Emkay Research

Banking

Sector Update

Annual monetary policy statement 2010-11

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Allahabad bank

(%)	1M	3M	6M	12M
Absolute	6	15	20	215
Rel. to Sensex	5	15	18	96

Andhra Bank

(%)	1M	3M	6M	12M
Absolute	14	5	(2)	109
Rel. to Sensex	13	5	(3)	30

Axis Bank

(%)	1M	3M	6M	12M
Absolute	0	8	14	144
Rel. to Sensex	(0)	8	13	52

Bank of Baroda

(%)	1M	3M	6M	12M
Absolute	3	16	18	119
Rel. to Sensex	3	16	16	36

Bank of India

(%)	1M	3M	6M	12M
Absolute	10	(7)	(21)	40
Rel. to Sensex	9	(7)	(22)	(13)

Canara Bank

(%)	1M	3M	6M	12M
Absolute	0	2	5	110
Rel. to Sensex	(0)	2	4	31

Corporation Bank

(%)	1M	3M	6M	12M
Absolute	9	10	6	142
Rel. to Sensex	8	10	4	51

HDFC Bank

(%)	1M	3M	6M	12M
Absolute	8	16	14	84
Rel. to Sensex	8	16	12	14

ICICI Bank

(%)	1M	3M	6M	12M
Absolute	(3)	10	(4)	116
Rel. to Sensex	(3)	10	(5)	35

Punjab National Bank

(%)	1M	3M	6M	12M
Absolute	7	8	15	105
Rel. to Sensex	6	8	13	28

State Bank of India

(%)	1M	3M	6M	12M
Absolute	1	(5)	(17)	62
Rel. to Sensex	0	(5)	(18)	1

Union Bank of India

(%)	1M	3M	6M	12M
Absolute	15	16	10	88
Rel. to Sensex	14	16	9	17

Yes Bank

(%)	1M	3M	6M	12M
Absolute	2	(7)	6	268
Rel. to Sensex	1	(7)	4	129

The Reserve Bank of India (RBI) has raised CRR, reverse repo and repo rate by 25bps each in annual monetary policy statement for 2010-11. Though repo and reverse repo rate increase was inline with market expectations (our expectations NIL), 25bps increase in CRR was lower than our expectation of 50bps. The hike in policy rates is followed by 75bps hike in CRR in the Third Quarter Review of January 2010 and mid-cycle increase of 25 basis points each in the repo rate and the reverse repo rate on March 19, 2010.

The focus of monetary policy statement for 20010-11 has now clearly shifted from growth to inflation management. The growth forecast has been upped to 8% for FY10-11 (vis-à-vis 7.5% in FY10) with two key risks being southwest monsoon for 2010 and inflation.

We expect the 10-year G-Sec yields to remain around 8-8.2% for FY11. We expect the banks to raise lending rates by 25-50bps over next few months, even as they have remained immune to policy changes till date. Our top picks in banking space are Andhra Bank, Bank of Baroda, PNB and South Indian Bank.

25bps increase in across policy rates

The RBI has raised the CRR, repo and reverse repo rate by 25bps each to 6.0%, 5.25% and 3.75% respectively. Though repo and reverse repo rate hike was inline with market expectations (our expectations – no change), 25bps increase in CRR was lower than our expectation of 50bps.

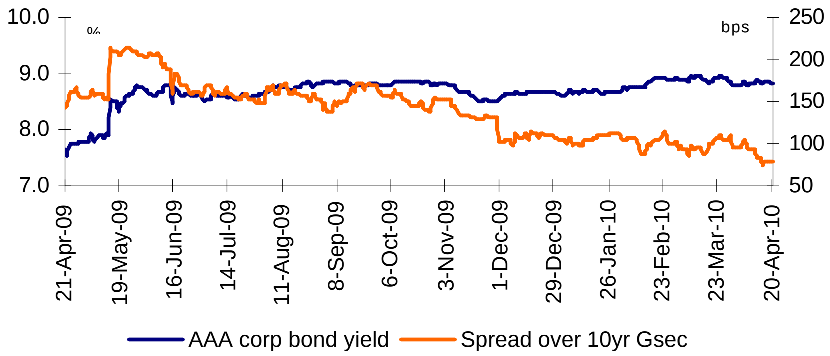
Pressure on banks to increase rate

The lending rates have remained immune to the changes in the policy rates till date, as reflected in limited changed in the lending rates for selected categories and also as reflected in the corporate bond yields. However, we believe that the banks will be raising lending rates over next few months as:

- Cumulative 1% increase in CRR has sucked out Rs500bn from the market, equivalent to almost more than 50% of the excess liquidity
- Frontloading of the RBI's gross borrowing programme will increase the demand for funds in the first half. With credit growth picking up pace, the chase for funds will intensify.
- Implementation of Interest on daily average CASA deposit since April 2010, has increased the cost of funds for banks by 10-15bps.

Though yield on G-Sec has hardened by 50-60bps since December, the corporate bond yield has risen by just 15-20bps. We believe it will be difficult for corporate bonds to sustain at these levels.

10-year AAA corporate bond yield



Source: Bloomberg, Emkay Research

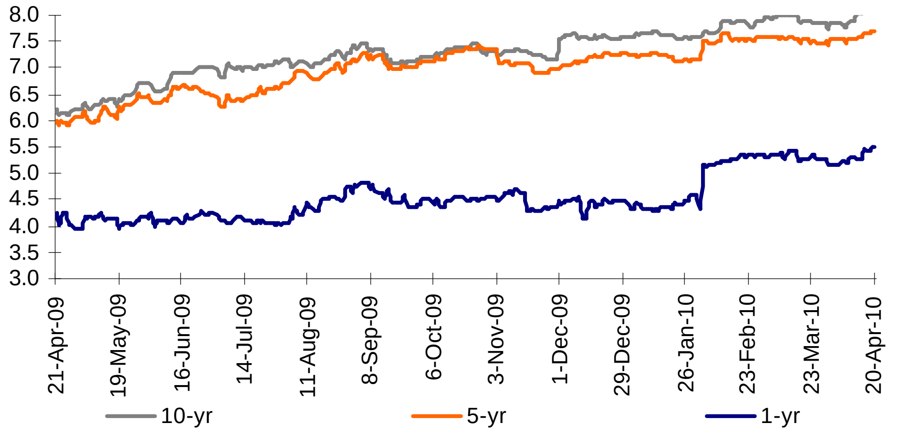
Bond yields to remain elevated – expect few positive announcements

The 10 year bond yield has increased by 26bps over last fortnight, amid expectation of 50bps rise in CRR and 25bps rise in repo and reverse repo each. The bond yields are likely to remain elevated at 8-8.2% driven by the fact that the fresh issuances this year are likely to be higher at Rs3.42tn compared with Rs2.5tn (adjusted for unwinding of MSS) in last year.

We believe that there could be few positive announcements in coming months from RBI on this front looking at the higher government borrowings which may include

- Increase in the FII limit on G-Sec investments from current USD5bn (for a financial year) as the FIIs has already bought G-Secs worth USD7bn YTD CY10.
- Increase in the HTM limit from current 80% of the SLR

Government bond yields (%)



Source: Bloomberg, Emkay Research

CRR may not be tinkered too much

We believe that from hereon, the RBI may not use CRR as tool of policy management too much looking at the requirements of high government borrowings. In FY10, approximately Rs85bn of government borrowing was financed by unwinding MSS. The fresh issuance was limited to Rs2.5tn. However, this year the net borrowing of Rs3.4tn will be largely financed through fresh issuances. Hence, we believe that the RBI may not like to tinker with the liquidity to facilitate the government borrowing programme.

Infrastructure lending made marginally lucrative for banks

The annual monetary policy statement has given strong boost to infrastructure lending with following measures.

Measure	Impact
To classify investments by banks into non-SLR bonds issued by companies engaged in infrastructure activities under HTM category	Banks will be less reluctant to hold such bonds as there will not be any risk of mark to market
To treat annuities under build-operate-transfer (BOT) model in respect of road/highway projects and toll collection rights as tangible assets#	To reduce capital adequacy requirement for banks and provisioning in case of loan defaults. For infrastructure companies it will mean cheaper loans once the commencement of project happens
Infrastructure loan accounts classified as sub-standard will attract a provisioning of 15% instead of the current prescription of 20% if banks have first claim on cash flows	Positive for infrastructure companies. Reduces provisioning requirement for banks in case of technical defaults in the loans.

RBI Target rates for FY11

- Real GDP growth -8% with upward bias.
- WPI inflation by end-March 2011- 5.5%.
- Money supply (M3) - 17.0%
- Aggregate deposits -18.0%.
- Non-food credit – 20%

Valuation table

				PER (x)		P/ABV (x)		RoE (%)	
Bank	**CMP (Rs)**	**Reco**	**TP (Rs)**	**FY010**	**FY11E**	**FY10E**	**FY11E**	**FY10E**	**FY11E**
Allahabad Bank	153	BUY	150	5.5	5.1	1.2	0.9	19.3	17.9
Andhra Bank	113	ACCUMULATE	130	5.0	4.1	1.3	1.1	27.2	27.2
Axis Bank	1,150	UR	UR	18.9	15.2	2.9	2.5	18.8	17.9
Bank of Baroda	631	ACCUMULATE	550	8.1	6.7	1.8	1.5	20.3	20.5
Bank of India	360	REDUCE	320	8.8	6.2	1.6	1.3	15.0	18.5
Canara Bank	400	Reduce	280	4.9	4.5	1.5	1.2	24.5	22.0
Corporation Bank	487	HOLD	430	6.2	5.5	1.3	1.1	20.9	20.0
HDFC Bank	1,957	REDUCE	1,500	29.4	23.0	4.1	3.5	16.7	16.6
ICICI Bank	922	HOLD	800	25.7	19.3	2.2	2.0	7.9	9.8
Punjab National Bank	995	ACCUMULATE	950	8.4	6.7	2.0	1.7	23.2	24.2
South Indian Bank	175	Buy	180	7.0	6.0	1.4	1.2	19.8	19.7
State Bank of India	2,047	Reduce	1,800	12.9	12.0	2.4	2.0	16.2	15.3
Union Bank of India	305	Reduce	220	7.5	6.8	2.0	1.7	21.3	19.8
Yes Bank	250	REDUCE	200	16.4	12.4	3.0	2.4	22.5	21.4

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