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Performance of Banks: Q3-FY17

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The banking sector is going through considerable stress given the burgeoning NPA challenge as banks are working towards reviewing their asset portfolio and making the requisite provisions which in turn has affected their profits. Based on the AQR guidelines brought in by the government in late 2015 banks have been making substantial provisions as the NPA levels have increased sharply. Conditions continue to remain grim in Q3-FY17. But it does appear that things are poised to improve after two quarters.

The foregoing study is based on the performance of a sample of 39 banks including 24 PSBs and 15 private banks for the third quarter of FY17. This quarterly performance has been juxtaposed with that in 2014 and 2015 to get a fair picture. The banking system it may be remembered was subjected to a 'clean-up' operation towards the end of 2015 which has changed the numbers significantly. Further, the performance across the two segments is quite disparate.

For the aggregate sample Table 1 highlights the following:

- Net interest income growth has been declining in the last 2 years from 8.1% in 2014 to 5.3% and 3.4% respectively in 2015 and 2016 respectively. The performance has been drawn down by the PSBs, which have witnessed negative growth of 1.8% and 0.8% in the last two years. Growth in interest expenses has been higher than that of interest earned in both the years. For the private banks while growth in both interest earned and expended was high and positive, NII growth slowed down to 11.5% in 2016 from 21.5% in 2015.
- The sample companies benefited from 'other income' which was largely treasury gains as interest rates have declined in 2016 following RBI's reduction of the repo rate as well as suasion at better rate transmission by banks. For the sample, other income increased by 43.8% with PSBs witnessing 63.3% and private banks 15.9%. This has helped in steadying growth in operating profits even though growth in operations expenses was higher.
- The share of other income in total income (defined as interest income plus other income) increased for the sample from 12.2% to 16.3% with PSBs being at 15.4% and private banks 18.4% level.

- Operating costs for the sample companies increased at a higher rate of 13.5% in 2016 compared with 10.7% in 2015. This was witnessed for both the sets of banks.
- Growth in operating profit was higher at 18% compared with 3.3% last year. It increased for PSBs from -8.2% to 25.4% and in case of private banks has slowed down from 24.8% to 7.8%.
- Growth in provisions (where typically 85% is for NPAs) has slowed down sharply in Q3-FY17 from 106.2% to – 8.0%. This was more because of very high provisioning being made in in 2015 following the RBI's guidance.
- Net profit, which declined from Rs 16,807 cr in 2014 to Rs 313 crore in 2015, increased to Rs 10,219 crore in 2016. For PSBs there was an improvement from (-) Rs 10,905 crore to Rs 568 crore whereas for private banks there was a decline from Rs 11,218 crore to Rs 9,651 crore.
- Overall profit margin for the banking sector shows improvement, though the movement for PSBs was from -6.6% to 0.3%.

Table 1: Performance of 39 banks in Q3 (October-December)

Rs cr	2014	2015	2016
Interest earned	214,587	223,582	228,526
Other income	28,063	30,984	44,565
Interest paid	147,888	153,323	155,882
NII	66,700	70,258	72,644
Operating cost	45,198	50,028	56,762
Operating profit	49,565	51,215	60,447
Provisions	23,646	48,764	44,879
PBT	25,782	2,451	15,568
PAT	16,807	313	10,219
Gross NPA	292,193	437,859	697,409
Gross Advances	6,615,922	7,273,068	7,495,631
Growth (%)			
Interest earned	8.6	4.2	2.2
Other income	27.6	10.4	43.8
Interest paid	8.8	3.7	1.7
NII	8.1	5.3	3.4
Operating cost	12.0	10.7	13.5
Operating profit	14.5	3.3	18.0
Provisions	11.8	106.2	-8.0
PBT	16.5	-90.5	535.2
PAT	12.1	-98.1	3166.1
Gross NPA	20.4	49.9	59.3
Gross Advances	10.2	9.9	3.1
Ratios (%)			
Other income to total income	11.6	12.2	16.3
PAT to interest earned	7.8	0.1	4.5
Provisions to Operating profits	47.7	95.2	74.2
NPA/advances	4.4	6.0	9.3
Operating cost to total cost	23.4	24.6	26.7

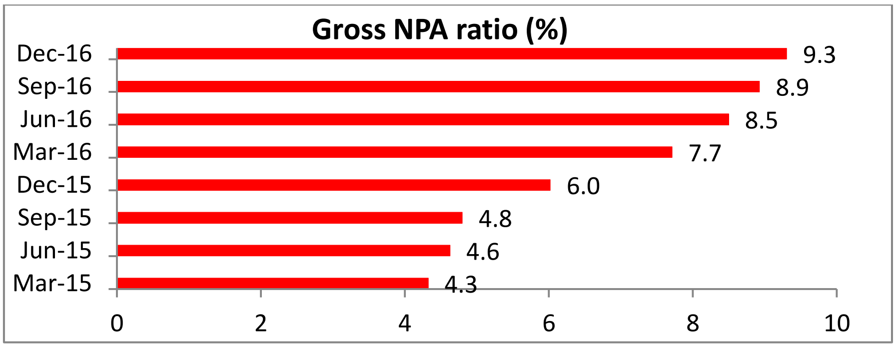
Source: Ace equity

Non-performing assets

Gross NPAs continued to increase in 2016 by 59.3% on top of 49.9% in 2015. This was witnessed in both PSBs which was almost stable at 56.4% (50.1% in 2015) and private banks where they increased sharply by 84.2% (47.7%). This is probably the biggest challenge for the system where the government and RBI are working on various modes of controlling the proliferation of NPAs.

The Gross NPA ratio was high at 9.3% for the entire sample with PSBs having a ratio of 11.2% and private banks 4.1%. Both sets of banks witnessed an increase in this ratio over this time period. The comparable ratios in 2015 were 7.2% and 2.5% respectively.

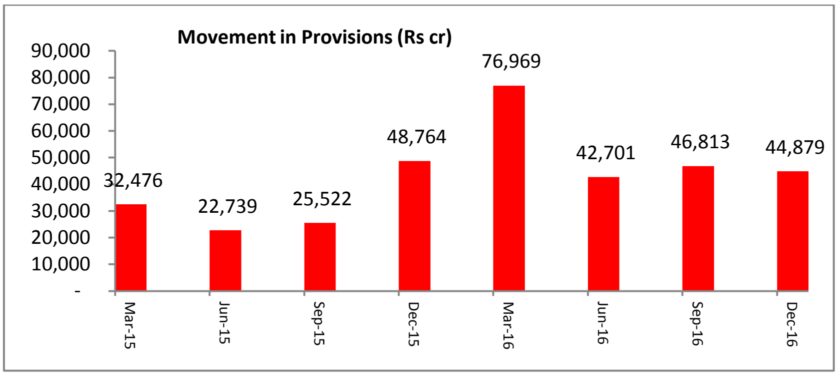
The Chart below tracks the movement in the Gross NPA ratio since March 2015. The recognition norms came in from December 2015 onwards, but have shown a rising trend since March 2015 with acceleration setting in post-December.



Source: Ace equity

Is the worst over yet?

The return to normalcy will be predicated by a combination of factors. First, the state of the economy should improve. A negative relationship has been observed between GDP growth and NPA growth. A recovery in the economy, which is expected in FY18, would help to control incremental growth in NPAs. Second, the extent to which NPAs have been recognized would be important for presently it is uncertain whether this part is completed or not. The RBI had spoken of the books being in order by March 2017, which implies that there should be theoretically one more quarter of distress which will have to address past NPAs. Third, going by the aggregate provisioning that has been made by banks over the last 5 quarters, it does appear that the level had moderated in the last three quarters and should taper downwards hopefully in FY18.



Source: Ace equity

Fourth, the demonetization impact on NPAs is still not clear. The RBI had made allowances here for the SMEs by widening the window. However, the Q4 number on NPAs would be critical when it can be gauged whether or not the amount is significant. Putting these factors together it is expected that the NPA strain would last for two more quarters up to June 2017.

On the profitability front, banks would tend to be challenged based on the present state of liquidity where deposits have risen while credit has lagged. NII margins would tend to be pressurized until such time that demand for credit picks up at the normal pace. With GSec yields remaining stable at a higher level, and no rate cut expected till March 2017, treasury gains would tend to get restricted in Q4. Subsequently, the RBI action on interest rates would guide such prospects.

Major developments to look forward to in FY18

- Growth of small and payments banks and their impact on commercial banks
- Proliferation of e-wallets and other modes of payments and their impact on bank business.
- RBI stance on interest rates considering that a neutral position has been taken in the last Policy. Inflation will be the key to this decision.
- Capital infusion for PSBs and their progress to adhere to Basel III
- Merger of SBI and Associates and the harmonization process.

Appendix:

Table 2: Performance of Public sector banks

	Public sector banks		
Growth Rates (%)	**2014**	**2015**	**2016**
Interest earned	7.6	0.5	-0.7
Other income	30.6	3.3	63.3
Interest paid	8.8	1.3	-0.6
NII	4.6	-1.3	-0.8
Operating cost	9.8	8.1	10.5
Operating profit	11.5	-8.2	25.4
Provisions	7.5	107.7	-17.5
PBT	18.2	-220.1	-111.2
PAT	5.9	-258.1	-105.2
Gross NPA	19.8	50.1	56.4
Gross Advances	8.6	6.7	-0.3
Ratios (%)	**2014**	**2015**	**2016**
Other income to total income	9.8	10.0	15.4
PAT to interest earned	4.2	-6.6	0.3
Provisions to Operating profits	64.5	145.9	95.9
NPA/advances	5.1	7.2	11.2
Operating cost to total cost	21.8	22.9	24.8

Table 3: Performance of Private sector banks

	Private sector banks		
Growth (%)	**2014**	**2015**	**2016**
Interest earned	12.2	15.9	10.2
Other income	22.9	22.5	15.9
Interest paid	9.0	12.7	9.4
NII	17.5	21.1	11.5
Operating cost	17.7	17.2	20.5
Operating profit	20.5	24.8	7.8
Provisions	58.7	95.6	66.6
PBT	15.1	10.9	-12.4
PAT	16.8	13.2	-14.0
Gross NPA	26.3	47.7	84.2
Gross Advances	16.1	21.4	13.4
Ratios (%)	**2014**	**2015**	**2016**
Other income to total income	16.9	17.7	18.4
PAT to interest earned	19.4	19.0	14.8
Provisions to Operating profits	16.4	25.7	39.6
NPA/advances	2.1	2.5	4.1
Operating cost to total cost	29.0	29.8	31.9

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