Banks

India

Sector View: **Attractive** NIFTY-50**: 24,045** **June 27, 2024**

Hanging on to the good numbers, for now

The RBI's FSR report indicated that Indian banks are still in a healthy position. Gross NPLs declined 40 bps to ~2.8% in 2HFY24. RoE is at a decadal high at ~14%; RoA has touched 1.3%. Near-term forecasts on NPLs are still being lowered. Loan demand is slowing down in certain specific sectors. Deposit growth has been weak and historical evidence suggests the likelihood of a slowdown in loan growth to converge this gap. Discussion on unsecured loans continues in this report, but it is still less worrisome for banks, at this point.

NPL ratios still declining; return ratios still improving

Key takeaways from the report: (1) Gross NPL ratio for 2HFY24 declined 40 bps to 2.8% for banks, while net NPL ratio also declined ~40 bps during 2HFY24 to 0.6%. (a) Gross NPLs in the industrial credit book declined to 4.8% from 23% in FY2018. (b) Gross NPLs for PSU banks continue to march lower to 3.7% (5.2% in FY2023). (c) Delinquencies in the retail portfolio for banks are on a downtrend, including the SMA portfolio. (d) The RBI is still revising the severe stress scenario downward for the system (2.5% for FY2025 from 3.1% for 2QFY25). (2) Capital is at comfortable levels to manage growth and near-term stress. (3) Deposit growth is a challenge, but the historical experience suggests a slowdown in credit growth to close the current gap between deposit and credit growth. (4) RoE at ~14% and RoA of 1.3% has improved, led by NIM expansion and lower provisions.

Unsecured loans: Trends not showing any stress for banks

There has been strong growth in the unsecured retail loan portfolio and the regulator has stepped up efforts to slowdown credit growth in this segment by increasing the risk-weighted assets. This has resulted in some slowdown in the growth of unsecured retail during FY2024. The headline gross NPL ratios are still not showing any signs of stress yet. Gross NPLs in the retail portfolio are at 1.2%. SMA 1 and 2 in this portfolio are at 2.6%. Within this, the unsecured loans NPL ratio is at 1.5% (1.6% in FY2023) and SMA 1 and 2 are at 2.1% (2.3% in FY2023). The stress level is relatively higher in the smaller ticket personal loans, but the share of banks in this segment is relatively lower. Even if there is a higher risk, the contribution to overall loans is likely to be even smaller. Similarly, there are a few other early warnings signs: (1) Ever 90+ on the 12 MOB portfolio remains elevated at 8.2%. (2) >50% of incremental retail borrowers had three live loans at the time of origination and (3) >33% of incremental retail borrowers had availed >3 loans in the past six months. We should see the stress levels peaking over the next 12-18 months, as most of these loans would either be repaid or would slip into delinquent pools. Based on our conversations, we should expect an increase in delinquency levels from the current lower levels, but there are no signs as yet that this would have a serious impact on our assessment of asset quality metrics for all banks.

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M B Mahesh, CFA
mb.mahesh@kotak.com
+91-22-4336-0886

Nischint Chawathe
nischint.chawathe@kotak.com
+91-22-4336-0887

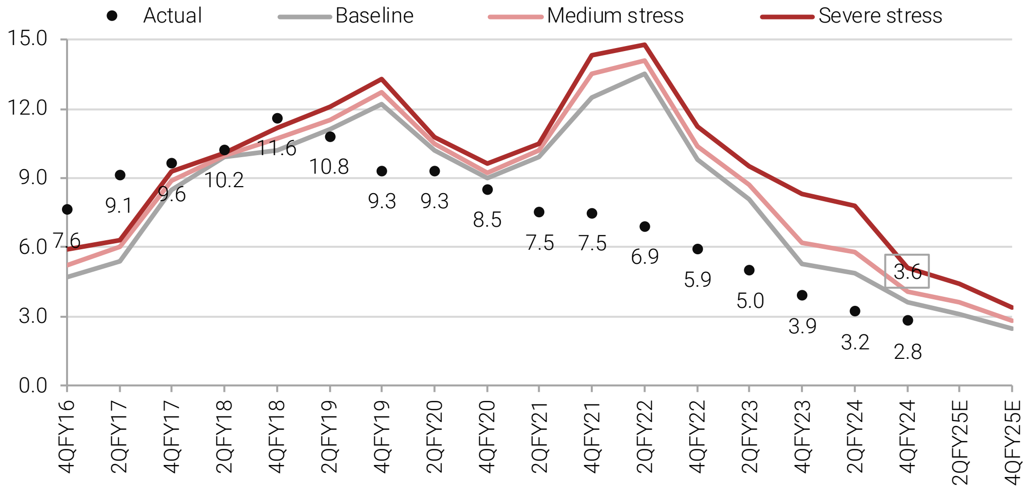
Ashlesh Sonje, CFA
ashlesh.sonje@kotak.com
+91-22-4336-0889

Abhijeet Sakhare
abhijeet.sakhare@kotak.com
+91-22-4336-1240

Varun Palacharla
varun.palacharla@kotak.com
+91-22-4336-0888

4QFY24 GNPA projection was conservative by ~80 bps

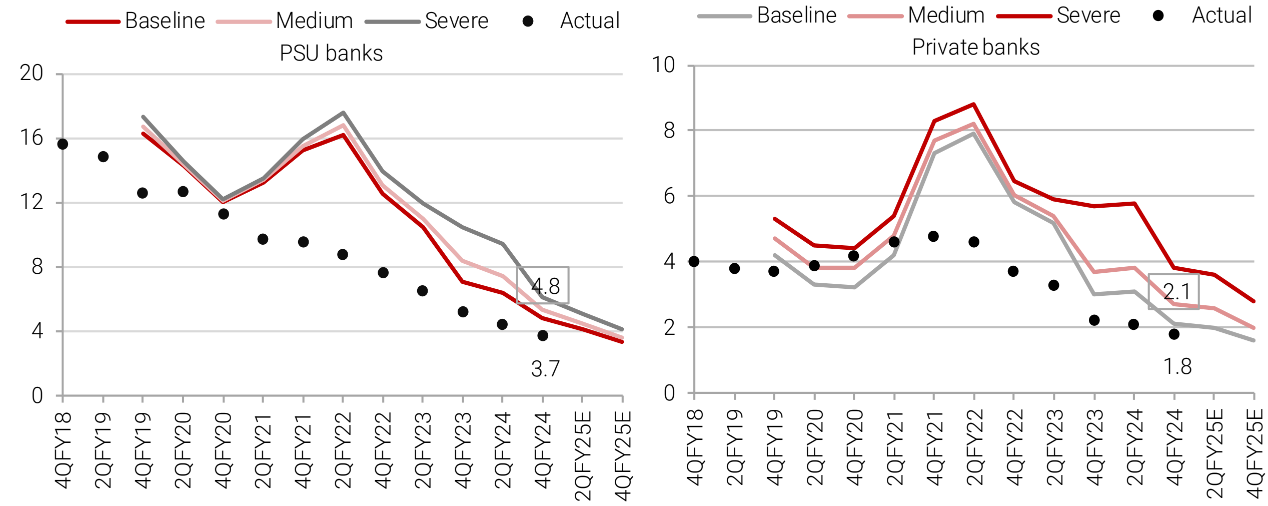
Exhibit 1: Actual and projected (9 months prior) GNPA ratio for all scheduled commercial banks, March fiscal year-ends (%)



Source: RBI Financial Stability Report

Error in projections has been higher for public banks

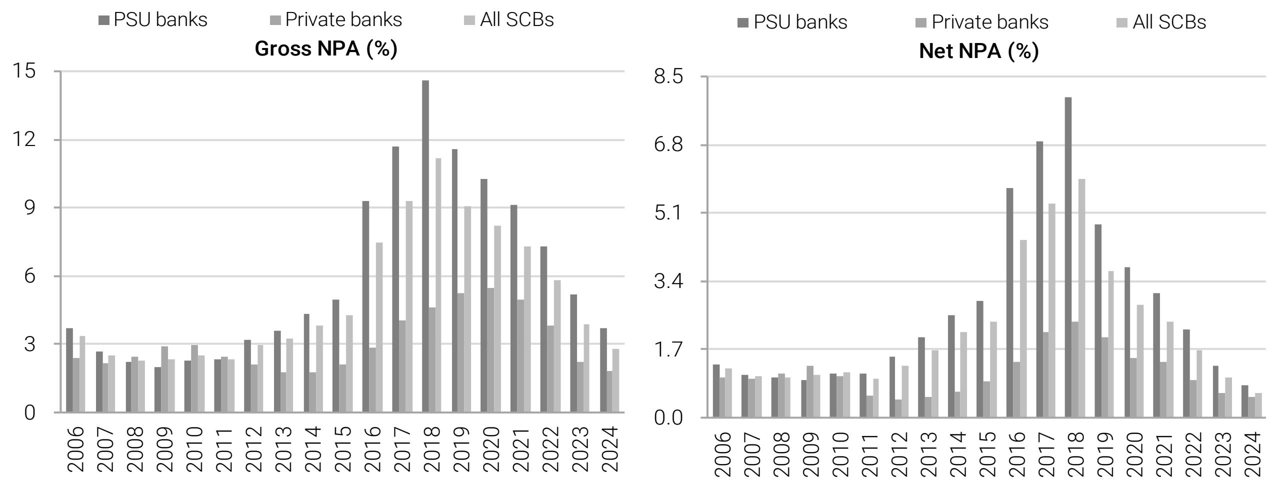
Exhibit 2: Projections for GNPA ratios of scheduled commercial banks, March fiscal year-ends (%)



Source: RBI Financial Stability Report

Moderation in NPL ratios for both private and PSU banks

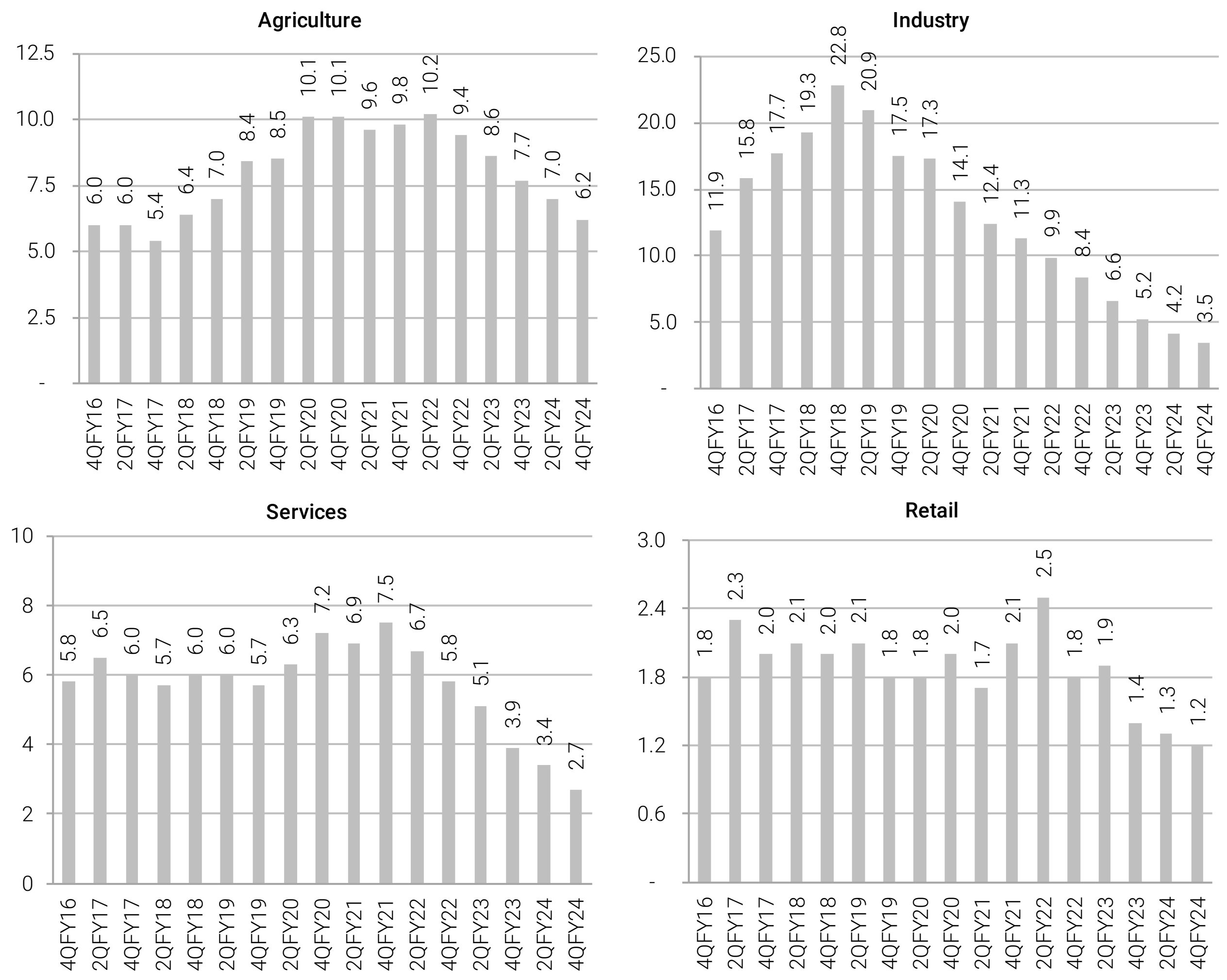
Exhibit 3: NPA ratios across bank groups, March fiscal year-ends (%)



Source: RBI Financial Stability Report

NPA ratios in industry sector have declined sharply over the past few years

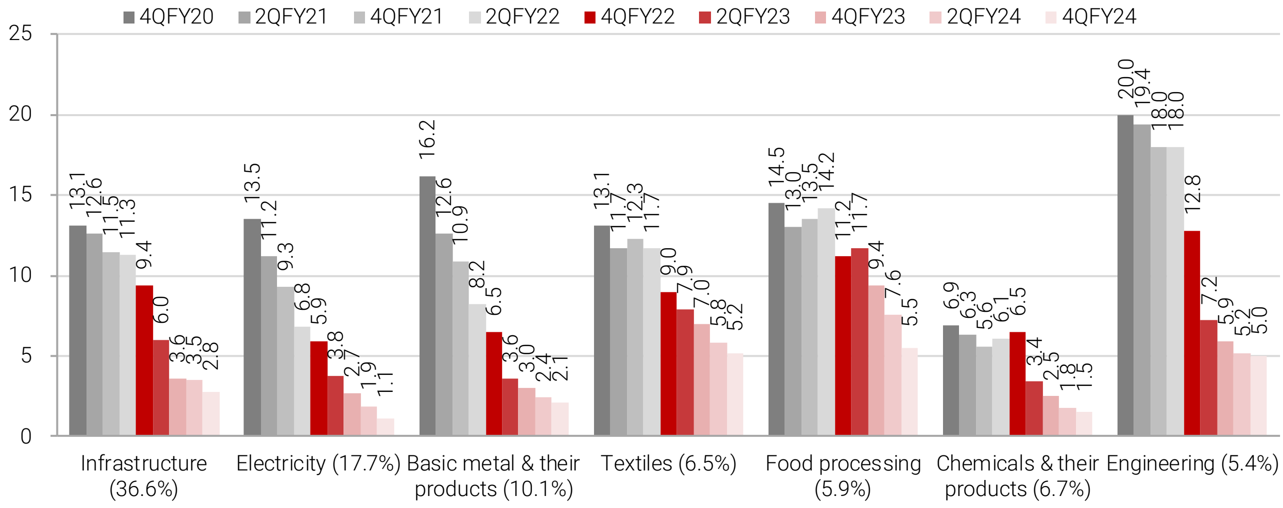
Exhibit 4: GNPA ratio across borrower's occupation category, March fiscal year-ends (%)



Source: RBI Financial Stability Report

GNPA ratio continues to decline across most industry sub-segments

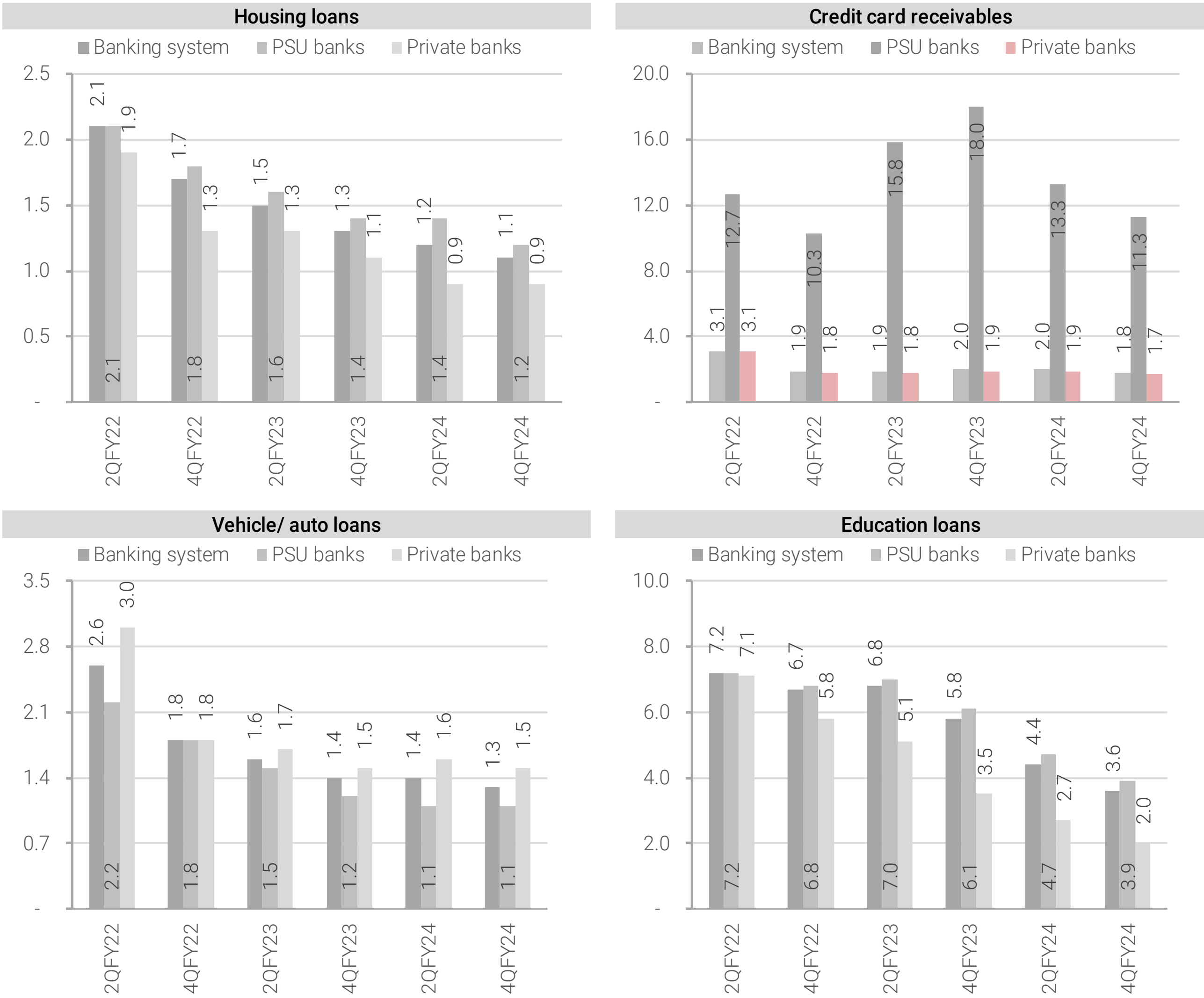
Exhibit 5: GNPA ratios in different segments within industry, March fiscal year-ends (%)



Source: RBI Financial Stability Report

NPA ratios continue to decline across retail loan categories

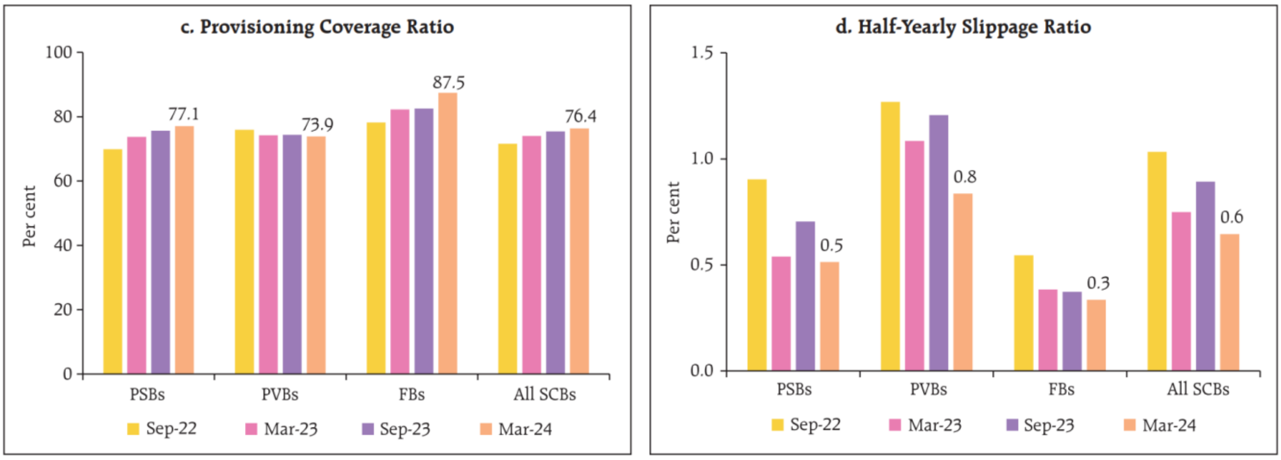
Exhibit 6: GNPA ratio across retail loan categories, March fiscal year-ends (%)



Source: RBI Financial Stability Report

Slippages saw a modest uptick in 1HFY24 for PSU and private banks, but we do not see that as a cause for concern yet

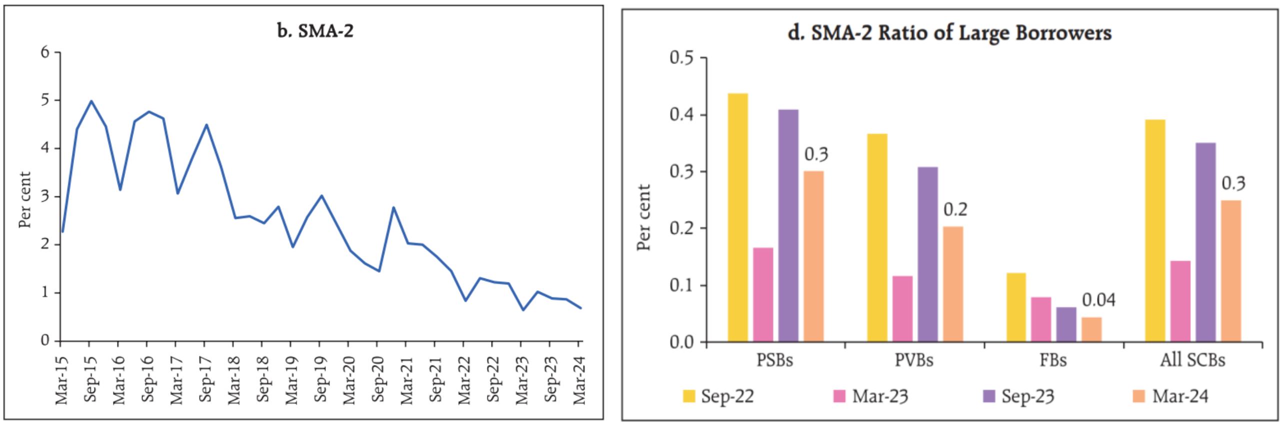
Exhibit 7: Slippages and PCR for SCBs, March fiscal year-ends (%)



Source: RBI Financial Stability Report

SMA-2 ratio has declined steadily for the overall banking system and large borrowers

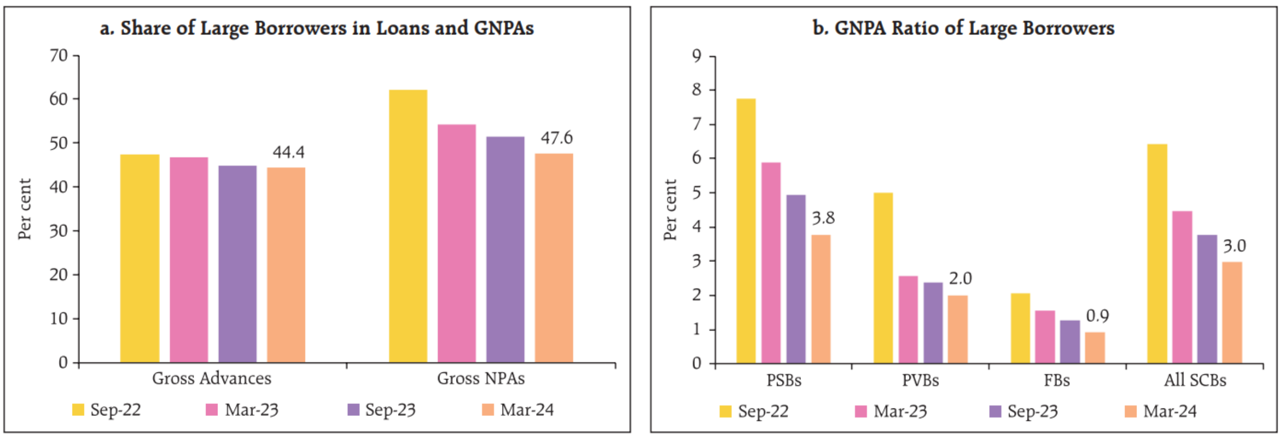
Exhibit 8: SMA-2 ratio for overall banking system and large borrowers (%)



Source: RBI Financial Stability Report

GNPA ratio of large borrowers has declined steadily

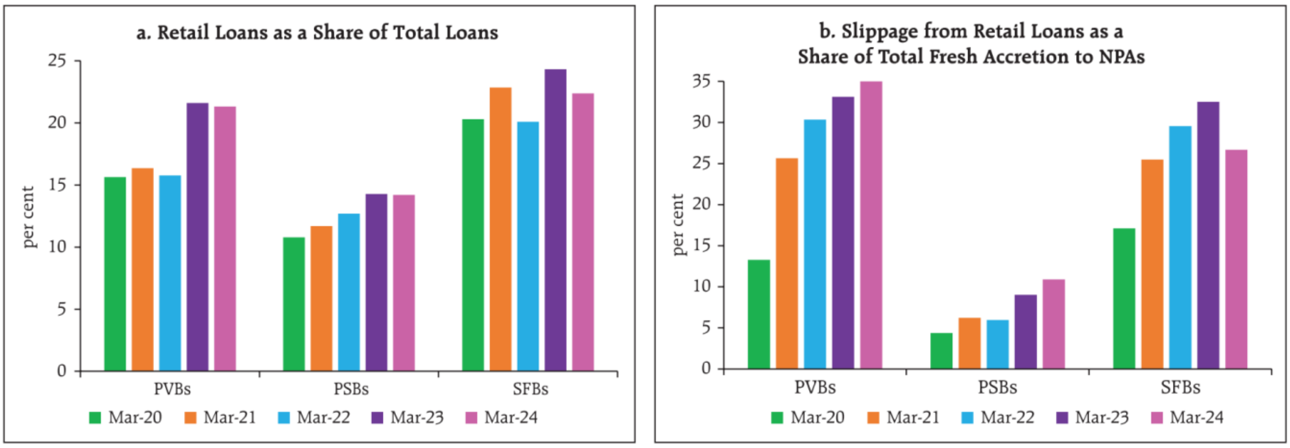
Exhibit 9: Asset quality indicators of large borrowers in loan portfolios of scheduled commercial banks (%)



Source: RBI Financial Stability Report

The share of retail slippages has been inching up steadily for PSU and private banks

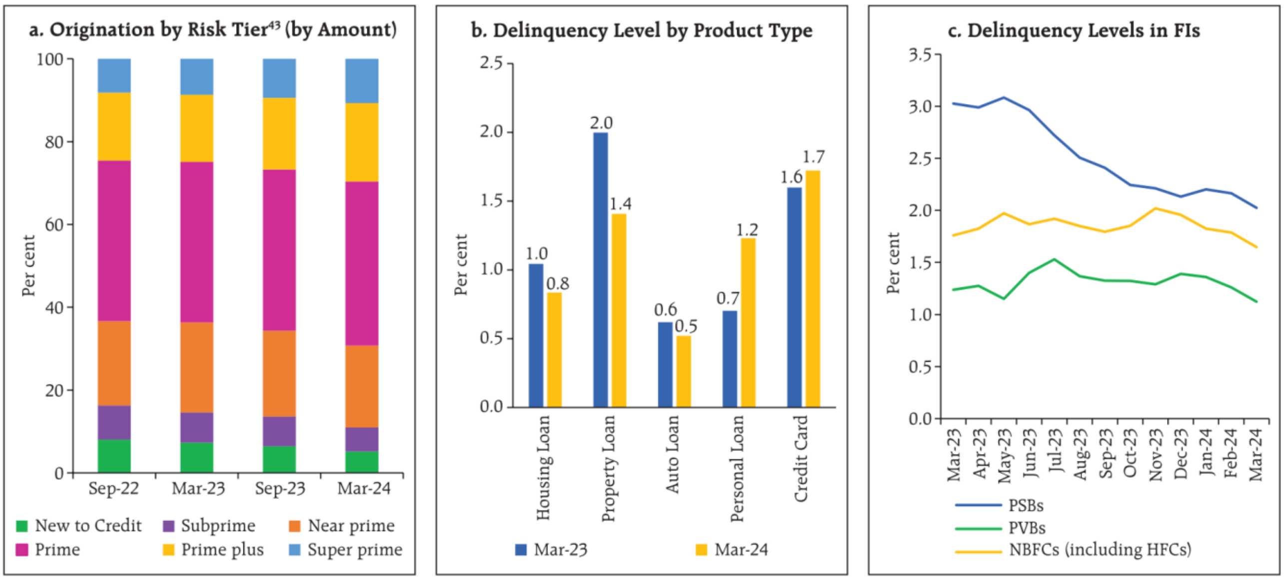
Exhibit 10: Share of retail loans in fresh accretion to NPA of scheduled commercial banks (%)



Source: RBI Financial Stability Report

Delinquency level increased a bit yoy in personal loans, but quality of new originations has been improving steadily

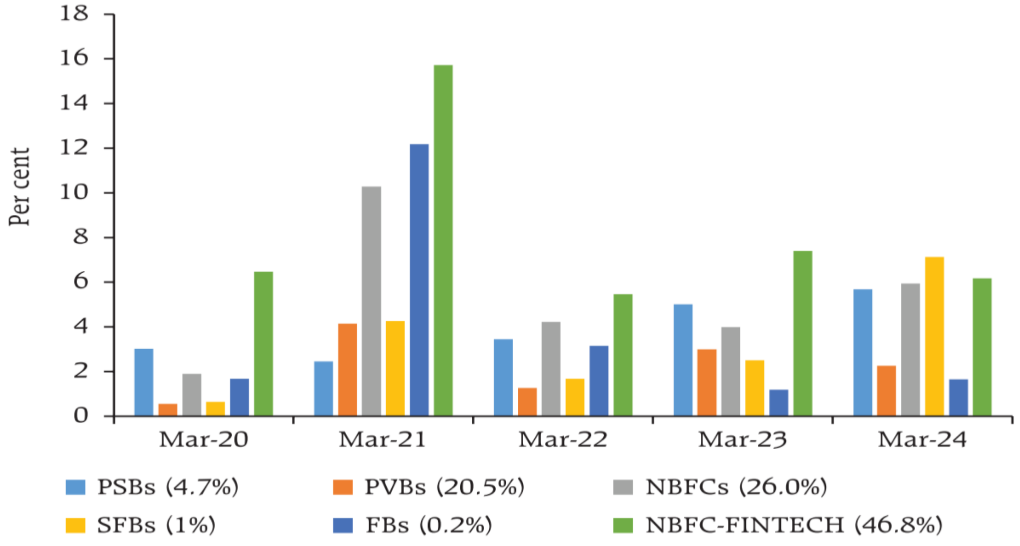
Exhibit 11: Asset quality in consumer credit across financial institutions (%)



Source: RBI Financial Stability Report

Delinquency in small ticket personal loans has been driven by NBFC fintechs who make up ~47% of the outstanding portfolio

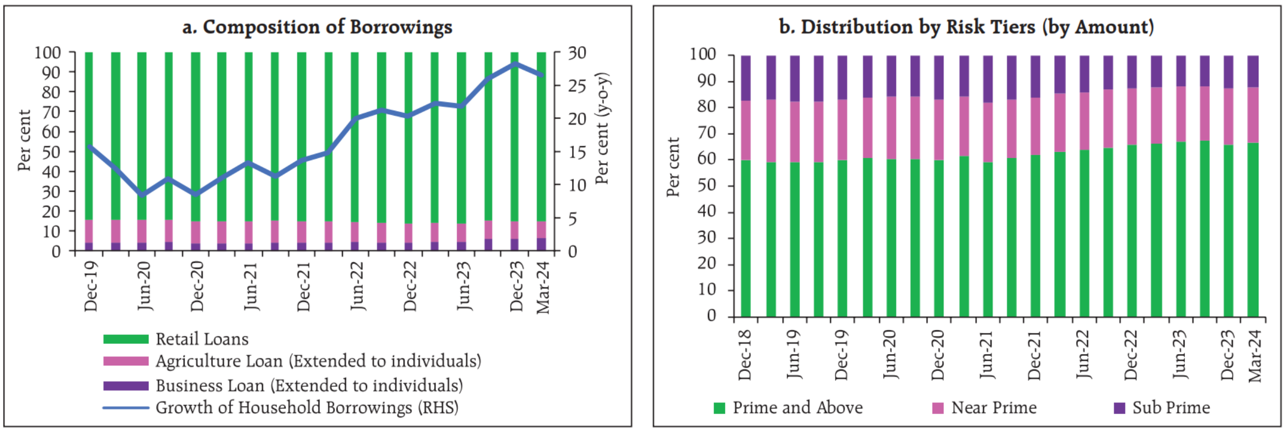
Exhibit 12: Delinquency level in small ticket personal loans (<Rs50k) (%)



Source: RBI Financial Stability Report

More than two-third of household borrowers are of prime or better quality

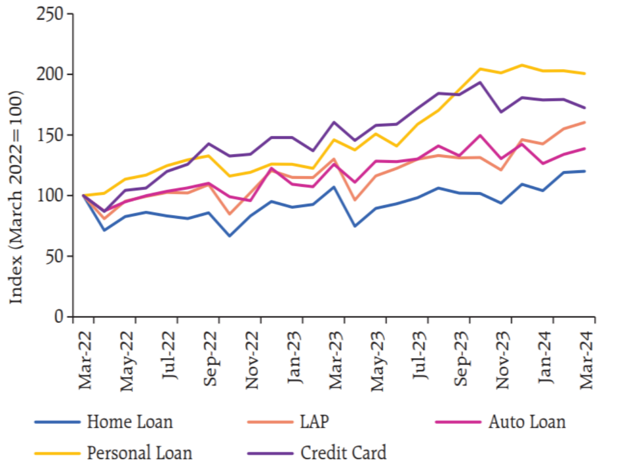
Exhibit 13: Trend in household borrowings from financial institutions (banks and NBFCs)



Source: RBI Financial Stability Report

Credit demand is robust across credit card, personal loans and LAP, but a bit sluggish in home loans

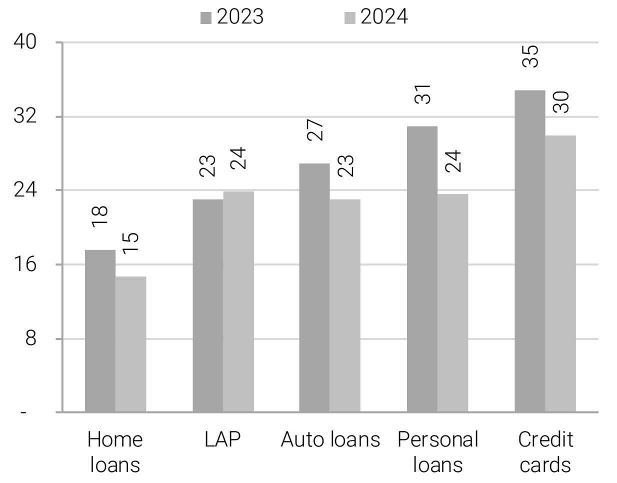
Exhibit 14: Inquiry volumes by product category



Source: RBI Financial Stability Report

Growth in unsecured retail has declined during FY2024

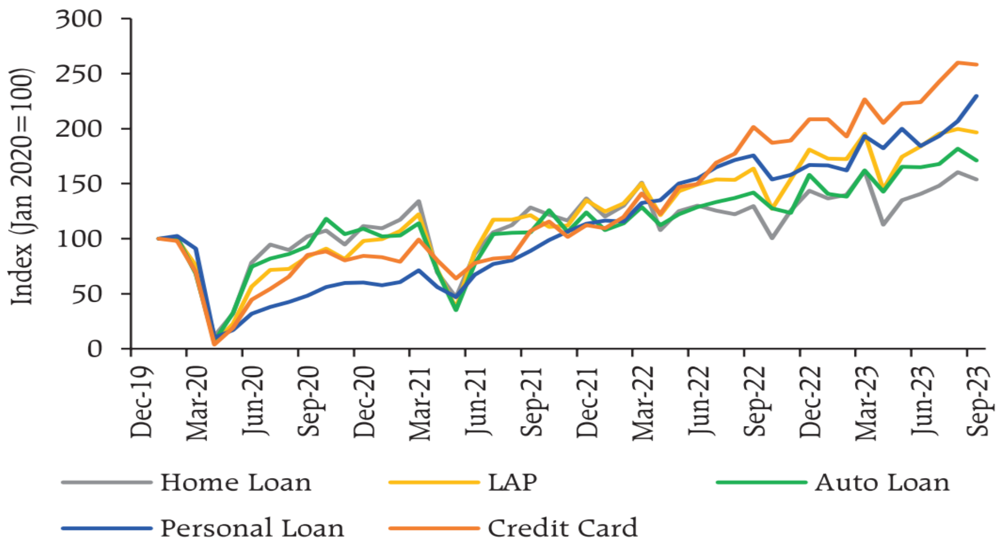
Exhibit 15: Loan growth across retail segments for all financial institutions (% yoy)



Source: RBI Financial Stability Report

Credit demand is robust across credit card, personal loans and LAP, but a bit sluggish in home loans

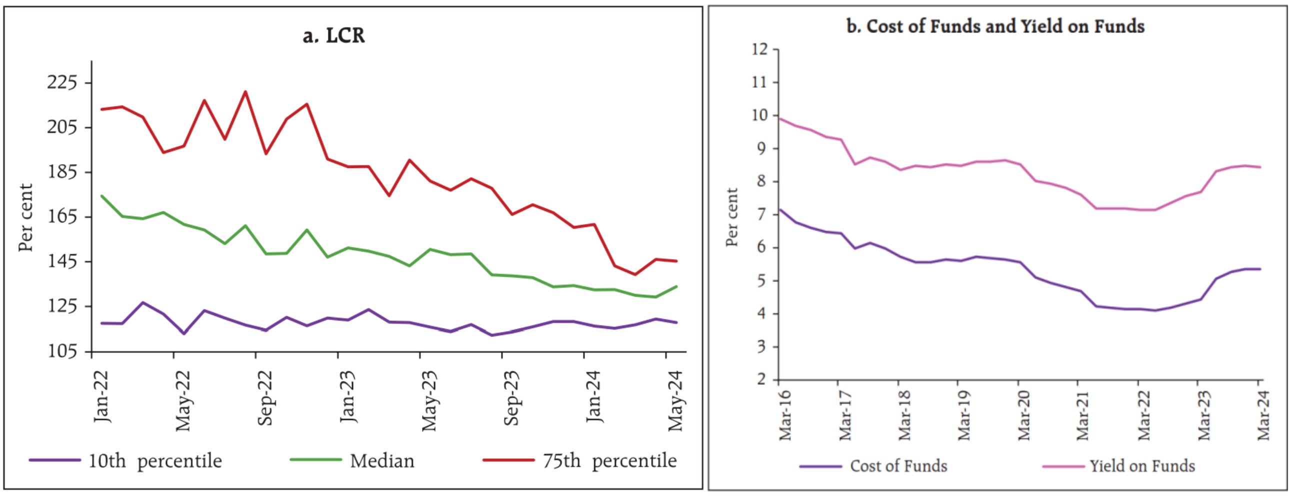
Exhibit 16: Inquiry volumes across product categories within retail (indexed)



Source: RBI Financial Stability Report

Cost of funds seems to be peaking out for the banking system

Exhibit 17: LCR and cost of funds for banking system (%)



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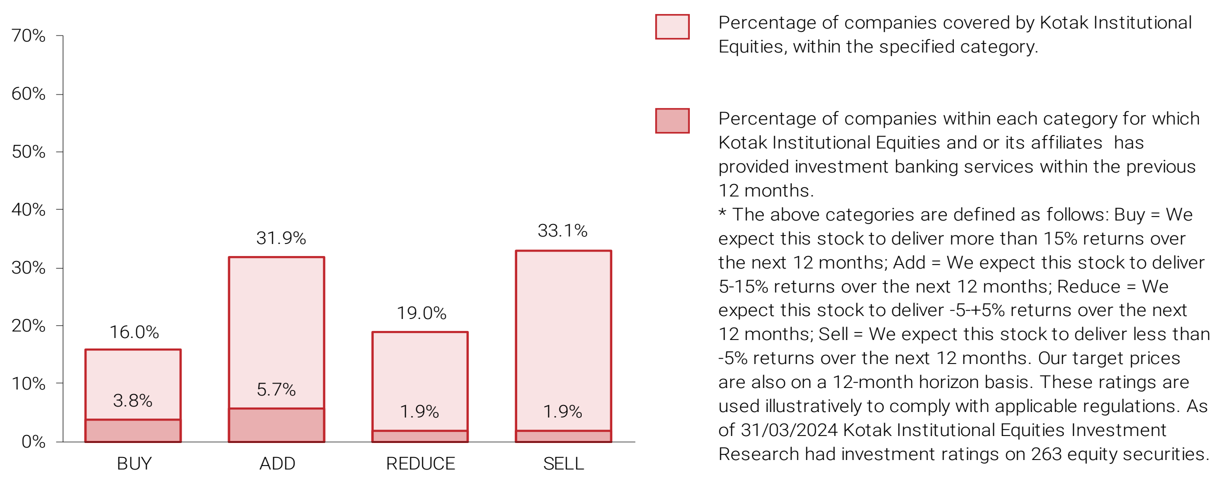

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Source: Kotak Institutional Equities

As of March 31, 2024

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Corporate Office

Kotak Securities Ltd.
27 BKC, Plot No. C-27, "G Block" Bandra Kurla Complex, Bandra (E) Mumbai 400 051, India
Tel: +91-22-43360000

Overseas Affiliates

Kotak Mahindra (UK) Ltd
8th Floor, Portsoken House
155-157 Minories, London EC3N 1LS
Tel: +44-20-7977-6900

Kotak Mahindra Inc
PENN 1,1 Pennsylvania Plaza,
Suite 1720, New York, NY 10119, USA
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