Decline in Credit Cost Drives Banks' Net Profit Up in Q4FY22

June 17, 2022 | BFSI Research

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Synopsis

The gross banking credit growth registered a more than double rise year-on-year (y-o-y) to reach 9.6% in March 2022 due to pick-up in the business activities, credit push by the banks at the close of the fiscal year and the low-base effect. The banks were also able to improve their Net Interest Margin (NIM) as retail growth picked up, witnessing lower cost of funds and the low-base effect. Non-interest income dropped sharply due to reporting lower other income as the rising yields impacted treasury profits. As a result, the Pre-Provisioning Operating Profit (PPOP) were muted. However, with the improvement in the asset quality requiring a lower amount of incremental provisioning, the overall profitability of the banks saw significant improvement.

Highlights

- The non-food credit rose by 9.7% y-o-y as against a growth of 4.5% in March 2021 due to a low-base effect, economic expansion, extended ECLGS support, rising commodity prices, low interest rate, and retail credit push by banks at the close of the fiscal year.

- NIMs of Scheduled Commercial Banks (SCBs) improved by 17 basis points (bps) y-o-y to 2.8% in Q4FY22 due to relatively higher growth in retail loans, improvement in asset quality, and a low-base effect.

- The total income of SCBs rose by 3.1% y-o-y in Q4FY22 on account of growth in interest income, primarily driven by private sector banks (PVBs). However, the decline in non-interest income partially impacted the overall growth. Non-interest income of SCBs declined by 18.6% in Q4FY22 as treasury income was impacted by a rise in bond yields.

- SCBs PPOP improved marginally by 2.4% y-o-y to Rs.1.0 lakh crore in Q4FY22 due to an improvement in net interest income (NII). However, it was partially impacted by higher operating expenses.

- Credit cost for SCBs (annualized) declined to 0.7% in Q4FY22 from 1.4% in Q4FY21 due to lower provisioning and improvement in asset quality.

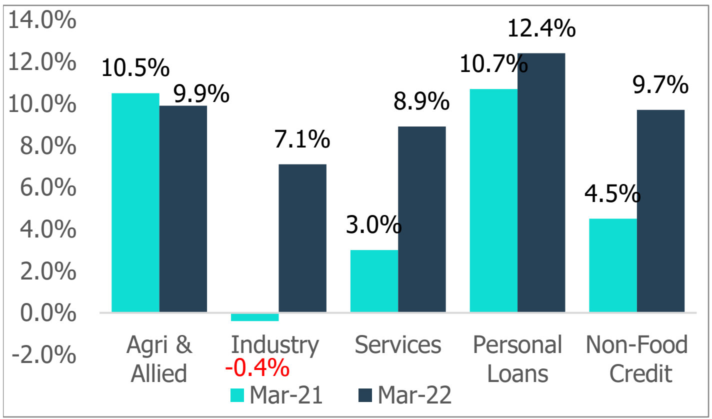
- The Gross Non-Performing Asset (GNPA) ratio of SCBs declined to 6.1% as of March 31, 2022, from 7.6% as on March 31, 2021, while net non-performing assets (NNPAs) reduced to 1.8% as of March 31, 2022, from 2.5% as on March 31, 2021.

- Net profit of SCBs grew by 89.0% y-o-y to Rs.48,527 crore in Q4FY22 due to lower credit cost (provisions) and marginal growth in PPOP. Public sector banks (PSBs) reported a rise of 86.5% in their net profit to Rs.18,088 crore in the reporting period, while PVBs reported a rise of 90.4% to Rs.30,439 crore.

- Return on assets (RoA, annualized) of SCBs improved by 35 bps y-o-y to 1.02% in Q4FY22 primarily due to lower credit cost. RoA of PVBs improved by 52 bps to 1.7% in Q4FY22 whereas PSBs improved by 24 bps to 0.57% in the reporting period.

Overview

Figure 1: Segmental Credit Growth (%)



Source: RBI

The non-food credit rose by 9.7% y-o-y as against a growth of 4.5% in March 2021, expanding by a huge 521 bps due to a low-base effect, pickup in the business activities, and credit push by the banks at the end of the fiscal year. The credit of the retail loans segment continued its double-digit growth at 12.4% in y-o-y in March 2022 primarily on account of growth in small ticket loans. Credit growth for the industry also rose by 7.1% y-o-y in March 2022 compared to a drop of 0.4% in March 2021. Services' credit also saw an acceleration to 8.9% y-o-y in March 2022 as compared to 3.0% in March 2021.

Table 1: Movement in Interest Rates (%)

SCBs			PSBs			PVBs		
Month	**TDR<1 yr**	**WALR (O/S loan)**	**Month**	**TDR<1 yr**	**WALR (O/S loan)**	**Month**	**TDR<1 yr**	**WALR (O/S loan)**
Dec-20	5.46%	9.27%	Dec-20	5.51%	8.69%	Dec-20	5.65%	10.31%
Mar-21	5.28%	9.10%	Mar-21	5.33%	8.52%	Mar-21	5.53%	10.14%
Jun-21	5.17%	9.00%	Jun-21	5.24%	8.51%	Jun-21	5.39%	9.92%
Sep-21	5.07%	8.92%	Sep-21	5.14%	8.44%	Sep-21	5.27%	9.80%
Dec-21	5.04%	8.86%	Dec-21	5.12%	8.36%	Dec-21	5.18%	9.77%
Mar-22	5.03%	8.74%	Mar-22	5.11%	8.22%	Mar-22	5.13%	9.65%

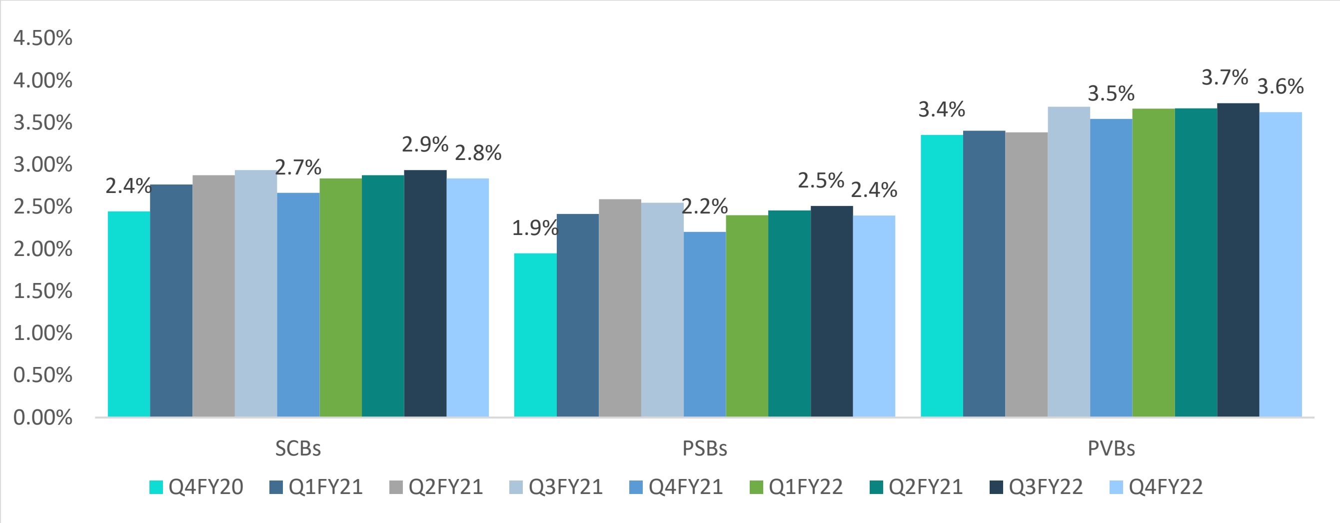
Source: RBI

SCB's spread between Weighted Average Lending Rate (WALR) for outstanding loans and Weighted Average Domestic Term Deposit Rate (WADTDR) marginally declined by 11 bps y-o-y and stood at 3.71% in March 2022 due to a higher drop in WALR as compared to WADTDR. PSBs' WATDR and WALR outstanding loan spread dropped by 9 bps to 3.24% in March 2022, while PVBs' spread declined by 3 bps to 4.52% in the same period. Overall, interest rates declined during the quarter and ruled at low levels which helped the banks to improve their credit growth.

In one of the key recent developments for the sector, RBI has increased the repo rate twice by 40 bps to 4.4% on May 04, 2022, and 50 bps to 4.9% on June 08, 2022. Given that inflation continues to remain above RBI's target, additional hikes are expected during the year. Banks have also raised their MCLR and deposit rates. Thus, the banking interest rates have bottomed out and would rise in the period ahead, however, the banks are likely to protect their NIMs.

NIM

Figure 2: Net Interest Margin (NIM %) of SCBs



Source: Ace Equity, CareEdge Calculations

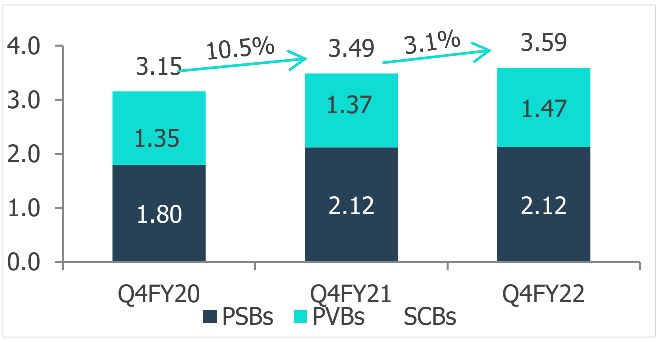
- NII of SCBs grew by 17.1% y-o-y to Rs.1.41 lakh crore in Q4FY22 on account of a low base, growth in interest income driven by improved lending activities. NII of PSBs grew by 18.5% y-o-y, while NII of PVBs rose by 15.5% vs Q4FY21 due to growth in the interest income. The NII of PVBs is higher than their interest expenses due to maintaining a higher interest spread, indicating their strong franchise with both depositors and borrowers.

- NIM of SCBs improved by 17 bps y-o-y at 2.8% in Q4FY22 due to higher growth in retail loans and improvement in asset quality. NIM of PSBs improved by 20 bps at 2.4% in Q4FY22 whereas PVBs improved by 8 bps to 3.6% in the same period.

- In September 2020, the Supreme Court of India, considering the Covid-19 situation, directed that accounts which were not declared NPA till August 31, 2020, shall not be declared NPA. Hence the banks did not recognize the NPAs. Eventually, the final order of the Supreme Court came in Q4FY21, and the banks were allowed to recognize NPAs during the quarter which impacted interest income and NIM.

Total Income

Figure 3: Total Income of SCBs (Rs. Lakh - Crore)



Source: Ace Equity, CareEdge Calculations

- Total income of SCBs rose by 3.1% y-o-y to Rs.3.59 lakh crore in Q4FY22 on account of healthy recovery in loan growth due to a low-base effect. The loan growth was driven by retail loans. However, the total income growth was partially impacted by an 18.6% drop in other income during Q4FY22.

- Other income of SCBs accounted for a 16.0% share of the total income in Q4FY22, declining from 20.2% in Q4FY21 and 16.5% in Q4FY20.
- Non-interest income of PSBs witnessed a sharp drop of 28.9% y-o-y in Q4FY22 due to a rise in the yield on government securities driven by hardening interest rates.
- Other income of PVBs also witnessed a marginal decline of 1.3% y-o-y and stood at Rs.26,012 crores for Q4FY22 vs. Rs.26,348 crores for Q4FY21 as fee income partially offset the loss of treasury income.

Operating Expenses (Rs. Lakh – Crore)

Figure 4: Employee Costs

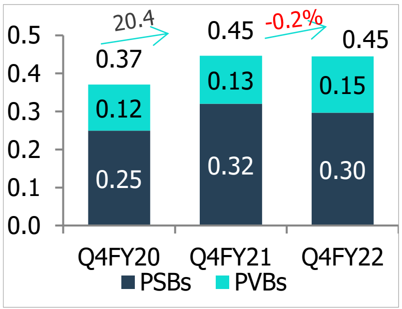


Figure 5: Other Expenses

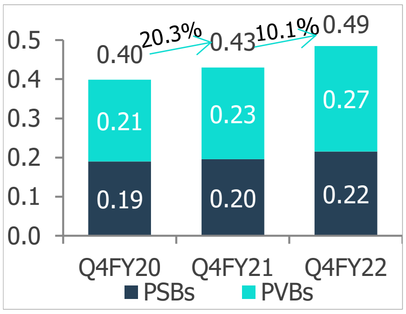
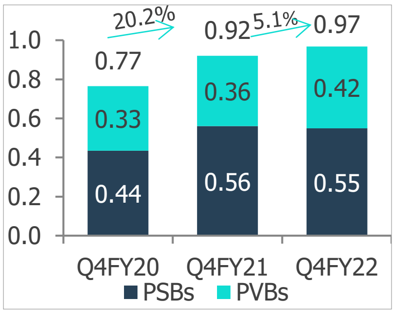


Figure 6: Total Op. Expenses



Source: Ace Equity, CareEdge Calculations

- The operating expenses of SCBs rose by 5.1% y-o-y to Rs.96,741 crore in Q4FY22 on account of an increase in other expenses due to higher commission and marketing expenses as the retail loan growth picked up. In view of digitalization, the banks are also focusing on process improvement and gradually increasing expenses for the same, thus adding up to the other expenses. Other expenses accounted for 50.1% of total expenses in Q4FY22 vs 46.7% in Q4FY21.
- Operating expenses of PVBs saw a rise of 16.2% y-o-y in Q4FY22 as other expenses rose by 15.0% and employee costs increased by 18.4%. The rise in employee cost was due to an increase in provisioning for variable compensation of employees.
- Meanwhile, PSBs saw a reduction in operating expenses of 2.0% y-o-y for Q4FY22, driven by a 7.4% reduction in employee cost. On an absolute basis, Q4FY22 operating expenses stood at Rs.54,922 crore vs Rs 56,205 crore for Q4FY21.

Table 2: Movement of Cost to Income Ratio

Cost to Income Ratio (%)	Q4FY20	Q4FY21	Q4FY22
PSBs	53.6%	51.5%	50.9%
PVBs	44.8%	43.7%	46.1%
SCBs	49.4%	48.1%	48.7%

Source: Ace Equity, CareEdge Calculations

- Cost to income ratio of SCBs expanded by 56 bps y-o-y to 48.7% due to relatively higher growth in other expenses driven by higher commission and marketing expenses as the retail loan growth picked up, and lower other income due to the impact of rising yields on treasury income.

- Cost to income ratio of PVBs rose by 240 bps y-o-y to 46.1% in Q4FY22 due to a sharp increase in their operating expenses whereas for the PSBs it declined by 62 bps y-o-y to 50.9% due to growth in NII (18%) and a decline in employee expenses.

Asset Quality

Figure 7: Gross NPAs & Net NPAs (Rs. Lakh Crore)

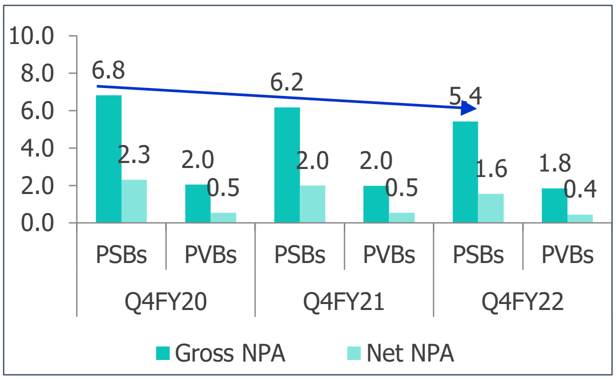
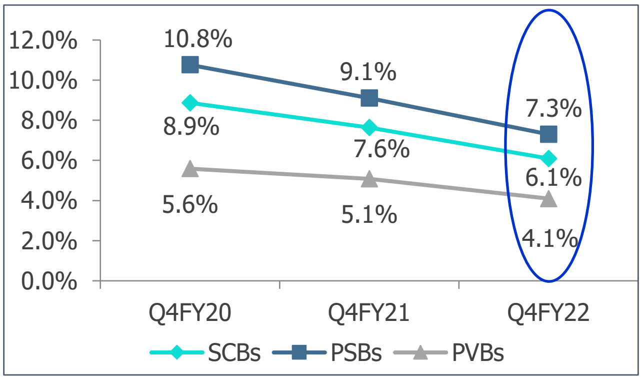


Figure 8: GNPA Ratio



Source: Ace Equity, CareEdge Calculations

- The GNPAs of SCBs dropped by 11.0% y-o-y to Rs.7.3 lakh crores as of March 31, 2022, vs Rs.8.2 Lakh crores as of March 31, 2021. The reduction was due to improvement in asset quality driven by lower slippages, higher recoveries and upgradations, and an increase in write-offs. GNPAs of PSBs also declined by 12.1% y-o-y to Rs.5.4 lakh crore in Q4FY22.

- The GNPA ratio of SCBs reduced to 6.1% as of March 31, 2022, from 7.6% as on March 31, 2021 and 6.7% as of December 31, 2021, which was largely driven by PSBs (GNPA ratio declined from 9.1% as on March 31, 2022 to 7.3% as on March 31, 2022.

- The GNPA ratio of PVBs reduced by 82 bps y-o-y to 4.1% as of March 31, 2022. PVBs fresh slippages hit a record low of 6 years standing at Rs.21,817 crores for Q4FY22 vs Rs.49,289 crores for Q4FY21.

- The credit cost of the SCBs (Annualized) declined to 0.7% in Q4FY22 from 1.4% in Q4FY21 and 2.0% in Q4FY20 due to improvement in asset quality and the SCBs assessing that they held adequate provisions (requiring lower additional provisions). The credit cost of the PSBs declined to 0.9% in Q4FY22 from 1.3% in Q4FY21 whereas for PVBs it declined to 0.5% in Q4FY22 from 1.7% in Q3FY22. In the wake of Covid-19, banks created more than the required level of provisions to have enough cushion in the balance sheet due to the uncertain scenarios created by the pandemic. However, the situation improved in H2FY22 and the impact on asset quality was lower than expected.

Table 3: Recoveries & Upgradation, Write-offs, and Slippages in Q4FY22 (Rs. Crore)

Banks	Recoveries & Upgradation	Write-Offs	Slippages
BoB	3,248	4,425	4,514
BoI	1,670	313	1,502
ICICI*	4,693	2,644	4,204
AXIS	3,763	1,697	3,981
PNB	4,769	10,548	9,575

*Gross Additions for slippages, Source: Bank filings

Table 4: Outstanding Restructured Assets in Q4FY22 (Rs. Crore)

PSBs	Q4FY20	Q4FY21	Q3FY22	Q4FY22
State Bank of India	8,881	17,852	40,000	30,960
Punjab National Bank	12,171	20,777	17,854	11567
Union Bank of India	10,605	31,826	22,211	21,442
Central Bank of India	4,950	12,992	9,511	8794
Indian Overseas Bank	12,627	14,674	11,996	9452
Total	**51,672**	**1,01,757**	**1,08,183**	**87,762**

Source: Bank filings

- Outstanding restructured assets of five PSBs (mentioned in table 4) dropped by 14.0% y-o-y 0.9 lakh crore as of March 31, 2022, from a year-ago period. Sequentially, it dropped by 19.0% in Q4FY22 from Rs.1.1 lakh crore.

Table 5: Outstanding Restructured Assets in Q4FY22 (Rs. crore)

PVBs	Q4FY20	Q4FY21	Q3FY22	Q4FY22
HDFC Bank Ltd.	254	10,086	23,200	15,500
ICICI Bank Ltd.	8,435	22,139	9,684	8,267
Axis Bank Ltd.	3,520	2,396	4,643	4,029
Yes Bank Ltd.	310	1,244	6,878	6,752
The Federal Bank Ltd.	397	1,618	3,723	3,963
The South Indian Bank Ltd.	848	1,277	2,567	2,417
Total	**13,764**	**38,760**	**50,695**	**40,928**

Source: Bank filings

- Outstanding restructured assets of six PVBs (mentioned in table 5) increased by 6.0% y-o-y to Rs.0.4 lakh crore as of March 31, 2022d. Sequentially, it dropped by 23.9% in Q4FY22 from Q3FY22.

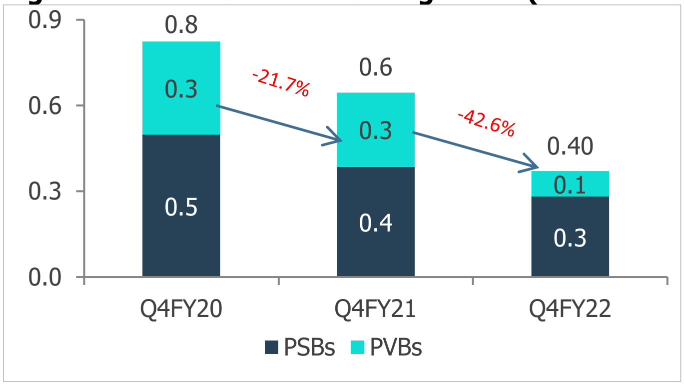
- SCBs NNPA dropped by 21.3% y-o-y to Rs.1.99 lakh crore in Q4FYY22 due to improvement in asset quality and lower provisioning. NNPAs of PVBs were also reduced from Rs.54,856 crores in Q4FY21 to Rs.44,029 crores in Q4FY22.

- The NNPA ratio of SCBs reduced to 1.8% in Q4FY22 from 2.5% in Q4FY21 and 2.03% in Q3FY22.

- The NNPA ratio of PSBs also reduced to 2.2% in Q4FY22 from 2.6% in Q3FY22 and 3.1% in Q4F21, whereas PVBs' NNPA ratio stood at 1.0% in Q4FY22 vs 1.4% in Q4FY21

Provisions and Contingencies (Profit & Loss)

Figure 9: Provisions and contingencies (Rs. Lakh Crore)



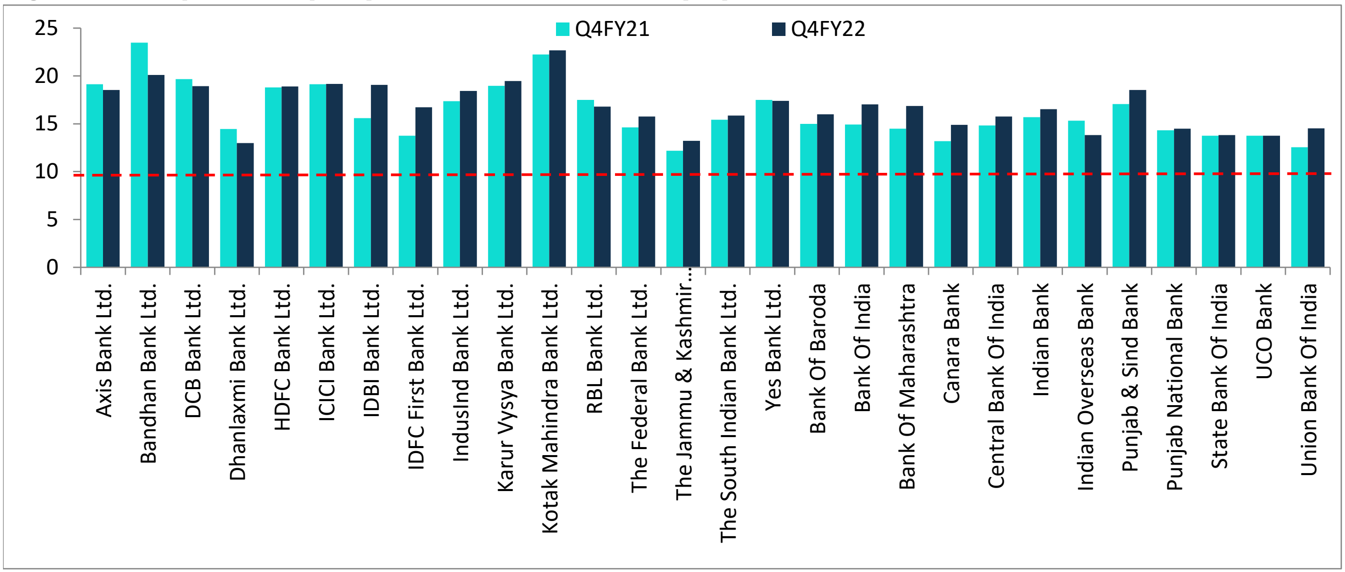
Source: Ace Equity, CareEdge Calculations

- Provisions (made by) of SCBs declined by 42.6% y-o-y to Rs.0.4 lakh crore in Q4FY22, the lowest in the last two years due to improvement in asset quality and with banks already holding a substantial buffer for provisions.

- Provisions (made by) of PSBs stood at Rs.0.28 lakh crore in Q4FY22, down from Rs.0.39 lakh crore in Q4FY21, marking an improvement of 26.9% y-o-y. Provisions of PVBs also declined by 66.0% y-o-y to Rs.0.09 lakh crore in Q4FY22 from Rs.0.26 lakh crore in Q4FY21.

Capital Adequacy (CAR)

Figure 10: Capital Adequacy Ratio under Basel III (%)



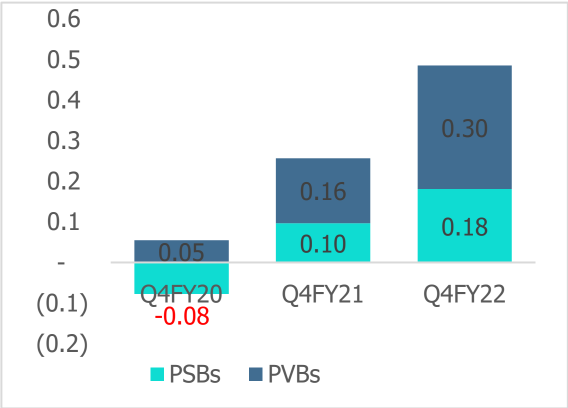
Source: Ace Equity, bank filings, CareEdge

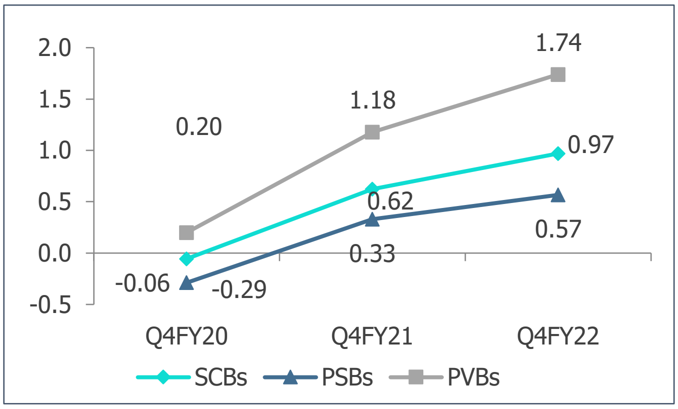
All SCBs have maintained CAR greater than the minimum required ratio for Q4FY22. The Government of India (GoI) has been infusing capital into public sector banks to increase their net worth. Further, at the beginning of the pandemic, most banks had raised capital to deal with any unforeseen shocks, hence, the system remains adequately capitalized.

On January 14, 2022, RBI issued a discussion paper on the Review of Prudential Norms for Investment Portfolio of Banks. The discussion paper proposes investment portfolios be characterized in three categories, viz. Held to Maturity (HTM), Available for Sale (AFS) and Fair Value through Profit and Loss Account (FVPTL), within which the Held for Trading (HFT) will be a sub-category. It proposes inter alia, symmetric recognition of unrealized gains and losses, with concerns on such recognition addressed through prudential filters on regulatory capital and dividend distribution supplemented by enhanced disclosures. For Q4FY22, all SCBs seem to be adequately capitalized with a cushion over regulatory requirements.

Net Profit and Return on Assets

Figure 11: Trend in net profit (Rs. Lakh, Crore) **Figure 12: Movement of RoA (Annualized, %)**





Source: Banks performance results, Ace Equity

- The net profit of SCBs grew by 89.0% y-o-y to Rs.48,527 crore in Q4FY22 due to a substantial decline in provisions and a marginal growth in PPOP.
- The net profit of PVBs also rose by 90% y-o-y to Rs.30,439 crore in Q4FY22, whereas PSBs reported a rise of 86.5% in their net profit to Rs.18,088 crore.
- The RoA of SCBs improved by 24 bps from 0.57% in Q4FY21 to 0.97% in Q4FY22 due to a reduction in credit cost and a low base effect, PSBs ROA also increased from 0.33% in Q4FY21 to 0.57% in Q4FY22.
- The RoA of PVBs improved by 52 bps from 1.05% in Q4FY21 to 1.74% in Q4FY22 due to a sharp decline in credit cost.

Concluding remarks:

The Banking Sector has improved on its financial parameters in Q4FY22. After a modest credit growth in recent years, the outlook for bank credit offtake is positive due to the economic expansion tracking nominal GDP growth, rise in government & private capital expenditure, rising commodity prices, implementation of the PLI scheme, the extension of ECLGS for MSME and retail credit push. The earnings are expected to remain robust as most banks have maintained a positive outlook on margins for FY23, however, high inflation and rate hikes (already two hikes have been announced) could adversely impact credit growth. Banks which have a higher CASA share and a higher proportion of floating loans are expected to benefit from the current rising interest rate cycle. Further lower treasury income (due to rising rates impacting the AFS portfolio) and higher operating expenses could impact the PPOP margins. The broad asset quality parameters are expected to remain stable due to moderation in slippages, and healthy PCR resulting in lower credit costs. On the other hand, the possibility of increased slippages arising from sectors that were relatively more exposed to the pandemic continues as support measures are unwound along with rising interest rates. The performance of restructured accounts continues to be monitorable during the current fiscal.

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