# Indian Financial Services

## On Bank Street - Vol 140

India
Banks

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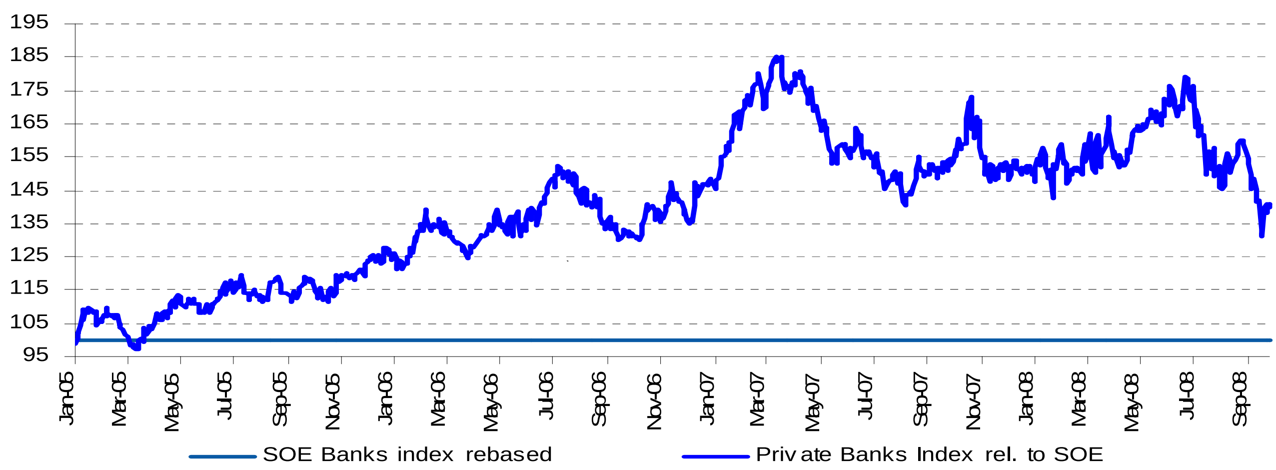
- **News flash – SBI** has introduced a 1,000-day deposit rate of 10.5%, a full 100bp increase from the earlier rate of 9.5% for 2-3 year deposits.
- The **government** plan to auction bonds worth Rs390B in October-December to finance its deficit.
- **Banks'** credit growth rises 26% yoy to Rs24.91T despite RBI measures.
- The **government** is looking to sell up to a $1.2B stake in **Axis Bank**
- **RBI** is keeping close watch on use of LAF funds.
- **HDFC's** credit growth drops to 22% vs. 27% a year ago.
- **Banks** plan to tighten lending rules for all types of loans including housing, auto and personal loans.
- **PNB** stops offering loans against property; other banks also slow down.
- The **Private Bank Index** and the **SOE Banks Index** declined 7.6% and 7.8%, respectively, vs. a 6.7% decline for the **Sensex.** Biggest losers—**SOE banks:** Canara down 15.9%, and IOB down 10.5%. **Private banks:** ICICI down 10.7% and YES down 10.1%.

Figure 1: Private Banks Index relative to SOE since January 2005




Source: Bloomberg, J.P. Morgan.

See page 13 for analyst certification and important disclosures, including non-US analyst disclosures.

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### Stock Price Performance

| | 26-Sep | Chg |
|---|---|---|
| SOE | | |
| BOB | 293 | -9.4% |
| CBK | 191 | -15.9% |
| PNB | 473 | -9.8% |
| SBIN | 1,435 | -8.4% |
| UNBK | 144 | -5.0% |
| ALBK IN Equity | 65 | 1.3% |
| BOI IN Equity | 276 | -2.6% |
| IOB IN Equity | 97 | -10.5% |
| SNDB IN Equity | 67 | 4.2% |
| | | |
| Private | | |
| HDFC | 2,091 | -9.8% |
| HDFCB | 1,245 | -4.2% |
| ICICIBC | 560 | -10.7% |
| IDFC | 74 | -9.6% |
| YES | 125 | -10.1% |
| DEVB IN Equity | 38 | -7.0% |
| KBL IN Equity | 134 | -7.4% |
| | | |
| Sensex | 13,102 | -6.7% |
| SOE Bank Index | | -7.8% |
| Pvt Bank Index | | -7.6% |

Source: Bloomberg, J.P. Morgan estimates.
Change in prices is weekly.

### ADR/GDR (USD)

| | 26-Sep | Chg | Prem |
|---|---|---|---|
| HDFCB | 91.49 | 0.9% | 13.93% |
| ICICIB | 24.94 | -10.9% | 3.46% |
| SBI | 62.00 | -7.5% | 0.45% |
| AXIS | 15.60 | 4.3% | 2.87% |

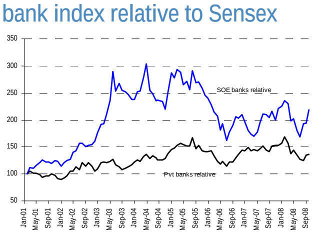
Source: Bloomberg, J.P. Morgan estimates.
Change in prices is weekly.

### Others

| | 26-Sep | Chg |
|---|---|---|
| 10 year yield | 8.45 | 0.05 |
| Rs/US$ | 46.52 | 0.83 |
| Brent (US$/bbl) | 102.03 | 4.13 |
| Inflation* | 12.14 | 0.00 |

Source: Bloomberg, J.P. Morgan estimates.
Change in prices is weekly.
*Inflation data is for week ended 13 Sep 2008.

Figure 2: SOE bank and private bank index relative to Sensex




Source: Bloomberg, J.P. Morgan estimates.

# On Bank Street

We are happy to present you with our banking news digest for the week ended 26 September 2008.

## Sector news

1. Govt to auction bonds worth Rs 390 bn in Oct-Dec
2. Banks now have less bonds to pledge
3. Bank credit growth rises 26% despite RBI measures
4. Govt selling up to $1.2 bn stake in axis bank
5. Bond yields up on Govt borrowing plan
6. Corporate investors shy away from fmps
7. BIG 9's $420 MN TRAPPED IN US ST COLLAPSE
8. Banks permitted to use floating provisions
9. Banks forced to offer 12% on bulk deposits
10. India Inc may have to live with higher loan rates
11. RBI keeps close watch on use of LAF funds
12. Crisis-wary banks to tighten lending rules, hike rates
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Valuation

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## Sector news

**Govt to auction bonds worth Rs 390 bn in Oct-Dec (Sep 26 BS)** ***Top***

Government will sell bonds worth Rs 390 bn between October and mid-December this year to finance deficits. The government will hold auctions for Rs 100 bn of bonds each between October 3-10, October 17-24 and October 31-November 7, according to the indicative borrowing calendar released by the Finance Ministry today. There will be further auctions of Rs 60 bn of bonds between November 14-21 and Rs 30 bn between December 5-12. After today's auction of Rs 100 bn worth of bonds, government has borrowed Rs 1,060 bn in the first half of 2008-09.

**Banks now have less bonds to pledge (Sep 25 ET)** ***Top***

Banks' bond portfolio is gradually shrinking as loans continue to post a strong growth. Their investment deposit ratio for the first time dipped below 30% by mid-September. Many banks have lesser surplus bonds to pledge, against which they borrow from the market, or the central bank to meet their daily cash requirement. With more non-bank participants like insurance companies, bond houses and provident funds lapping up the bonds issued by the government, it could well be the time to bring down the statutory bond holding (statutory liquidity ratio-SLR) limit from the current 25% of deposits. RBI has already allowed banks the flexibility to borrow by pledging their bonds. It has allowed a leeway of 1% for their SLR, effectively bringing down the SLR to 24%.

**Bank credit growth rises 26% despite RBI measures (Sep 25 BS)** ***Top***

RBI on Wednesday said the flow of credit from SCBs including regional rural banks, went up by 26% on a year-on-year basis to Rs 24.91 trillion as of September 12 this year, as against Rs 19.76 trillion. The growth is higher than the 23.4% reported in the corresponding period last year and also more than the 20% non-food credit growth being targeted by RBI this year. Despite repeated rate hikes, credit growth has hovered around the 25% mark. The rise in bank credit is attributed to high demand for funds from oil firms and the infrastructure sector. The RBI data also said that the deposits with scheduled commercial banks till September 12 rose 22.5% to Rs 34.05 trillion from Rs 27.80 trillion in the same period last year. The growth in deposits is also higher than the RBI target of 17%. This includes demand deposit with a tenure of up to one year, which rose 21.5% to Rs 4.68 trillion and time deposit by 23% to Rs 29.36 trillion.

**Govt selling up to $1.2 bn stake in axis bank (Sep 25 ET)** ***Top***

An Indian government agency is selling a stake worth roughly $1.2 billion in private sector lender Axis Bank. The Administrator of the Specified Undertaking of the Unit Trust of India, known as SUUTI, has tapped Citigroup, JP Morgan and ICICI Securities to sell a 21% stake in the lender. An investor roadshow began on Tuesday in Dubai and was scheduled to continue on Wednesday in Dubai and Abu Dhabi.

**Bond yields up on Govt borrowing plan (Sep 25 Mint)** ***Top***

The yield on 10-year securities rose to 8.64% on Wednesday, after the Union government said it would auction two long-term papers worth Rs 100 bn, before closing at 8.62%. After the stock markets closed on Tuesday, the government announced it would sell Rs 60 bn of 7.94% 2021 bonds and Rs 40 bn of 8.28% 2032 bonds, in an auction on 26 September. On Tuesday, the 10-year paper had closed with yield at 8.44%. Bond yield and price move in opposite directions. The government had exhausted its first round of market borrowing of Rs 960 bn and not

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announced its second borrowing schedule. It plans to borrow Rs 1.45 trillion from the market for expenses. Bond dealers were caught by surprise at the auction announcement as the market already has an acute liquidity shortage. RBI is infusing some Rs 600 bn a day into the system for the past eight days.

**Corporate investors shy away from FMPs (Sep 25 ET)** ***Top***

Once a hit with investors, especially corporates, fixed maturity plans (FMPs) seem to have fallen out of favour. The turbulence in the global financial markets and worries over the credit quality of some assets in the portfolio of FMPs have prompted a few large corporate investors to move to safer investment options such as fixed deposits. The product was attractive, considering that it offered a better yield compared to fixed deposits in a rising interest scenario without any major risks. The fact that FMPs were a hit, especially with corporate treasuries, is reflected in the assets under management in this category which stand at over Rs 1,000 bn. The Indian mutual fund industry manages assets close to Rs 5.5 trillion.

**Big 9's $420 mn trapped in US st. collapse (Sep 23 ET)** ***Top***

Nine of the country’s largest commercial banks including State Bank of India (SBI), ICICI Bank and HDFC Bank have exposure of $420 million in the US financial giants which collapsed recently. The government feels banks other than SBI would suffer losses of Rs 6 bn due to the crisis. According to preliminary estimates, SBI alone has exposure of $170 million in Freddie Mac and Fannie Mae. The public sector giant’s exposure in Lehman Brothers is estimated at $17 million. ICICI Bank (UK) has invested $83 million in senior bonds of Lehman Brothers. The MTM loss to ICICI Bank due to the recent downturn would be $71.25 million. Union Bank of India has a large exposure to Merrill Lynch. The bank has given a Rs 3bn line of credit and a Rs 1 bn term loan to DSP Merrill Lynch Capital. Merrill Lynch holds 89.7% in the NBFC. Bank of India through its overseas subsidiary, is expected to suffer an MTM loss of Rs 457.1 mn on derivative deals with Lehman Brothers on its exposure of $10 million through floating rate notes. PNB would suffer a loss of Rs 360 mn if its four derivative deals with Lehman are settled prematurely. In addition, PNB’s UK subsidiary has invested in credit-linked notes of $5 million in Lehman Brothers. HDFC Bank is expected to suffer Rs 170 mn MTM loss because of its rupee swap and forex option deals with Lehman Brothers.

**Banks permitted to use floating provisions (Sep 23 BS)** ***Top***

RBI has allowed banks to use floating provisions held for the advances portfolio to meet the interest/charges arising out of agricultural debt waiver and debt relief scheme. Floating provisions are free reserves earned in profitable times maintained by banks for the provisioning requirement in the future.

**Banks forced to offer 12% on bulk deposits (Sep 23 ET)** ***Top***

Tight liquidity conditions have forced banks to offer 12% on three-month bulk deposits, way above 7% offered on retail deposits. The spread between retail and bulk deposits is lower on one-year deposits with banks offering between 11.75% and 11.80% on bulk deposits against 10% on retail. Treasury heads blame tight liquidity condition to global meltdown and quarterly tax flows, which were in the region of Rs 250 bn. Aggressive bidding for bulk deposits is despite dictates from government to state-owned corporates not to invite for at least 60% of their deposits. Instead, these corporates have been asked to roll over their deposits. However, not many corporates seemed to have toed the lines.

**India Inc may have to live with higher loan rates (Sep 22 BS)** *Top*

After a gap of almost five years, banks have started charging benchmark prime lending rate (PLR) for loans extended to some of the top corporates. Till now, top-notch corporates could borrow at rates below prime—a negotiated rate which is well below PLR. But not any longer, thanks to tight liquidity conditions in the money market. Since the time the Reserve Bank of India (RBI) allowed banks to lend below PLR, the best-rated borrowers have availed of loans at sub-PLR rates. Last week, a large state-owned bank disbursed loans to a top-rated automobile company and an airline company at PLR which is 14%, a banker close to the development said.

**RBI keeps close watch on use of LAF funds (Sep 22 BS)** *Top*

Regulator wants to know if banks deploy the money to meet lending needs. After a week marked with tight liquidity and volatility in the financial markets, the RBI is watching how banks are deploying the funds raised through the repo window. RBI is checking if banks used the liquidity adjustment facility (LAF) for raising resources to meet short-term lending needs or pay off high-cost bulk deposits. Though it was quite difficult to pinpoint the end-use of funds, the scan was a part of regulatory monitoring to reduce prospects of directing the money for purposes other than meeting temporary cash needs. Bankers said the central bank might be worried that the steps taken by it so far had not eased the liquidity situation and that call rates remained high.

**Crisis-wary banks to tighten lending rules, hike rates (Sep 22 ET)** *Top*

Bankers plan stricter lending norms soon for all types of loans including housing, auto and personal. Banks may also follow more stringent norms for deciding the creditworthiness of individuals and corporates so that they do not run into a Lehman-like crisis. Banks also plan to hike deposit rates to mobilise liquidity. This will result in an increase in lending rates. Bankers feel interest rates may go up even if RBI refrains from hiking key rates in the October credit policy review.

**Higher CRR forcing SLR kitty drawdown (Sep 22 ET)** *Top*

Higher cash reserves requirement for banks imposed by central bank is now taking its toll on their statutory bond portfolio. Fund-starved banks are offloading their stock of bonds to finance loans. Many banks could well have breached their minimum mandatory holdings level of 25% of deposits. According to the latest Reserve Bank of India data, the investment-deposits ratio has slipped from 31.3% in early April to 30.3% at the end of August. Though the level of bonds for the entire banking system as a whole is much higher than the stipulated SLR of 25% of the total deposits, what is worrying is that some banks could have breached this threshold as bond investments are sliding this year.

## Private Banks

**AGM clears way for CSB takeover by Federal Bank (Sep 26 ET)** ***Top***

The unanimous appointment of five directors on the board of the Thrissur-based Catholic Syrian Bank Ltd (CSB) at its AGM on Friday appears to have cleared the decks for its possible takeover by Federal Bank Ltd, also a Kerala-based private bank, which holds a 4.99% stake in CSB. According to S. Santhanakrishnan, a director of Federal Bank who was present at the AGM, the no-contest nomination at the AGM is an indication of "the smoother things to follow".

**ING Vysya focusing on retail banking, expansion (Sep 26 ET)** ***Top***

Private sector lender ING Vysya Bank on Friday said it is focusing on retail banking and was in an expansion mode. The bank's focus is on retail banking and expansion to increase its footprint. The bank has received the RBI approval for opening 56 new branches and 100 ATMs.

**Bank slump may go on for 2 yrs: ICICI Bank-ED (Sep 26 FE)** ***Top***

ICICI Bank executive director V Vaidyanathan has said that the current slowdown witnessed in the Indian banking space could continue for the next 18-24 months. "Since most Indian banks including ICICI Bank have already tightened their credit norms and the retail borrowers too are currently not opting for huge amount of loans across various segments, the credit off-take has relatively slowed down in the last quarter of the current fiscal. Mortgage loan business also witnessed a considerable slowdown as sales in the property market have dipped in the recent past," said Vaidyanathan. He said that contrary to the phenomenon earlier, retail customers now a days are trying their best not to take bank loans by putting personal equities in their buy transactions as much as possible. "However, the current scenario in the country is not going to affect our branch expansion strategy that is expected to boost our CASA base" he said.

**Use swaps to gain from vanishing int. rate spread: HDFC Bk. (Sep 25 Mint)** ***Top***

India's five-year borrowing costs are set to climb faster than one-year rates as the government increases debt sales and investors should use swaps to profit from the move. Five-year rates, currently lower than shorter-term costs, will rise more as the government needs to fund higher spending before general elections due in seven months. Traders should enter two simultaneous swap contracts, agreeing to make five-year fixed-rate payments in exchange for a floating rate in one and doing an opposite in the one-year segment.

**HDFC credit growth drops to 22% (Sep 25 FC)** ***Top***

HDFC, the largest housing sector lender in the country, is witnessing a slowdown in credit disbursal in the current financial year. The company has so far seen a credit growth of close to 22% in the current financial year against 27% a year ago. The fall in credit off-take is mainly attributed to higher interest rate in the country. HDFC has close to 40% market share in home finances. When asked if the upcoming festive season is likely to bring some hope in the real estate sector, Renu Karnad said that there were hopes of a minor recovery. However, she ruled out any substantial change in the scenario."Prices of residential flats have been kept abnormally high and unless the real estate developers reduce their profit margin, which is very high at present, no major spurt in demand is likely to be seen," she added.

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## SOE Banks

**PNB brakes on loans against property (Sep 25 ET)** ***Top***

Banks have started taking proactive measures to prevent defaults in their real estate portfolio by cutting exposure to loans against property. Punjab National Bank has taken a lead and has stopped giving such loans, while Bank of India, Bank of Baroda and Indian Overseas Bank have decided to go slow on such loans. While banks have always been cautious and selective on real estate loans, this is the first time a bank has taken a decision to avoid this business. Banks' real estate exposure includes loan against property, and loans to builders. Although home loans are a part of real estate exposure most of them constitute priority sector loans and are not a part of bank's exposure to sensitive sector.

**SBI plans aggressive foreign expansion, buyout on agenda (Sep 23 FE)** ***Top***

State Bank in India has drawn up an aggressive blueprint, which marks possible acquisitions, to expand its operations overseas. A senior executive of the bank's international banking division told FE that SBI is vetting a series of acquisition proposals in a bid to penetrate an unexplored market that has a high density of non-resident Indian population. The SBI executive, who preferred not to be named, said, "Such an acquisition could happen in Europe or North America where many banks are currently available at attractive valuations. The bank is also aiming for increased presence in Africa and the Middle East."

**Syndicate Bank puts QIP on hold (Sep 23 BS)** ***Top***

Syndicate Bank, the Manipal-headquartered public sector lender, has put on hold its plan to raise Rs 8 bn through a qualified institutional placement (QIP) and medium-term note (MTN), following unfavourable market conditions and the global financial crisis. The bank, however, plans to raise around Rs 500-600 bn to augment its tier-II capital in the domestic market. The bank is yet to get an approval from the finance ministry for its proposed QIP issue. The bank aims to go in for fund-raising some time during the fourth quarter of the current financial year.

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# Appendix 1

## *Valuations*

Top

Indian Financials – Valuation Summary

| | Price | Target | Upside | Stock | Earnings growth (%) | | | ROE (%) | | | P/E (x) | | P/B (x) | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | (Rs) | Price (Rs) | (%) | Rating | 2008E | 2009E | 2010E | 2008E | 2009E | 2010E | 2009E | 2010E | 2009E | 2010E |
| SOE Banks | | | | | | | | | | | | | | |
| Bank of Baroda | 293 | 420 | 43% | N | 41.2% | 14.1% | 26.5% | 15.7% | 15.8% | 17.5% | 6.5 | 5.1 | 0.96 | 0.84 |
| Canara Bank | 191 | 201 | 6% | UW | 6.9% | 15.9% | 12.6% | 13.8% | 14.3% | 14.3% | 4.4 | 3.9 | 0.60 | 0.53 |
| Punjab National Bank | 473 | 678 | 43% | OW | 21.9% | 27.6% | 21.0% | 16.8% | 18.5% | 19.1% | 6.2 | 5.1 | 1.07 | 0.91 |
| State Bank of India | 1435 | 2847 | 98% | OW | 26.4% | 35.3% | 25.9% | 15.5% | 15.4% | 16.9% | 9.7 | 7.7 | 1.41 | 1.22 |
| State Bank of India (Consol) | 1435 | 2847 | 98% | OW | 20.0% | 33.7% | 25.9% | 16.4% | 16.6% | 18.0% | 7.4 | 5.8 | 1.14 | 0.98 |
| Union Bank of India | 144 | 228 | 58% | OW | 38.7% | 24.5% | 20.9% | 20.7% | 21.8% | 22.1% | 5.0 | 4.1 | 1.00 | 0.84 |
| Allahabad Bank | 65 | 91 | 41% | UW | 10.3% | -3.2% | 14.5% | 17.2% | 14.6% | 14.9% | 3.6 | 3.1 | 0.50 | 0.44 |
| Bank of India | 276 | 380 | 38% | N | 32.4% | 34.0% | 24.6% | 22.6% | 23.8% | 24.0% | 6.8 | 5.4 | 1.46 | 1.18 |
| Indian Overseas Bank | 97 | 228 | 134% | OW | 10.8% | 18.5% | 26.5% | 25.2% | 24.3% | 25.1% | 4.0 | 3.2 | 0.89 | 0.72 |
| Syndicate Bank | 67 | 96 | 44% | UW | -14.4% | 26.7% | 18.3% | 16.5% | 16.9% | 17.5% | 4.5 | 3.8 | 0.71 | 0.62 |
| Private Banks | | | | | | | | | | | | | | |
| HDFC Bank | 1245 | 1150 | -8% | N | 19.2% | 16.8% | 45.3% | 16.2% | 13.1% | 15.9% | 26.1 | 18.0 | 3.06 | 2.68 |
| HDFC | 2091 | 3240 | 55% | OW | 46.2% | 0.8% | 26.2% | 27.8% | 20.0% | 21.6% | 22.9 | 18.1 | 4.24 | 3.65 |
| ICICI Bank | 560 | 965 | 72% | OW | 19.5% | -11.6% | 62.6% | 11.7% | 8.5% | 12.8% | 15.3 | 9.4 | 1.27 | 1.15 |
| YES Bank | 125 | 260 | 109% | OW | 102.4% | 53.5% | 60.0% | 19.0% | 19.4% | 23.3% | 11.7 | 7.3 | 1.93 | 1.52 |
| Development Credit Bank | 38 | 98 | 156% | N | 433.9% | 129.6% | 31.8% | 9.3% | 14.6% | 16.7% | 6.2 | 4.7 | 0.85 | 0.74 |
| Axis Bank | 705 | 750 | 6% | OW | 28.0% | 42.0% | 46.9% | 17.6% | 16.2% | 20.2% | 16.6 | 11.3 | 2.51 | 2.10 |

Source: Bloomberg, J.P. Morgan.
Prices as of 26-Sep, annual data represents financial year ending March

## *Macro Indicators*

Table 1: Loan, Deposit growth

Top

| As at Sep-12-2008 | |
|---|---|
| Loan Growth (yoy) | 25.6% |
| Deposit Growth (yoy) | 22.5% |
| Incremental LDR | 81.0% |
| LDR | 73.2% |

Source: RBI, J.P. Morgan.
Note: YoY growth rates have been computed by taking 14 Sep 2007 as the base date

Table 2: Interest Rates

Top

| Yields | 26-Sep | 1M Chg | 3M Chg | 12M chg |
|---|---|---|---|---|
| 3m T Bill | 8.40 | -0.62 | -0.48 | 1.33 |
| 10 year g sec | 8.45 | -0.36 | -0.17 | 0.51 |
| 1 year AAA corp | 11.29 | 0.16 | 0.69 | 2.49 |

Source: Bloomberg.

Table 4: Bank ETFs

Top

| Name | AUM (Rs MM) | B'berg Ticker |
|---|---|---|
| BEES | 26,694 | BBEES IN Equity |
| PSU-BEES | 1,214 | PSUBBE IN Equity |
| Kotak PSU | 331 | KOPSUB IN Equity |

Source: Bloomberg. Note: AUM as of Aug-08.

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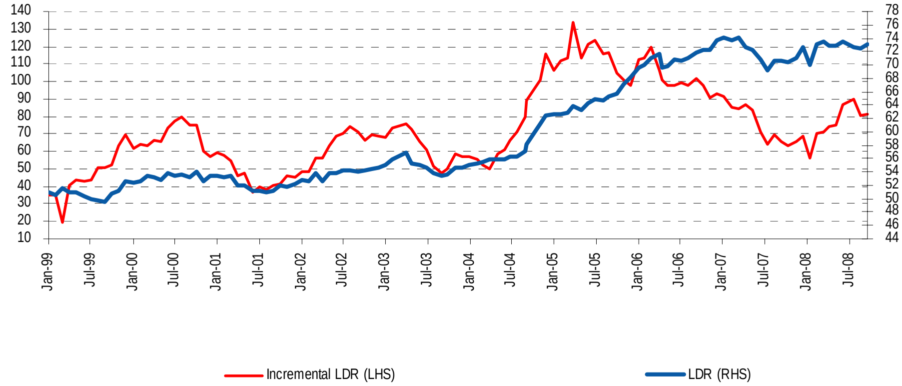
Figure 3: 10-year bond yields


Source: Bloomberg.

Figure 4: System loan and deposit growth

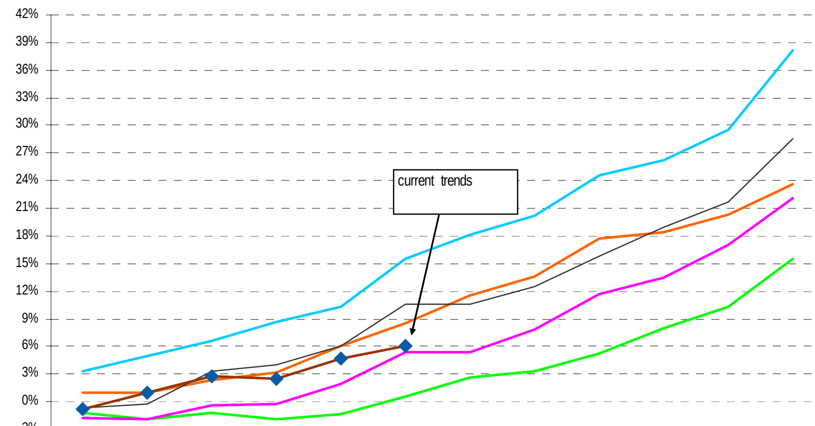

Source: Reserve Bank of India, J.P. Morgan.

Figure 5: System Loan-Deposit Ratios




Source: Reserve Bank of India, J.P. Morgan.

Figure 6: System: YTD loan growth, FY04-current




| | April | May | June | July | August | September | October | November | December | January | Feb | March |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| F2004 | -1% | -2% | -1% | -2% | -1% | 1% | 3% | 3% | 5% | 8% | 10% | 15% |
| F2005 Excl IDBI | 1% | 1% | 2% | 3% | 6% | 9% | 12% | 14% | 18% | 18% | 20% | 24% |
| F2006 Excl IDBI | 3% | 5% | 7% | 9% | 10% | 15% | 18% | 20% | 25% | 26% | 30% | 38% |
| F2007 | -1% | 0% | 3% | 4% | 6% | 11% | 11% | 13% | 16% | 19% | 22% | 29% |
| F2008 | -2% | -2% | 0% | 0% | 2% | 5% | 5% | 8% | 12% | 13% | 17% | 22% |
| F2009 | -1% | 1% | 3% | 2% | 5% | 6% | | | | | | |

Source: RBI, J.P. Morgan.

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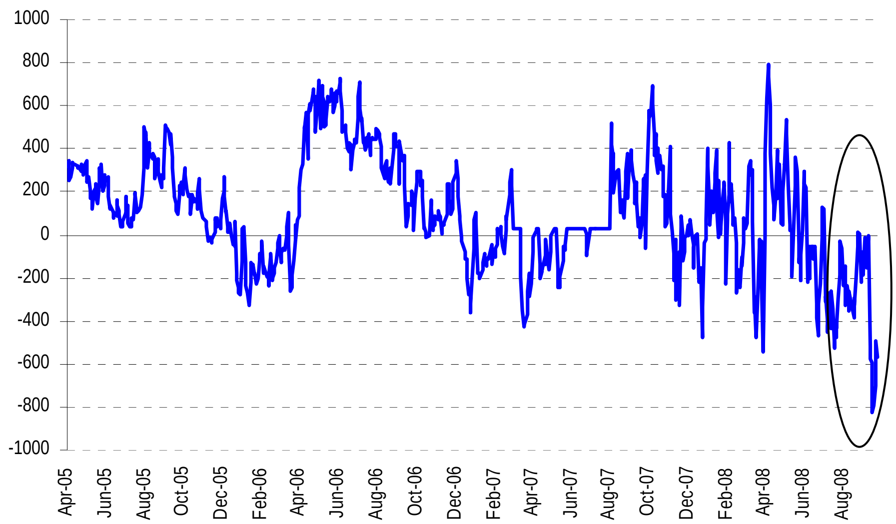
## Liquidity Metrics

Figure 7: Net Reverse Repo Amount Outstanding

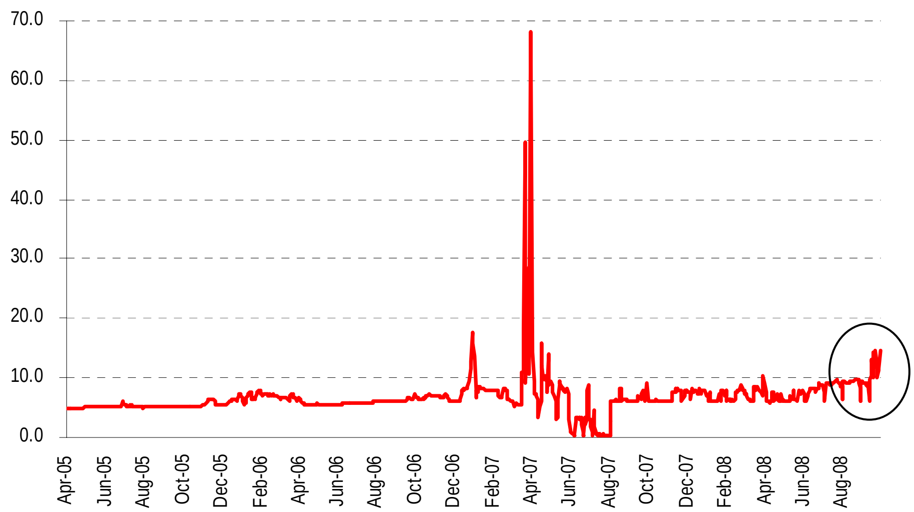
Rs B




Source: Bloomberg.

Figure 8: Inter-bank Rate

%




Source: Bloomberg.

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# Glossary of terms

CNBC: CNBC TV 18 India

BS: Business Standard

DC: Deccan Chronicle

ET: Economic Times

FE: Financial Express

HBL: Hindu Business Line

DH: Deccan Herald

HT: Hindustan Times

TOI: Times of India

IE: Indian Express

RBI: Reserve Bank of India

FM: Finance Minister

MoF: Ministry of Finance

**Analyst Certification:**
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