

## Box A

# Non-performing Loans at Asian Banks

Over the past decade, aggregate non-performing loan (NPL) ratios for most banking systems in Asia have fallen to low levels (Graph A1).<sup>1</sup> This improvement in loan performance has coincided with a period of strong growth in nominal incomes and credit, and increasing financial market inclusion. As a result, intermediated credit has been extended to a wider cross-section of sectors and individuals in these economies. Periods of strong credit growth tend to support loan performance because newer loans, which have had less time to go bad, make up a larger share of total loans. Efforts made by supervisory authorities in the region to improve banks' credit risk management and underwriting practices in the years following the Asian financial crisis are also likely to have assisted the decline in NPL ratios in a number of countries.

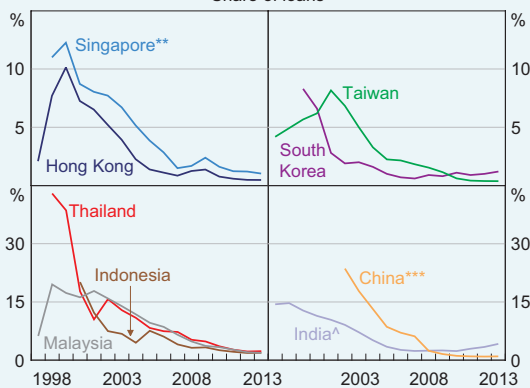
Some commentators expect NPL ratios in Asia to rise amid slower income growth and less accommodative financial conditions, particularly given that NPLs are typically a lagging indicator of asset quality. To date, increases in aggregate NPLs have occurred in some economies, particularly in India but also in Korea. In China, reported NPLs have picked up in certain sectors and regions but remain low in aggregate.

## India

The Reserve Bank of India (RBI) has identified declining asset quality as a concern.<sup>2</sup> India has had the most pronounced increase in NPLs in the region, with the aggregate NPL ratio rising to 4.2 per cent in late 2013 from a low of 2.3 per cent in 2009. Similarly, restructured loans increased to around 6 per cent of total loans in September 2013 from 2.5 per cent in June 2011. This suggests that more firms are having difficulty meeting their repayments than is implied by the NPL ratio alone.

In contrast to other Asian economies, credit growth in India had started to slow before the global financial crisis. The rise in NPL ratios and debt restructuring since 2009 has coincided with a slowdown in GDP growth. There is some evidence that credit appraisal standards may have eased during the earlier period of strong credit growth.<sup>3</sup> More recent increases in policy rates, aimed at addressing persistently high inflation and supporting the currency, could make debt servicing more difficult for some firms and households.

**Graph A1**  
**Asia – Non-performing Loans\***  
Share of loans



\* Definitions of 'non-performing' differ across jurisdictions; data are for year-end  
 \*\* Singaporean-owned banks only  
 \*\*\* Data for 2002–04 are for major commercial banks only  
 ^ Latest available data are for September 2013  
 Sources: CEIC Data; RBA; banks' annual reports; national banking regulators

1 Non-performing loans typically include loans more than 90 days in arrears or loans less than 90 days in arrears that are unlikely to be fully repaid. However, definitions differ so it may not be meaningful to compare the level of NPL ratios across economies.

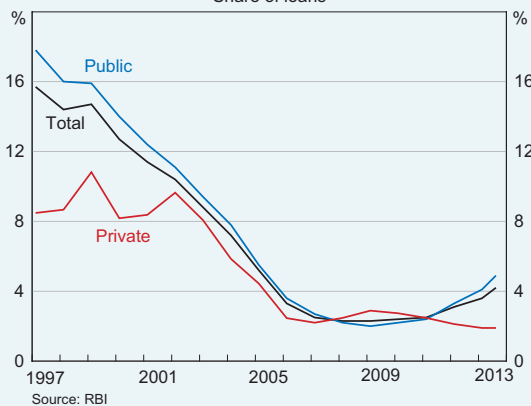
2 See, for example, Reserve Bank of India (2013), *Financial Stability Report*, December.

3 Lokare S (2014), 'Re-emerging Stress in the Asset Quality of Indian Banks: Macro-Financial Linkages', Reserve Bank of India Working Paper 03/2014.

The rise in NPLs has been driven by deteriorating asset quality at publicly owned banks (Graph A2). NPLs in the infrastructure sector have grown particularly quickly recently. Given the importance of infrastructure to development, Indian authorities provide incentives for banks to increase infrastructure lending. These projects typically only become cash flow positive towards the end of their life cycle and, for some, regulatory delays have made it harder to service their debt. Overall, the infrastructure, iron & steel, textiles, aviation and mining sectors together accounted for 53 per cent of non-performing or restructured loans in 2013, compared with 24 per cent of total loans.

Since 2008, the Indian Government has injected capital into public banks to help them absorb losses on bad loans and meet Basel III capital rules. The RBI also proposed a new framework for dealing with distressed assets in January.<sup>4</sup> The framework includes rules to ensure the timely recognition of bad assets, improve the efficiency of the restructuring process and support the sale of stressed assets.

**Graph A2**  
**India – Non-performing Loans**  
Share of loans

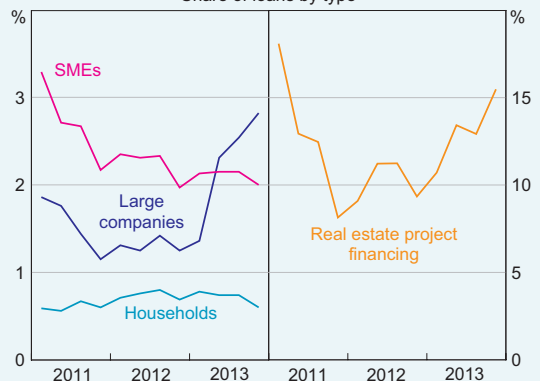


4 See RBI (2014), 'Early Recognition of Financial Distress, Prompt Steps for Resolution and Fair Recovery for Lenders: Framework for Revitalising Distressed Assets in the Economy', Reserve Bank of India, 30 January.

## Korea

The aggregate NPL ratio at Korean banks also increased in 2013, albeit from a low level. This has been driven by a rise in NPLs to large companies (Graph A3). Corporate failures of large enterprises have increased in recent years, particularly among firms in the shipping, shipbuilding and construction sectors. Demand for new vessels grew strongly alongside a boom in world trade before the global financial crisis, which spurred a significant increase in shipbuilding capacity. Following the crisis, a combination of an oversupply of ships, sharp declines in freight rates and higher fuel costs placed significant stress on shipping and shipbuilding firms. In the construction sector, the rise in problem loans has been driven by a sustained real-estate market downturn in the Seoul metropolitan area. As is often the case in the commercial real-estate sector, NPLs in 2013 have been concentrated among a few large firms. Within the construction sector, the NPL ratio for real estate project finance increased sharply in 2013. These loans accounted for around 10 per cent of Korean banks' NPLs in 2013, compared to less than 2 per cent of total loans.

**Graph A3**  
**South Korea – Non-performing Loans\***  
Share of loans by type



\* Domestic banks; substandard-and-below loans, which include loans overdue by more than three months, plus doubtful loans

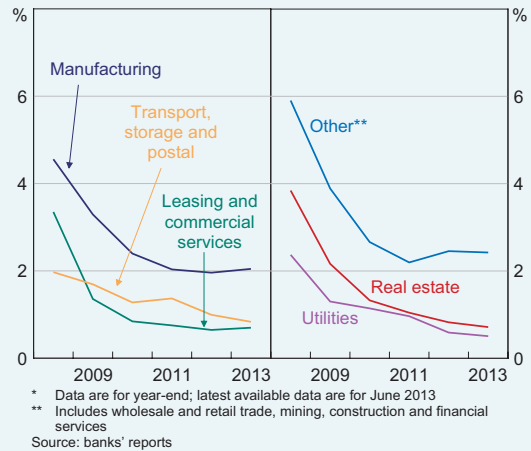
The increase in NPLs has been most pronounced at banks with substantial government ownership. Some market commentary has suggested that several of these banks may require capital injections if there is further corporate distress. In aggregate, banks' share-price-to-book-value ratios in Korea have increased over the past year, but remain below one.

While the NPL ratio for banks' loans to households remains low, it has risen for mortgages made by non-bank institutions such as mutual savings banks and credit cooperatives. In recent years, banks have reduced their exposure to higher-risk mortgages, which have increasingly become concentrated in non-bank financial institutions. In 2012, authorities introduced regulations for these institutions aimed at reducing their exposure, including higher risk weights for risky mortgages and a maximum loan-to-deposit ratio of 80 per cent. Household loan growth by non-bank institutions has since slowed substantially, but the NPL ratio for housing loans made by these institutions has increased amid the sustained fall in property prices in Seoul and slower growth in household incomes.

## China

While the aggregate stock of manufacturing NPLs in China has risen, the stock of loans has grown commensurately, leaving the corresponding NPL ratio broadly unchanged (Graph A4). Detailed data available for mid 2013 show that increasing NPL ratios have been confined to particular industries and regions, such as the Yangtze River Delta region, which has a large manufacturing industry. The increase in NPLs has centred on industries which

**Graph A4**  
**China – Non-performing Loans\***  
Large banks, share of loans



the People's Bank of China has identified as facing excess capacity, including the photovoltaic, steel, shipping, chemical and cement industries. The quality of infrastructure-related loans made to local governments has continued to attract scrutiny, and banks are commonly thought to be forbearing on part of these portfolios.

Chinese authorities have endorsed a range of options to address problem loans, including use of over-the-counter exchanges to help banks find buyers for problem assets and the creation of provincial 'bad banks' to purchase NPLs. New regulations have also been introduced that require banks to regularly report on their off-balance sheet exposures. That said, Chinese banks typically have high regulatory capital ratios, which suggest they ought to be well placed to absorb losses. ❖