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January 12, 2007

Industry View
In-Line

India Financial Services

Ordinance on SLR – Impact on Indian Banks

Quick Comment: Newspapers today have reported that the cabinet has given its approval to pass an ordinance to remove the bands within which the RBI was allowed to set the Statutory Liquidity Ratio (SLR) (see, "Cabinet unshackles RBI on SLR" in today's Economic Times). We believe that this move will be a long term positive, but in the short run it's likely to be neutral. This is because the RBI has been tightening liquidity in the last few months in India (see our note, "CRR Hike – Negative for Indian Banks", dated 10 December 2006), and is unlikely to take a step back and lower the SLR requirement from 25% currently. Hence, it is just an enabling provision, in the near term.

SLR is the proportion of net liabilities, which banks have to invest in government bonds in India. The ratio is currently at 25%. Until now, the RBI was allowed to set the ratio within a band of 25-40%. However, now it appears the government has removed this band to enable the RBI to conduct monetary policy more effectively.

This amendment was a part of Banking Regulation Act, which government had presented in early 2006 in parliament. But, that amendment included a provision to increase voting rights in private banks – which, it seems, was not supported by a majority in parliament. Hence, the government has now passed this provision to remove the SLR band as an ordinance (this needs to be passed by the parliament in the next 12 months or the ordinance becomes void). They are still discussing the provision on voting rights with their partners.

We do not think the RBI will immediately reduce SLR levels – We believe that the ordinance is just an enabling provision. In fact, in early 2006, the government had removed the floor on Cash Reserve Ratio (prior to that, the RBI could not lower CRR below 3%). However, since then rather than lowering CRR the RBI has actually increased it.

We believe that given the strong credit growth (which is much higher than the RBI's target of 20%), the RBI is unlikely to go back on its tightening mode. Hence, while the removal of SLR bands is a long-term positive (as more resources can move towards loans rather than government bonds), it's unlikely to impact near-term fundamentals for banks. In fact, if the RBI wanted to inject liquidity it could theoretically take CRR down to 0 from the current 5.5%. But it is actually increasing the CRR requirement – implying that it's unlikely to reduce SLR immediately.

Hence, we do not expect any positive impact on our earnings for F2007.

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Overweight/Buy	**814**	**37%**	**288**	**42%**	**35%**
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Total	**2,187**		**683**		

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Industry Coverage:India Financial Services

Company (Ticker)	Rating (as of)	Price (01/11/2007)
Anil Agarwal		
Canara Bank (CNBK.BO)	O (05/25/2006)	Rs257.40
Corporation Bank (CRBK.BO)	O (08/10/2006)	Rs307.65
HDFC (HDFC.BO)	E (04/08/2004)	Rs1,522.50
HDFC Bank (HDBK.BO)	E (10/18/2006)	Rs999.35
ICICI Bank (ICBK.BO)	E (04/04/2006)	Rs894.20
IDBI (IDBI.BO)	U (10/21/2005)	Rs86.45
IDFC (IDFC.BO)	O (09/16/2005)	Rs81.60
Kotak Mahindra Bank (KTKM.BO)	U (08/21/2006)	Rs411.40
Oriental Bank of Commerce (ORBC.BO)	E (05/25/2006)	Rs212.00
Punjab National Bank (PNBK.BO)	E (09/20/2006)	Rs486.25
State Bank of India (SBI.BO)	U (11/19/2004)	Rs1,150.00
Union Bank of India (UNBK.BO)	O (05/15/2006)	Rs117.70
UTI Bank (UTBK.BO)	E (07/15/2005)	Rs480.70
Anil Bang		
Bank of Baroda (BOB.BO)	O (10/06/2006)	Rs226.00
Bank of India (BOI.BO)	O (11/30/2006)	Rs192.95

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