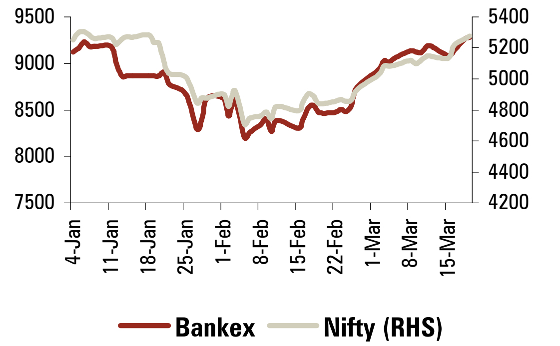
April 21, 2010

Monetary Policy Update

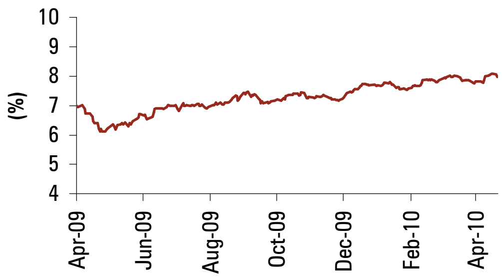
Coverage Universe (banks)

Company	CMP	TP	Upside (%)
Axis Bank	1188	1298	9.3
BOI	322	363	12.8
BOB	620	645	4.0
Dena Bank	77	86	11.2
HDFC Bank	1840	1880	2.2
IOB	89	90	1.1
IDBI	116	141	21.1
Kotak Bank	744	734	-1.3
SBI	2040	2216	8.6
UBI	272	290	6.5
Yes Bank	241	286	18.9

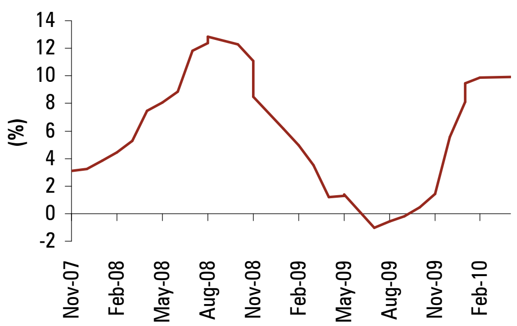
Price movement



Movement in G sec yields



Inflation trending up



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WHAT'S CHANGED…

CRR .... Hiked by 25 bps to 6%
Repo rate .... Hiked by 25 bps to 5.25%
Reverse Repo rate.. Hiked by 25 bps to 3.75%

Rate hikes as anticipated….

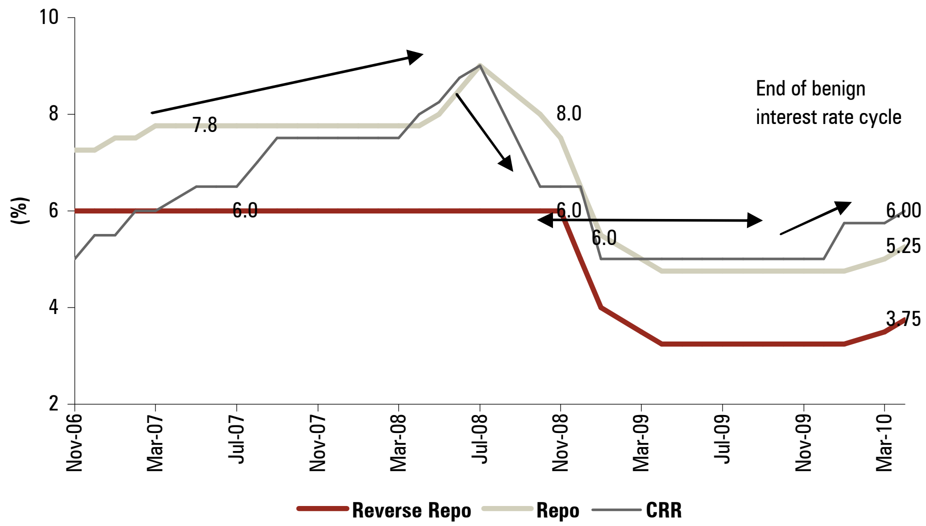
Key announcements

- The repo rate and reverse repo rates were hiked by 25 bps each to 5.25% and 3.75% from 5.00% and 3.50% respectively, with immediate effect
- The CRR was hiked by 25 bps to 6% from April 24, 2010, to drain Rs 125 billion from the system
- Banks will be allowed to classify non-SLR bonds issued by infrastructure companies in the HTM category
- Infra loans, which are classified as sub-standard will attract 15% provisioning vs. 20%
- Discussion paper to be prepared on the issue of new bank licenses by July 2010

Major targets for FY11

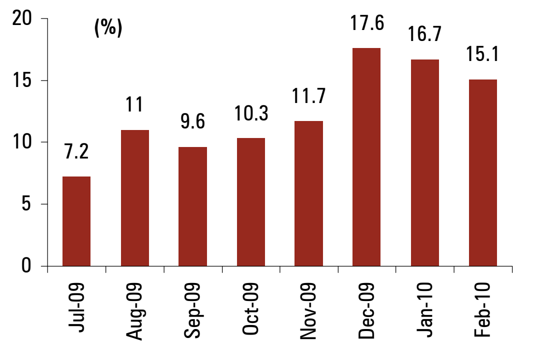
- GDP growth is projected at 8.0% with an upside bias
- Bank's credit will grow at 20%
- Bank's deposits will grow at 18%
- Money supply growth projection at 17.0%
- Inflation is projected at 5.5% by March end

Exhibit 1: Policy rates moving northwards

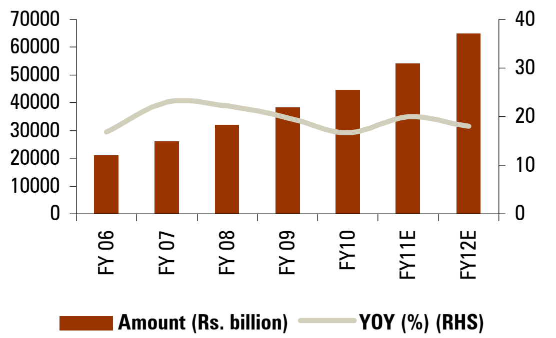


Source: Company, ICICIdirect.com Research

IIP trend depicting recovery



Credit growth picking up



Policy Impact Analysis

- RBI's stance seems hawkish as inflation spreads across sectors including manufacturing and it is open to step in anytime, as required to tame mounting inflation. Headline inflation (WPI at 9.9% for March 2010) has already surpassed the March 2010 target of 8.5% set by the RBI in its last policy meeting. Monsoon uncertainty and volatile crude oil prices also cloud the inflation outlook

- As credit growth remains dull in the first quarter, the excess funds with banks (Rs 28,000 crore deposited under LAF on April 19, 2010) can continue creating inflationary conditions. Hence, a CRR cut seems justified

- Infra companies non-SLR bonds classification is a positive move for infrastructure companies and NBFCs like IDFC and large cap banks like SBI, PNB, etc are lending in that segment

- In FY11, almost the entire budgeted borrowings will be funded by fresh issuance of securities (Rs 3,42,000 crore). This is nearly 36% higher than last year. Thus, managing the borrowings of the government during FY11 will be a bigger challenge than it was last year, whereby pressure on bond yields will continue. We expect the 10 year G-sec yields to touch 8.4% to 8.5% during H1FY10. This, in turn, will hurt public sector banks with longer maturity portfolios and higher exposure to AFS category like **Dena Bank, SBI and BoI**

- We remain bullish on banks with better asset quality and strong CASA base like HDFC Bank, Bank of Baroda and value buys like Oriental Bank of Commerce (OBC).

We do not expect major hikes in lending rates due to the sluggish credit offtake trend in the first quarter for banks. Also, NIM will also be maintained at current levels. We remain overweight on the banking sector for FY11 as the core business is expected to pick up with industry credit growth estimated at 20%.

Impact of 75 bps rise in G sec yields (i.e. 8.25%) on banks profitability

PSU banks	AFS	AFS to Gross Invt (%)	AFS Modified Duration in years	FY10E PAT (Rs crore)	10 yr yield at 8.25% MTM losses (Rs crore)	Impact on PAT FY10E (%)
SBI	67000	23.3	3.5	9780	1758.8	18.0
PNB	13466	18.2	2.6	3260	259.6	8.0
BoI	14500	22.5	4.0	1948	435.0	22.3
BoB	10717	19.9	2.2	2822	176.8	6.3
Union Bank	14678	27.3	1.9	1886	98.8	5.2
OBC	7323	21.1	2.8	1102	152.7	13.9
IOB	8000	25.8	3.0	1292	180.0	13.9
Dena Bank	2799	18.0	4.4	494	91.7	18.6
Axis	15500	31.4	3.4	2166	395.3	12.2
HDFC Bank	12800	20.0	1.0	3135	96.0	3.1
South Indian Bank	1905	23.0	0.6	248	8.3	3.3

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