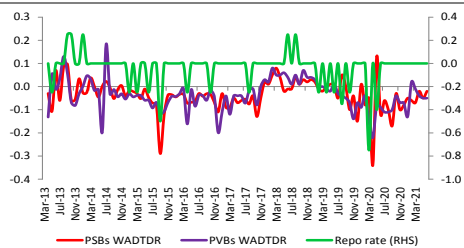


16 August 2021

## SECTOR UPDATE

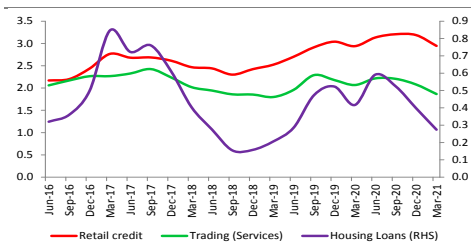
### Industry Banking

Change in PSBs & PVBs WADTDR and Repo rate



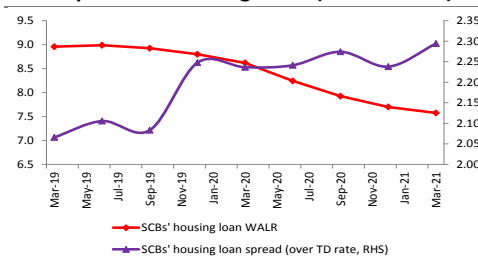
Source: RBI, Systematix Institutional Research

SCBs' segmental loans spread over median MCLR



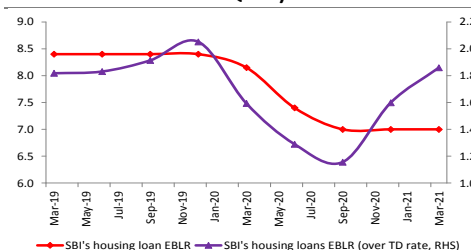
Source: RBI, Systematix Institutional Research

SCBs' spreads in housing loans (over TD rate)



Source: RBI, Systematix Institutional Research

SBIN's housing loans EBLR & spreads (over calculated TD rate on QABs)



Source: Company, Systematix Institutional Research

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## Loan switching to augment private banks' margins

The Reserve Bank of India (RBI) mandated scheduled commercial banks (SCBs) to link all incremental floating rate loans (retail loans and micro & small enterprises loans) to the external benchmark lending rate (EBLR) regime in Oct'19. The regulator also mandated the linking of incremental fresh loans to medium enterprises to EBLR in April'20. At present, the cumulative credit composition of retail, MSE (manufacturing & services) and medium enterprise is at ~36.9% of the total banking system credit. Banking system-wide, 21.3% of total loans and ~57.8% of mandated loans are on EBLR as of March'21 (vs. ~18.9% in March'20).

**In a tighter interest rate regime, upward shift in policy repo rate to push margins**

Most private banks (PVBs) & public sector banks (PSBs) have chosen policy repo rates as an external benchmark. Some banks use the certificate of deposit rate/other benchmarks, while some foreign banks use OIS, MIBOR and 3-month-T bill rate as a benchmark, indicating that they mostly deal with short-term loan products. On the liabilities side, these banks depend more on short-term wholesale/institutional deposits in the absence of widespread retail deposit franchises.

During March'13-June'21, interest rates have been soft. In an accommodative policy regime & declining interest rate scenario, there would be some strain on margins as the term deposit (TD) rate would fall with a time lag. But, in a tighter interest rate regime, should the interest rate harden, margins would get favourably impacted as repo-linked loans would get re-priced much faster than the re-pricing of TDs, leading to margin expansion. As highlighted in our previous notes, slower deposit mobilization could lead to a rise in interest rates post consumption of excess liquidity in the banking system.

Any un-parallel movements in policy repo rates and the banking system TD rates would have implications on margins. Considering the repo rates and PVBs & PSBs term deposit rate trajectories during March'13-June'21, we conclude that TD rates take time to re-align with repo rates. Generally, banks take 6-9 months to re-price their term deposits. In the last 8-years, we have seen banks' TD rates react post policy repo rate actions.

**Long-term margin gains post a near-term strain; PVBs running ahead in loan switching**

Banks have progressively linked their eligible loans to EBLR, with 28.5% of the floating rate loans and 21.3% of total loans of the banking system benchmarked to the EBLR regime as of March'21. PVBs and PSBs entire floating rate loan proportions are at 62% and 85% of their total loan books currently, while loans based on EBLR are at 43% and 20.3% of their floating rate loans, respectively. PVBs and PSBs have 26.4% and 17.3% of their loans on EBLR (from 2.8% & 0.3% of their respective total loans in Sep'19) respectively. **PSU banks still have a long way ahead to switch their eligible floating rate loans to the new interest rate regime (EBLR).** Based on the publicly available data, AXSB & ICICIBC have 28% & 35.6% of their loans on EBLR. Data for HDFCB and SBIN is not available in the public domain.

In the soft interest rate cycle & during the transitory phase of switching loans to EBLR, banks' (particularly PVBs) margins would appear suppressed. **But, it is important to note that when banks are done with switching their mandated loans**

**to EBLR and in a likely tighter interest rate cycle, their margins (particularly PVBs) would surprise positively.**

Banks appear to have undergone some dent in their spreads due to the difference between 1-year MCLR and EBLR. Our analysis of one of the most competitive retail loan segments indicates that although the banking system lending rates (O/s housing loan WALR) have shrunk during March'19-March'21, spreads over term deposit rates on housing loans have increased.

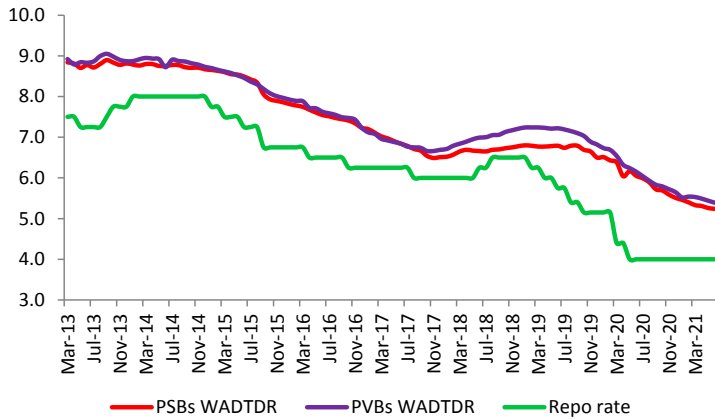
In the case of SBIN's housing loan spreads, the bank's EBLR shrunk at a faster pace due to interest rate transmission and spread on calculated term deposits cost (on quarterly average balances) was at 186bps in March'21 (almost similar to the March'19 levels). But, SBIN's spread (in the EBLR regime) was ~43bps below SCBs' spread (in the WALR regime). As compared to SBIN's spreads in the MCLR regime in March'19, the spread in the EBLR regime was 35bps lower.

**Assuming SBIN's credit risk premium (CRP) did not change much during the period (Oct'19-March'21) since the EBLR regime was mandated, we conclude that SBIN's spreads on housing loans contracted by 35-40bps while switching from the MCLR regime to the EBLR regime.**

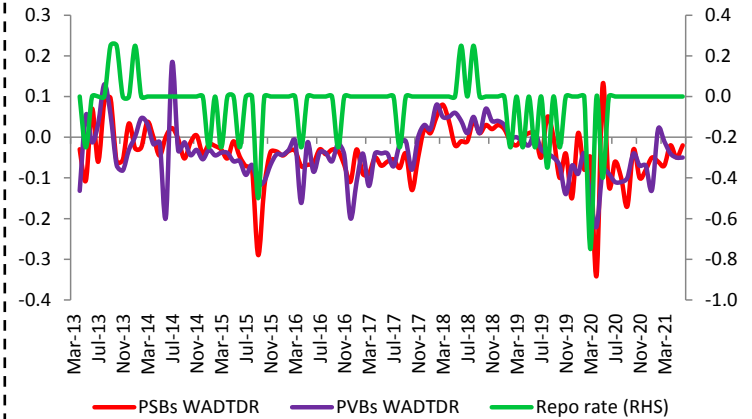
**EBLR regime requires faster interest rate reset frequency; policy rate transmission improves**

In the EBLR regime, RBI regulations necessitate banks to change their EBLR as and when the policy repo rates are altered. ~90% of the banks (PSBs & PVBs) use policy repo rates as an external benchmark. Therefore, interest rate transmission (on the assets & liabilities side) would be faster in a declining interest rate regime but slower in a rising interest rate scenario, particularly on the liabilities side.

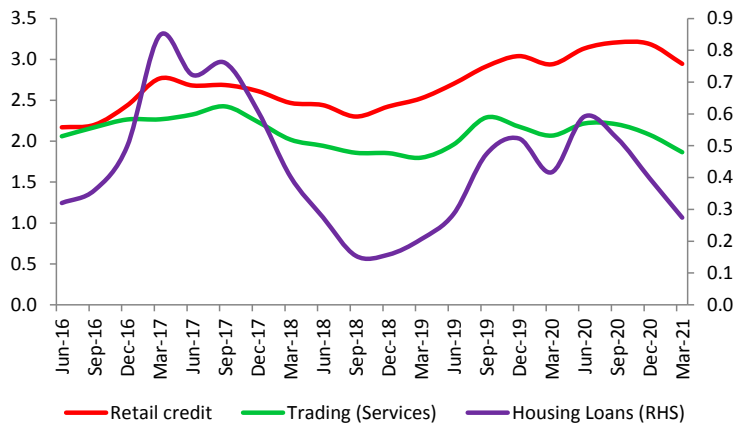
Banks have to transmit the change in benchmark interest rates within 3 months under the EBLR regime vs. within 12 months in the MCLR regime, as most retail loans are linked to 1-year MCLR rates. Notably, banks cannot change borrowers' CRP frequently; it can be changed only once in 3 years unless there are specific observations on borrowers' credit risk behaviour.

**Exhibit 1: PSBs & PVBs WADTDR and repo rate trajectories**

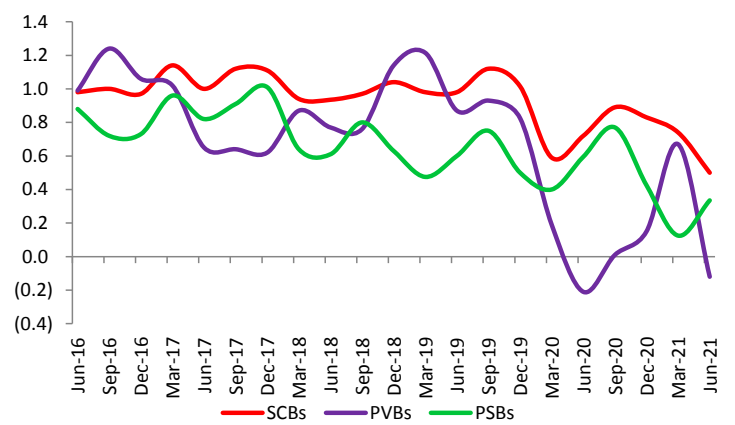
Source: RBI, Systematix Institutional Research

**Exhibit 2: Change in PSBs & PVBs WADTDR and repo rate**

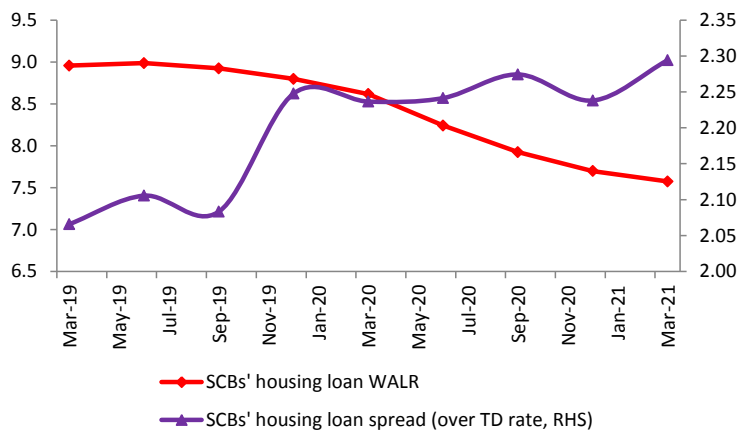
Source: RBI, Systematix Institutional Research

**Exhibit 3: SCBs' segmental loans spread over median MCLR**

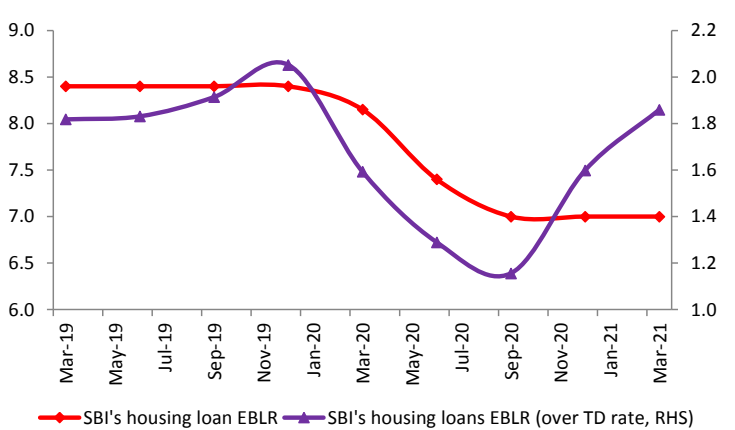
Source: RBI, Systematix Institutional Research

**Exhibit 4: Banking group's fresh loans spreads over median MCLR**

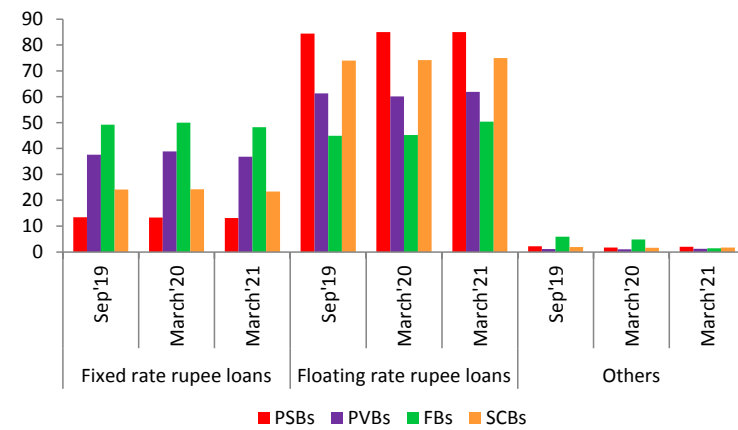
Source: RBI, Systematix Institutional Research

**Exhibit 5: SCBs' spreads in housing loans (over TD rate)**

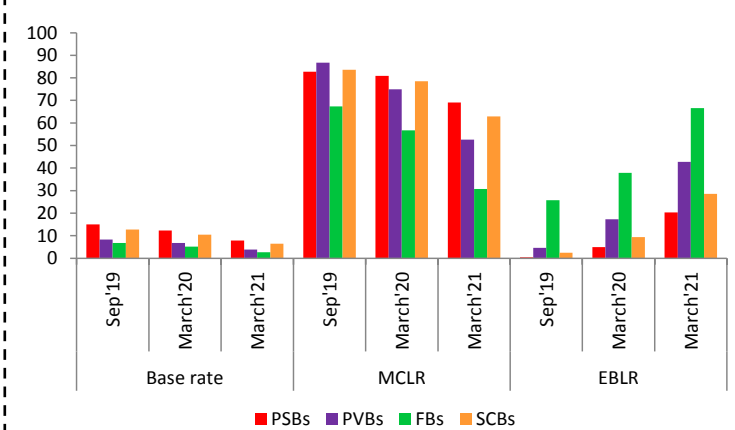
Source: RBI, Systematix Institutional Research

**Exhibit 6: SBIN's housing loans EBLR & spreads (over calculated TD rate on QABs)**

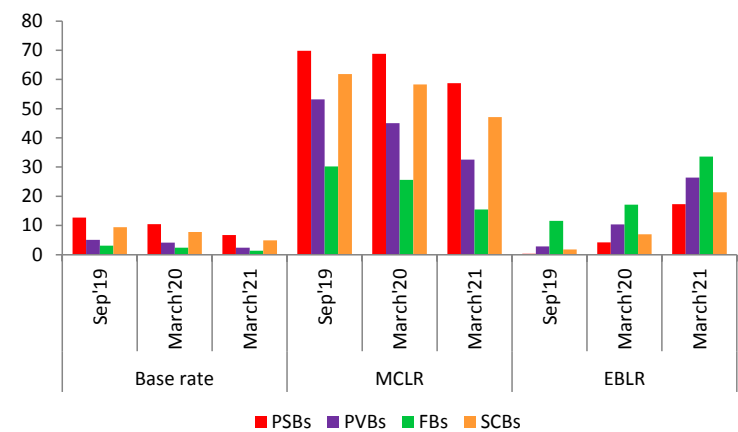
Source: Company, Systematix Institutional Research

**Exhibit 7: SCBs' fixed & floating interest rate loans proportion (%)**

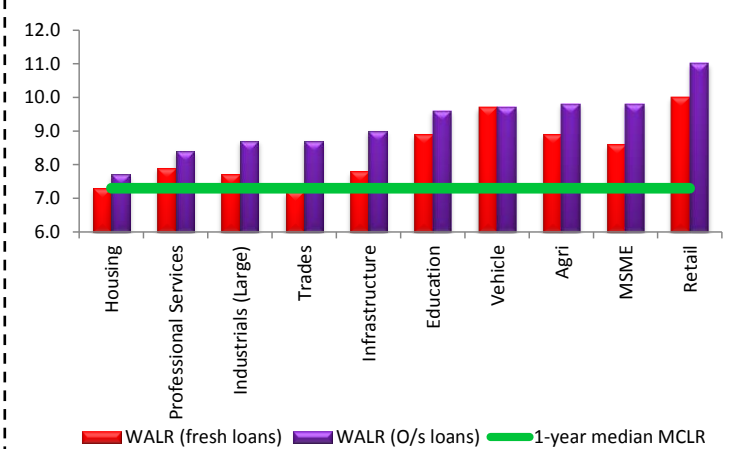
Source: RBI, Systematix Institutional Research

**Exhibit 8: SCBs' O/s floating interest rate proportion (%): Interest rate regimes**

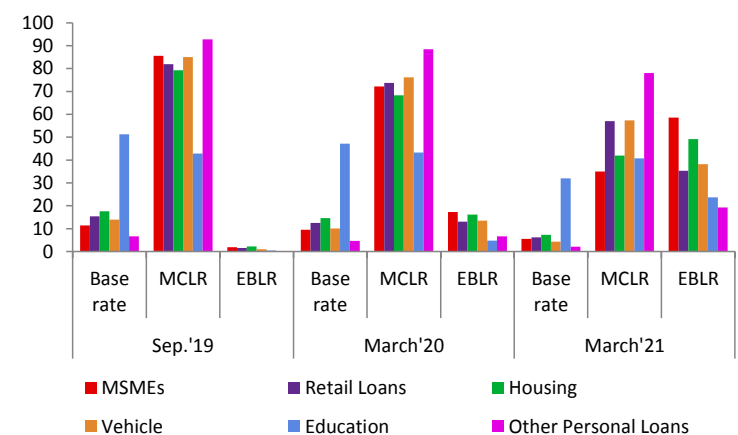
Source: RBI, Systematix Institutional Research

**Exhibit 9: SCBs' O/s loans floating interest rate proportion (as a % of total loans): Interest rate regimes**

Source: RBI, Systematix Institutional Research

**Exhibit 10: Sectoral WALR vs. 1-year median MCLR (May'21)**

Source: RBI, Systematix Institutional Research

**Exhibit 11: Sectoral O/s floating rate loans proportion: Interest rate regimes**

Source: RBI, Systematix Institutional Research

**Exhibit 12: SCBs' external benchmarks - May'21**

	Policy Repo Rate	CD	OIS	MIB OR	3-Month T-Bill	Sector-specific benchmark (other than Repo)	Total
PSBs	11.0						11.0
PVBs	17.0	1.0				2.0	20.0
FBs	10.0		1.0	3.0	10.0	3.0	27.0
SCBs	38.0	1.0	1.0	3.0	10.0	5.0	58.0

Source: RBI, Systematix Institutional Research

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