

Industry Focus

4 March 2009 | 10 pages

India Banks

Rate Cuts = Stock Performance?

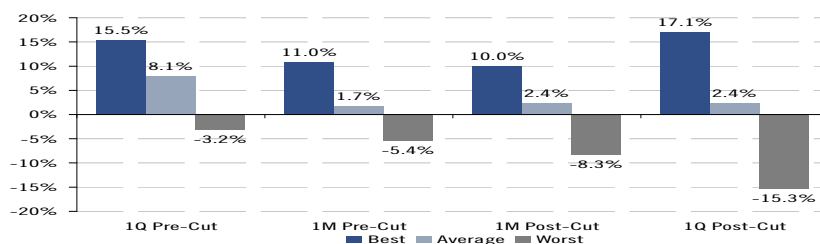
- Consensus appears to be positioned for a Repo Rate Cut** — India's bond yields have been implying a reduction in policy rates for some time, recent weakness in economic data (GDP growth, inflation) has led to firming up of these expectations – both ours and consensus. Consensus is for a 50bps cut; we expect 100-150 bps (staggered over 1HCY09). But do rate cuts really drive stocks in the short term?
- Stock performance suggests policy rate cuts have minimal impact** — Repo rate cuts have a positive impact on stocks – but only marginal. Banks have outperformed by an average +2% in 1 month post such cuts (PSU banks slightly better at +4%). Importantly in 3 of the past 4 instances stocks have outperformed 1 month before the cuts (underperforming 1 month after cuts) suggesting that the market has been increasingly efficient in anticipating possible rate cuts.
- CRR cuts also not a significant positive** — Fundamentally, we believe the possibility of CRR cuts are relatively low given ample liquidity – in the system and on banks balance sheets. Even so, reduction in reserve requirements are likely to provide more operating gains (Higher NIMs; +5-6 bps for 50bps cut) than stock performance (+2% avg. outperformance post CRR cuts previously).
- Rate cuts: Impact on lending/deposit rates** — Policy rates set direction for movements in lending/deposit rates, however, impact usually comes with a lag (1-3 months). Currently ample system liquidity, slower growth and government talk has led banks to reduce loan yields ahead of deposit rates. Good economics suggest more aggressive deposit rates cuts ahead, which could be better for stock prices.

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Figure 1. Repo Cuts and Bankex Relative Performance since 2002 (Percent)



Source: RBI, Bloomberg, Citi Investment Research and Analysis

See Appendix A-1 for Analyst Certification and important disclosures.

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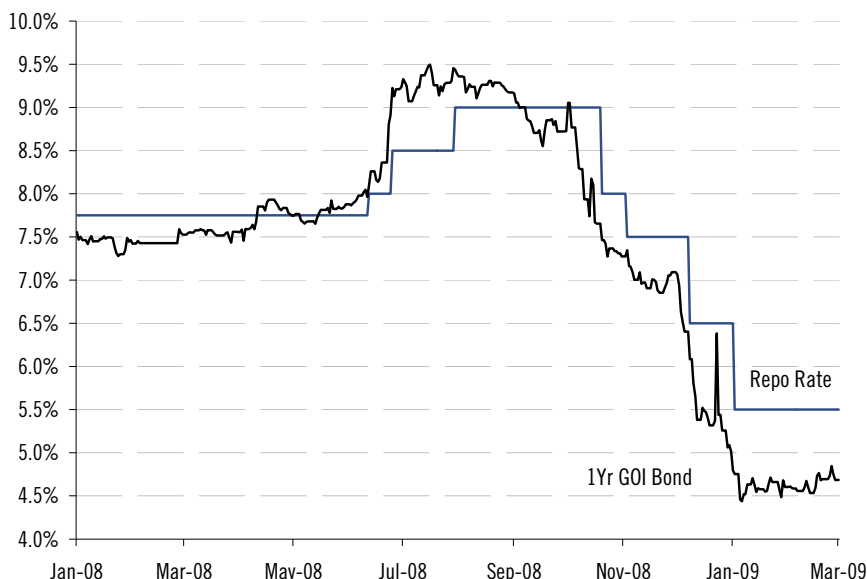
Fall in Bond Yields Imply a Rate Cut

1Yr Sovereign bond yields have closely tracked changes in policy rates and been a leading indicator of such changes in the recent past ...

Yields appear to suggest a 50bps repo rate cut since the beginning of the year ...

However, policy rates have remained unchanged and cuts have been elusive thus far

Figure 2. Sovereign Bond Yields appear to imply Reductions in Policy Rates



Source: Bloomberg and RBI

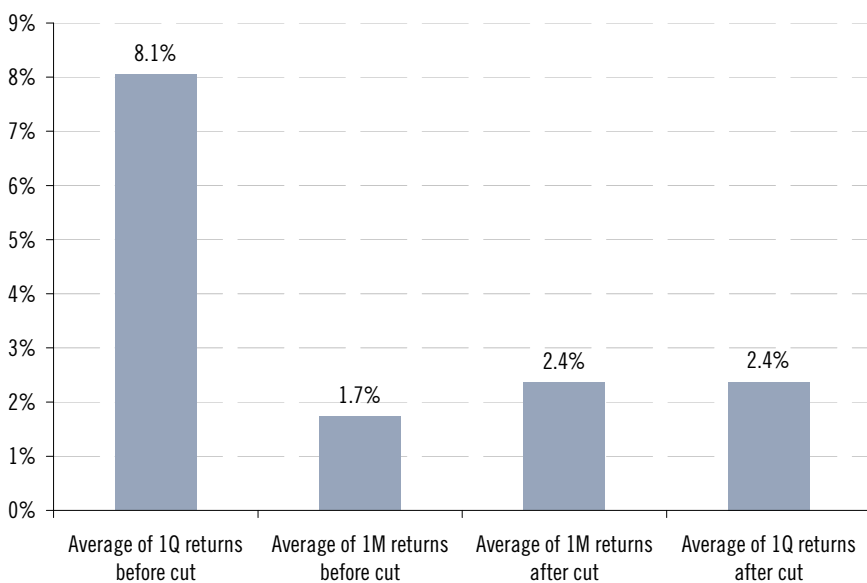
Bank Stocks Outperform Post Repo Rate Cuts

On average, Repo cuts have led to outperformance from bank stocks, though relatively small.

Stock performances seem to indicate – "the earlier the anticipation the higher the returns".

However, stocks still outperform post the event – though impact is highly reduced.

Figure 3. Repo Rate Cuts and Bankex Relative Performance over select time periods



Source: RBI, Bloomberg, Citi Investment Research and Analysis

However, in 3 out of last 4 instances, banks have outperformed 1M prior to rate cuts and underperformed 1M post cuts

This suggests that the market has become increasingly efficient in factoring such an event

Between individual instances, the return variance seems to be relatively high with wide divergences between the best and worst outcomes.

PSU Banks are more leveraged to reductions in interest rates – through their longer duration bond portfolios.

Stock performances too seem to indicate significant outperformance of PSU banks relatively to Private banks and the sector.

More recently banks have underperformed post rate cuts

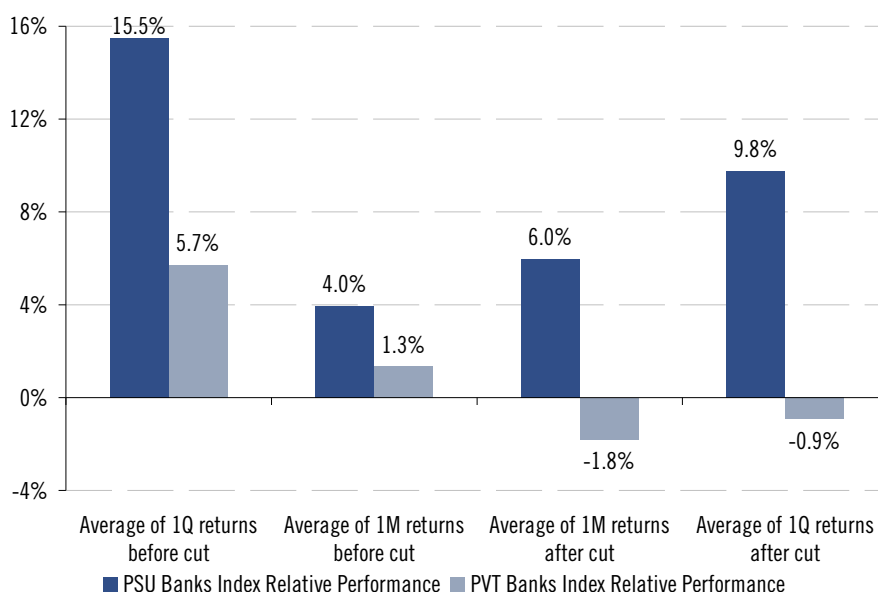
Figure 4. Detailed Table of Bankex Relative Performance and Repo Cuts

Date	REPO Post-Cut (%)	Extent of Cut (bps)	BANKEX Relative Performance (%)			
			Pre 1Q	Pre 1M	Post 1M	Post 1Q
28-Mar-02	8.0	50	8.9	-1.7	4.2	12.2
12-Nov-02	7.5	50	-3.2	-4.5	3.2	17.1
07-Mar-03	7.1	40	15.5	0.3	3.2	15.6
19-Mar-03	7.0	10	10.2	-0.5	8.9	9.2
31-Mar-04	6.0	100	9.9	7.9	5.4	-4.9
20-Oct-08	8.0	100	13.4	7.3	-5.1	-2.8
03-Nov-08	7.5	50	5.5	1.3	-0.2	-0.2
08-Dec-08	6.5	100	3.5	-5.4	10.0	-9.7
02-Jan-09	5.5	100	8.8	11.0	-8.3	-15.3
Mean Returns (%)			8.1	1.7	2.4	2.4
Median Returns (%)			8.9	0.3	3.2	-0.2

Source: RBI, Bloomberg, Citi Investment Research and Analysis

PSU Banks do better on Rate Cuts – Expectations and Post

Figure 5. PSU Banks perform better during times of Reductions in Policy Rates



Source: RBI, Bloomberg, Citi Investment Research and Analysis

Performance Variance for PSU banks are also wide ...

However, in recent times, PSU banks have outperformed sharply on rate cuts – both before and post the event.

Again – earlier anticipations are much better – but there are still reasonable returns if held for longer periods of time

As with Repo cuts, CRR cuts also yield better on earlier anticipations, however, the extent of outperformance is relatively smaller ...

Fundamentally we believe ample system liquidity, balance sheet liquidity and slowing loan growth do not call for immediate reductions in reserve requirements

PSU Banks typically still outperform post rate cuts

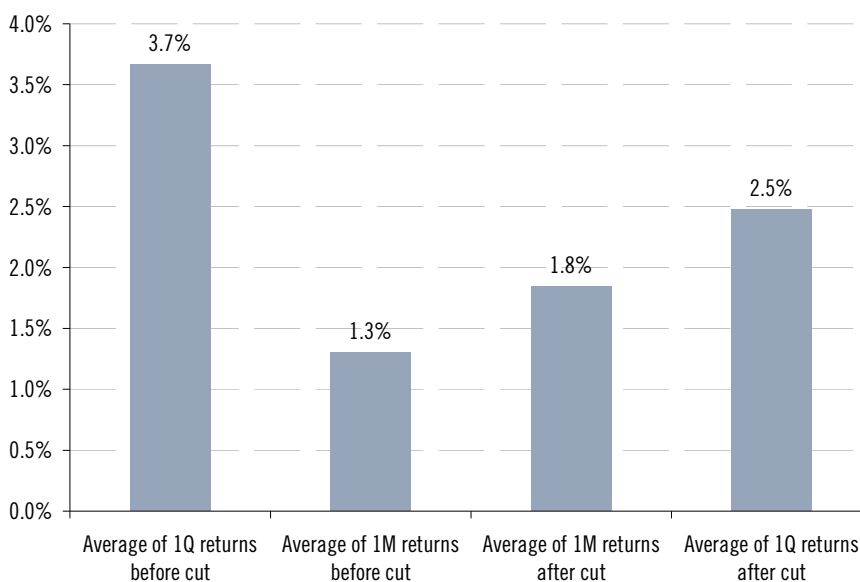
Figure 6. Detailed Table of PSU Banks' Relative Performance and Repo Cuts

Date	REPO Post-Cut (%)	Extent of Cut (bps)	PSU Banks Index Relative Performance (%)			
			Pre 1Q	Pre 1M	Post 1M	Post 1Q
28-Mar-02	8.0	50	15.4	-5.5	11.2	21.4
12-Nov-02	7.5	50	1.5	4.0	8.2	26.0
07-Mar-03	7.1	40	18.6	-1.1	10.6	40.8
19-Mar-03	7.0	10	13.1	-0.3	16.4	29.3
31-Mar-04	6.0	100	14.2	9.5	8.5	-10.6
20-Oct-08	8.0	100	32.7	20.1	-5.0	-6.0
03-Nov-08	7.5	50	10.8	2.7	8.9	4.7
08-Dec-08	6.5	100	17.2	0.2	3.9	-6.9
02-Jan-09	5.5	100	16.0	6.0	-9.0	-11.0
Mean Returns (%)			15.5	4.0	6.0	9.8
Median Returns (%)			15.4	2.7	8.5	4.7

Source: RBI, Bloomberg, Citi Investment Research and Analysis

CRR Cuts Not a Significant Driver of Bank Stocks

Figure 7. CRR Cuts and Bankex Relative Performance over select time periods



Source: RBI, Bloomberg, Citi Investment Research and Analysis

Lending and Deposit Rates are impacted with a lag

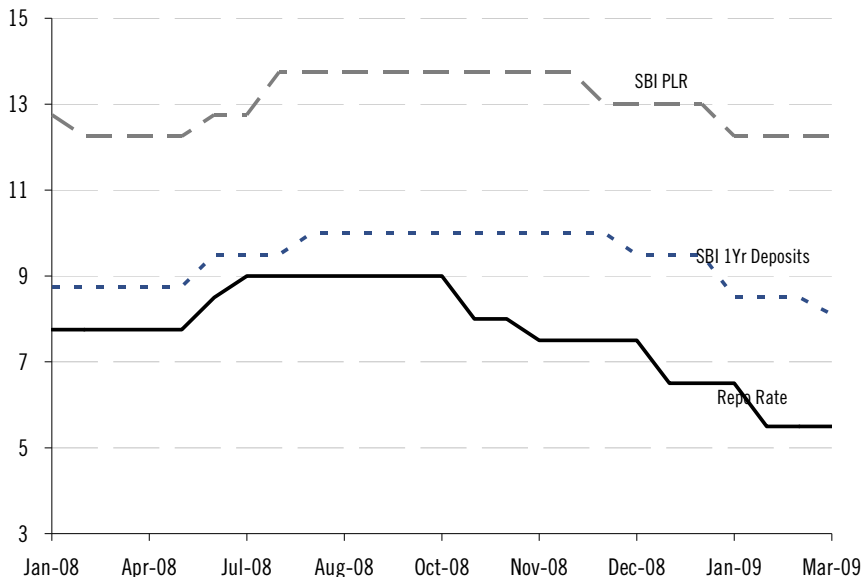
Cuts in policy rates impact lending and borrowing rates for banks – but with a lag.

Typically, lending rates have lagged 1-2 months while deposit rates by 2-3 months.

Banks have already started sub-PLR loans to corporates and retail loans have also been aggressively recently.

We expect more deposit rate reductions going forward, especially if policy rates are reduced further.

Figure 8. Repo Rates and Impact on Lending (PLR) and Deposit Rates (Percent)



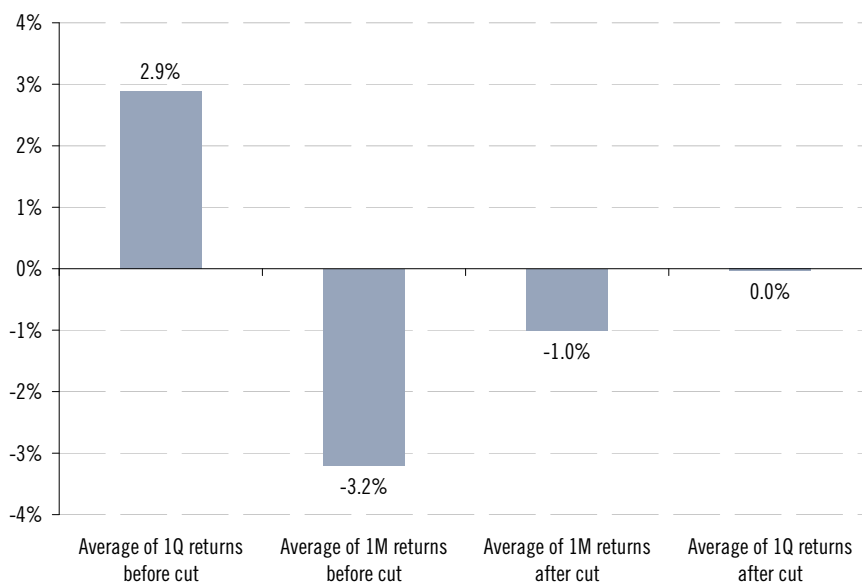
Source: SBI, RBI

And Lending Rate Cuts Have Only a Mild Stock Reaction

Banks stocks seem to react mildly following any cuts in lending rates.

Performance before rate cuts are also relatively small and on average not significant.

Figure 9. Lending Rate (PLR) Cuts and Bankex Relative Performance over select time periods



Source: SBI, Bloomberg, Citi Investment Research and Analysis

Figure 10. India Banks – CIR Valuation Table

	RIC Code	Price (Rs) 4-Mar	TP (Rs)	Rating	P/E (x) 2010	P/B (x) 2010	ROE (%) 2010	ROA (%) 2010	Div-Yld (%) 2010	M-Cap USD Mn	EPS 2010		EPS 2011		BVPS 2010		BVPS 2011		
											Abs.	Grth.	Abs.	Grth.	Abs.	Grth.	Abs.	Grth.	
Private Sector Banks																			
ICICI Bank	ICBK.BO	284.3	489	1H	9.4	0.6	6.9%	0.9%	3.9%	6,090	30.3	-3%	38.8	28%	452	4%	477	6%	
HDFC Bank	HDBK.BO	838.8	1350	1L	11.2	1.7	18.1%	1.5%	1.1%	6,865	74.8	29%	96.1	28%	494	37%	582	18%	
AXIS Bank	AXBK.BO	322.6	710	1L	6.8	1.0	15.7%	1.1%	2.0%	2,228	47.3	5%	51.3	8%	326	15%	371	14%	
Kotak Mahindra Bank	KTKM.BO	234.0	282	3H	13.4	1.2	9.1%	1.3%	0.4%	1,556	17.5	8%	19.2	9%	201	9%	219	9%	
IDFC	IDFC.BO	49.3	58	3M	6.2	0.9	15.4%	2.9%	2.6%	1,227	7.9	22%	9.2	16%	55	13%	62	14%	
Yes Bank	YESB.BO	46.0	75	3H	4.4	0.7	18.1%	1.2%	0.0%	263	10.5	28%	13.3	27%	63	20%	77	21%	
Federal Bank	FED.BO	120.5	215	1M	4.7	0.4	9.7%	1.1%	3.7%	396	25.6	-16%	27.4	7%	275	8%	297	8%	
Public Sector Banks																			
State Bank of India	SBI.BO	957.6	1453	1L	6.4	0.9	15.7%	1.0%	2.3%	11,698	150.4	5%	169	12%	1018	14%	1160	14%	
Punjab National Bank	PNBK.BO	306.0	420	3M	3.7	0.6	17.0%	1.0%	4.9%	1,856	83.6	-2%	88.2	5%	526	14%	595	13%	
Bank of Baroda	BOB.BO	204.2	315	1M	4.1	0.5	13.9%	0.8%	4.4%	1,431	50.1	2%	52.8	5%	382	12%	423	11%	
Canara Bank	CNBK.BO	159.3	165	3M	3.6	0.5	14.5%	0.8%	5.6%	1,257	44.3	4%	51.0	15%	323	12%	362	12%	
Union Bank Of India	UNBK.BO	124.2	165	1L	4.1	0.6	16.2%	0.9%	3.6%	1,207	29.9	-6%	31.8	6%	198	14%	224	14%	
Oriental Bank of Commerce	ORBC.BO	112.4	175	3H	2.6	0.4	15.8%	1.0%	4.4%	542	43.9	27%	48.2	10%	298	15%	340	14%	
Corporation Bank	CRBK.BO	164.8	175	3H	2.8	0.4	16.3%	1.1%	7.6%	455	59.6	1%	60.3	1%	389	14%	436	12%	
Andhra Bank	ADBK.BO	42.1	76	1M	2.9	0.5	18.4%	1.0%	10.5%	393	14.4	25%	17.3	20%	83	13%	95	14%	
Central Bank Of India	CBI.BO	31.6	34	3M	2.7	0.2	7.9%	0.3%	3.2%	246	11.5	-22%	12.2	6%	151	7%	162	7%	

Source: Citi Investment Research and Analysis estimates

Appendix A-1

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