Fitch Sees Profit Squeeze as HDFC to Axis Pay More: India Credit
2013-08-06 06:49:54.483 GMT

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Aug. 6 (Bloomberg) -- Fitch Ratings predicts profitability at Indian banks will worsen from a five-year low as a cash crunch forces them to pay more to attract deposits even as loans grow at the slowest pace since 2009.
HDFC Bank Ltd., the nation's largest lender by market value, raised interest rates on savings maturing up to one year by as much as one percentage point from July 27, while Axis Bank Ltd. increased them by 4 percentage points effective July 31, according to their websites. Yes Bank Ltd. said it added as much as 50 basis points, or 0.5 percentage point, from Aug. 1.
Lenders in Asia's No. 3 economy are battling for deposits as a record jump in money-market rates erases gains from three reductions in benchmark borrowing costs in the first half, eroding earnings and boosting bad debts. Three-month interbank rates jumped an unprecedented 223 basis points in July to 10.75 percent as the Reserve Bank of India tightened cash supply to shore up the rupee. A similar gauge is at 4.65 percent in China.
"While some of the larger banks may be able to pass on the increased cost of funds to borrowers, many medium-sized ones will see lending margins narrowing further," Saswata Guha, a Mumbai-based director at Fitch's India unit, said by telephone yesterday. "This will be a further drag on profitability."
Neeraj Jha, Mumbai-based spokesman for HDFC Bank, declined to comment on the reasons for the deposit-rate increase. Axis Bank raised the deposit rates to align it with prevailing market rates "after taking into account current money-market conditions," a spokesman for the lender said in a e-mailed statement yesterday.

Interest Margin

The return on local lenders' equity, a gauge of profitability, fell to the lowest in at least five years in the twelve months ended March 31 as their net interest margin, or the difference between earnings on loans and the cost of funding, narrowed to 3 percent from 3.1 percent in the previous period, the latest central bank data show.
Soured debt in the banking system swelled to 3.7 percent of total loans at the end of December, the highest in at least five years, and eased to 3.4 percent at the end of March, according to central bank data. The measure may rebound to 3.8 percent by

September, the RBI said in a report last month.
RBI Governor Duvvuri Subbarao raised money-market rates last month to shore up the rupee that has lost 10.7 percent this year, Asia's second-worst performance, as foreign funds sold a net $3.7 billion of local debt. The central bank boosted two borrowing costs while keeping the benchmark repurchase rate unchanged at 7.25 percent, curbed funding support for banks and raised lenders' daily reserve requirements. It signaled last week the measures are temporary.

Rupee, Yields

The currency plunged to a record 61.64 per dollar today.
The yield on the 7.16 percent government debt due 2023 rose six basis points to 8.27 percent.
The tightening measures drove up benchmark five-year AAA-rated corporate bond yields in India by 124 basis points last month to 10 percent, according to data compiled by Bloomberg. The rate on 10-year sovereign notes rose 75 basis points to 8.20 percent. The yield on State Bank of India's 9.95 percent notes due March 2026 rose to 9.22 percent on July 29 from 8.47 percent on May 30, prices from the Fixed Income Money Market and Derivatives Association of India show.
"It wasn't just an increase in interest rates, but a total surprise," Vaibhav Agrawal, who tracks the banking industry for Angel Broking Ltd. in Mumbai, said by telephone on Aug. 2. "Banks weren't really well positioned for that. Credit-growth estimates are likely to get scaled down considering where economic growth is. We would expect only a 10 to 12 percent growth in loans this year."

Loans Growth

Bank lending increased 13.7 percent in the 12 months through June 14, the least since 2009, RBI data show. India's economy expanded 5 percent in the year ended March 31, the least in a decade, official data show. The RBI last week cut its gross domestic product growth forecast for the year through March 2014 to 5.5 percent from 5.7 percent.
Mumbai-based State Bank posted a 19 percent decline in profit for the quarter ended March 31 as provisions for bad loans rose.
"If the tight liquidity is to continue in coming months additional impact on profitability will be from mark-to-market losses on government debt holdings," said Guha from Fitch.
Central bank rules require lenders to keep at least 23 percent of the deposits they collect in government debt and report the gains or losses on these holdings in every quarter.

State Lenders

While private-sector banks have started raising deposit rates, state-owned lenders will await clarity on the prospects of the RBI's policy before considering similar action, according to Rajiv Takru, banking secretary at India's finance ministry.

"The state-run banks will wait to see how long these tightening measures are going to last before taking a call on the rate hikes," Takru said in an Aug. 2 interview to Bloomberg TV India. "If this was a change in monetary policy stance towards tightening, the central bank would have raised policy rates instead of going for these short term measures."

Government-controlled Bank of Baroda and Union Bank of India said they aren't currently planning to raise deposit rates because of the slowdown in lending.

"We don't see the need to raise deposit rates until loan growth picks up," Debabrata Sarkar, chairman and managing director at Mumbai-based Union Bank said in an Aug. 1 interview. "Banks that aren't in a comfortable liquidity position may have to raise rates."

Credit Risk

Credit risk has risen. The cost to insure State Bank's debt against non-payment for five years using credit-default swaps climbed 80 basis points from this year's low of 174 on May 17, according to data provider CMA. The average swap price for five Indian lenders rose 76 basis points to 272 in the same period.

"The RBI's liquidity-suction exercise has banks trying to manage their assets and liabilities," Hemant Dharnidharka, the Bangalore-based head of credit research at SJS Markets Ltd., said in an Aug. 2 telephone interview. "It will take a month or two for things to settle down."

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