

Banks

NIM compression on the cards

Over FY20 so far, we've seen divergent NIM trends, but most of our coverage banks saw NIM improve. The drivers of movement on either sides, however, varied vastly.

Banks' core spreads and NIMs are likely to compress in the near term. Our stance is premised on the following, (1) faster growth in high yielding segments which supported WALR (o/s) is likely to slow, this may be inferred from by the sharp dip in WALR (fresh) which has dipped sharply in Mar-20, (2) the effects of lower MCLR will become more pronounced, (3) external benchmark-linked loans will see a significant fall in yields and a gradual rise in share and (4) slower re-pricing of liabilities will limit benefits of lower TD rates although, SA rate cuts will provide some cushion here.

In the current environment, banks with a higher proportion of fixed rate loans and a stronger liability franchise are likely to be better off. Within our coverage, we believe RBK is set to see the highest NIM compression. KMB is best placed as it will benefit from a fund raise and sharp SA rate cut. We continue to prefer ICICIB and AXSB amongst the larger banks and CUBK amongst the smaller banks within our coverage.

An analysis of weighted average lending and deposit rates along with MCLR, yields the following trends:

- WALR (o/s) have remained fairly steady, dipping just 27bps (11bps in case of private banks) from Jan-19. The difference between WALR (o/s) and the repo has increased sharply (to 560bps and to 660bps in case of private banks). While this does hint at weak policy transmission, we believe that it could also reflect faster growth in high yielding retail loans during this period.
- WALR (fresh) have seen a sharper fall, down 114bps between Jan-19 and Mar-20. In case of private banks, the fall has been sharper and extremely recent (cumulative 140bps of which 98bps in Mar-20).
- Banks' 1 yr MCLR have trended downwards gradually over this period. However, the spread of WALR (fresh) over SCBs' median 1 year MCLR dipped sharply in Mar-20, esp. for private banks.
- WATDR have trended downward gradually, falling 51bps (70bps in case of private banks) between Jan-19 and Mar-20. The spread between WATDR and the repo widened between Mar-19 and Oct-19, after which it contracted until Feb-20.
- Banks have reduced their SA rates over the last few months. For e.g., most recently, SBIN has reduced its SA rate by 25bps to 2.75%, ICICIB by 25bps to 3.25% and KMB by a whopping ~150bps to 3.5% (starting SA rates).

Note:

WALR (o/s)- weighted average lending rates on o/s loans

WALR (fresh)- weighted average lending rates on fresh loans

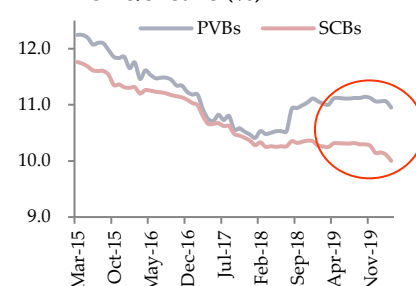
WATDR- weighted average term deposit rate

NIM trends over FY20/9MFY20

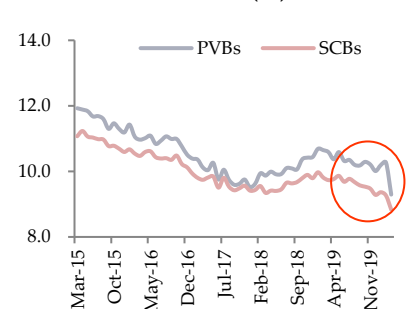
Bank	Trend
AUBANK	^
AXSB	^
CUBK	v
DCBB	v
FB	v
IIB	^
ICICIB	^
KMB	^
KVB	v
RBK	^
SBIN	^

Source: Banks, HSIE Research

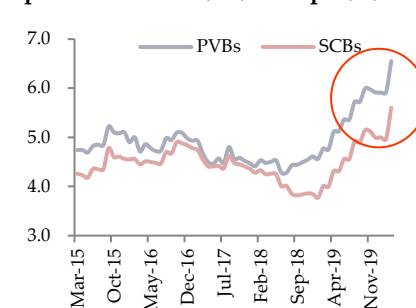
WALR on o/s loans (%)



WALR on fresh loans (%)



Spread of WALR (o/s) on repo (%)



Source: RBI, HSIE Research

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Recent NIM trends at our coverage banks

Over FY20, we've seen divergent trends on this front across our coverage. NIMs have moved either ways and the drivers vary considerably across banks.

Exhibit 3: Recent NIM trends and drivers

Bank	NIM (%)*	Trajectory	Driver
AUBANK	5.50	^	Book mix
AXSB	3.55	^	Book mix and CoF
CUBK	3.96	v	Declining yields (book re-pricing) and CD ratios
DCBB	3.64	v	Declining yields (book re-pricing) and CD ratios
FB	3.00	v	Declining yields (book re-pricing) and CD ratios
IIB	4.25	^	Book mix
ICICIBC	3.87	^	Book mix and CoF
KMB	4.72	^	Book mix and CoF
KVB	3.33	v	Declining yields (book re-pricing) and CD ratios
RBK	4.93	^	Book mix
SBIN	3.27	^	Recoveries and CoF

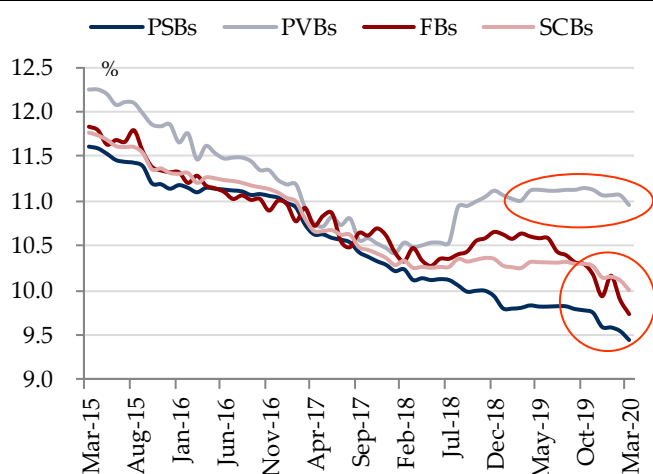
Source: Banks, HSIE Research, *Note: For 3/4QFY20

System level lending and deposit rate trends

An analysis of weighted average lending rates (on fresh and o/s loans), deposit rates, spreads and MCLR suggests the following:

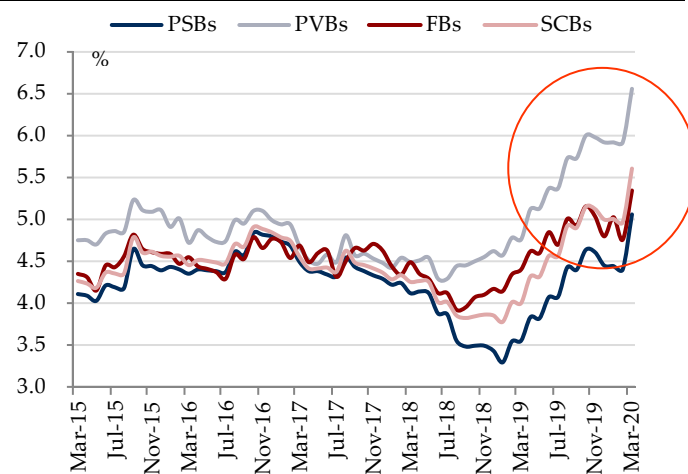
- **WALR (o/s)** have held their ground quite strongly (particularly in the case of private banks). This trend is particularly evident when the WALR (o/s) is viewed against the policy rate. WALR (o/s) have dipped 27bps since Jan-19 and 14bps since Sep-19 to ~10% in Mar-20 vs. the repo which dipped ~210bps. Private banks' WALR (o/s) dipped 11bps since Jan/Sep-19 to 11%. The difference between WALR (o/s) and the repo has increased considerably (to 560bps and to 660bps in case of private banks).
- We hypothesise that faster growth in higher yielding retail segments by private banks is responsible for this trend.

Exhibit 4: WALR (o/s)



Source: RBI, HSIE Research

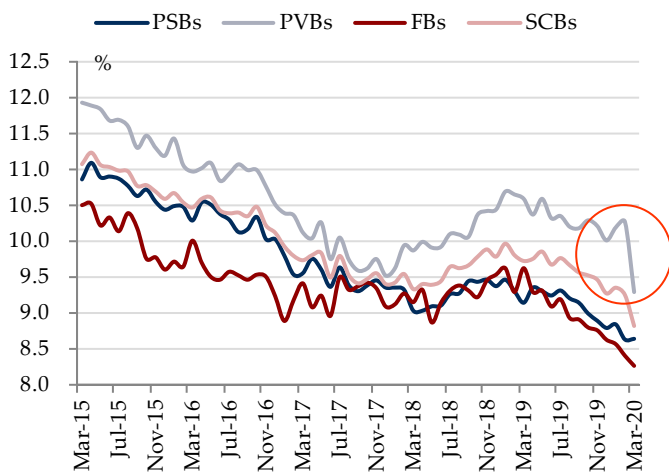
Exhibit 5: Spread of WALR (o/s) over the repo



Source: RBI, HSIE Research

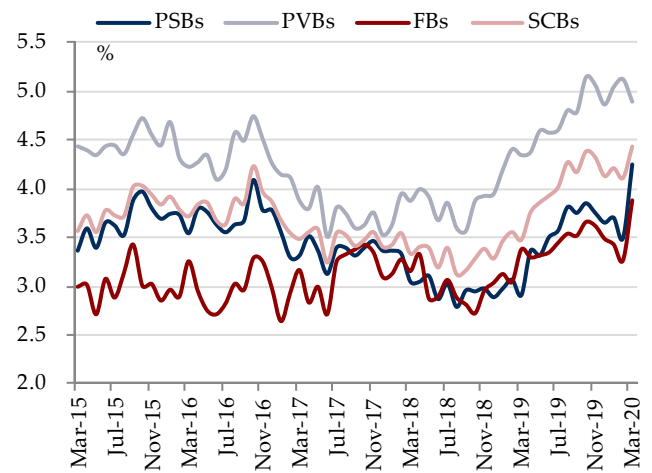
- **WALR (fresh)** expectedly registered a greater decline vs. WALR (o/s). WALR (fresh) dipped 114bps between Jan-19 and Mar-20 and in the case of private banks, WALR (fresh) dipped 140bps during the corresponding period. However, one must note that the dip in case of private banks has been very recent (98bps out of 140bps between Feb-20 and Mar-20 alone).
- Here too, we believe faster growth in higher yielding segments supported WALR (fresh). Mar-20 sectoral deployment figures suggest decisively slower growth in these sectors. We believe that this, along with the pent-up effect of MCLR cuts resulted in the sharp fall in WALR (fresh).
- The difference between WALR (fresh) and the repo has increased sharply (to 440bps and to 430bps in case of PSBs). IN the case of private banks, the spread has dipped by 20bps MoM to 490bps.

Exhibit 6: WALR (fresh)



Source: RBI, HSIE Research

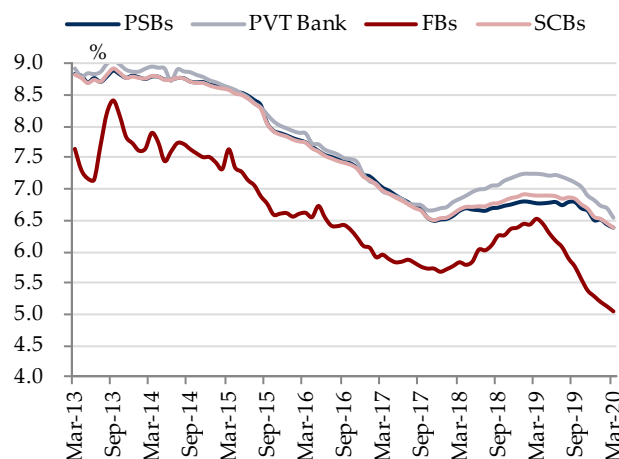
Exhibit 7: Spread of WALR (fresh) over the repo



Source: RBI, HSIE Research

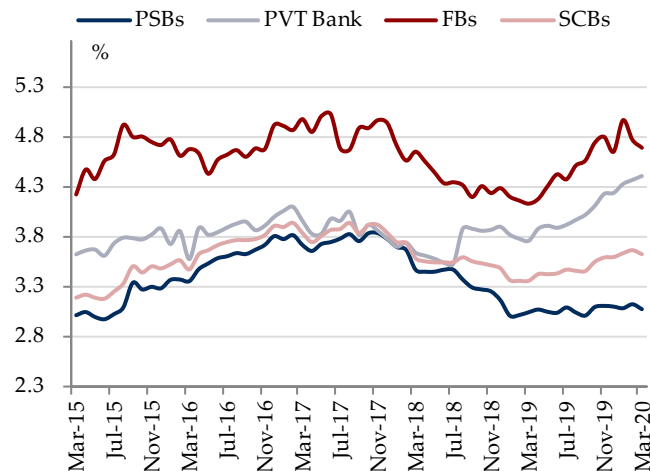
- **Weighted average term deposit rates (WATDR)** have trended down, falling 53/46/7bps between Jan/Sep-19/Feb-20 and Mar-20. Private banks registered a 70/56/15bps fall during the corresponding period. The fall in WATDR has been lesser than the fall in WALR (fresh) but greater than the fall in WALR (o/s).
- The spread between WATDR and the repo trended upward between Mar-19 and Oct-19 to 1.6% and then trended downward to 1.3% in Feb-20. Following the sharp rate cut in Mar-20, it expanded again to 1.98%.
- Banks have reduced their SA rates over the last few months. For e.g., most recently, SBIN has reduced its SA rate by 25bps to 2.75%, ICICIB by 25bps to 3.25% and KMB by a whopping 150bps to 3.5% (starting SA rates).

Exhibit 8: WATDR



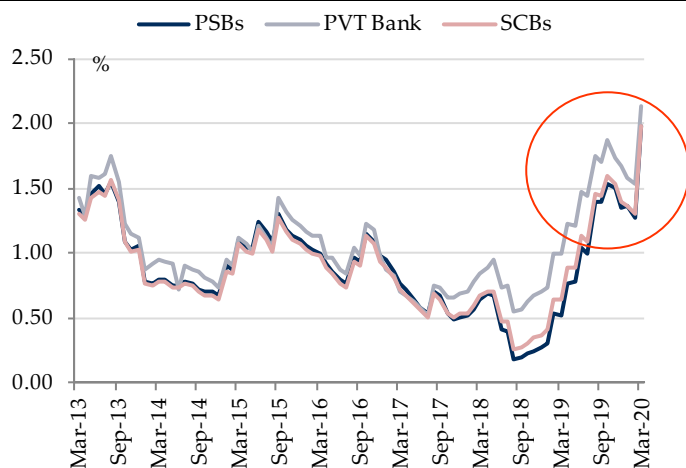
Source: RBI, HSIE Research

Exhibit 9: WALR (o/s) spread over WATDR



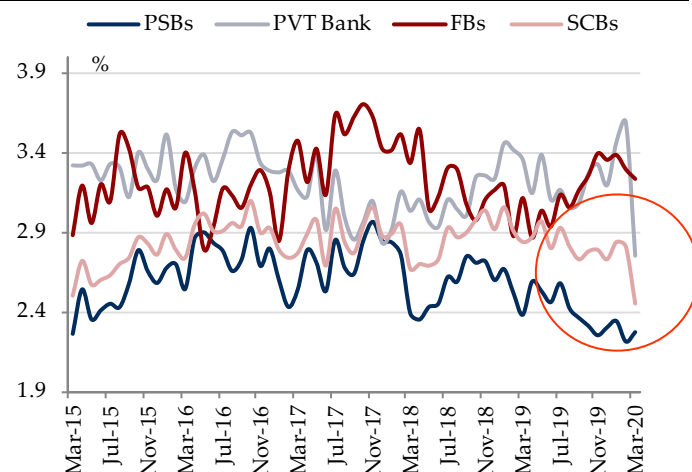
Source: RBI, HSIE Research

Exhibit 10: WATDR spread over the repo



Source: RBI, HSIE Research

Exhibit 11: WALR (fresh) over WATDR



Source: RBI, HSIE Research

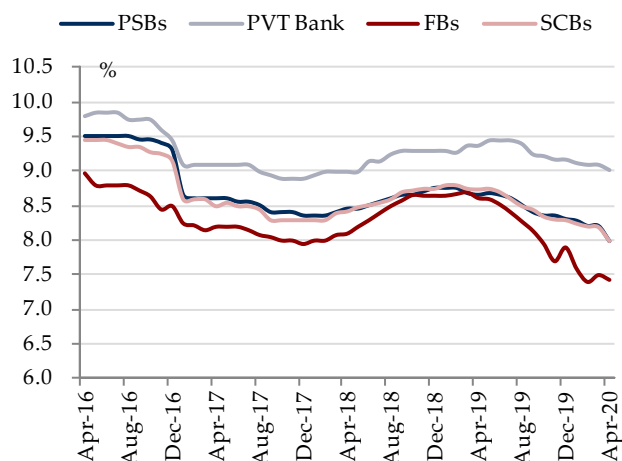
Exhibit 12: Recent change in SA rates (for lowest bracket)

Bank	SA rate	Δ	Date
AUBANK	4.00%		25-May-20
AXSB	3.50%		01-Jan-20
CUBK	4.00%		01-Apr-20
DCBB	4.00%		
FB	Repo-165bps		26-May-20
IIB	4.00%		
ICICIBC	3.25%	-0.25%	09-Apr-20
KMB	3.50%	-0.25%	25-May-20
KVB	3.50%		21-May-20
RBK	5.00%		01-Oct-19
SBIN	2.75%	-0.25%	15-Apr-20

Source: Banks, HSIE Research

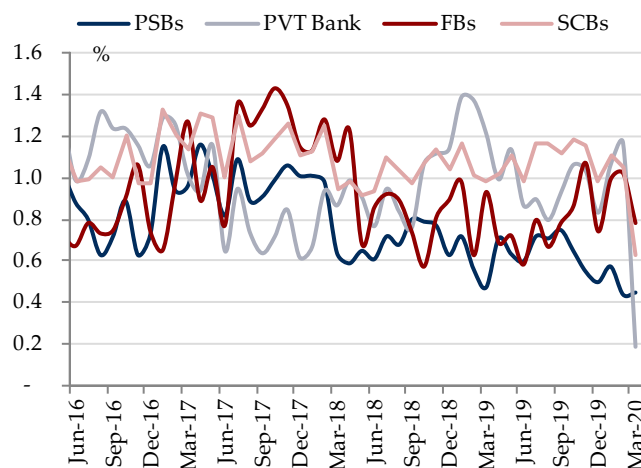
- The **median 1 year MCLR** fell by 80/45/20bps for all categories of banks between Jan/Sep-19/Feb-20 and Mar-20. Private banks' MCLR's were even stickier and they fell by just 28/25/10bps. These trends reconcile with those of WALR (o/s) but are slightly divergent from those seen in case of WALR (fresh). A comparison between WALR (o/s) and median 1 year MCLR's does not show any meaningful trends. However, the spread between WALR (fresh) and median 1 year MCLR's has compressed significantly These could possibly be explained by changes in the incremental lending mix.

Exhibit 13: Median 1 year MCLR's



Source: RBI, HSIE Research

Exhibit 14: WALR (fresh) spread over 1 year MCLR's



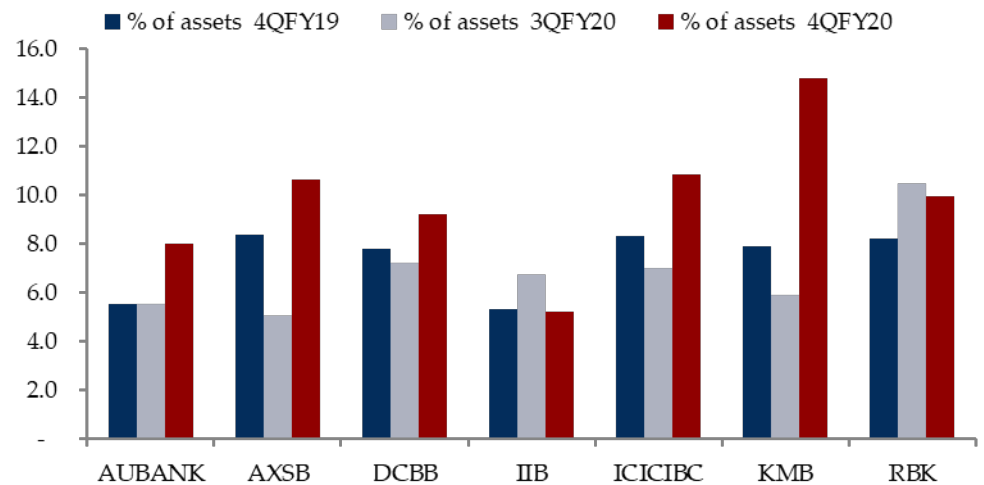
Source: RBI, HSIE Research

Exhibit 15: Recent MCLR trends across banks

Bank	1 yr MCLR Apr-20 (%)	Change since (bps)		
		Mar-20	Sep-19	Jan-19
AXSB	7.95	15	50	90
BOB	8.00	15	40	65
CBK	7.85	35	55	85
CUBK	8.50	50	50	80
DCBB	9.50	7	50	69
FB	8.60	20	38	60
IIB	9.25	0	30	65
ICICIBC	8.00	15	55	80
KMB	8.10	25	65	90
KVB	9.40	0	5	25
PNB	7.75	30	55	75
RBK	9.35	10	60	90
SBIN	7.40	35	75	115
UNBK	7.75	25	69	95

Source: RBI, HSIE Research

- Within our coverage, all banks (which have declared results so far) have reported a rise in their stock of liquid assets. Banks are likely to continue to maintain a higher proportion of liquid assets.

Exhibit 16: Banks' liquid assets as a % of total assets

Source: Bank, HSIE Research

Outlook

Based on our analysis of system level data on bank lending and deposit rates and bank credit growth, we expect banks' core spreads and NIMs to compress in the near term. WALR (o/s) are likely to see a meaningful decline. While WATDR too are likely to trend downward, the effect on overall CoD/CoF will be visible with a lag. Sluggish loan growth is likely to limit CD ratios and banks are likely to stock up on liquid assets, dragging overall yields further. Our stance is premised on the following:

- Faster growth in high yielding retail loans which had been supporting WALR (o/s) is likely to slow. Consequently, the support to overall yields will lessen considerably. This will also allow the pent-up and potential effects of MCLR reductions to become more noticeable.
- The sharp decline in WALR (fresh) seen between Feb-20 and Mar-20 may be evidence of this. The effect of this fall will become more pronounced in terms of WALR (o/s) with the passage of time.
- Higher potential slippages will also exert some downward pressure on yields on advances in the near term.
- While WATDR is likely to fall, on an o/s basis, the fall is unlikely to be commensurate as the assets side of the b/s is likely to be re-priced faster.
- Recent SA rate cuts will have some cushioning impact.
- An increase in the proportion of low yielding liquid assets will also drag margins.
- Banks with a higher proportion of fixed rate loans and strong liability franchises are better off in the current environment.

Peer set comparison

	MCap (Rs bn)	CMP (Rs)	Rating	TP (Rs)	ABV (Rs)			P/E (x)			P/ABV (x)			ROAE (%)			ROAA (%)		
					FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
AUBANK	120	395	ADD	549	124	137	163	19.2	18.9	15.6	3.07	2.78	2.34	16.6	13.3	14.1	1.61	1.35	1.39
AXSB	1,093	387	BUY	541	268	292	341	63.9	11.2	8.4	1.38	1.26	1.07	2.1	10.4	12.4	0.19	0.98	1.20
CUBK	92	125	BUY	176	66	72	83	12.1	12.2	11.4	1.89	1.73	1.50	14.6	12.7	12.1	1.61	1.47	1.43
DCBB	19	62	ADD	100	93	94	114	5.7	6.4	5.0	0.67	0.66	0.55	10.3	8.5	9.9	0.91	0.76	0.89
FB	81	41	BUY	71	65	67	77	5.1	4.9	4.8	0.63	0.61	0.53	11.5	10.8	10.2	0.95	0.89	0.84
ICICIB	2,064	319	BUY	442	155	173	201	16.5	9.0	7.2	1.30	1.13	0.96	6.3	10.9	12.1	0.77	1.23	1.39
IIB	261	369	ADD	575	459	512	575	5.8	8.9	6.3	0.80	0.72	0.64	14.7	8.1	10.2	1.51	0.93	1.21
KMB	2,407	1,217	ADD	1,282	240	292	330	29.9	30.1	25.6	3.87	3.28	2.80	13.6	11.6	11.1	1.78	1.67	1.75
KVB	19	23	REDUCE	33	56	53	62	7.9	4.7	4.0	0.42	0.44	0.38	3.7	6.0	6.9	0.33	0.53	0.59
RBK	60	118	REDUCE	136	185	194	215	11.9	12.3	7.3	0.64	0.61	0.55	5.6	4.5	7.2	0.60	0.53	0.84
SBIN	1,415	159	BUY	316	179	183	227	2.7	2.2	1.7	0.27	0.26	0.21	7.0	8.2	9.6	0.43	0.50	0.60

Source: Banks, HSIE Research, #Adjusted for subsidiaries

Rating Criteria

BUY: >+15% return potential
 ADD: +5% to +15% return potential
 REDUCE: -10% to +5% return potential
 SELL: >10% Downside return potential

Disclosure:

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