

## India: Financial Services

### RBI hikes rates, CRR; No change in view

#### RBI rate and CRR hike in line with expectation

As we had expected, the RBI has hiked the Cash Reserve Ratio (CRR), reverse repo rate and repo rate by 25 bps each. The CRR now stands at 6%, reverse repo at 3.75% and repo rate at 5.25%. In aggregate the RBI has hiked CRR by 100 bps and reverse repo and repo rates by 50bps since the tightening began. We have already factored another 50 bps CRR hike (over and above the current rate hike) into our estimates for banks under our coverage. Given comfortable liquidity in the market, banks may not rush to hike deposit rates and the prime lending rate for now, though we expect rates on the shorter end of the market to start inching up. We have assumed a 100-125 bps increase in cost of funds and lending rates over FY2011 for our coverage.

#### Step to increasing flow to infrastructure sector

Two other changes that will likely be long-term positive for the bond market are: (1) allowing banks to classify investments in non-SLR bonds from infrastructure companies under Held-to-maturity (minimum residual maturity of seven years), earlier classified either under held for trading (HFT) or available for sale (AFS) category - both of which were subjected to 'mark to market' requirements and (2) Banks' investment in unlisted non-SLR securities is restricted to 10% of their total investments; this has now been relaxed to include in non-SLR debt securities (both primary and secondary market) by banks where the security is proposed to be listed within a specified time.

#### No change in our view on the banking sector

We have an attractive stance on the sector and think a buoyant economy will offset risk of rising rates. In our view, stock price performance will be driven by: (1) a strong economy: our ECS Research team projects GDP growth for FY11E at 8.2%/FY12E at 8.7%, vs. 6.6% in FY10E; (2) strong earnings growth driven by higher credit growth (20% for FY11E/FY12E vs. 16.75% as per RBI data released on Mar 26), higher margin/fees and lower NPLs in FY10E-12E; and (3) limited risk of MTM on GSec book given likely more benign GSec yields. We prefer banks with: high earnings growth, low risk to balance sheet, and high/improving RoEs. Our top picks continue to remain the same: Bank of Baroda (BOB.BO, Buy, CL), HDFC Bank (HDBK.BO, Buy, CL) and (3) Punjab National Bank (PNBK.BO, Buy).

Key risks: (1) Elevated inflation levels could lead to stronger measures by RBI; (2) slippage in fiscal deficit could lead to crowding out of private investments/rise in GSec yields.

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**Exhibit 1: Stock price performance has been strong over the last one year and ytd**  
 Absolute and relative performance of banking and finance companies

Reuters Ticker	GS Rating	Price (Rs) 4/19/2010	Mkt cap (US \$ bn)	1-year (Rs)		Absolute price perf (%)					Rel price perf % (to BSE)					Rel to MSCI APxJ Bk					
				High	Low	1-wk	1-mo	3-mo	1-yr	ytd	1-wk	1-mo	3-mo	1-yr	ytd	1-wk	1-mo	3-mo	1-yr	ytd	
<b>Public Banks</b>																					
BOB	BOB.BO	Buy*	640	5.21	675	282	(0.5)	3.7	15.5	115.9	25.2	2.1	4.8	16.0	58.1	25.6	1.8	3.5	16.0	78.2	25.2
BOI	BOI.BO	Neutral	355	4.17	464	229	(3.2)	8.5	(8.7)	34.3	(7.8)	(0.7)	9.5	(8.2)	(23.6)	(7.5)	(1.0)	8.3	(8.2)	(3.4)	(7.8)
PNB	PNBK.BO	Buy	992	6.99	1,037	466	0.3	2.9	7.9	101.4	9.4	2.8	4.0	8.4	43.6	9.8	2.5	2.7	8.4	63.8	9.4
SBI	SBI.BO	Sell	2,032	28.84	2,465	1,233	(2.9)	(1.3)	(6.5)	55.5	(10.5)	(0.4)	(0.3)	(6.0)	(2.3)	(10.1)	(0.7)	(1.5)	(6.0)	17.8	(10.5)
Union Bank	UNBK.BO	Buy	305	3.44	307	158	1.8	12.2	13.2	83.7	15.5	4.3	13.2	13.7	25.9	15.9	4.0	12.0	13.7	46.0	15.6
<b>Private banks</b>																					
Axis	AXBK.BO	Buy	1,157	10.48	1,200	473	(1.7)	0.2	4.8	129.7	17.1	0.8	1.2	5.3	71.9	17.4	0.5	(0.0)	5.3	92.0	17.1
HDFCB	HDBK.BO	Buy*	1,935	19.80	1,965	1,067	(0.8)	6.4	8.8	81.2	13.8	1.8	7.5	9.3	23.3	14.2	1.5	6.2	9.3	43.5	13.8
ICICI	ICBK.BO	Neutral	920	22.92	998	399	(4.7)	(3.7)	6.5	108.4	5.0	(2.2)	(2.7)	7.0	50.5	5.4	(2.5)	(3.9)	7.0	70.7	5.1
IndusInd Bank	INBK.BO	Buy	182	1.67	182	40	3.0	4.9	23.1	353.2	28.3	5.5	5.9	23.6	295.4	28.6	5.2	4.7	23.6	315.5	28.3
KMB	KTKM.BO	Neutral	725	5.64	874	364	(5.1)	(2.9)	(15.6)	81.4	(9.6)	(2.6)	(1.9)	(15.1)	23.6	(9.3)	(2.9)	(3.1)	(15.1)	43.8	(9.6)
Yes Bank	YESB.BO	Neutral	253	1.92	284	74	(3.9)	2.4	(10.9)	259.8	(5.3)	(1.4)	3.4	(10.4)	202.0	(4.9)	(1.7)	2.2	(10.4)	222.1	(5.3)
<b>NBFC's</b>																					
HDFC	HDFC.BO	Neutral	2,692	17.29	2,845	1,671	(4.6)	(0.0)	7.2	50.2	0.5	(2.1)	1.0	7.7	(7.7)	0.9	(2.4)	(0.2)	7.7	12.5	0.5
IDFC	IDFC.BO	Neutral	162	4.71	177	68	(6.7)	(1.3)	0.9	143.8	5.2	(4.2)	(0.3)	1.4	85.9	5.5	(4.5)	(1.5)	1.4	106.1	5.2
LIC Housing	LICH.BO	Sell*	851	1.81	907	277	(4.1)	4.1	2.9	206.3	6.0	(1.5)	5.1	3.3	148.4	6.3	(1.8)	3.9	3.3	168.6	6.0
Shriram Transport	SRTR.BO	Buy	556	2.80	564	208	(0.8)	10.3	8.0	159.2	14.7	1.7	11.3	8.5	101.4	15.1	1.4	10.1	8.5	121.6	14.7

\* Conviction List

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Source: DataStream, Company data, Goldman Sachs Research estimates.

**Exhibit 2: We maintain our ratings & 12-month target prices in light of current valuations vs. expected earnings and profitability**

Valuation summary

Reuters ticker	Rating	Price 4/19/2010 (Rs)	Target Price (Rs)	Total Return Potential (Rs)	BVPS (Rs)			EPS (Rs)			ROE			P/B (X)			P/E (X)			
					FY 2010E	FY 2011E	FY 2012E	FY 2010E	FY 2011E	FY 2012E	FY 2010E	FY 2011E	FY 2012E	FY 2010E	FY 2011E	FY 2012E	FY 2010E	FY 2011E	FY 2012E	
<b>Public banks</b>																				
BOB	BOB.BO	Buy*	640	730	16%	342.2	422.2	514.2	80.08	87.79	106.52	22%	21%	21%	1.87	1.52	1.25	8.0	7.3	6.0
BOI	BOI.BO	Neutral	355	370	7%	260.4	303.7	357.5	36.14	52.73	66.73	13%	17%	19%	1.36	1.17	0.99	9.8	6.7	5.3
PNB	PNBK.BO	Buy	992	1,100	14%	511.7	620.0	745.8	117.66	135.84	159.14	23%	22%	22%	1.94	1.60	1.33	8.4	7.3	6.2
SBI	SBI.BO	Sell	2,032	1,940	-3%	919.5	1,051.8	1,224.2	159.44	173.15	225.82	17%	18%	20%	2.21	1.93	1.66	12.7	11.7	9.0
Union Bank	UNBK.BO	Buy	305	310	6%	173.0	212.4	255.4	42.35	49.19	59.11	23%	22%	23%	1.76	1.44	1.19	7.2	6.2	5.2
<b>Private banks</b>																				
Axis	AXBK.BO	Buy	1,157	1,280	12%	394.4	451.9	524.3	64.14	75.08	94.41	19%	18%	19%	2.93	2.56	2.21	18.0	15.4	12.3
HDFCB	HDBK.BO	Buy*	1,935	2,120	10%	466.7	531.3	614.2	68.02	84.29	108.26	16%	17%	19%	4.15	3.64	3.15	28.5	23.0	17.9
ICICI	ICBK.BO	Neutral	920	960	6%	465.2	493.8	531.6	36.16	43.58	58.26	8%	9%	11%	1.98	1.86	1.73	25.4	21.1	15.8
IndusInd Bank	INBK.BO	Buy	182	200	10%	52.5	63.6	77.7	8.49	10.83	13.89	17%	17%	18%	3.47	2.87	2.34	21.5	16.8	13.1
KMB	KTKM.BO	Neutral	725	870	20%	123.5	139.0	158.2	14.50	17.58	21.78	12%	13%	15%	5.87	5.21	4.58	50.0	41.2	33.3
Yes Bank	YESB.BO	Neutral	253	270	7%	102.6	112.0	135.8	15.47	18.83	23.86	20%	18%	19%	2.47	2.26	1.86	16.3	13.4	10.6
<b>NBFC's</b>																				
HDFC	HDFC.BO	Neutral	2,692	2,760	4%	527.7	595.5	676.4	95.19	114.80	137.00	19%	20%	22%	5.10	4.52	3.98	28.3	23.5	19.7
IDFC	IDFC.BO	Neutral	162	170	6%	54.0	61.1	69.2	7.71	8.99	10.28	15%	16%	16%	3.00	2.66	2.34	21.0	18.0	15.8
LIC Housing Finance	LICH.BO	Sell*	851	795	-5%	373.6	413.5	484.4	70.36	80.10	95.56	23%	21%	21%	2.28	2.06	1.76	12.1	10.6	8.9
Shriram Transport	SRTR.BO	Buy	556	560	2%	166.9	208.5	261.7	37.55	51.92	66.41	28%	28%	28%	3.33	2.67	2.13	14.8	10.7	8.4

\* Conviction List

For important disclosures, please go to <http://www.gs.com/research/hedge.html>. For methodology and risks associated with our 12-month price targets, please see our previously published research.

Source: DataStream, Goldman Sachs Research estimates.

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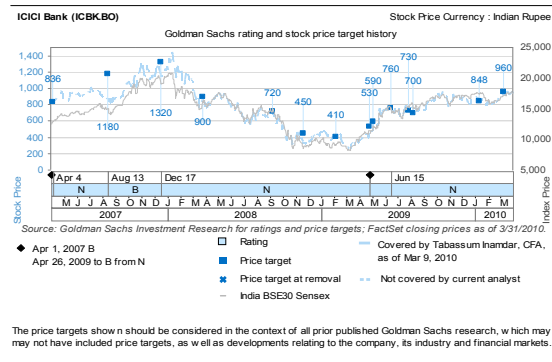
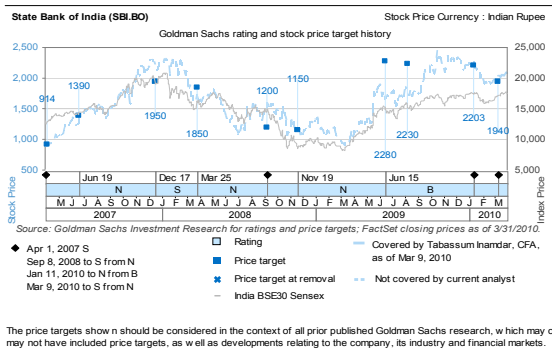
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