

BANKING SECTOR PERFORMANCE STUDY – H1FY14

Our study covers 39 banks – 26 Public Sector Banks & 13 Private Sector Banks.

Foreword

As per the Central Statistical Organization (CSO) the GDP growth stood at 5% in FY13 as compared to 6.2% in FY12 with growth in most sectors being lower than earlier presented advance estimates of GDP. For Q2FY14, the GDP growth was at 4.8% as compared to 4.4% for Q1FY14, indicating continuing broad-based slowdown in the economy with moderation in the services sector, and contraction in industrial output.

The Index of Industrial Production (IIP) numbers during the month of September, 2013 showed that the cumulative growth in H1FY14 showed marginal improvement to 0.4% as compared 0.1% in H1FY13. However, the growth scenario continued to be largely subdued. The manufacturing sector showed stagnated growth (0.1%) on account of slackened demand conditions both in domestic as well as global markets, high borrowing costs and overall dull investment scenario in the country.

In the Second Quarter Review of the Monetary Policy, the Reserve Bank of India (RBI)'s major area of focus was to curb increasing inflationary pressures in a situation of weak economic growth. The RBI raised the repo rate by 25 bps from 7.50% to 7.75% and reduced the Marginal Standing Facility (MSF) rate by 25 bps from 9.00% to 8.75% to complete the re-aligning of interest rates to normal monetary operations.

The environment of overall subdued economic activity continued to impact the banking sector as weakening of corporate top-line resulted in deceleration in credit and deposit growth and in turn impacted their profitability indicators. The banking sector has also seen marked deterioration in its asset quality during FY13 with significant rise in Non Performing Assets (NPAs) and restructured advances. The persistent slowdown continued to put pressure on the asset quality of banks further deteriorating the asset quality of the banks during H1FY14.

Asset quality – remains to be the area of concern

Slowdown in the overall economy and high interest rates has affected the debt repayment capacity of the borrowers which has put pressure on the asset quality of banks during H1FY14. CARE has done a study of performance of 39 banks for H1FY14. The Gross NPAs of the banks under study showed an increase of 38.11% (y-o-y) in H1FY14 vis-à-vis credit growth of 17.96% (y-o-y) during the same period. The Gross NPAs of the Public Sector Banks (PSBs) saw an increase of 41.41% while that of the private sector banks was comparatively lower at 12.91%.

Overall Gross NPA ratio has sequentially risen from 2.79% as on March 31, 2012 to 3.26% as on March 31, 2013 to 3.98% as on September 30, 2013.

On comparing the asset quality of PSBs vis-à-vis private sector banks, it can be observed that PSBs have witnessed higher deterioration in asset quality than their private sector peers. The Gross NPA ratio for PSBs stood at 4.47% (March 2013: 3.59%) as compared to 1.95% (March 2013: 1.86%) for private sector banks as on September 30, 2013.

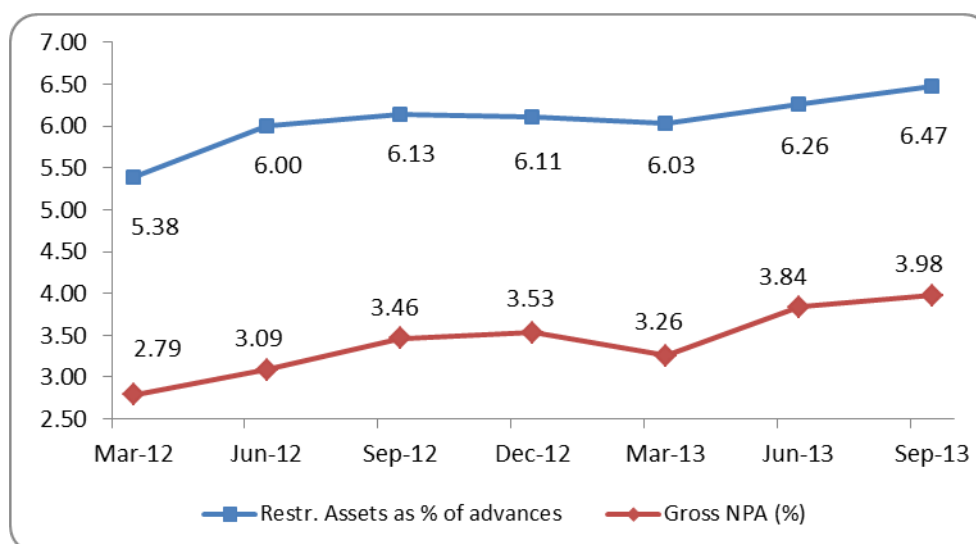
	Overall			Public Sector Banks			Private Sector Banks		
	31.03.12	31.03.13	30.09.13	31.03.12	31.03.13	30.09.13	31.03.12	31.03.13	30.09.13
Gross NPA Ratio	2.79	3.26	3.98	2.98	3.59	4.47	1.96	1.86	1.95
Net NPA Ratio	1.04	1.71	2.27	1.18	2.00	2.67	0.36	0.36	0.61
Net NPA / Net Worth	13.04	16.39	20.91	17.54	22.39	29.26	2.70	2.97	3.39
Rest. Advances / Net Advances	5.38	6.03	6.47	6.24	7.05	7.61	2.02	1.71	1.76

In addition to higher NPAs, the PSBs also had a large amount of restructured advances which stood at 7.61% of advances (March, 2013: 7.05%) as on September 30, 2013. The restructured advances are accounts which have seen stress and there is a higher probability of them turning into NPAs.

The restructured advances as a proportion of advances stood comparatively lower at 1.76% (March 2013: 1.71%) for private sector banks as on September 30, 2013. An industry-wise analysis of NPAs shows that the major industries which have been putting pressure on asset quality are infrastructure (especially power), iron & steel, textiles and aviation.

The following graph shows the trend of Gross NPA (%) and restructured advances (%) from March 2012 to September, 2013.

Figure 1. Trend in Gross NPA ratio and Restructured Assets to Advances ratio



Source: CARE, Banks

Rise in restructured assets

The banks continued to see rise in restructured advances during H1FY14. Total restructured assets of the banks under study increased to Rs.3.6 trillion as on September 30, 2013 from Rs.3.4 trillion as on March 31, 2013. The restructured advances as a proportion of advances stood at 6.47% as compared to 6.03% as on March 31, 2013 (March 31, 2012: 5.38%).

A study of the industry-wise distribution of the restructured accounts for 10 banks¹ revealed that Infrastructure, Power, Iron & Steel, Textiles and Aviation industries accounted for approximately 60% of the restructured assets outstanding as on September 30, 2013 (March, 2013: 59%). Following table gives the industry wise restructured assets outstanding.

Industry	Amount (Rs trillion)	(% share)
Infrastructure (including Power)	0.77	36.63
Textiles	0.19	9.24
Iron and Steel	0.18	8.54
Aviation	0.11	5.29
Total	1.26	59.71

¹ Banks for which industry-wise restructured assets was analysed accounted for 57% of the total restructured assets outstanding for all the banks under study

An analysis of the progress report of the Corporate Debt Restructuring (CDR) Cell during the period March, 2013 and September, 2013 shows that the major sectors where maximum cases of restructuring have been approved are iron & steel, infrastructure, textiles and power. The following table shows the amount approved under CDR for the top four industries as on various dates and their percentage share in the total amount approved for CDR.

(Rs crore)

Industry	31-Mar-13	% share	30-Jun-13	% share	30-Sep-13	% share
Iron & Steel	52,682	23.00	53,543	21.39	41,812	21.30
Infrastructure	21,912	9.60	34,676	13.85	35,543	18.11
Textiles	17,767	7.80	20,662	8.26	19,545	9.96
Power	18,460	8.10	18,460	7.38	17,225	8.78
Total	229,014	100.00	250,279	100.00	196,267	100.00

Source: www.cdrindia.org

Note: These amounts do not account for the restructuring done by banks on a bilateral level.

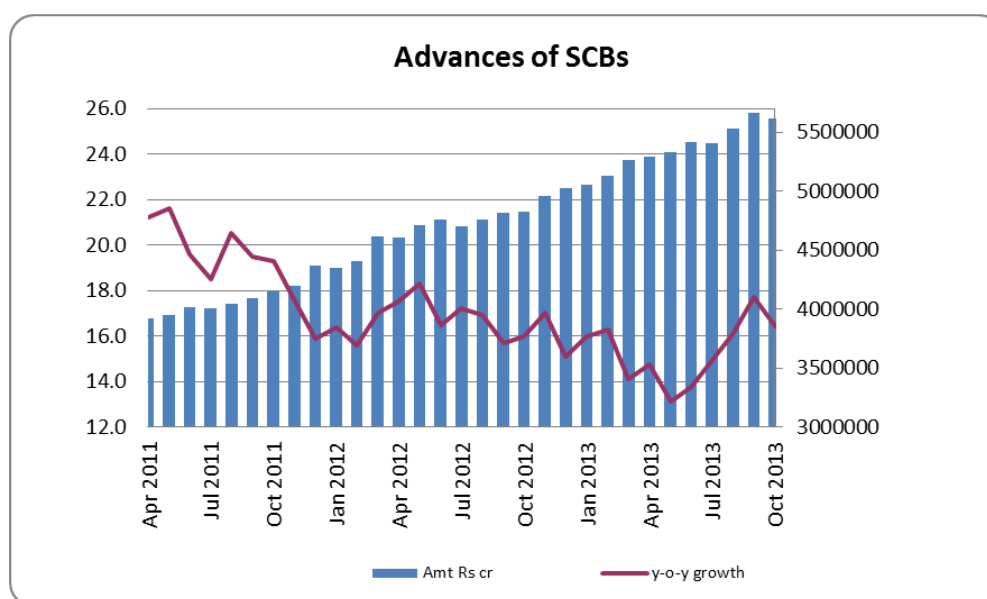
The total amount restructured under the CDR mechanism increased to Rs.2.5 trillion by June, 2013 as compared to Rs.2.3 trillion as on March, 2013. However, the amount of restructured debt under CDR declined to Rs.1.9 trillion by September, 2013 due to certain accounts exiting due to successful performance in the CDR package and certain accounts getting withdrawn on account of failure. The total number cases declined from 401 as on March 31, 2013 to 261 as on September 30, 2013. The infrastructure sector saw stress mainly during H1FY14 with the amount under CDR increasing by 62% as on September 30, 2013 as compared to March 31, 2013.

Some revival in credit growth

As per RBI publication, the credit growth for scheduled commercial banks (SCB) in India saw a decline in credit growth to 14.1% for FY13 as compared to 17% for FY12. A slowdown in the overall economy, risk aversion by banks due to rise in quantum of bad debts and regulatory bottlenecks affecting infrastructure sector led to the moderation in the credit growth.

During H1FY14, the banks saw some revival in credit growth at 17.70% (y-o-y) to reach outstanding credit at Rs.56.7 trillion as on October 04, 2013. Credit growth was observed in all the major sub-sectors, barring engineering, construction, and mining & quarrying. The RBI's liquidity tightening measures resulted in spike in interest rates in the money market resulting in the corporates shunning the CP market and approaching banks for their funding requirements. This led to higher credit growth in September, 2013.

Figure 2. Total Credit for SCBs and y-o-y growth



Source: RBI

The above graph shows a secular declining trend in credit growth since April, 2011 up to June, 2013. However, since Q2FY14, the overall credit growth has seen some uptick. The following table exhibits the Y-o-Y growth variation for industries:

Industry	Y-o-Y Variation %			
	31-Mar-12	31-Mar-13	30-Sep-12	30-Sep-13
Infrastructure	19.8	16.5	16.4	20.6
Of which Power	23.1	26.4	22.0	26.3
Of which Telecommunications	(6.2)	(5.5)	0.0	0.4
Of which Roads	20.0	18.8	23.0	16.7
Textiles	10.4	16.2	14.3	14.4
Metal & Metal Products	25.0	20.7	18.6	21.1
Engineering	21.3	12.9	18.2	16.7
Gems & Jewellery	30.0	18.5	15.9	28.8
Chemicals & chemical products	34.8	26.2	18.5	29.9
Mining & Quarrying	42.2	8.0	17.8	0.6

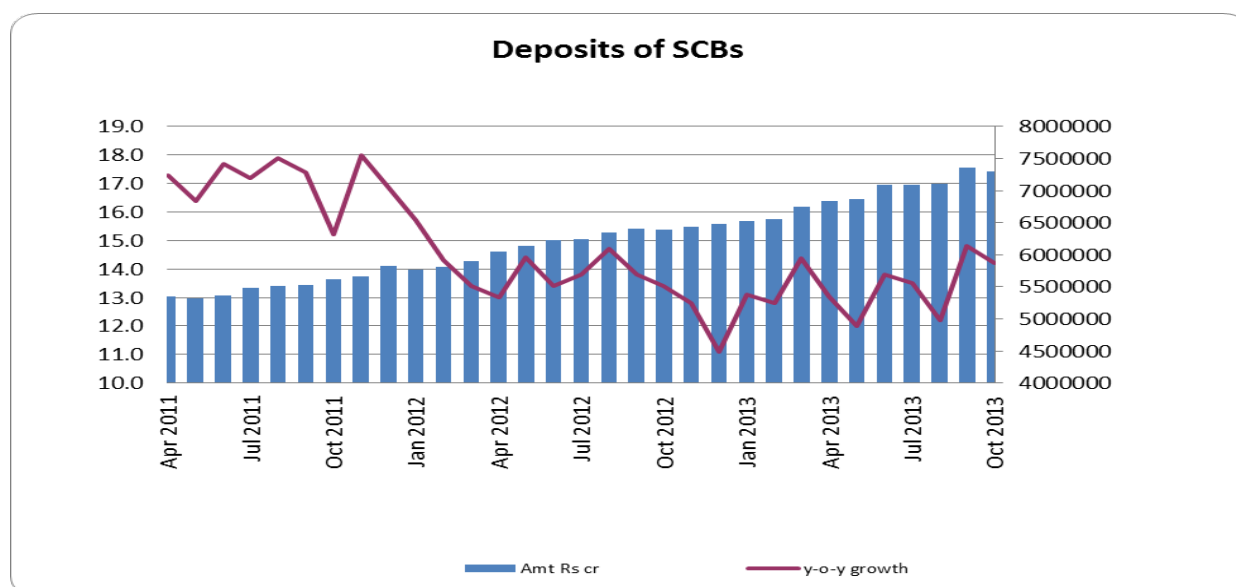
The following table shows the growth percentage for public sector banks and private banks covered in our study.

Advances	31-Mar-12		31-Mar-13		30-Sep-13	
	Amt (Rs bn)	Y-o-Y growth (%)	Amt (Rs bn)	Y-o-Y growth (%)	Amt (Rs bn)	Y-o-Y growth (%)
Overall	47,791	17.84	55,702	16.55	58,336	17.96
Public Sector Banks	38,795	17.25	45,082	16.21	47,006	18.48
Private Sector Banks	8,996	20.44	10,619	18.05	11,330	15.88

Moderation in deposit growth continued

The published data by the RBI showed that SCBs recorded a deposit growth of 14.4% during FY13 as compared to 13.4% during FY12. During H1FY14, the deposit growth was at 14.8% to reach Rs.73.06 trillion as on October 04, 2013.

Figure 3. Total Deposits for SCBs and y-o-y growth

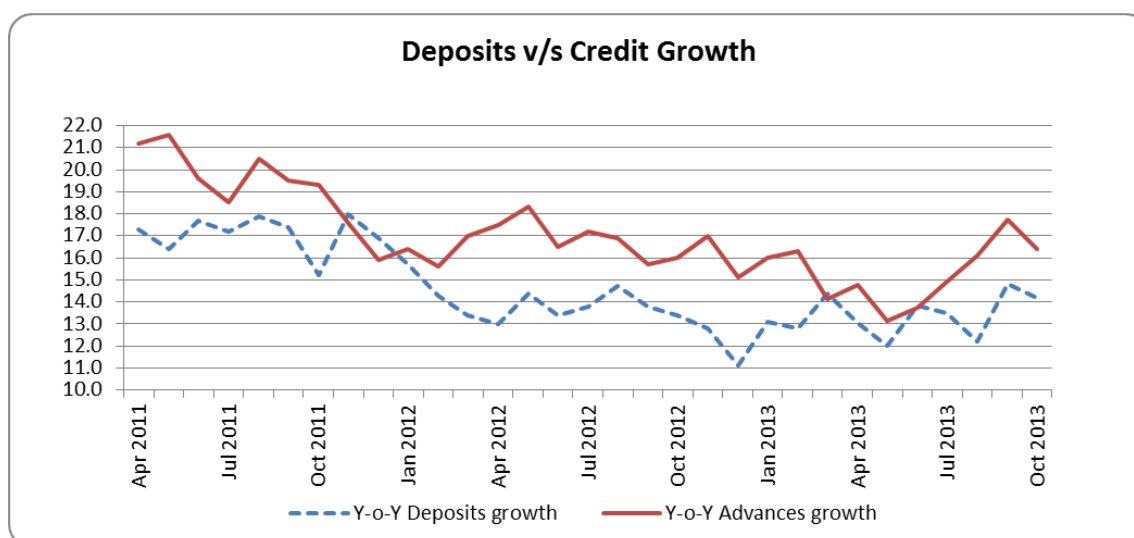


Source: RBI

For the banks covered in our study, the growth in total deposits stood at 15.54% y-o-y in FY13 (FY12:-15.25%). Deposit growth marginally declined to 15.30% (y-o-y) in H1FY14. The proportion of low cost Current Account Savings Account (CASA) remained at around 30%-33% as on September 30, 2013.

Deposits	31-Mar-12		31-Mar-13		30-Sep-13	
	Amt (Rs bn)	Y-o-Y growth (%)	Amt (Rs bn)	Y-o-Y growth (%)	Amt (Rs bn)	Y-o-Y growth (%)
Overall	60,881	15.25	70,343	15.54	73,932	15.30
Public Sector Banks	50,020	15.01	57,457	14.87	60,700	15.98
Private Sector Banks	10,861	16.36	12,886	18.64	13,231	12.28

Figure 4. Deposits v/s Credit growth



Source: RBI

Financial performance for the half year ended September, 2013

Pressure on margins and asset quality stress has impacted profitability especially for public sector banks

The 39 banks covered in our study showed that the growth in total income continued to show saw sharp moderation to 12.29% (y-o-y) during H1FY14 as compared to 19.73% (y-o-y) growth during H1FY13. The Net Interest Income (NII) grew by 10.87% during H1FY14 as compared to 13.73% during H1FY13 due to higher cost of funds and rise in NPAs resulting in reversal of interest income. The banks saw a growth of 26.44% in non-interest income led by treasury income generated in Q1FY14 on account of soft interest rates.

Growth H1FY14 (Y-o-Y)	Total Income	Net Interest Income	Net Profit (PAT)	Non-Interest Income
Category	%	%	%	%
Overall	12.29	10.87	(11.30)	26.44
Public Sector Banks	11.43	6.87	(27.43)	27.41
Private Sector Banks	15.21	23.44	22.85	24.62

The impact of moderation in credit growth and slowdown in the manufacturing and core sector was largely felt by public sector banks as they were unable to maintain spread in FY13. The Net Interest Margin (NIM) for public sector banks declined to 2.58% for FY13 as compared to 2.78% for FY12 and remained at FY13 levels during the first half of FY14.

Growth Y-o-Y %	Net Interest Margin (NIM) (%)			Return on Total Assets (ROTA) (%)		
	FY12	FY13	H1FY14*	FY12	FY13	H1FY14*
Overall	2.86	2.73	2.78	1.01	0.96	0.80
Public Sector Banks	2.78	2.58	2.58	0.88	0.78	0.56
Private Sector Banks	3.17	3.26	3.55	1.52	1.61	1.69

*annualized

Due to contraction in margins coupled with rise in provisioning (mainly for NPAs) on account of worsening asset quality and rise in operating costs the profitability of public sector banks was impacted. The public sector banks under study reported de-growth of 27.43% in Profit After Tax (PAT) during H1FY14 as compared to growth of 2.16% in FY13 over FY12. Public sector banks other than the State Bank of India (SBI) group reported de-growth of 28.73% in PAT for H1FY14. However, the private sector banks were able to maintain their margins and asset quality due to which they were able to report a growth of 22.85% in PAT for H1FY14.

The provisioning cost (excluding provision for Income Tax) for banks under study increased sharply by 56.33% (y-o-y) in H1FY14. Overall provisions for public sector banks increased by 56.98% and for private sector banks the provisions increased by 52.00% for during H1FY14. The provisioning cost as a proportion of Net Interest Income stood at 41.03% for PSBs as compared to 16.08% for private sector banks for H1F14 indicating credit costs largely impacted the profitability of PSBs.

The operating expenses increased by 21.66% in H1FY14 for the banks under study. The rise in operating costs for PSBs was at 24.21% on account of increase in employee costs as compared to rise of 14.98% for private sector banks. Overall the Cost to Income ratio for public sector banks was 48.94% whereas that for private sector banks stood at 42.91% for H1FY14.

To summarize, the profitability of the public sector banks was largely impacted on account of slowing economy leading to weakening of income profile, pressure on margins and higher provisioning on account of weakening asset quality. On the other hand, the private sector banks continued to show stable growth in income and were able to maintain profitability and asset quality.

Government support to public sector banks required to maintain healthy capital adequacy ratio under Basel III

The capital adequacy levels for the select banks continued to be comfortable with strong levels of core (Tier I) capital. The overall median CAR stood at 12.59% as on March 31, 2013 as compared to median CAR of 13.26% as on March 31, 2012.

As mandated by the RBI, Indian banks started computing and reporting CAR under Basel III from quarter ended June 30, 2013. As on September 30, 2013 all the banks under study continued to report CAR in excess of minimum regulatory requirement of 9%. The median Tier I CAR under Basel III was at 8.73% with the median Tier I CAR for private sector banks being higher at 11.38% as on September 30, 2013 which was higher than stipulated minimum of 6.5% as on March 31, 2014 during the transition phase of fully shifting to Basel III by March 31, 2018.

Category	Median CAR (%)				Median Tier I CAR (%)			
	31.03.12	30.09.12	31.03.13	30.09.13	31.03.12	30.09.12	31.03.13	30.09.13
	Basel II			Basel III	Basel II			Basel III
Overall	13.26	12.41	12.59	11.43	9.45	8.99	9.12	8.73
Public Sector Banks	12.92	12.22	12.10	10.87	8.99	8.57	8.49	8.00
Private Sector Banks	14.00	13.73	14.73	14.64	11.37	11.40	12.05	11.38

The Basel III guidelines lay emphasis on the quality of a bank's capital to provide robustness in order to absorb any shocks arising from financial and economic stress. As a result, there is a higher emphasis on the component of equity and equity-like instruments counted as capital of a bank which form the Tier I component of equity.

Under Basel III, all Indian banks have to maintain a minimum Common Equity Tier I capital of 5.5% excluding Capital Conservation Buffer (CCB) and minimum Total CAR of 9% by March 31, 2018. Over and above the total CAR of 9%, the banks have to build up a CCB of 2.5% by March 31, 2018 and maintain on an on-going basis. The CCB would constitute of equity capital. The banks would be allowed to issue two types of capital instrument viz. Tier I bonds and Tier II bonds which would be classified as part of Tier I capital or Tier II capital respectively.

Tier I Bonds under Basel III have additional loss absorption features and coupon discretion features. The loss absorption feature requires the issuing bank to write-off / convert the bond into equity in case the bank faces financial difficulties and its minimum Common Equity Tier I ratio of 6.125% breached or the bank has reached the Point of Non Viability (PONV) as determined by the RBI. Under Basel III, only one category of Tier II bonds are allowed which have loss absorption features by which the instruments can be written-off / converted into equity up on declaration of non-viability by the RBI.

Outlook

A host of factors like slowdown in the overall economy, risk aversion by banks due to rise in quantum of bad debts and regulatory bottlenecks affecting sectors like infrastructure led to the decline in the credit growth for scheduled commercial banks in FY13 to 14.1% from 17% a year ago. As on October 4, 2013, on a y-o-y basis, credit growth stood at around 18% whereas deposits grew around 15%. Credit to industry increased by 17.6% in September 2013 as compared with the increase of 17.0% in September, 2012. Acceleration in credit growth to industry was observed in all the major sub-sectors, except engineering, construction, and mining & quarrying. On the deposit front, growth in term deposits base was low at 13.7% as compared to 17.6% growth in demand deposits as on September 30, 2013. The RBI's liquidity tightening measures resulted in spike in interest rates in the money market, as a result corporate approached banks for their funding requirements shunning the CP market. This led to higher credit growth in H1FY14. However, gradual withdrawal of measures has softened rates in the CP market. This may result in corporates shifting to CP market for funds which would lead to softening of credit growth going forward. For FY14, CARE expects advance growth to be around 13-15% given CARE's GDP growth estimate of 4.9%. With capex plans being on hold the project loan demand is expected to be tepid. CARE expects the deposit growth to be around 14-15% given that the high level of inflation has impacted the savings ability of people as well as the attractiveness of fixed deposits as a mode of investment.

Slower credit growth leading to weakening of income, pressure on margins and higher provisioning on account of weakening asset quality impacted the profitability of Indian banks. The PSBs saw higher impact on their profitability as compared to private sector banks which were able to maintain profitability and asset quality.

Deterioration in asset quality continues to be the major factor impacting profitability of banks in the near future. As per CARE's estimate the overall Gross NPA ratio for the banks under study would be around 4.5% by March 31, 2014 with higher proportion coming from PSBs whose Gross NPA ratio is estimated to rise to around 5%. Further, banks will have to provide more for restructured assets as per the RBI's guidelines. These factors would exert downward pressure on margins and are likely to impact profits for FY14 by around 25%-30% (y-o-y).

The capital adequacy levels for the select banks continued to be comfortable. Indian banks would require capital infusion at regular intervals to maintain their credit growth as well to maintain adequate cushion to withstand asset quality pressures and comply with Basel III norms. This coupled with the sharp rise in NPAs necessitates the Government of India (GOI) to infuse capital in PSU banks. The continuing pressures on asset quality and profitability are the major challenges faced by the Indian banking sector.

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