account of a gradual slowdown in the economy and the resultant fall in demand. Credit growth declined to 6.1% as of March 2020. The outbreak of COVID-19 led to a further easing of credit growth to 5.6% as of March 2021. Following the end of COVID-19-related lockdowns, the credit growth registered a pick up and ended Fiscal 2022 at Rs. 118.9 trillion, 8.6% higher than at end of Fiscal 2021.

A default in debt repayments by a large NBFC in India in 2018 led to heightened investor focus around the health of the broader NBFC sector as well as their sources of liquidity. This led to some tightening in liquidity available to certain NBFCs and, as a result, it become more difficult for certain NBFCs to access debt and raise equity capital. NBFCs recorded a similar trajectory in their credit growth over the past three years. NBFCs' credit grew by 9.6% in Fiscal 2021, it moderated to 5.6% as of March 2022 over March 2021. CareEdge Research believes that the moderation was partly due to caution on the part of NBFCs in deploying credit while maintaining asset quality, and largely due to the second wave of the pandemic, which impacted rural and semi-urban India – and this demographic group forms the large chunk of NBFCs' customer base.

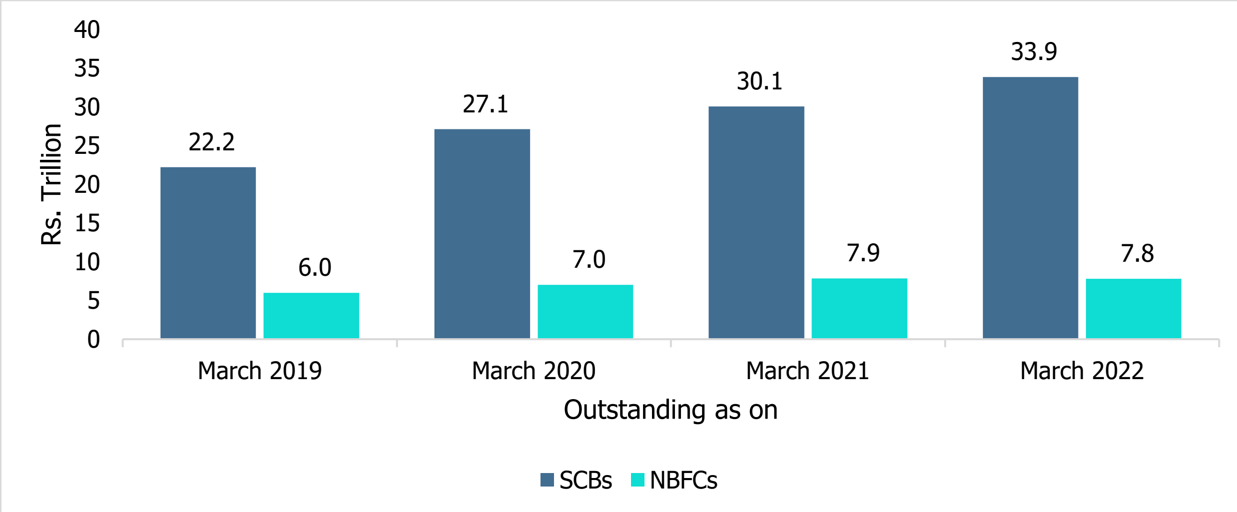
Chart 11: Gross credit deployed by NBFCs



Source: CMIE, RBI, *CareEdge Research*

To maintain the asset quality post the moratorium in the first half of FY22, NBFCs were more cautious while deploying any fresh credit, which led to a slight decline in NBFCs' total credit deployed. As of March 2022, NBFCs' credit deployed reached Rs. 28.5 trillion, this increase was on account of ramp-up in economic activity, improved liquidity and strong balance sheets coupled with high provisions, which supported the asset quality and credit growth for NBFCs.

Chart 12: Retail Credit portfolio of SCBs & NBFCs



Source: CMIE, RBI, CareEdge Research

As of March 2022, retail credit was approximately 26% of NBFCs' gross credit deployed and nearly 29% of SCBs' gross credit deployed. Banks and NBFCs are shifting their focus towards retail lending due to an increase in demand for retail credit. There has been a shift in consumer behaviour towards borrowing, consumers want to create a better standard of living and are ready to borrow personal loans to fulfil those needs.

2.3 Growth Drivers

Last mile financing & unbanked population

NBFCs have a strong presence in unorganized and under-served areas where banks may not have a strong foothold. This is on account of the absence of necessary infrastructure of banks in these areas as well as an aversion on the part of banks to disburse loans to smaller companies. The ease of internet access and affordable data packs have not only contributed to increased spending and demand for retail credit from these areas, but have also increased the potential consumer base of NBFCs.

Focus on informal customer base

Traditional banks may not be very keen on lending to retail borrowers from semi-urban and rural areas or small companies with weaker credit scores and lack of documentation, when compared to larger borrowers. However, in terms of volume, the number of potential customers in this category is higher and NBFC have created niche segment by having customized credit assessment method based on cash flow assessment and field verification. This gives NBFCs an opportunity to extend credit to the financially weaker set of customers, a growing customer base in the informal customer segment opens up avenues for NBFCs' growth.

Technological adoption and Co-lending arrangements:

NBFCs deploy technological solutions to develop innovative products and lower operational costs. Since NBFCs are fairly new in the financial landscape as compared to most banks, they are more agile and better positioned to leverage technology to enhance their reach while increasing efficiency.

NBFCs also partner with various alternative financiers and commercial banks, which enables them to diversify their income avenues and reach their targeted customer base through different channels.

Shift in buying behaviour

Over the years, there has been significant change is perception of consumers towards borrowing. With the need to improve lifestyle, more and more people especially the younger population are moving towards borrowing to attain a certain standard of living.

Rising demand from retail customers

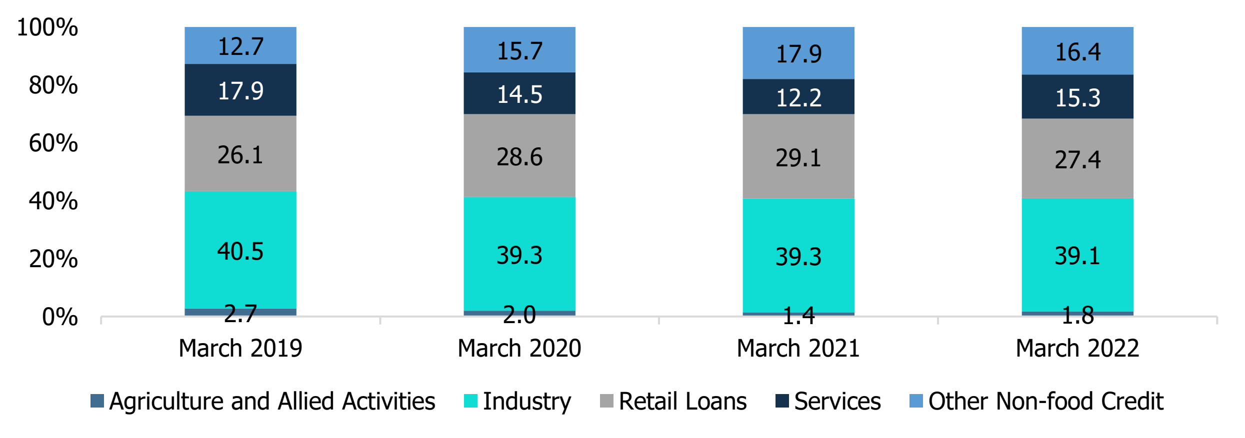
Retail borrowers accounted for around 26% of total credit disbursed by NBFCs as on 31 March 2022, as per data published by the RBI. Along with being a significant chunk of the customer base of NBFCs, the retail segment has shown a consistent growth in credit demand throughout the pandemic. Going forward, CareEdge Research believes that the demand for consumer durables, consumption of services, home loans and gold loans are likely to support the growth in retail demand and, consequently, aid in the new business of NBFCs.

Increased demand from MSME and agriculture

Favourable Government policies aimed at boosting agriculture, small-scale industries and consumption are likely to act as long-term growth catalysts in improving demand for MSME and agricultural credit. The "Make in India", "Start-up India" initiatives, for example, are likely to support industrial activity and contribute to the demand for credit from NBFCs. As on 28 November 2022, more than 12,244,823 micro, small and medium enterprises (MSMEs) have registered on the Udyam portal, of which 11.778,071 are micro enterprises; 427,267 are small enterprises; and 39,485 are medium enterprises. Micro and small enterprises represent 99.7% of the total registered MSMEs as of 28 November 2022. The coverage of the formal banking system in MSMEs still remains low, which provides a major opportunity to NBFCs to expand their reach.

2.4 Distribution between segments

Chart 13: Sectoral distribution of NBFCs' credit



Source: RBI, CareEdge Research
Note: Industry includes credit to micro, small, medium and large enterprises;
Retail loans are personal loans for housing loans, consumer durables, auto loans, and other personal loans;
Services include credit towards commercial real-estate, retail trade and other such loans

The industry sector has remained the largest recipient of credit extended by NBFCs followed by retail loans, services, other non-food credit, and agriculture & allied activities. Following the IL & FS crisis, NBFCs' exposure to the manufacturing declined, as per data published by RBI, as NBFCs were facing liquidity crunch and were hesitant to deploy long term credit to industry. However, after recovering from the IL & FS crisis and the impact of the COVID-19 pandemic, NBFCs have improved liquidity and stronger balance sheets. NBFCs have increased the amount of credit deployed to industry on account of an improved demand for credit amid the reopening of the economy and resumption of manufacturing activities. As of March 2022, industry credit contributed to Rs. 11.1 trillion that is around 40% of NBFCs gross credit deployed, according to the RBI.

While NBFCs' credit to industry is growing, their credit to services is declining majorly on account of the decline in credit to the commercial real estate sector and retail trade. The commercial real estate sector and the retail trade sector were highly impacted during the COVID-19 pandemic as the nationwide lockdown halted construction activities and the movement of people and goods. However, in FY22 NBFCs credit to services has increased on account of improved demand from transport operators, professional services and other NBFCs. As of March 2022, as per data published by RBI, credit deployed to the service sector contributed to Rs. 4.4 trillion that is around 15.3% of NBFCs gross credit deployed.

Retail loans comprise housing loans, vehicle loans, loans against gold, consumer durables loans and other such personal loans. In 2019, retail credit accounted for around 26% of total credit deployed by NBFCs. As of March 2022, the contribution of retail loans increased to nearly a third of NBFCs gross credit deployed, which stood at Rs. 28.5 trillion.

2.5 Outlook

CareEdge Research believes assets under management of NBFCs is expected to be higher at around 6-9% in Fiscal 2023 driven by an increased focus on extending credit to customers belonging to segments where the penetration of bank credit is low, ease of access to internet and investments made in technology infrastructure due to the COVID-19 pandemic. In terms of segmental growth, CareEdge Research expects the retail segment to continue its growth momentum, while credit to industry will likely remain a laggard.

CareEdge Research believes that NBFCs are shifting their focus towards retail financing, which is anticipated to show a healthy growth with a pick-up in economic activity and increased penetration of financial institutions providing convenient financing options to borrowers. The retail segment comprises vehicle loans, consumer durable loans, advances against golds, real estate loans and other such individual loans.

The retail segment is likely to significantly contribute to NBFCs' growth, especially in case of housing loans and vehicle loans. These segments are likely to continue their growth momentum on the back of steady demand. Growth in vehicle segment is anticipated to see growth on the back of automotive industry's growth. In the near term, the growth is likely to be supported by new model launches and sustained demand for vehicles during the first four months of FY23, supported by improved availability of semi-conductors.

Gold loans are a highly secured and liquid asset class that generates high returns with minimal credit losses and encourages financial institutions to extend their credit towards gold loans. CareEdge Research believes that with the rise in the price of gold amidst geopolitical unrest, a large geographic reach and the fast turnaround time on loan application, the demand for gold loans to fund the working capital of micro enterprises and an individual's personal requirements will grow.

CareEdge Research believes that real estate financing will grow with the sustained demand for affordable housing. However, the hike in interest rates and high property prices will continue to be a key monitorable for the real estate finance segment as a whole.

In the coming months, CareEdge Research expects NBFCs to grow on account of improved demand for credit that will facilitate disbursements. In addition to this, CareEdge Research expects high provisions against non-performing assets and improved capital positions will aid this growth.

3 MSME

3.1 Introduction to MSMEs

The micro, small and medium enterprises ("**MSME**") sector is a vibrant and dynamic sector with crucial linkages to employment. The MSME sector is considered the growth engine of the Indian economy, with significant contribution to the GDP, exports and employment generation. The sector contributes significantly in the economic and social development of the country by fostering entrepreneurship and generating large employment opportunities at comparatively lower capital cost, next only to agriculture. MSMEs are complementary to large industries as ancillary units and the sector therefore contributes significantly in the inclusive industrial development of the country.

MSMEs are widening their domain across sectors of the economy, producing a diverse range of products and services to meet demands of domestic as well as global markets.

In accordance with the provision of Micro, Small & Medium Enterprises Development ("**MSMED**") Act, 2006 MSMEs are classified as follows:

Enterprise Category	Investment in Plant & Machinery or Equipment	Annual Turnover
Micro Enterprises	Does not exceed 10 million	Does not exceed Rs. 50 million
Small Enterprises	More than Rs. 10 million but does not exceed Rs. 100 million	More than Rs. 50 million but does not exceed Rs. 500 million
Medium Enterprises	More than Rs. 100 million but does not exceed Rs. 500 million	More than Rs. 500 million but does not exceed Rs. 2,500 million

Table 5: Number of MSMEs in India

Category	Number of MSMEs
Micro	11,778,071
Small	4,27,267
Medium	39,485
Total	**12,244,823**

Source: Udyam portal, Data as of 28th November 2022.

As per the Udyam portal, around 12 million MSMEs are registered under Udyam portal, of which around 96.2% enterprises are micro category and around 3.8% of the enterprises fall under small category and the remaining are medium enterprises.

As per the National Sample Survey (NSS) 73rd round, conducted by National Sample Survey Office, Ministry of Statistics & Programme Implementation during the period 2015-16, there were 63,388,000 unincorporated non-agriculture MSMEs in the country engaged in different economic activities (manufacturing, electricity, trade and other services). Of this, micro enterprises sector with 63,052,000 accounted for more than 99% of total estimated number of MSMEs. While the small enterprise sector with around 3,31,000 makes up 0.52% of total estimated number of MSMEs and the medium enterprise sector with around 5,00,000 that is around 0.01% of total estimated MSMEs, respectively.

3.2 Credit to MSMEs

Table 6: SCBs and NBFCs credit exposure to MSMEs

(Figures in Rs. Billion)

Outstanding as on	NBFCs			SCBs		
	Micro and Small Enterprise	Medium Enterprise	Total	Micro and Small Enterprise	Medium Enterprise	Total
March 2019	373.6	160.2	**533.8**	3,755.1	1,063.9	**4,819.0**
March 2020	364.4	139.3	**503.7**	3,922.6	10,510.0	**4,973.6**
March 2021	442.9	150.4	**593.3**	4,331.9	1,386.0	**5,717.9**
March 2022	445.7	111.4	**557.2**	5,327.9	2,140.0	**7,467.9**

Source: RBI, CareEdge Research

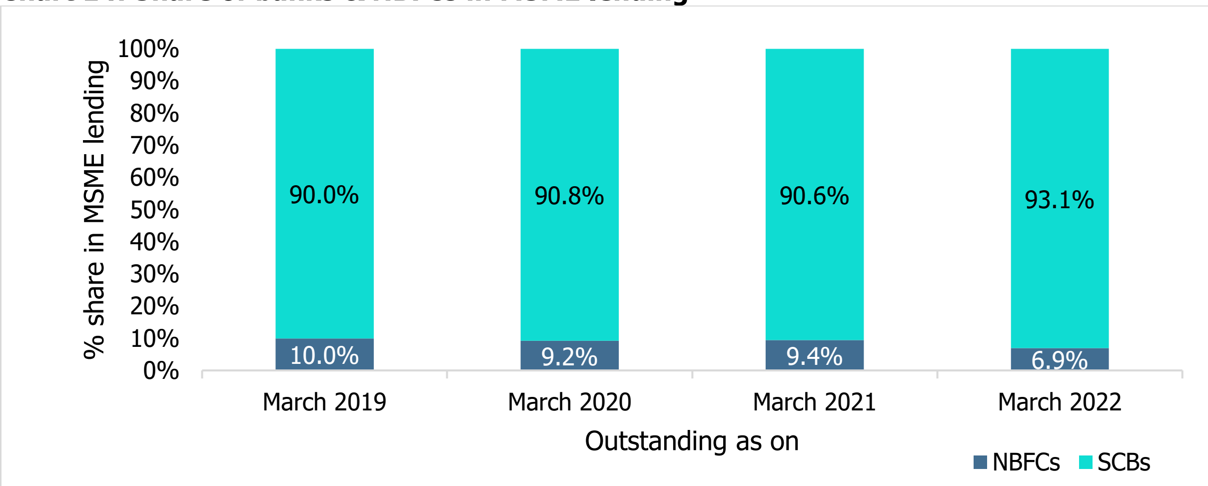
Note: The credit exposure for MSMEs is NBFCs and SCBs credit exposure to `Micro & Small' and `Medium' enterprises under 'Industrial Sector' only.

NBFCs' credit deployed to MSMEs engaged in the manufacturing sector as per RBI was on a downtrend and stood at Rs. 503.7 billion as of March 2020 due to a combination of weakened demand from MSMEs and nagging liquidity issues of NBFCs. NBFCs mainly deploy credit to MSMEs belonging to the services and agricultural sectors. In comparison, bank credit to MSMEs witnessed a consistent growth. Bank credit deployed to MSMEs witnessed an improvement in the year ending March 2021 and strengthened further in the first half of Fiscal 2022 on account of a resurgence in demand from MSMEs as well as support from the Central Government by way of credit guarantee. The emergency credit line guarantee scheme or the Emergency Credit Line Guarantee Scheme (ECLGS) announced by the Government in May 2020 after the pandemic hit the country in March 2020 revived credit offtake by MSMEs. The scheme was introduced to help mitigate the economic distress faced by MSMEs by providing them additional funding in the form of a fully guaranteed emergency credit line.

The credit extended towards MSME has increased significantly as the Government encouraged banks to extend credit to MSMEs and aid them to buffer the effects of the COVID-19 pandemic. AS micro and small enterprises were more vulnerable, the credit towards them during the pandemic increased significantly during Fiscal 2021, as per data published by the RBI. On the other hand, medium enterprises were able to buffer the effects of pandemic to a certain extent. Although the credit towards medium enterprises increased over the previous Fiscal year, the growth was moderate compared to growth in credit extended to micro and small enterprises.

3.3 Share of Banks & Non-Banks in MSME lending

Chart 14: Share of banks & NBFCs in MSME lending



Source: RBI, CareEdge Research

Note: The credit exposure for MSMEs is NBFCs and SCBs credit exposure to `Micro & Small' and `Medium' enterprises under 'Industrial Sector' only.

The MSME sector is underpenetrated by NBFCs and there is a huge unmet credit demand in the sector, primarily due to lack of documentation and credit history required to access to financing from formal banking channels. There is also a significant gap between the original credit requirement and the actual credit exposure of formal channels to MSMEs, which provides a huge opportunity in MSME lending.

3.4 Asset Quality Trends for Banks

Table 7: Bank-wise SMA distribution of MSME Portfolio

Period ended	Public sector banks + Private sector banks				
	0 days past due	SMA-0	SMA-1	SMA-2	GNPA
March 2021	74.0%	7.3%	5.7%	2.2%	10.8%
June 2021	72.4%	8.6%	3.8%	3.4%	11.9%
September 2021	76.3%	6.6%	2.6%	3.1%	11.3%
December 2021	75.4%	8.8%	3.1%	2.3%	10.4%
March 2022	79.7%	6.4%	3.5%	1.1%	9.3%

Source: RBI, CareEdge Research

MSMEs have poor financial muscle and were severely impacted by the COVID-19 pandemic. Since most MSMEs operate in the manufacturing sector, the nationwide lockdown, which impacted production as well as demand, caused increased stress to MSMEs. Additionally, MSMEs likely witnessed delayed payments on orders serviced and the inability to adopt digitization or accommodate higher costs on social distancing and limited workforce impaired MSMEs' operations. Many went out of business and some struggled to tide over the crisis with cash flow issues, which translated into a strain on their ability to repay banks.

MSMEs seeking loans from banks also struggled to meet their obligations due to uncertainty and the second wave of the pandemic. As per data published by the RBI, GNPAs from the MSME segment witnessed a spike in Fiscal 2021 and rose further to 18.8% towards the end of June 2021, which coincided with the second wave of COVID-19. GNPAs declined at the start of September 2021 as operations returned back to normalcy. GNPAs have further improved and declined to 9.3% in Fiscal 2022. CareEdge Research estimates GNPA levels to ease gradually over the next fiscal year.

3.5 Outlook

The MSME sector is the driving force of the Indian economy and has major potential to spread industrialization across the economy. However, this sector is small in terms of scale of operations, business size. MSMEs employ a large number of people making the sector a key contributor to the economic development of the country. The sheer number of work force engaged also results in this sector receiving Government support and benefits.

Apart from Government initiatives, the improved use of digital solutions adopted during the pandemic (such as easy payments and marketing through digital platforms) increased demand for finished products have strengthen the MSMEs and resulted in recovery of their business.

In addition to this the extension of Emergency Credit Line Guarantee Scheme (ECLGS), that assists MSMEs in availing credit required to ensure recovery, until March 31, 2023 is likely to aid in the recovery and growth of this sector. Besides, an additional Rs. 2,000 trillion provided by Government through the Credit guarantee trust for micro and small enterprises (CGTMSE) are expected to further encourage growth of the sector. These initiatives are expected to stimulate credit outreach to MSMEs, provide last-mile financial inclusion and promote job creation in the sector.

The MSME sector is expected to help India achieve its goal of becoming a USD 5 trillion economy by 2025 and in order to achieve this goal, MSMEs have to generate employment opportunities, improve performance, transform their business operations and carry out technology-based production and invest in research and development activities. In addition to this, MSMEs are expected to contribute more than 40% of India's nominal GDP by Fiscal 2025 for which it will require immense support from the Government, institutions and banks.

4 Housing Finance

The real estate industry is one of the most crucial and recognized sectors across the globe. The industry can be further segmented into four sub-sections – housing, commercial, retail, and hospitality. Of these, the residential segment contributes to close to 70 percent of the overall sector as on March 2022. The growth of the overall real estate industry also depends upon the growth in the corporate environment and the demand for office space, urban and semi-urban accommodations. The construction industry is therefore one of the major sectors in terms of its direct, indirect, and induced impacts on all the sectors of the economy.

The housing finance sector in India comprises financial institutions, scheduled commercial banks, regional rural banks, agriculture, and rural development banks, housing finance companies, state-level apex cooperative housing finance society, Non-banking financial companies (NBFCs), Finance institutions (MFIs), and self-help groups.

4.1 Credit Growth in housing finance

The residential real estate segment was performing exceptionally well during the first half of the previous decade on account of growth in the economy and the services sector which resulted in migration to metros and propelled the demand for housing units in these areas. However, problems related to elevated property prices, delayed launches by developers, and stalled projects triggered some cold feet towards the sector. From the point of view of financing too, the IL&FS crisis created problems in the NBFC sector, which is a pivotal source of funding for real estate. To add to this, the COVID-19 outbreak in early 2020 and the concomitant lockdowns across the country caused acute stress to the residential real estate segment to grow further in Fiscal 2024.

Table 8: SCBs, HFCs' and NBFCs' housing loans

Outstanding as on	Housing Loans (Rs. billion)		
	SCBs	HFCS	NBFCs
March 2019	12,043.60	7,676.80	184.5
March 2020	13,964.40	7,693.20	194.8
March 2021	15,619.20	8,304.70	214.8
March 2022	16,844.20	10,395*	NA

Source: RBI, CareEdge Research

Note: * indicates HFCs housing loans for March 2022 is estimated and SCBs and NBFCs include retail housing loan only, HFCs only includes home loans.

As of March 2022, SCBs continue to contribute to a major portion of housing loans. Nearly 63% of the housing loans are deployed by SCBs, while HFCs form around 37% of housing loans. SCBs' housing loan book is more than 1.5x that of housing finance companies' housing loan book.

4.2 Growth Drivers

The non-banking housing finance market in India is fragmented, with over 80 HFCs. However, the top four players command over 70 percent of the market share. The top two players, Housing Development Finance Corporation (HDFC) and LIC Housing Finance Limited, each have assets over Rs. 1 trillion and command over 60 percent of the overall market as of March 2021. In addition, unlike banks, the HFCs are governed by the National Housing Bank ("**NHB**"), a subsidiary of the RBI. As HFCs were not able to accept deposits from consumers in normal circumstances earlier, they have less stringent regulations vis-à-vis banks.

The HFCs gained prominence when the retail housing segment was neglected by banks, with many small consumers unable to fulfil the stringent documentation requirements of banks. Although the interest rates charged were higher than that of banks (due to a higher cost of funding), this did not deter small consumers from pursuing HFCs because of a clear lack of alternatives. Thus, in the last few years, there has been a large influx of new players, taking the number of non-deposit-taking HFCs from 55 in Fiscal 2014 to currently more than 80 in Fiscal 2022, according to the National Housing Bank.

In cases where the home value does not exceed Rs. 1 million, HFCs may add stamp duty, registration costs and other documentation charges to the home value to increase the maximum allowable loan on a property. This in turn, allows these HFCs to lend more to home buyers as compared to banks. Further, with banks having switched to marginal-cost-based lending rates (changing from base rate regime) in 2016, interest rates may increase with funding costs, thereby, reducing the gap in rates offered by banks and HFCs. Despite the banks' larger scale and funding advantages, they have been losing out to the HFCs.

- **Population Demographic & Increase in Urbanization**

As per United Nations – Population Division - Department of Economic and Social Affairs, the Indian age demographic has two-thirds of its population below 35 years of age, and the share of people in the age group of 0-14 is 26.16%. The share of the working-age population (15-65 years) is 67.27%, which indicates a very positive future outlook for the Indian housing sector.

The demand for new houses is steadily increasing as the pace of urbanization is expected to increase with the Government's focus on building new smart cities as well as a focus on Tier 2 cities, which have a population of around one million, and Tier 3 cities, which have a population of less than one million. Thus, CareEdge Research expects that surging growth and employment in these cities will prove to be a significant driver for people in the rural and semi-urban areas to shift to Tier 2 and Tier 3 cities.

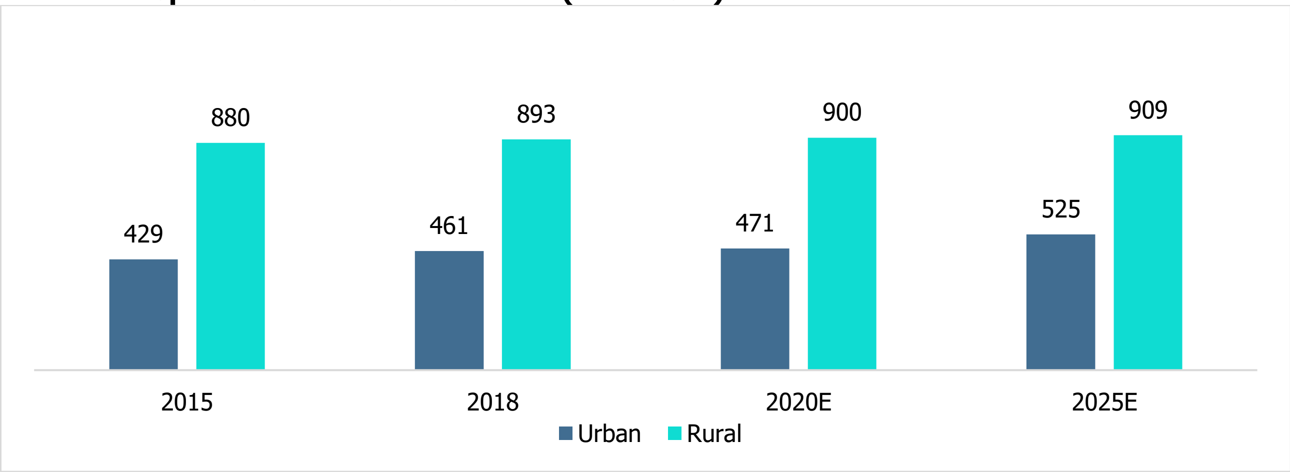
- About 10 million people migrate to cities every year.
- Growing economy driving demand for commercial and retail space. Residential segment contributes ~80 percent of the real estate sector.

The Indian economy has experienced robust growth in the past decade and was expected to be one of the fastest-growing economies in the coming years.

- According to a United Nations report named "World Urbanisation Prospects", India's urban population is expected to reach 525 million by 2025, up from an estimated 461 million in 2018.
- Rising income and employment opportunities have led to more urbanisation and more affordability for real estate in cities.
- COVID-19 had negatively impacted the Indian housing sector. Since then, the sector has started

recovering and reached pre-pandemic level growth in Fiscal 2022 as the Government supported the housing industry since it has majorly contributed towards India's economic growth over the last few years and would aid overall growth if it is supported efficiently. The income in the hands of the urban population in Tier 1 and Tier 2 cities will be an important aspect of the growth of the housing finance industry in the next few years.

Chart 15: Population breakdown of India (in millions)



Source: Ministry of Home Affairs, CareEdge Research

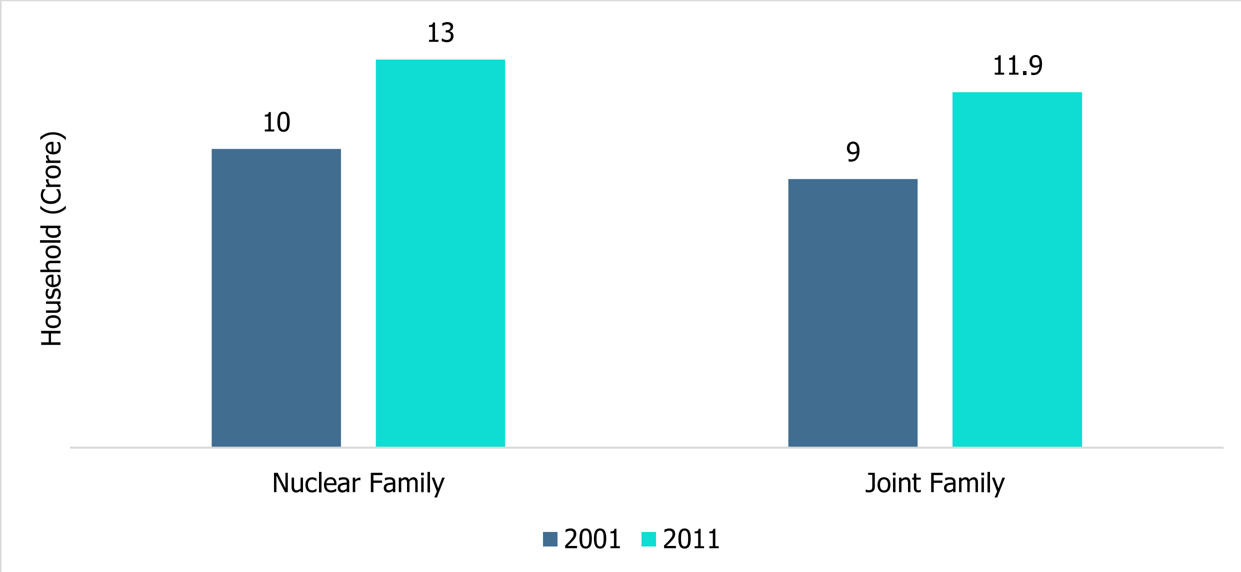
Note: E means estimated

- **Nuclear Family Trend**

There are fundamental changes in the social setup of Indian families. We are heading from the joint family concept to the nuclear family concept. In the traditional Indian joint family setup, many people lived in the same house with their families. However, the traditional Indian concept of the joint family has seen a radical change. Nuclear families are now the norm, rather than the exception. Usually, a nuclear family consists of a couple and their children. Nuclear families do not require as much space, as compared to a joint family. Consequently, the property buying decisions of a nuclear family are radically different from those of a joint family, both, in terms of the people who take the decisions and the choices that are made. As this trend is spreading in urban sections of India, the demand for homes is increasing tremendously. Previously, the bread earners were the senior-most male member in the family but now there are married couples who are earning members, which makes buying a house a viable option. The Growth in Household Incomes in Indian Cities has increased consistently. This has led to an increase in demands for new homes tremendously.

According to 2001 census, out of 190 million households, 100 million or a little over 50 % were nuclear households. In the 2011 census, the share grew to 52.1% - 130 million nuclear out of 249 million households.

Chart 16: Nuclear & Joint Family Household



Source: Census Data & CareEdge Research

- **Technological development (Fintech)**

  - Technology has helped HFCs/ Non-banking Financial Companies (NBFCs) to provide fast, efficient, cost-effective, customized products and services to customers. It helps in increasing the productivity of the manpower, better utilization of resources, and automation of many manual procedures. Fintech is among the most talked-about development in the world currently, having emerged as the world's second-largest fin-tech hub (trailing only the US), India, too, is experiencing this 'FinTech Boom'. Given that consumer banking is on the verge of disruption, there should be greater emphasis on the customer.

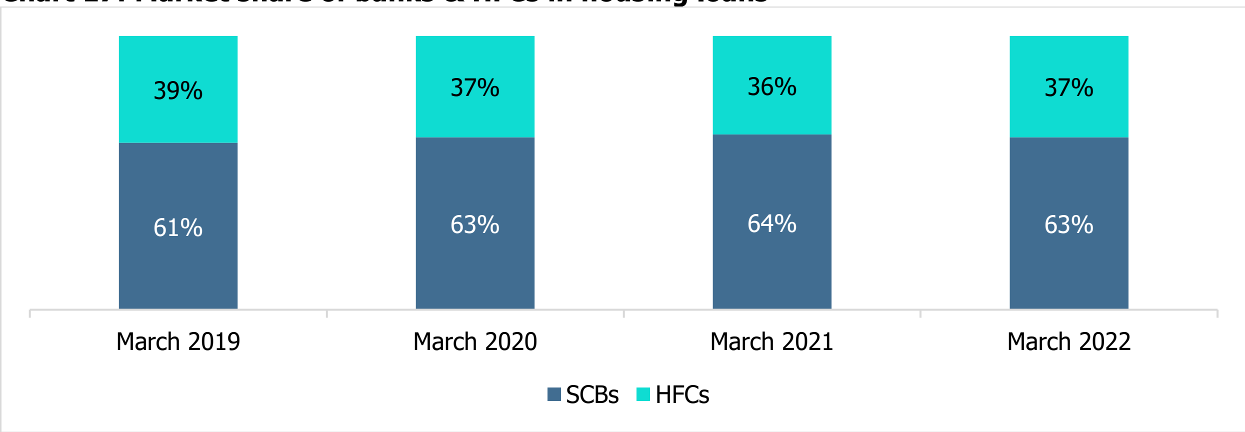
  - While traditional banks have yet to embrace a customer-centric model, fintech can help guide and boost the housing finance industry. It has helped in reaching out to larger geographies for business acquisition without setting up brick and mortar setup. The use of mobile and mobile technology has made the on boarding of a customer easy, fast, and cost-effective. Technology helps to manage risk through analytics. It helps in making informed credit decisions.

The collection and recovery processes have become far more effective and efficient and significant scale-up of business across geographies at a cost-effective manner is possible with the help of technology. CareEdge Research believes that technological advancements will significantly help housing finance companies , as it will help them have a closer eye on NPAs as it will be customer-centric and companies will understand their consumers more effectively.

4.3 Market Share of Banks vs HFCs

A rapid growth of housing loans in banks' portfolio over the last two decades has resulted in housing loans becoming a significant component of the overall loan portfolio of banks. Similarly, housing loans form a large chunk of HFCs loan portfolio - more than half of HFCs' loan books are housing loans. As of March 2022, outstanding individual housing loans by SCBs were around Rs. 16.8 trillion, which represented 63% of the total outstanding home loans. Outstanding housing finance by HFCs were around Rs. 9.9 trillion, which represented 37% of the total outstanding home loans.

Chart 17: Market share of banks & HFCs in housing loans

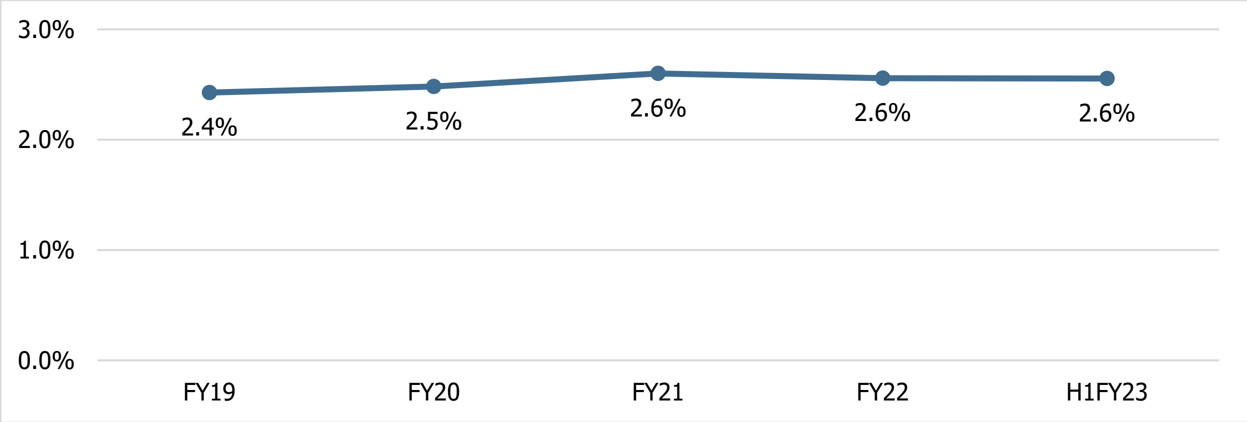


Source: RBI, CareEdge Research
Note: HFCs' share excludes loans disbursed by HFCs in LAP, construction finance, and others.

Banks continued to account for a majority of the housing loan market and made up around 60% of total housing loans disbursed during Fiscal 2022. The share of HFCs in overall housing loans is expected to increase gradually in tandem with the increase in demand for affordable housing and home loans from smaller towns and cities. During Fiscal 2021, demand for new homes is estimated to have come from urban areas where the presence of banks remains dominant.

4.4 Profitability Trends of HFCs

Chart 18: Net interest margin of HFCs



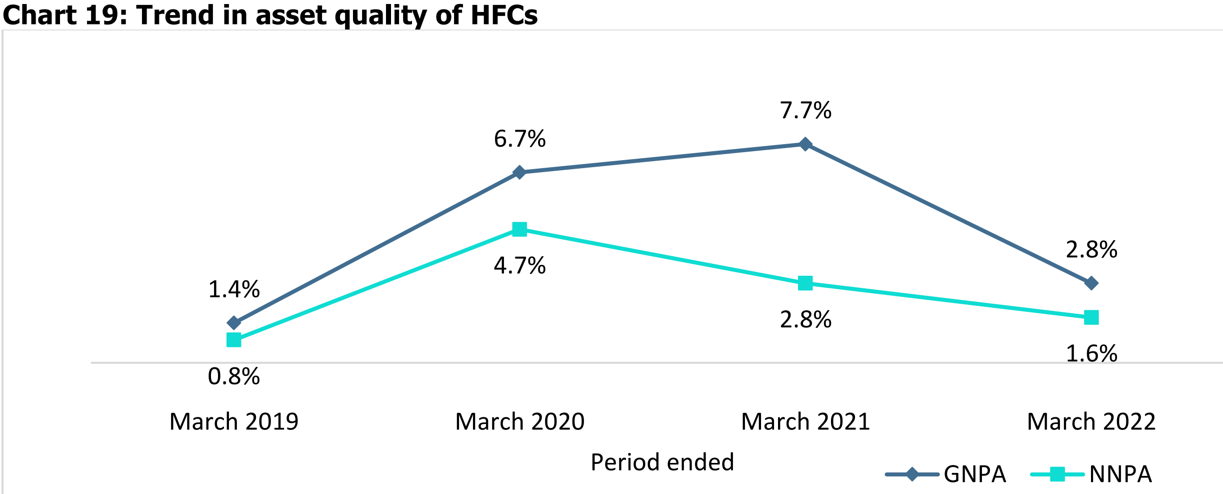
Source: Industry Reports
Note: Data includes top 4 HFCs constituting more than 70% market share

The profitability of HFC's remained stable despite RBIs hike in interest rates amid inflationary pressures, as HFCs pass on the increased credit costs to its customers by charging high interest rates.

4.5 Asset Quality trends of HFCs

The asset quality of HFCs improved in FY22 on account of good recoveries, healthy growth in assets under management and improved demand for credit post the ramp up in economic activity. In FY23, the asset quality of HFCs is likely to further improve on account of high provisions and increased collections efforts of HFCs.

Chart 19: Trend in asset quality of HFCs



Source: RBI, CareEdge Research
Note: Data for March 2022 are of top 5 HFCs

4.6 Outlook

CareEdge Research expects the housing finance sector to grow by 10% in FY23, primarily due to sustained demand from the affordable housing segment, steady growth in disbursements and improving macro-economic environment. CareEdge Research expects affordable segment to continue to outpace the industry with an expected growth rate of around 18% in FY23. At present, there is a huge unmet demand for affordable housing in India. However, the hike in interest rates and high property prices will continue to be a key monitorable for the housing finance segment as a whole.

Lending rates of banks, and consecutively, housing financiers have inched up in FY23 after registering a deceleration in FY21. Interest rates on loans eased sharply following an expansionary monetary policy as the coronavirus pandemic prompted the central bank to prioritise growth and recovery. Interest rates subsequently remained benign during FY22 as weak investment climate, muted demand for fresh credit and recurrent COVID-19 waves kept a lid on credit growth.

However, so far, FY23 has witnessed a gradual restoration of benchmark policy rates on account of food inflation and fuel inflation led by geopolitical tensions. CareEdge Research expects the upward revision in lending rates to further increase the cost of funds for housing financiers. Resultantly, the effective lending rates of housing finance companies have inched up. A rise in interest rates is unlikely to bode well for the recovery of the economy and will dissuade consumers, particularly retail consumers, from actively seeking home loans. CareEdge Research expects lending rates to remain elevated amidst high property prices and a hike in stamp duty of Tier 1 cities, which will make high-priced homes more expensive. The effective hike in prices will affect the affordability of homes leading to a slower growth in property sales and housing finance.

The Government is making ample of efforts towards affordable housing finance, such as the Pradhan Mantri Awas Yojana ("PMAY"), which was launched in June 2015 to provide affordable housing to the urban poor. In February 2022, the Government allocated an outlay Rs. 480 billion under PMAY towards the construction of 80 million homes. While CareEdge Research expects this to facilitate the affordable housing segment, it is unlikely that significant benefits will be witnessed in FY23. CareEdge Research expects the outcome of this additional outlay under PMAY in the medium term to remain contingent upon the efficient construction and timely delivery of houses.

As per data from PMAY, since inception, the Government sanctioned 12.7 million houses under PMAY, of which 6.4 million houses were completed as of November 2022. CareEdge Research expects affordable housing demand to gain slight momentum on account of Government incentives. CareEdge Research expects the overall boost in demand in the residential segment to aid the need for housing finance.

5 Construction Finance

Construction finance constitutes loans extended for the purpose of real estate construction, including residential buildings, commercial offices, warehouses, hotels, malls, retail stores and hospitals. Construction loans are generally non-individual loans extended to real estate developers for the duration of construction, which typically ranges from three to five years (same as the construction period of the project).

Types of construction financing –

1) Construction funding towards financing the overall cost of a real estate project;

2) Discounting of receivables towards flats/ apartments that are already sold or to be sold; and

3) Inventory Financing for flats / apartments / office / malls that are unsold.

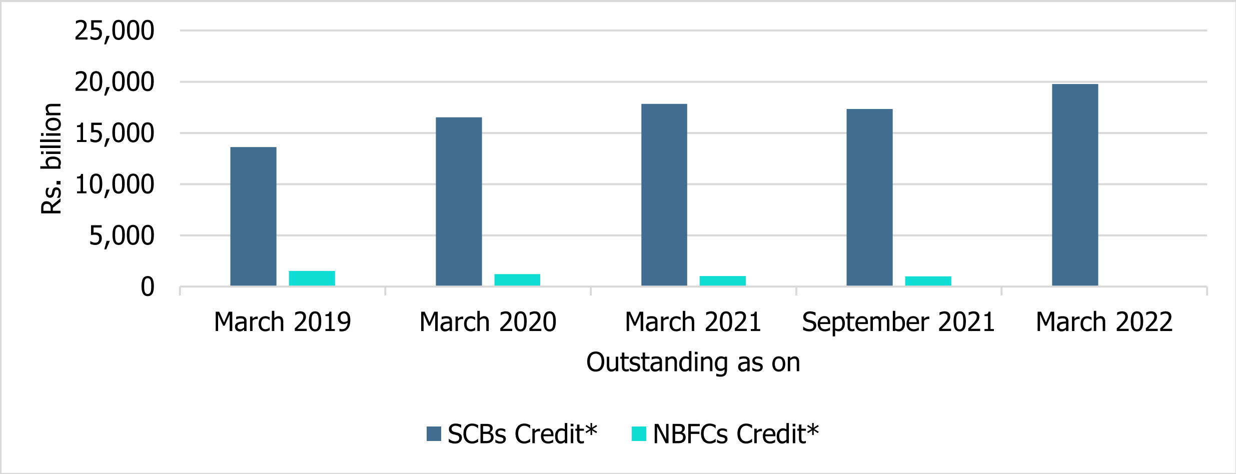
Banks and NBFCs are usually selective when it comes to lending to the construction finance industry. As a result, the loan approval process includes a detailed evaluation of the technical, financial, legal, commercial aspects of the project and the borrower's financial strength, experience and credibility. Construction finance loans are usually fully secured and lending institutions have full recourse against the borrowers. Lenders are also likely to require borrowers to submit periodic reports regarding the progress made on the project. Further, the disbursement of a construction finance loans depends on the progress of construction of a project and therefore has a lag between the approval of the loan and the full disbursement of the same.

Over the past few years, the construction finance segment witnessed a gradual pick-up in credit growth on account of the growth in the Indian real estate industry, which in turn was driven by increased demand for homes, particularly in the affordable segment, lower inventory levels and a strong pipeline of new project launches as well as grade A offices in the commercial real estate space. Additionally, the impetus on domestic manufacturing post the introduction of the Production Linked Incentive scheme and a robust growth in e-commerce translated into demand for construction finance for warehousing. The construction finance segment also registered continued traction from the retail industry, particularly in large format stores in tier 1 cities and malls in tier 2 and tier 3 cities. Along with this, the hotels industry also continued to be steady demand driver for construction finance.

The demand for construction finance is driven by the real estate and infrastructure sectors. Construction finance is therefore critical in ensuring sustainable real estate and infrastructure development.

5.1 Credit growth

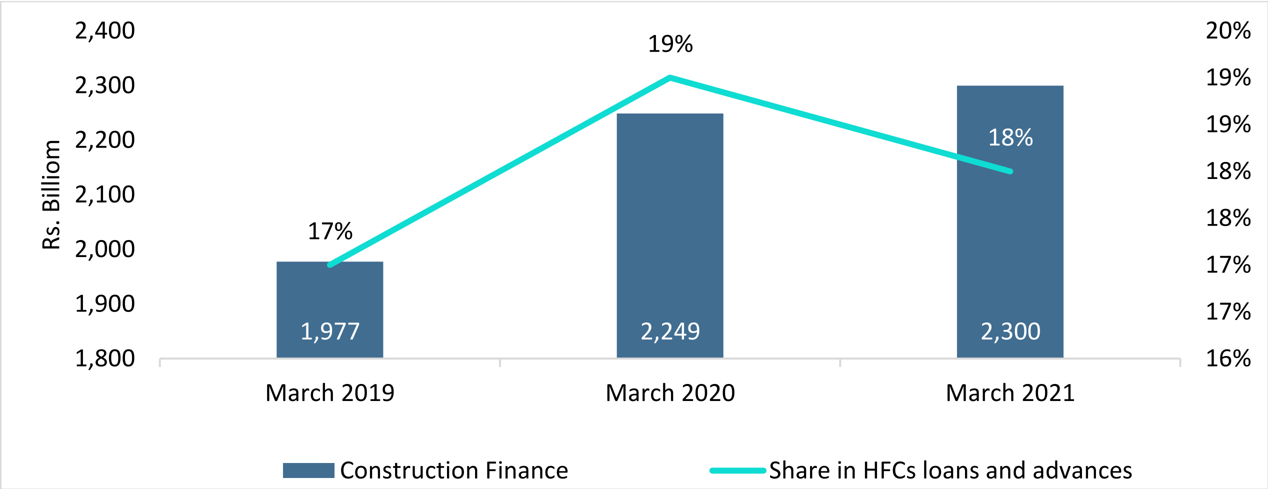
Chart 20: SCBs and NBFCs credit to commercial and residential real-estate



Source: RBI, CareEdge Research
Note: * denotes credit to commercial and residential real-estate

At present, SCBs form a major chunk of credit towards commercial and residential sector. With the increase in need for affordable financing in semi-urban and rural areas, SCBs have increased their lending towards priority sector. In addition to this, Government's focus on infrastructure development has also encouraged SCBs to extend more credit towards construction finance.

Chart 21: Trends in construction finance loans by HFCs



Source: CareEdge Research

Over the period of three years ending March 2021, construction portfolio of HFCs grew at a CAGR of 4.31%. However, the Indian economy was severely impacted due to the lockdowns imposed to restrict the spread of COVID-19. This restriction of movement led to the migration of labourers. Construction projects came to halt and the construction finance portfolio of HFCs declined in Fiscal 2021, constituting just 15% of HFCs portfolio at around ₹ 2.07 trillion. The portfolio further declined by 5.5% in June 2021.

5.2 Growth drivers

- **Increased demand holiday and second homes**

  The need for social distancing and pandemic-led cabin fever opened up a new avenue for realtors – second homes and holiday homes. Consumers, mainly the affluent classes, are feeling the need to go on a holiday for a quick getaway over the weekend or even to socially distance themselves in second homes. CareEdge Research expects the demand for holiday homes close to metros and tier-1 cities to increase due to higher demand from consumers residing in these cities.

- **Relocations**

  The pandemic made the middle-income consumers aware of the drawbacks of their present residences. As the pandemic forced individuals to spend all their time within the confines of their homes, most families did not have sufficient space within their homes. This is also compounded by the limited facilities offered in their complexes. CareEdge Research expects such families, mostly from metros and tier-1 cities, to relocate and make new purchases from a desire for more open spaces, modern amenities, closer proximity to their workplaces and a desire to relocate closer to extended families and friends.

- **Growth in economy coupled with increased urbanisation to boost demand**

  - The Indian economy has experienced steady growth in the past decade and CareEdge Research expects it to be one of the fastest growing economies in the post-pandemic era.
  - CareEdge Research expects the India's urban population to reach over half a billion by Fiscal 2025 from an estimated 461 million in Fiscal 2018.
  - Rising income and employment opportunities have led to migration to urban areas, thereby creating greater need for real estate in major Indian cities.

- **Government policies enabling demand through greater transparency**

  - The real estate segment has received a massive boost from Government initiatives, such as the Affordable Housing Scheme, Goods and Services Tax (“GST”) and the Real Estate Regulation and Development Act, 2016 (“RERA”).
  - While the initial months following the implementation of these initiatives created some disruption, the policies increased transparency and competence of the sector. As a result, confidence of domestic and foreign investors in the real estate industry witnessed a boost leading to higher Foreign Direct Investment in the sector.

- **Growth in e-commerce to be key driver for warehousing**

  CareEdge Research believes that the e-commerce industry is likely to be the demand driver for the warehousing industry. Unlike most sectors, the e-commerce industry benefited from the coronavirus pandemic. While the nationwide lockdown during the June 2020 quarter halted operations of online marketplaces selling non-essential products, the pandemic accelerated the shift to the online medium for shopping. Even consumers who were averse to using e-commerce websites to shop were forced to do so as retail stores remained shut and malls were not allowed to operate. The reliance on online marketplaces selling groceries and medicines also increased and in such times of distress, discounts and offers offered by these companies made them more attractive to consumers. CareEdge Research expects the shifts in buying habits of consumers are unlikely to change after the departure of the pandemic and this will create the demand for more storage facilities for online marketplaces.

- **Congestion at ports, food grain storage capacities to support demand**

  CareEdge Research expects agricultural warehousing to benefit from higher demand on the back of increased procurement prices and improved kharif output this year. According to industry estimates, additional storage capacities to the tune of one million metric tonnes are likely to come up near Agricultural Produce Market Committees (APMCs) Along with higher food grain storage, new warehousing capacities are likely for cold storage. The requirement of temperature-controlled warehouses is increasing for storage of vaccines, food products for quick service restaurants ("**QSRs**") and perishable foods like dairy, meats, fruits and vegetables.

  Besides food grains, warehousing plays an important role in the EXIM trade of any country. Container Freight Stations ("**CFS**"), where cargos belonging to exporters and importers are stored before being exported or imported, and Internal Container Depots ("**ICDs**") have assumed greater relevance in the pandemic times. CFS and ICDs essentially help reduce congestion at ports. This is relevant because as countries are re-opening at different times, the problems of container shortage and delayed turnaround at ports are getting accentuated. Additional warehousing facilities close to ports will ease constraints and help to streamline transportation. CareEdge Research expects this segment to see an improved demand in the post-pandemic era.

- **Demand for cold chain logistics to increase due to pharma, packaged foods industries**

  Cold chain logistics is another key demand driver for the supply chain industry. The cold chain logistics system allows for the safe transport of temperature-sensitive goods and products along the supply chain. This branch of logistics depends on science and technology to maintain the balance between temperature and perishability.

  In the post-pandemic world where the safe transportation of vaccines and booster doses will remain crucial, CareEdge Research believes cold chain logistics will propel the demand for efficient integrated supply chain management. Apart from the pharma industry, another user of cold chain logistics is the grocery and meat products industry. With the advent of e-commerce and specialty companies offering varieties of meat and meat products, the reliance on cold chain, and, consequently on integrated supply chain will increase.

5.3 Outlook

Given the massive funding requirement for construction, there remains a need for a sound and robust financing ecosystem that is aided by Government initiatives. At present, CareEdge Research believes banks are likely to be the key source for construction finance followed by NBFCs and HFCs. Bank credit to construction finance remains challenging as access to funds for smaller projects is costlier. However, over the past few years various policy measures, such as re-finance schemes, were announced by the Government and the RBI also relaxed their external commercial borrowings framework to permit developers to raise funds for low -cost and affordable housing projects. Additionally, the transparency and structure provided by the introduction of RERA has helped support the sourcing of foreign funding. CareEdge Research expects this to give a leg-up to the growth in construction finance loans disbursed particularly in the real estate space.

The scope of funding has been widened further by way of real estate and infrastructure funds (“**REITs and InVITs**”) and this has opened up funding avenues for niche segments, such as logistics, data centres and warehousing. Going forward, CareEdge Research expects the construction finance segment to be a key driver of loan growth for banks as well as NBFCs due to a combination of increased demand for housing, technological innovation and growth in the manufacturing sector.

- **Office spaces -**

Commercial real estate, particularly commercial leasing, was disrupted by the pandemic. Work-from-home policies negatively affected office leases as rentals fell sharply. However, with the effects of the pandemic subsiding, employees are now able to return to the office and “working from office” has resumed in full swing. As a result, CareEdge Research expects demand for offices, especially Grade A offices, to strengthen in the medium term. CareEdge Research expects a sharp pick-up in office space leasing in the short term and new investments in the commercial real estate are projected reach completion.

- **Warehousing -**

The warehousing industry is projected to come out of the coronavirus pandemic stronger than pre-COVID-19. The pace of growth of the warehousing industry is likely to surpass pre-COVID levels in the medium term. CareEdge Research believes companies will want to stock up on inventory to avoid supply shortage, as e-commerce companies will want to cater to increased consumption. Lastly, the preference for grade A and B warehouses will also increase. The outlook for the warehousing industry is positive with strong green shoots for this year.

- **Retail & Hospitality –**

CareEdge Research expects the hospitality and retail industries to see an uptick in investments on new projects as well as the revamping of existing ones as a result of a resurgence in consumption demand. The growth in demand is likely to come on the back of leisure travel, particularly from domestic tourists, and a gradual increase in foreign tourist arrivals. Along with tourism, CareEdge Research expects the construction finance segment to witness an increase in demand from the retail sector by way of standalone and experience stores, retail outlets of e-commerce and luxe brands, and new malls. The average Indian consumer is returning to socialising and shopping after a two-year hiatus and CareEdge Research believes this is likely to propel the demand for newer, larger retail spaces.

6 Gold Finance

6.1 Overview of Gold Industry

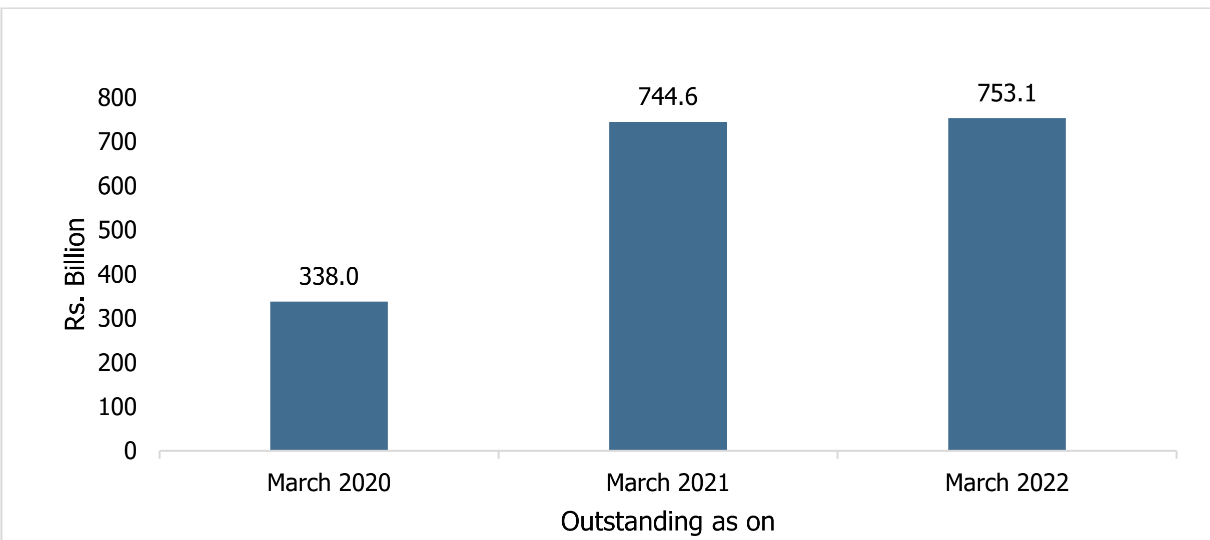
The Indian jewellery market is traditionally dominated by gold jewellery. Gold jewellery purchases in India are not only limited to consumption, as is the case with fashion jewellery, but they do have a strong saving significance. This is more evident in rural communities where access, literacy, and acceptance of other financial savings instruments are all lower. These factors have resulted in gold being a major saving asset class. Cultural differences, religious and trust concerns, as well as other elements that influence jewellery purchases have all contributed to gold jewellery's significance.

Resultantly, the gold financing industry offers strength and support for economic growth. With an emotional sentiment attached to the metal, Indians rarely sell their gold jewellery but pledge it as a collateral with financiers for securing short-term loans.

During the COVID-19 pandemic, the gold prices surged amid the rise in demand for gold. Gold is considered as safe heaven and there was uncertainty in the market during the pandemic, which lead to rise in offtake of gold loans.

6.2 Trend in credit towards gold loan financing

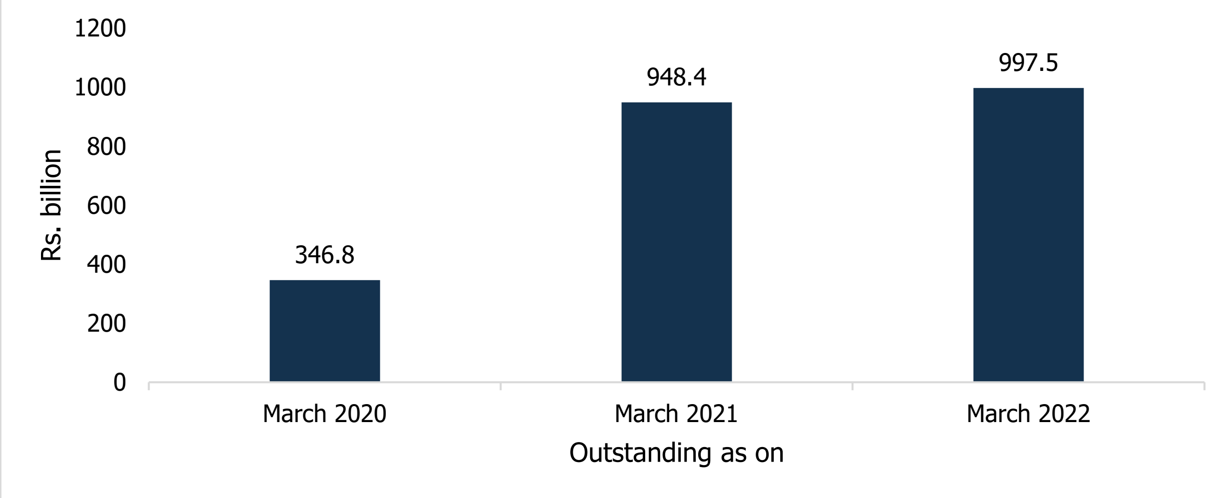
Chart 22: SCBs’ loans against jewellery



Source: RBI, CMIE, CareEdge Research

As per RBI data, SCBs’ loans against jewellery grew by 2.2x in Fiscal 2021 over Fiscal 2020. This growth was due to the pandemic-led financial distress, unemployment, salary cuts and sudden health expenses, which led to people borrowing loans by pledging gold. As of March 2022, the Y-o-Y growth of credit deployed to gold loans was around 1% over March 2021. This came as the impact of the pandemic waned with increased vaccinations and the economy reopened and recovered during Fiscal 2022.

Chart 23: NBFCs' advances to individuals against Gold



Source: RBI, CMIE, CareEdge Research

The Indian gold loan market is divided into two segments namely organised and un-organised segment.

Organised Segment

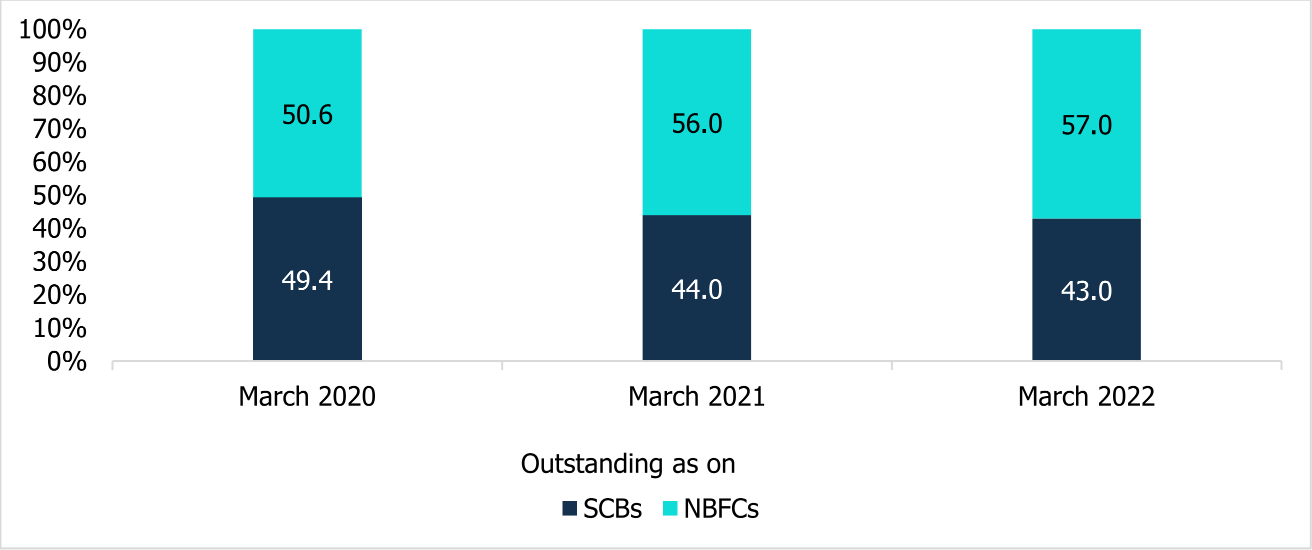
The organised Gold loan market accounts for only a minor part of the overall Indian gold loan market and CareEdge Research expects it to grow exponentially between 2021-25 due to the increasing number of financial institutions providing gold loans to the under-banked population.

As per RBI Data, at the end of March 2021, NBFCs advances against gold stood at ₹ 948.4 billion, indicating 2.7x growth over previous financial year, NBFCs credit against gold further grew to ₹ 997.5 billion by the end of March 2022.

Unorganised Segment

While the formal organised sector comprises financial institutions, the unorganised (informal) sector comprises of indigenous bankers, money lenders, etc., that provide loans against gold at high interest rates to local borrowers.

6.3 Share in Credit deployed towards Gold loan financing



Source: RBI, CareEdge Research

NBFCs' share in gold loans accounted for more than half of total gold loans extended for two consecutive years ending Fiscal 2021, as per data published by the RBI. The share of growth increased to 57% as of March 2022, RBI data showed. A majority of gold loans in India is disbursed by NBFCs, particularly gold loan focused ones, due to their rapid expansion in rural and semi-urban areas and a faster conversion rate. As NBFCs have a strong presence in these regions, reaching out to NBFCs for loans is a more lucrative proposition when compared to local moneylenders who may be charging a higher interest rate.

Of late, NBFCs have been aggressive in on boarding new customers through branding, advertising and expansion. Banks too increased their focus on the gold loan segment as higher demand from gold loans, particularly during the pandemic, meant a steady avenue for credit growth. Other factors that drive the growth of gold loans are need for credit, attractive interest rates of banks and NBFCs vis-à-vis local moneylenders, faster loan processing, digitization, gold loans for varied tenures, accurate gold valuation, safekeeping and auctioning, which are extremely vital to gold loan customer segment.

Additionally, in August 2020, the loan-to-value (LTV) ratio for loans against gold ornaments for non-agricultural end-users increased from 75 per cent to 90 per cent. This provision was applicable till 31 March 2021 and was aimed at offering support to households and small businesses to help them mitigate the economic impact of the pandemic. This resultant growth in these loans indicates the extent of relief of this measure and may have played a part in retail loans holding their growth rates.

6.4 Key risks for Gold loan NBFCs

- **Asset price risk**

Gold loans are primarily disbursed based on the value of the collateral. Hence any asset price fluctuations increase asset quality risks for the financier.

Asset price risk is the risk of a decline in the value of a security below the value of the loan. Gold financiers are exposed to asset price risks as any significant fall in gold prices could adversely affect the cover on a loan.

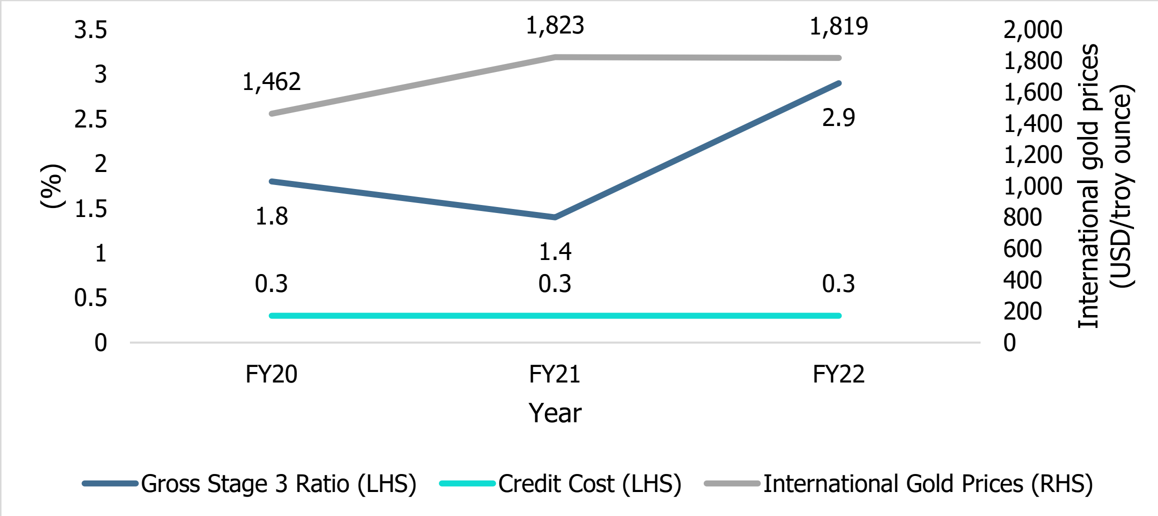
Generally, gold prices face a downside from improving economic conditions across the globe, such as an upward movement in the interest rates of the US dollar, among others, which lowers the risk aversion of investors and their appetite for gold.

Decline in gold prices have the following impacts on gold financiers.

- The value of collateral gets impacted, affecting the ability to recover loans. For example, gold prices fell sharply in 2013 which had implications on gold loans that were disbursed at a higher loan-to-value ratio. As the value of the collateral diminished, the borrower was required to pay for the difference between the current value of the collateral and the amount of loan issued, thereby increasing the probability of default.
- Customers opting for gold loans tend to be based out of rural regions or engaged in small, localised businesses and are largely insulated from global trade. As a result, the impact of a fall in gold prices is not offset by improved repayment capacity of borrowers of gold loans.
- Additionally, close to 95% of borrowers of gold loans tend to be individuals from rural areas or smaller towns. This segment of society is more vulnerable to downturns in the domestic economy. A sluggishness in India’s economic growth can also have a broad-based impact on the portfolio quality of gold loan companies. Data show that gold loan companies witnessed an uptick in their gross NPA levels due to a combination of moderation in global economic growth and a rise in gold prices in Fiscal 2020.

During the Covid-19 pandemic, gold prices increased considerably, as gold is considered a secure asset. Hence, the asset price risk was lower. The GNPA as indicated by gross stage 3 assets increased in Fiscal 2022 due to the effect of the pandemic on the borrower segment. However, credit cost was under control during Fiscal 2021 and Fiscal 2022 with aggressive recovery through auctions taken by larger NBFCs.

Chart 24: Asset Price and Asset Quality Risks for Gold Loan NBFCs



Source: CareEdge Research

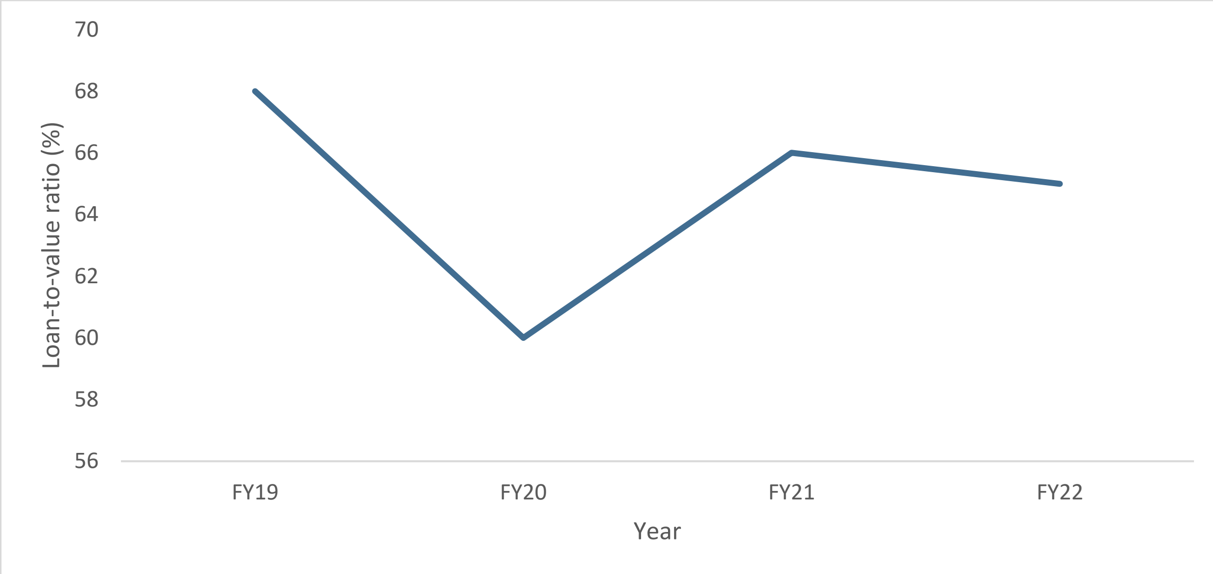
- **Regulatory risks**

Regulatory risks are defined as any regulatory changes that may affect operations and cash flows. Given that gold financing is regulated by the RBI, the regulator has undertaken changes depending on gold price volatility, which also had a bearing on the operations of gold financiers.

On August 6, 2020, the RBI relaxed the norms for lending by increasing the ceiling for loan-to-value ("LTV") ratio for gold loans from 75% to 90% for scheduled commercial banks ("SCBs"). This extension was valid until March 31, 2021. NBFCs remained subject to the 75% LTV ceiling for gold loans. The RBI's amendment in LTV ratio for gold loans gave borrowers the chance of availing a higher loan amount against the same quantity of gold. The increase in the permissible LTV ratio for gold loans in India helped ease the financial distress of borrowers whose immediate needs were difficult to service due to the disruptions caused by the COVID-19 pandemic. As this relaxation was only applicable for banks, it helped banks grow their gold loans significantly and gain market share in the gold loan segment.

The increase in the LTV ratio cap to 90% made gold loan NBFCs more susceptible to ceding their market share to banks. However, a majority of banks' gold loan portfolios is made up of agriculture-based gold loans, while NBFCs are majorly present in the retail gold loans space. In addition, the relaxation in LTV ratio for banks was valid only up to March 31, 2021 and therefore does not currently pose a risk for NBFCs. However, the relaxation announced for banks and its impact on the gold loan segment during Fiscal 2021 indicates that NBFCs are not insulated from risks brought about by regulatory changes in the future.

Chart 25: Loan-to-value Ratio of Gold Loan NBFCs



Source: CareEdge Research

- ## Concentration risk

Gold loan NBFCs' business models pose an inherent concentration risk as these companies' loan assets are primarily collateralised by only one product – gold. This gives rise to concentration risk arising from most of the lending being concentrated in just one segment – gold, which heightens the risk of decreases in golds prices.

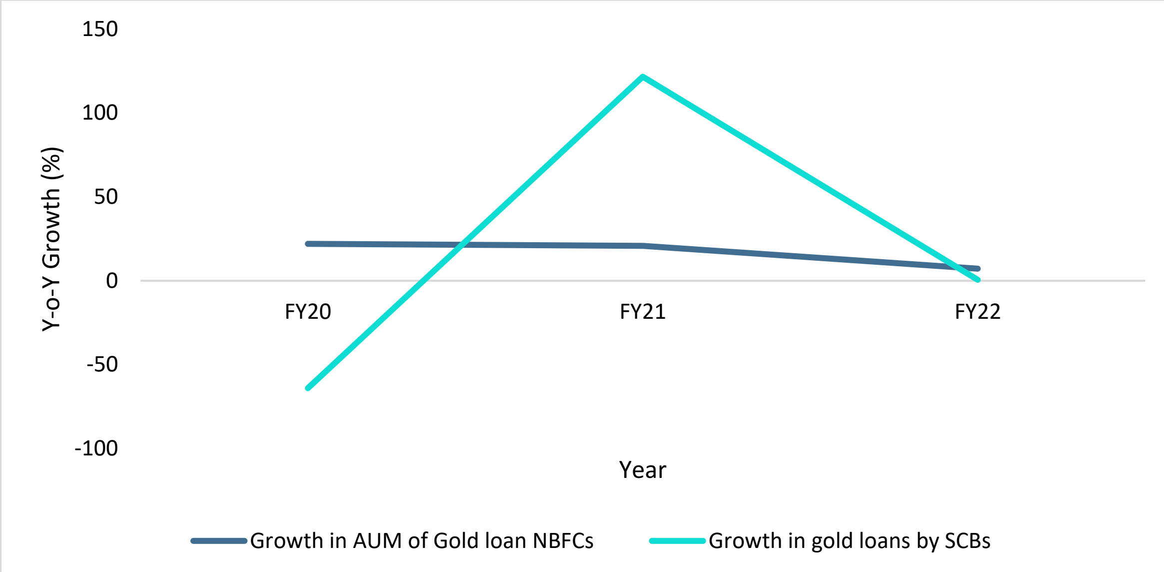
Moreover, close to 60% of gold loans disbursed by gold loan NBFCs are concentrated in southern states in India, thereby increasing the risks related to regional concentration. Gold loans traditionally do not find a lot of traction in northern India as gold is viewed as an auspicious asset which results in reluctance over pledging it for financing needs. This restricts the growth of gold loans in northern India and increases dependence on southern India.

- ## Competitive intensity

Companies engaged in gold loans depend on disbursement of quick loans against gold jewellery. Given the increased presence of banks in the gold loans segment, speedy disbursal of loans may be a key differentiator that NBFCS may rely on to maintain or gain their market share. However, speedy loan disbursal may result in a compromise on (i) the quality of due diligence on customers, (ii) adherence to KYC norms and processes and (iii) an adequate assessment of the quality of gold pledged against loans.

Additionally, the temporary increase in the LTV ratio cap applicable to banks up until March 31, 2021 resulted in the presence of banks in gold loans increasing significantly in FY21. Small finance banks are also engaged in the gold loans business and this is likely to intensify the competitiveness of the gold loan segment. Borrowers of gold loans sometimes prefer local lenders due to their familiarity and long-standing association with them, so the unorganised market is unlikely to completely give way to formal lending channels in the near future.

Chart 26: Growth in Gold Loans by SCBs and Gold Loan NBFCs



Source: CareEdge Research

The growth in AUM of gold loans depends on the growth in gold holdings and gold prices. International gold prices edged higher in FY21 as compared to FY20. However. gold loan NBFCs also witnessed increased competition from banks in the gold loan segment in FY21. This was due to the COVID-19 pandemic-led disruption of demand for credit, which resulted in banks increasing their focus on the gold loan segment, as this segment remained a safe asset class, and the temporary increase in LTV for gold loans that was applicable to banks only. While NBFCs witnessed a 20.8% growth in gold loans in Fiscal 2021, banks' gold loans, which had recorded a de-growth in FY20, grew by 121.7% in FY21.

- **Substitute financial products and digital lending**

Gold loans, which are primarily sought by low-income households, are collateralised loans. In comparison, microfinance loans are collateral-free loans extended by banks as well as NBFCs. Of late, the microfinance segment is witnessing a pick-up in demand and financial institutions are also increasing their involvement in the microfinance segment. This poses a risk to the gold loans segment, since an increase in penetration of microfinance loans may translate into reduced need for gold loans.

Gold loans NBFCs also face risks arising from quick lending done by fintech players. The advent of digital lending has made procuring loans quick and hassle-free and some digital lenders are also engaged in gold loans, which may require gold loan NBFCs to improve their technological infrastructure and digital presence.

6.5 Outlook for Gold Loans

For financial institutions, gold loans are highly secured assets and liquid collateral that generate high returns with minimal credit losses. CareEdge Research anticipates that with large geographic reach and fast turnaround time on loan applications, the demand for gold loans to fund working capital of micro enterprises will grow in the near term.

The outlook for gold loans remains positive also due to continued focus on part of banks and NBFCs on the gold loan segment. CareEdge Research expects growth in AUM of gold loan NBFCs to hover at 12-13% for Fiscal 2023.

The gold loan segment is a highly liquid one and in case of delayed repayments, the lender can easily sell the asset pledged and recoup the funds. In the post pandemic era, where rising inflationary concerns are likely to slow down growth and impact pace of economic revival, gold loans will continue to remain as a source of funds for consumers who may have the need for urgent financing, and banks who may perceive this segment to be a lucrative.

Going forward, the growth is expected to come on account of the following drivers:

Geographic Reach:

Organised financial institutions especially NBFCs have a geographically wider reach especially in the southern regions with high coverage in non-metro, semi-urban and rural areas. Borrowers keen on availing gold loans are more likely to choose a specialised NBFC over an unorganised lender if the location is convenient and minimises the risk of travelling a distance with valuable assets.

Quicker Turnaround time:

The turnaround time of financial institutions is short. This is attributed to a smaller loan ticket size, the desire of the borrower to procure the loan amount as quickly as possible, and the availability of well-trained and experienced employees in the assessment and valuation of the gold collateral being pledged.

Focused business areas and efficiency in operations:

Although banks also extend gold loans, some NBFCs have developed expertise in this segment by exclusively focusing on gold loans. Through this, gold financing companies have specialised capabilities and also offer customised solutions to customers. As a result, NBFCs are likely to maintain their strong foothold in the gold financing segment.

Increased stock of gold:

According to the World Gold Council, a 1% rise in income supports the demand for gold by 1%. CareEdge Research expects India’s total gold stock to increase following the recovery and growth in the economy and this will likely translate into a higher stock of gold in India. With consumers being less averse to using gold to meet their credit requirement, a higher stock of gold bodes well for the gold finance segment.

Challenges to growth:

Increased competition among companies and other financial products:

With the thrust on gold loans by the banking sector, NBFCs are likely to continue their aggressive strategies to maintain their share in overall gold loans. However, the gold loan segment also faces challenges from financial services providers dealing in unsecured loans, which offer customers the option of availing a loan without pledging any collateral.

Security:

Gold as an asset class has high value for a low quantity and has to be handled cautiously during the loans life cycle. It becomes crucial for financial institutions to be aware about the possibility of theft and other fraudulent behaviour.

Operating expenses:

The nature of the gold loan business results in high operating cost due to large number of branches required as proximity to the customer plays a key role in gold loan financing.

Storage Costs:

Providing secure storage hubs at each branch is expensive and effects operating revenues at the branch level. In addition, to this there are other costs, such as strong electronic monitoring and cybersecurity protocols, to protect client data.

Reluctance over pledging:

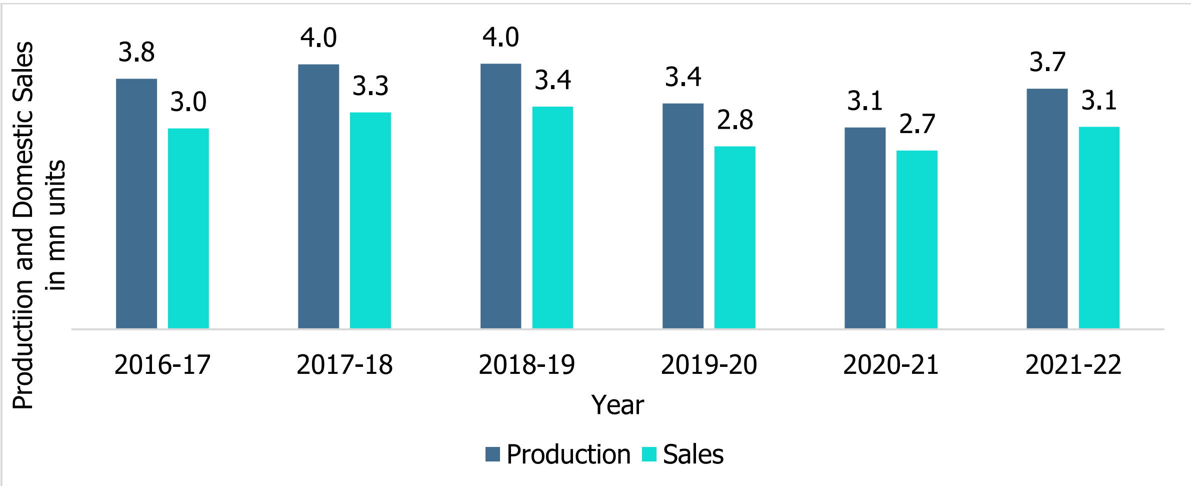
Indians consider gold as one of the most reliable and auspicious liquid assets. With an emotional sentiment attached to the metal, Indians are reluctant on pledging it as a collateral with financiers for securing short-term loans. This makes it difficult for financers to convince the borrowers to take a loan against gold. But of late, it's not only the rural communities who are open to using gold jewellery to meet their financial needs, but also individuals from urban areas who are no longer considering gold finance as a taboo. Over time, CareEdge Research expects the relatively untapped market of urban areas to open new frontiers for gold financiers.

7 Auto Finance

7.1 Overview of passenger vehicles (PVs)

The Indian passenger vehicle ("**PV**") industry forms around 15% of total automobile industry in India in terms of domestic sales volumes. Passenger vehicles registered a 13.2% growth in sales during Fiscal 2022 while overall automobiles sales volumes declined by 6% on account of a fall in two-wheeler sales. Passenger vehicles witnessed a continued traction in sales volumes due to a combination of high demand, new launches and gradually reducing waiting period with easing of supply-side issues.

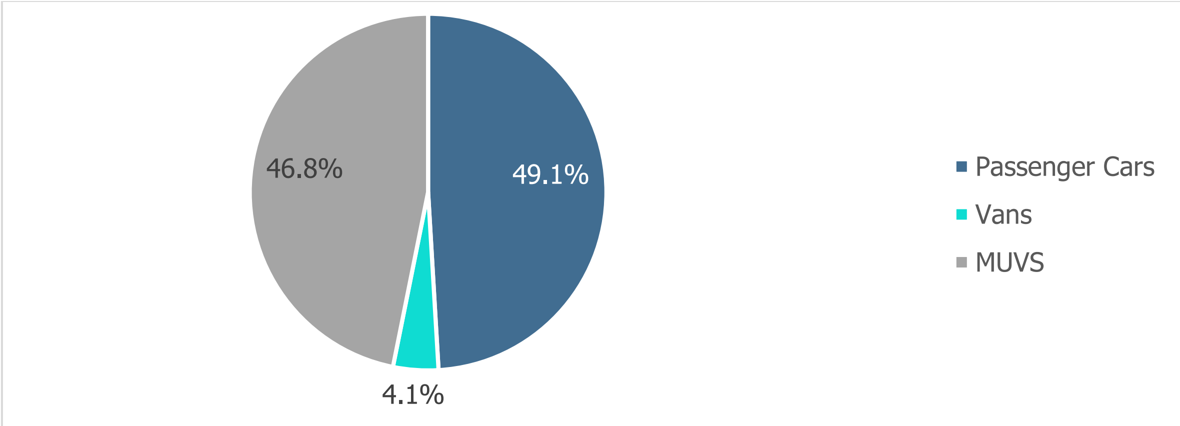
Chart 27: Production and Domestic Sales of Passenger Vehicles in India



Source: SIAM, CareEdge Research

The passenger cars segment contributed highest to the domestic PV sales at 49.1% in Fiscal 2022 followed by multi utility vehicles ("**MUVs**") at 46.8% and vans at 4.1%. The break-up of domestic sales of PVs into various categories in Fiscal 2022 is depicted below:

Chart 28: Category-Wise break-up of Domestic Sales of Passenger Vehicles in Fiscal 2022



Source: SIAM, CareEdge Research

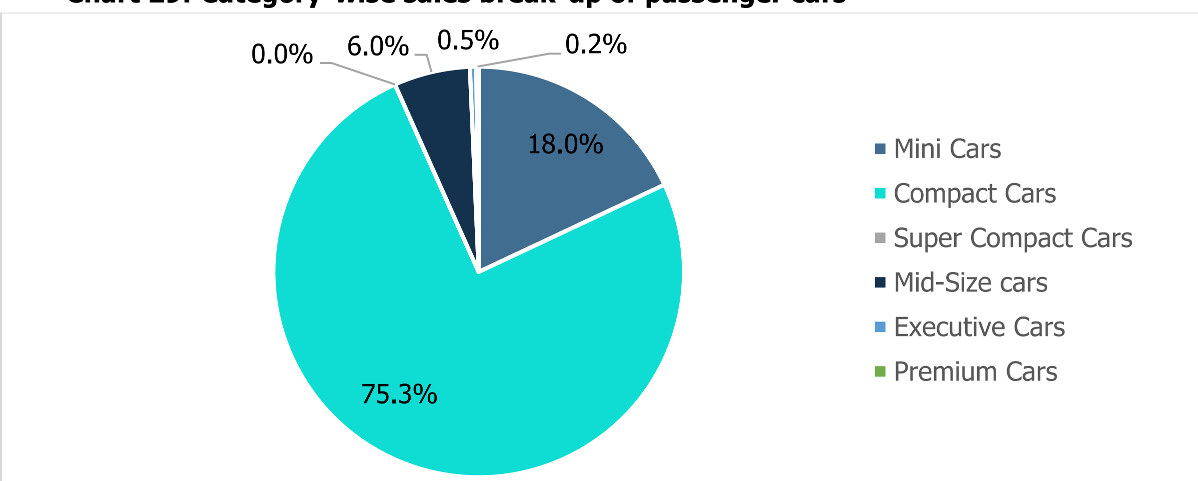
Passenger cars can further be classified into six main categories, namely, Mini Cars, Super Compact Cars, Compact Cars, Mid-Sized Cars, Premium Cars and Executive cars.

The classification of segment is done on the basis of the length of the vehicle as depicted below:

- **Mini**: Seats up to 5, Length Normally <3600 mm, Body Style-Hatchback, Engine Displacement Normally up to 1.0 Litre, Example – Nano (Tata)
- **Compact**: Seats up to 5, Length Normally between 3,600 – 4,000 mm, Body Style-Sedan/Estate/Hatch/Notchback, Engine Displacement Normally up to 1.4 litres, Example – Alto, Wagon R (Maruti)
- **Super Compact**: Seats up to 5, Length Normally between 4,000 – 4,250 mm, Body Style-Sedan/Estate/Hatch/Notchback, Engine Displacement Normally up to 1.6 litres
- **Mid-Size**: Seats up to 5, Length Normally between 4,250 – 4,500 mm, Body Style-Sedan/Estate/Hatch/Notchback, Engine Displacement Normally up to 1.6 litres, Example – Dzire (Maruti), Amaze (Honda)
- **Executive:** Seats up to 5, Length Normally between 4,500 – 4,700 mm, Body Style-Sedan/Estate/Hatch/Notchback, Engine Displacement Normally up to 2 litres, Example – Corolla (Toyota)
- **Premium:** Seats up to-5, Length Normally between 4700 - 5000 mm, Body Style-Sedan/Estates, Engine Displacement Normally up to 3 litres, Example – Accord (Honda)

The share of the aforementioned segments in the Indian passenger cars market in Fiscal 2022 is depicted below:

Chart 29: Category-wise sales break-up of passenger cars



Source: SIAM, CareEdge Research

It can be observed from the above figure that compact cars segment leads the Indian passenger car market with around 75.3% market share followed by mini cars, which hold around 18% share.

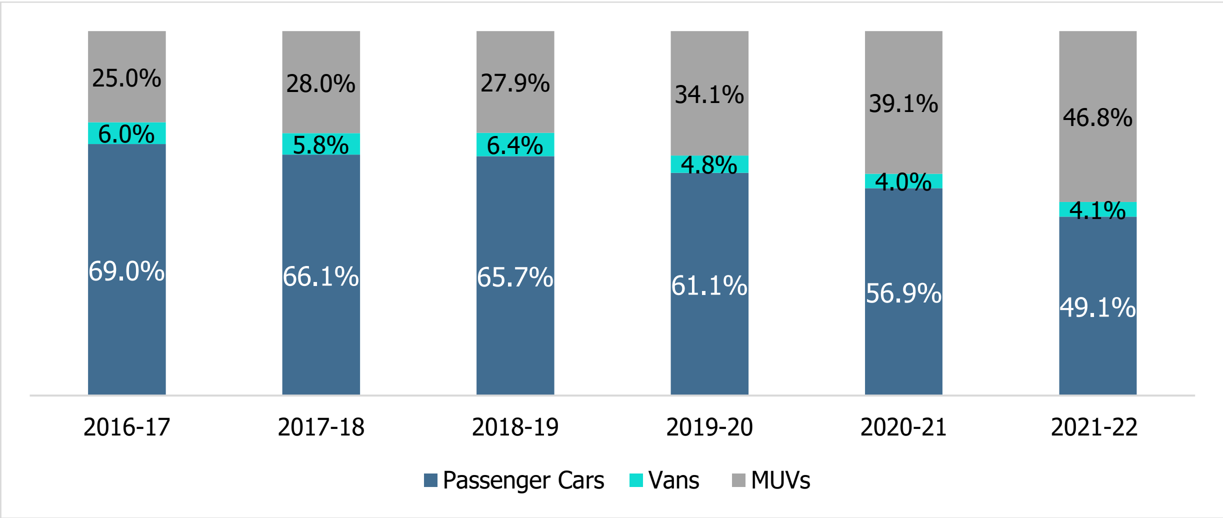
MUVs can be classified into various categories based on length and price namely – Up to 4400 mm & price < ₹ 2 million, 4,401mm-4,700mm & price < ₹ 2 million, above 4,700mm and price < ₹ 2 million, price between ₹ 2-3 million and price above ₹ 3 million.

Vans can be classified as hard-top vans and soft-top vans.

The trend of share of various segments in the total domestic sales of passenger vehicles is depicted below:

The passenger cars segment contributed highest to the domestic PV sales at 49.1% in Fiscal 2022 followed by MUVs at 46.8% and Vans at 4.1%. The break-up of domestic sales of PVs into various categories in Fiscal 2022 is depicted below:

Chart 30: Trend in share of various PV segments in overall sales



Source: SIAM, CareEdge Research

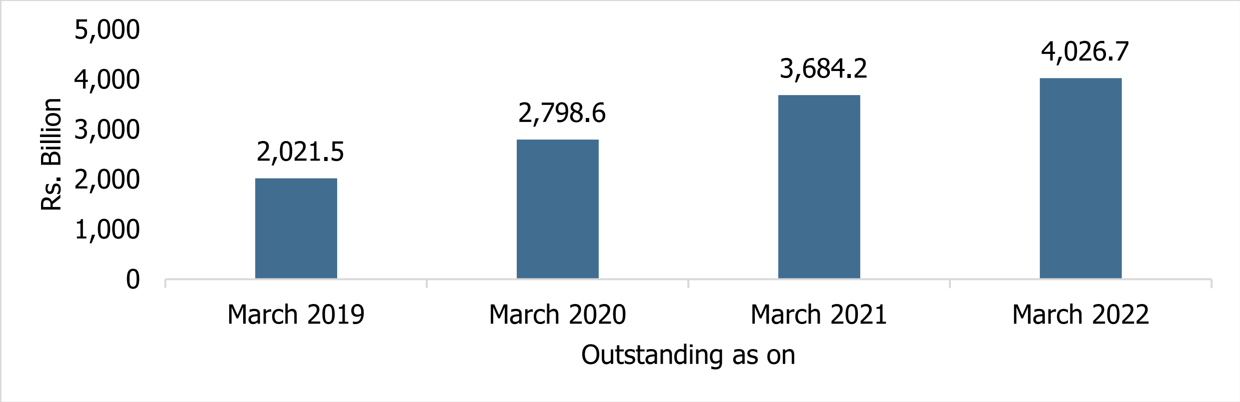
It can be observed from the above figure that the share of MUVs has grown consistently over the years while the share of passenger cars and vans has decreased. This reflects the growing inclination of consumers towards MUVs and increased focus of OEMs on product development and upgradations in MUVs.

While the demand for passenger vehicles remains upbeat, the global automobile industry is facing supply chain disruptions amidst the ongoing semiconductor shortage. The demand for used cars is rising sharply as the waiting period for new cars is getting longer. As customers are forced to postpone purchases due to long waiting period for popular models, they are opting for used cars and this is likely to prop up the demand for auto financing.

7.2 Overview of Auto Finance

Lending money to borrowers for purchasing new or pre-owned vehicles is termed as auto financing. Borrowers can avail auto loans to purchase two-wheelers, three-wheelers, commercial vehicles (CVs) and passenger vehicles (PVs), tractors.

Chart 31: Credit deployed by SCBs to Auto finance



Source: RBI, CareEdge Research

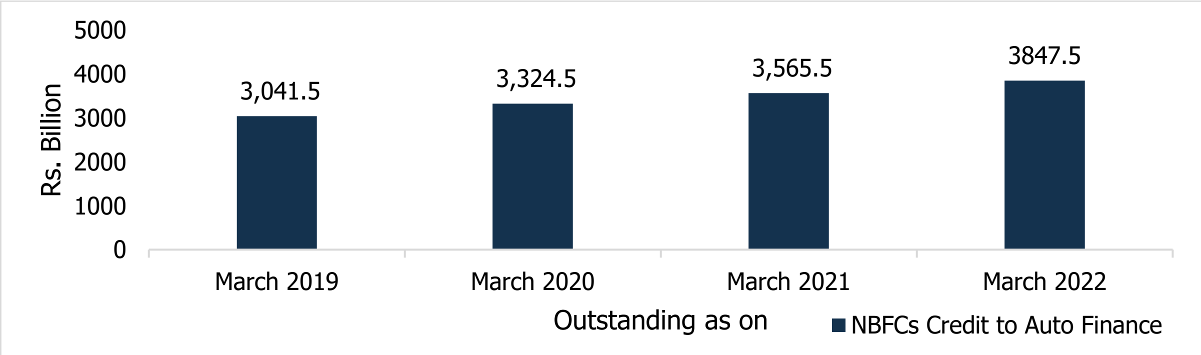
Note: Auto loans data published by the RBI includes loans extended towards financing of two wheelers, three wheelers, tractors, passenger vehicles and commercial vehicles

As of March 2022, the growth of SCBs credit to auto loans moderated to around 9.3% as vehicle sales declined due to the rise in acquisition costs and high fuel cost amid geopolitical tensions. In addition to this, the semi-conductor chip shortage due to global supply chain issues led to decline in vehicle sales, which further impacted the need for auto financing.

SCBs' auto loans had witnessed a growth of over 30 per cent for two consecutive years ending Fiscal 2021. This growth was on account of an increased in demand for vehicles, particularly during the pandemic year of Fiscal 2021, when automobile companies offered substantial discounts to push revenue growth.

Gradually, the pace of growth in auto loans disbursed appeared to moderate due to gradual recovery of the economy amid the COVID-19 pandemic. Sales of new vehicles faced headwinds due to supply-side constraints, such as semi-conductor chip shortage and global supply chain issues.

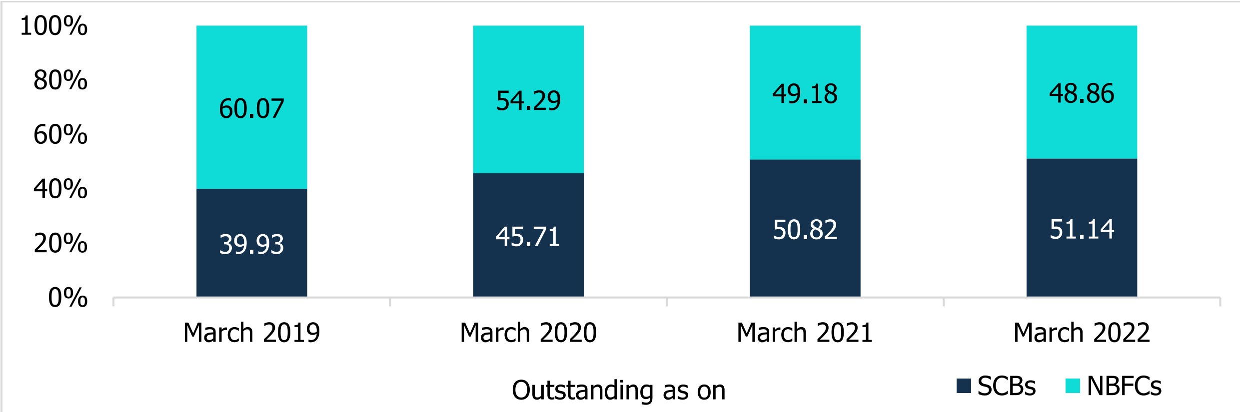
Chart 32: Credit deployed by NBFCs to Auto finance



Source: RBI, CMIE, CareEdge Research

Note: Auto loans data published by the RBI includes loans extended towards financing of two wheelers, three wheelers, tractors, passenger vehicles and commercial vehicles

Chart 33: Share in credit deployed towards auto financing



Source: CareEdge Research
Note: Auto loans data published by the RBI includes loans extended towards financing of two wheelers, three wheelers, tractors, passenger vehicles and commercial vehicles.

NBFCs have been a pillar of strength for the automobile industry, primarily lending to customers in semi-urban and rural areas where credit availability from the banking sector is generally difficult. NBFCs mainly disburse loans to the CV segment through captive financing arms of auto companies, while banks mainly lend in the PV segment. NBFCs' share in auto loans has been declining consequently in Fiscal 2021 and Fiscal 2022 as SCBs were aggressive in pushing auto loans. SCBs' share in auto loans correspondingly witnessed an uptick from less than 40% in Fiscal 2019 to 50% at the close of Fiscal 2021 as the COVID-19 pandemic led social distancing practice resulted in people preferred having private modes of transport. This led to increase in vehicle purchases and the need for financing such purchases. The latest data published by the RBI shows that SCBs continue to witness the uptrend in raising auto loans in Fiscal 2022. However, NBFCs had accounted for almost 49% of share in auto loans disbursed as of March 2022 which is relatively near to the share as of March 2021.

7.3 Outlook

During the H1FY23, domestic automobile sales witnessed a growth of about 31% year-till-date (YTD). Growth across the segments has been aided by a gradual improvement in festive season demand, the low base of last year, launching of new models and an uptick in vehicle production with the easing of semiconductor chip availability. There has been a recovery in the Medium and Heavy Commercial Vehicle (MHCV) segment led by a pick-up in road construction projects and strong demand for Light Commercial Vehicles (LCV) led by increasing last-mile mobility. In addition to this, the overall improvement in economic activities, rapidly growing infrastructure development with private and public capex, higher fleet utilisation levels, the thriving ecommerce sector, and a rebound in replacement demand augurs well for the industry.

The demand disruption caused by the pandemic and high input prices and fuel costs, rising interest costs along with continued inflation are posing as headwinds to the growth of the automobile industry.

CareEdge Research believes that the high pent-up replacement demand and robust growth in end-user industries like infrastructure and e-commerce would offset headwinds such as high-interest rates and commodity inflation. This will positively impact the growth of auto industry and will further lead to increase in demand for credit for financing vehicles.

Key Growth Drivers

Growth in demand for automobiles

- **Low car penetration & rising family income to support PVs demand:**
  - India's car penetration is expected to rise with the increase in household income as per a report by NITI Aayog. The growing domestic income is expected to make passenger vehicles more affordable for local consumers.
- **Favourable demographics and increasing domestic customer base:**
  - The customer base in India is witnessing rising income levels and improvement in overall employment. Rise in education among the youth could lead to a decline in dependency ratio and enhance lifestyles. This, in turn could strengthen discretionary spending on new vehicles as well as purchase of old vehicle.
- **Adoption of electronic vehicles**
  - There is a growing thrust on adoption of electric vehicles ("**EV**") across the globe amid increasing carbon emissions, which have serious repercussions, including global warming. As India is significantly dependent on crude oil imports and various cities in India are facing pollution menace, the Indian Government has also acknowledged the need to promote EVs. The Government has launched various favourable polices aimed at faster adoption of EVs in India. This will eventually aid the growth of the auto industry and growth of auto finance industry as more people opt for electronic vehicles.
- **Urbanisation**
  - Urbanization is a key driver of India's overall growth. More and more people are moving to urban cities, this is leading to increase in need for movement and thus increase in need for vehicles. Delhi, Mumbai, and Kolkata are among the world's largest cities and there is good opportunity for sales of passenger as

well as commercial vehicles. The rapid urbanization is likely to increase the demand of vehicles, followed by the need for vehicle financing.

- **Demand for commercial vehicles following pick-up in industrial activity**

  - CareEdge Research expects the commercial vehicle segment to show improvement in sales going ahead with Government's focus on improving infrastructure and construction activities. In addition to that, most of the corporates, schools & colleges will improve the demand for bus segment, two-wheeler and three-wheeler segment. CareEdge Research expects the tractors segment to show some improvement in the coming months due to increased budget allocation on rural and agri sector, higher reservoir levels and overall higher rabi sowing. With new launches by the auto manufacturers and with the increase in movement of goods and passengers, CareEdge Research expects there to be an improvement in overall automobile industry sales. However, continuing supply side challenges, increased acquisition costs of vehicles, higher commodity and fuel prices might impact sales in coming months.

Untapped potential and improvement in infrastructure of NBFCs

- **Digital over traditional**

  - The Indian retail loan market largely consists of a young population with high aspirations, and increased gap in their income and expenditure. Customers today prefer digital loan approval as it's hassle-free and the cost of transaction is low as compared to the traditional way of the loan application. As a result, retail loan lenders are using online and digital models and partnering with fintech companies to increase their reach or investing in their digital capabilities to on-board new customers. With the help of digitization, it has become possible to quickly process a loan, enhance collections and other operational efficiencies along with ensuring customer satisfaction. Incumbents in the industry will have to increase their investments in technology to capture the untapped market of tech-savvy customers and widen access to retail loan instruments.

- **Large population with low access to credit**

  - With the ease of internet access, there has been an increase in middle-class spending and growth in rural population consumption. NBFCs, fintech have transformed the credit distribution landscape to support the financial needs of these consumers. One can avail services from the comfort of their home with minimum documentation required.

  - Majority of India's population lives in rural areas, people do not have sufficient collateral and there is a lack of organized financial support. This is where financial institutions like banks and NBFCs play a crucial role in providing financial support through their various products that cater to the rural population.

Challenges to the Growth

Macroeconomic factors

- **Rising of interest rates**

  - The RBI has raised its benchmark policy rates due to inflationary pressures following persistent geopolitical tensions. This hike in interest rates comes after two years of benign rate regime and has translated into a corresponding rise in the cost of funds. CareEdge Research expects the commensurate rise in the cost of funds of NBFCs to be higher than that of banks since NBFCs primarily rely on banks for funding. The uptick in the cost of borrowing may have a bearing on the competitiveness of NBFCs vis-à-vis banks while servicing the demand for auto loans.

- **Nascent recovery in economy**

  - The domestic economy is grappling with higher inflation amid nascent recovery post the pandemic. This may culminate into sluggish demand resulting from limited income growth, higher prices and a high rate of unemployment. In this scenario, low income generating households may need to dip into their savings while leveraging themselves, which may constrain their ability to spend.

Dependence on the automobile industry

- **Semi-Conductor dependence**

  - Production volumes of automobiles had historically been under pressure and OEMs took production cuts during the June 2022 quarter on account of the semi-conductor chip shortage. While there have been some signs of improvement recently, the industry is yet to fully recover in terms of availability of semi-conductors.

- **Steep rise in raw material prices increasing the cost of vehicles**

  - The automobile industry faces headwinds from high acquisition costs of vehicles and rising fuel prices. Original equipment manufacturers ("**OEMs**") have raised prices of their products due to increasing input costs. Price sensitive consumers are likely to opt for lower priced vehicles instead of deferring vehicle purchases amid high costs. As a result, the impact on demand for auto financing is likely to be restricted.

- **Safety norms and BS-VI increasing the acquisition cost of vehicles**

  - In an attempt to improve the vehicle safety conditions, the Government has made safety features such as anti-braking system (ABS), combined braking system (CBS), air bags, seat belts, speed limit trackers and rear parking sensor mandatory for various vehicle segments. All these norms may marginally increase vehicle costs.