

April 16, 2007

## India Financial Services

### The CRR Flip Flop - II

**Quick Comment:** The government has notified RBI amendment, which dealt with norms relating to CRR. Following this RBI has announced removal of 3% floor for Cash Reserve Ratio (CRR). It has also said that it will not pay any interest on CRR balances (it was currently paying 0.5%).

RBI had initially announced these moves in June 2006 consequent to amendments in RBI Act. However, since it was not notified by the government, the 3% floor for CRR remained in place and RBI had to continue providing the interest on CRR (though it had lowered the interest rate). Now, with the government notifying the amendments to provisions relating to CRR, RBI has decided to not provide any interest on CRR balances.

Change	
22-Jun-06	RBI abolishes 3% floor on CRR balances and discontinues payment of interest on CRR balances
26-Feb-07	RBI has to pay interest on CRR balances from retrospective effect, starts paying interest rate at 1% and reinstates 3% floor as govt. did not notify the earlier amendments
02-Apr-07	RBI lowers interest rate on CRR balances to 0.5%
13-Apr-07	RBI removes interest payments on CRR balances and abolished 3% floor after govt notifies the amendments related to CRR

**Impact:** Given that the current CRR requirement is at 6.5% (and RBI has been raising it), removal of the 3% floor is a positive only in the longer term, in our view.

However, the removal of interest on CRR balances is likely to have a negative impact on the banks' earnings. In our calculation, it will decrease the F2008 Net Interest Margins (NIM) of banks by around 2 bps and earnings by around 1%.

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### Indian Banks: Impact of Removal of Interest on CRR Balances

	As % of F2008E PBT
SBI	1.3%
BOI	1.2%
BOB	1.1%
Canara	1.1%
ICBK	1.0%
Union	1.0%
PNB	0.9%
OBC	0.8%
CRPBK	0.8%
UTBK	0.7%
HDBK	0.5%

Source: RBI, Morgan Stanley Research

### Date to Watch

24<sup>th</sup> April – RBI Monetary Policy Meeting

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	Count	% of Total	Count	% of Total IBC	% of Rating Category
<b>Overweight/Buy</b>	<b>843</b>	<b>38%</b>	<b>292</b>	<b>44%</b>	<b>35%</b>
<b>Equal-weight/Hold</b>	<b>991</b>	<b>45%</b>	<b>284</b>	<b>42%</b>	<b>28%</b>
<b>Underweight/Sell</b>	<b>364</b>	<b>17%</b>	<b>95</b>	<b>14%</b>	<b>26%</b>
<b>Total</b>	<b>2,198</b>		<b>671</b>		

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**Industry Coverage:India Financial Services**

Company (Ticker)	Rating (as of)	Price (04/13/2007)
<b>Anil Agarwal</b>		
HDFC (HDFC.BO)	E (04/08/2004)	Rs1,561.1
HDFC Bank (HDBK.BO)	E (10/18/2006)	Rs979.35
ICICI Bank (ICBK.BO)	E (04/04/2006)	Rs872.6
IDFC (IDFC.BO)	O (09/16/2005)	Rs93.25
Kotak Mahindra Bank (KTKM.BO)	U (08/21/2006)	Rs489.15
Punjab National Bank (PNBK.BO)	O (03/23/2007)	Rs456.75
State Bank of India (SBI.BO)	E (03/23/2007)	Rs999.3
UTI Bank (UTBK.BO)	E (07/15/2005)	Rs469.05
<b>Anil Bang</b>		
Bank of Baroda (BOB.BO)	O (10/06/2006)	Rs226.85
Bank of India (BOI.BO)	O (11/30/2006)	Rs180.25
Canara Bank (CNBK.BO)	O (05/25/2006)	Rs196.3
Corporation Bank (CRBK.BO)	O (08/10/2006)	Rs281.45
IDBI (IDBI.BO)	U (10/21/2005)	Rs79.9
Oriental Bank of Commerce (ORBC.BO)	O (03/23/2007)	Rs189.2
Union Bank of India (UNBK.BO)	O (05/15/2006)	Rs103.85

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