

Equities

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India Banks

Alert: RBI Hikes Rates, Deregulates Savings Deposit Rates

■ Industry Overview

- **25bps rate hike** — RBI has raised repo rate by a further 25bps (to 8.25%), largely in-line with consensus – but also mentioned a near-term pause in rate actions. The rate hike will lead to higher cost of wholesale funding (~20% of total funds), will impact NIMs by ~5bps (3-4% of earnings) for the sector. We do not expect retail deposit rates or lending rates (slower economic growth, current festival demand, possible risks to asset quality) to be increased near term and banks will likely absorb the NIM impact.
- **Savings rate deregulation** — RBI also deregulated the savings deposit rate. Banks are now free to price savings deposits subject to: a) Uniform pricing for all deposits up to Rs100,000, b) Differential rates possible above this limit, but pricing same for similar deposit amounts. We believe this will lead to: a) More effective transmission of the monetary policy (provides greater rate-setting flexibility to banks), b) Higher savings deposit rates/cost of funds for all banks, and c) Increase competitive pressures on customer acquisition (pricing also a tool now, besides distribution and execution).
- **Possibility of near-term price disruptions; longer term, costs to increase for all** — We believe: A) There is possibility of near-term disruptive pricing (on savings deposits), but we believe these are unlikely to be sustained longer term. B) While extent of rate hikes is still uncertain, we expect average savings deposit rates to move up ~50-100bps for the sector. C) This is likely to impact NIMs by ~10-20bps (savings is ~20% of total funding), and earnings by around 7-15% for the sector. D) Banks will have to absorb part of this cost, but part likely to be passed through in higher lending rates, service charges, over a period of time.
- **Key players impacted** — **Near term:** Banks with higher savings to total funds likely to be impacted negatively (HDFC Bank, Axis, ICICI, SBI), while those with lower savings would be relative beneficiaries (Yes, Kotak), though NIMs will decline for these as well. **Longer term:** a) Private banks with stronger deposit franchises (including savings), will still have relatively lower cost of funding, should have least disruption to market positioning (HDFC Bank, Axis, ICICI); b) Small/regional government banks could see hastened loss in savings deposit market shares.
- **Other key developments** — a) Further liberalization of branch opening – banks given more flexibility to open branches (but 25% still required in unbanked areas); b) Likely revision in norms for priority sector classification, restructuring of loans, loan pricing (for floating rate loans) - timelines: end CY11/early CY12; c) Guidelines on Basel 3 norms (end CY12), presence of foreign banks, holding company structures, new bank licenses (contingent on amendments to Banking Regulation Act), also on the agenda.
- **Overall sector view** — We remain cautious on the sector near term (prefer HDFBK, Kotak), but believe longer term there is greater relative value in stocks with lower relative valuations and strong deposit franchises (Axis, ICICI, SBI).

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Figure 1. India Banks: Proportion of Savings to Total Deposits and Total Borrowed Funds, CASA Ratio

Banks (FY11)	Savings Account Deposits (% of Total Deposits)	Current Account Deposits (% of Total Deposits)	CASA ratio	Saving Account Deposits (% of Interest Bearing Liabilities)
Government Banks				
SBI	35.4%	14.0%	49.4%	29.1%
Bank of Baroda	21.1%	7.6%	28.7%	18.3%
Canara Bank	19.9%	8.3%	28.3%	17.9%
Union Bank	22.1%	9.7%	31.8%	19.3%
Corporation Bank	13.9%	12.1%	26.0%	11.3%
Oriental Bank of Commerce	17.8%	6.8%	24.6%	16.3%
Central Bank	26.6%	8.6%	35.2%	23.2%
Andhra Bank	21.3%	7.8%	29.1%	18.2%
Private Sector Banks				
ICICI Bank	29.6%	14.0%	43.6%	27.2%
HDFC Bank	30.4%	22.3%	52.7%	26.6%
Axis Bank	21.6%	19.5%	41.1%	19.8%
Kotak Mahindra Bank	12.2%	17.8%	30.0%	10.5%
Yes Bank	1.8%	8.6%	10.3%	1.6%
Federal Bank	21.3%	5.6%	26.9%	18.9%

Source: Citi Investment Research and Analysis, Company Reports

Figure 2. Sensitivity Analysis of NIMs and EPS to increase in 50bps Cost of Saving Deposits

Bank	ICICI Bank*	HDFC Bank*	Axis Bank	Kotak	Yes Bank**	Federal Bank	SBI*	BOB*	Union Bank**	Canara Bank
Impact On NIMs (Bps)	(8)	(12)	(9)	(3)	(1)	(9)	(14)	(9)	(10)	(9)
Impact On NIMs (%)	-3.4%	-3.0%	-3.1%	-0.5%	-0.3%	-2.7%	-4.2%	-3.3%	-3.6%	-3.6%
Impact On Earnings (%)	-3.9%	-4.8%	-3.9%	-0.7%	-0.4%	-0.7%	-10.6%	-4.7%	-8.6%	-5.3%

Source: Citi Investment Research and Analysis, Company Reports, * as of 1Q12, ** as of FY11; Else 2Q12

Companies Mentioned

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Appendix A-1

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