FY17 Outlook: Banks

Credit Costs to Erode Profits despite Growth Pickup; Capital Support Critical

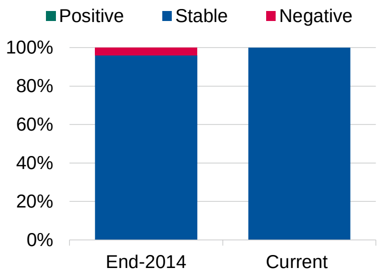
Outlook Report

Rating Outlook

STABLE

(FY16: STABLE)

Rating Outlooks



Source: Ind-Ra

Private Sector Banks, SFBs

STABLE

Public Sector Banks

STABLE TO NEGATIVE

(FY16: STABLE)

- Capital raising critical for growth and cushion against concentration risk.

Related Research

Other Outlooks

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Other Research

Ind-Ra: Economy to Expand, But Fiscal Slippage Likely in FY17

LCR Transition to Impact Banks' Profitability and Credit Growth

The INR1trn Shortfall from Distressed Corporates

Go to appendix for list of rated entities

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Stable Outlook: India Ratings and Research (Ind-Ra) has maintained a stable rating and sector outlook on private sector banks for FY17 and a stable-to-negative sector outlook for public sector banks (PSBs). While capital requirements towards the Basel III transition will continue to increase in FY17, Ind-Ra expects large private banks and few large PSBs to be better placed with healthy internal accruals, robust capitalisation and with better access to capital.

Most PSBs will Face Pressure: Mid-sized public sector banks will continue to experience pressure on profitability as increasing asset quality charges are likely to offset any gains from the uptick in credit. This, along with weak capitalisation and high funding gaps are likely to constrain the outlook of PSBs.

Capital Situation Getting Exacerbated Despite Government Support: Ind-Ra expects incremental Tier 1 capital requirement of INR2.9trn till FY19 towards the Basel III transition (including INR1.5trn in common equity Tier I: CET1). Of this INR630bn would be needed by FY17 (excluding INR250bn from the second tranche under the government's equity infusion plans) mostly in Additional Tier-1 (AT1) bonds. Support from the government remains critical for PSBs, given their low internal accruals, eroded equity valuations and the risk of further slippages due to their exposure to highly levered corporates. Ind-Ra will watch out for the union budget commentary on the potential ramp up of the state's equity infusion plan.

Development of AT1 Market Crucial: The development of the AT1 market will be critical in FY17, given the significant requirement and the burden of sluggish industrial activity in FY16. A Mere INR130bn of AT1 issuances have taken place so far, with insurance and pension funds (which have long-term liability and risk appetite to invest in these instruments) keeping away on account of regulatory hurdles and inadequate price discovery.

Stress from levered corporates to persists despite plateauing of Impaired Asset Ratio: Ind-Ra estimates around one third of the corporate sector borrowing from banks to be deeply stressed currently (totalling to 21% of bank credit) of which about half has been recognized currently as impaired in the books (Non-performing loans: NPLs and restructured). Schemes like 5/25, strategic debt restructuring and the recent discom (state electricity distribution companies) restructuring package are all likely to help contain headline impaired asset ratios. However, Ind-Ra expects the stress from PSBs exposure to highly levered corporates to persist over the next few years. Ind-Ra expects the impaired asset ratio to inch up to 12.5% (including ARC receipts but excluding Discom bonds) by (FY15:10.8; FY16E 12). Ind-Ra's assessment of the potential haircut that banks may face to revive the financial viability of distressed accounts which is still unrecognised is around INR1trn or about 1.7% of risk weighted assets (RWA) for PSBs.

Credit Cost to Remain High and erode bank profits in FY16E and FY17: While retail asset quality remains robust, Ind-Ra expects agri NPLs to inch up in FY17. Overall credit costs (P&L NPL provisions) are likely to remain high (120bp for FY17), given the low provision coverage as well as recent push by RBI to recognize the stress from levered corporates. Ind-Ra expects the banking system RoAs to dip to 66bp in FY16E and 69bp in FY17F (FY15:77bp, FY14:79bp)

Macro Tailwinds Point to Likely Pickup in Deposit and Credit: Ind-Ra expects credit growth to pick up in FY17 to 13.5% (FY16E:10.7%; FY15: 9.7%). While this is based on a nominal GDP uptick in FY17, the deposit multiplier has started expanding backed by monetary easing. On the demand front, while greenfield capex still remains sometime away, an increase in investment announcements after six years in FY15 may start reflecting in the corporate credit pickup for FY17. Ind-Ra expects retail credit growth to remain strong driven by mortgage and unsecured loans.

High Funding Gaps to Hurt More Under LCR and MCLR Guidelines: large asset liability management (ALM) gaps run by most mid sized PSBs will continue to impact their margins under the new liquidity coverage ratio (LCR) and marginal cost based pricing of loans rates (MCLR) regime. Ind-Ra expects activity in infrastructure bonds to pick up again in FY17 after a sluggish FY16, given the rate cycle and potential to lower the volatility in MCLR.

Stable outlook on Small Finance Banks Most of the recently announced small finance banks (SFBs) and payments banks (PBs) will commence banking operations meaningfully only by FY18, Ind-Ra believes the landscape particularly on the liability side has started to shift with rapid expansion in digital platforms and banking correspondent (BC) channels. Ind-Ra has also started coverage of the SFB segment with a stable outlook.

Outlook Sensitivities

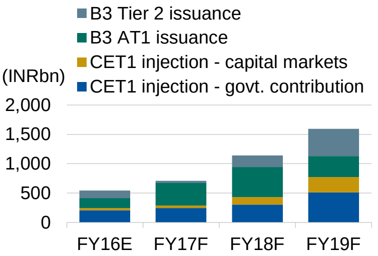
Long-Term issuer ratings for PSBs are largely support driven and will change only if there is any change in the government's support stance or a relative shift in their systemic importance.

Ratings for private sector banks and ratings on tier-1 bonds (like AT1) for all banks are linked to the respective banks' standalone profile. Positive triggers such as improvements in funding gaps and single-name concentrations together with increased capitalisation levels and lower loan loss provisions may result in a positive outlook for banks whose ratings are driven by performance.

Negative triggers will be pressure on capital ratios due to weak profitability, a spike in credit costs and delays in equity injections may lead to a negative sector outlook. Issuer ratings of government banks will mostly remain resilient on the expectations of continued government support.

Figure 1

Indian Banks: Capital Projections for Basel III Transition



Source: Ind-Ra's estimates. Study includes all government and elevel private banks

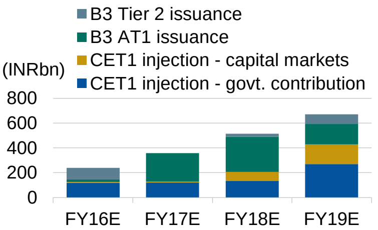
Assumptions:

- CCB and D-SIB buffer included in calculations. Additional buffer of 50bp considered for banks
- FY16-19 blended RWA CAGR of 13.5% for all banks
- Assuming normalized RoAs from FY17 onwards moving in tandem with asset growth
- Government ownership unchanged from FY16 to FY19

Figure 2

PSU Banks (SBI Consolidated, PNB, BOB, Canara, BOI)

Capital projections for basel III transition

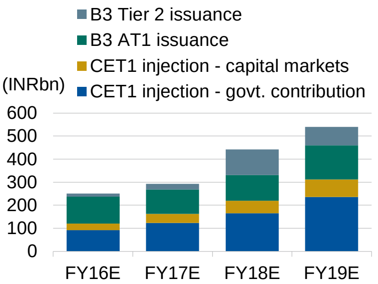


Source: Ind-Ra's estimates

Figure 3

Other PSU Banks

Capital projections for basel III transition



Source: Ind-Ra's estimates

Capital Requirement Situation Worsening; Pickup in Appetite for AT1 Crucial in FY17

Ind-Ra estimates a capital requirement of INR3.7trn from FY17 to FY19 for banks including INR1.5trn in CET1 and INR1.4trn in AT1 bonds. Of this CET1 requirement, INR1trn would be the likely share of the government, assuming no change in their current shareholding of PSBs. Of this INR1trn about INR450bn is expected to come as part of the remaining tranches t under mission Indradhanush, a plan to revamp PSBs. The government has already recapitalised banks by INR250bn this year as part of this programme.

Government support remains critical for PSBs, given their low internal accruals, eroded equity valuations and risk of further slippage from levered corporates. Ind-Ra will watch out for union budget commentary on the potential ramp up of the state's equity infusion plan.

Development of AT1 market would be critical in FY17, given the significant requirement and the burden of very weak market appetite in FY16. A mere INR130bn of AT1 issuances have taken place so far with insurance and pension funds (which have long-term liability and risk appetite to invest in these instruments) keeping away on account of regulatory hurdles and inadequate price discovery. RBI's amended guidelines in September 2014 to bring in temporary write-downs and a 5-year call option has helped improve investor interest to some extent, but active participation by insurance firms and provident funds are still to be seen. Both regulators, the Insurance Regulatory and Development Authority and Pension Fund Regulatory and Development Authority have advised their regulated entities to keep the rating floor at AA, which in Ind-Ra's opinion shuts the market on 50%-60% of the required amount. PSBs have also been reluctant to benchmark the coupons of these instruments against their respective cost of equity, leading to offers which have not been perceived as commensurate with the risk involved. The continued deterioration in the standalone credit profiles of most of these PSBs has kept marquee investors away. If domestic institutions continue to shy away from this market, Indian banks may have little choice but to tap the overseas markets.

PSBs Need Growth Capital

Assuming 14% CAGR in RWA for large PSBs, the total incremental tier-1 capital requirement is INR1.4trn (50% CET1, 50% AT1) with a strong frontloaded requirement for AT1 bonds. While most of these large five PSBs have been proactive in testing the AT1 market with a combined issuance of INR65bn so far, the requirement by FY17e will be another INR250bn.

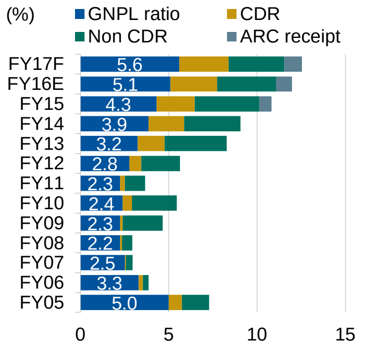
Ind-Ra estimates that mid-sized PSBs will require INR1.2trn in total capital by March 2019 (60% CET1 and 40% AT1), despite budgeting for a 12.5% RWA CAGR over FY16-FY19. Most of these PSBs have weak capitalisation, low internal accruals and low valuations, which is hampering their capital market support. The CET1 requirement by March 2019, without including the likely infusion under Indradhanush would be about 55% of their combined current market capitalization. Unless their market valuations improve over the next two years they will need to hugely depend on the government and quasi-government institutions for their capital requirement over the transition period. These banks have raised just INR75bn in AT1 capital so far, while the requirement by FY17E is an additional INR225bn.

Impact of Large Concentration to Further Weigh on Capital Requirement

While Ind-Ra believes the quantum of capital may be manageable through government finances, if effectively spread out through the transition period, the risk from large levered corporates could be an additional burden. . if we include Ind-Ra's estimate of INR1trn as a potential haircut for large stressed corporates, the additional fiscal burden of taking on the entire equity requirement for PSBs would amount to about 35-40bp of nominal GDP annually from FY16 to FY19.

Figure 4

Impaired Asset Ratio



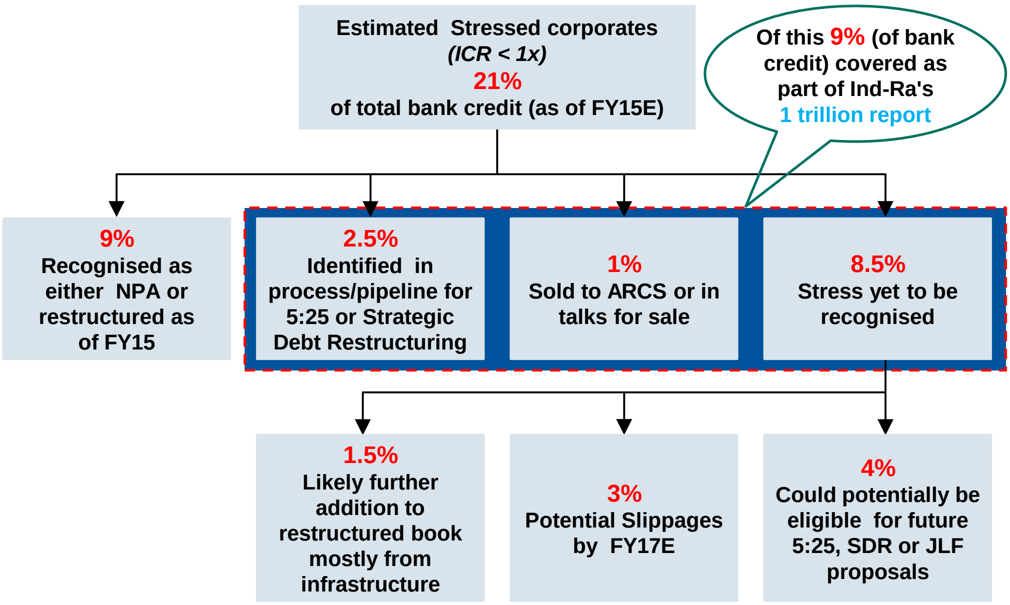
Source: Ind-Ra's estimate; RBI

Headline Impaired Asset Ratio Plateauing But Stress from Levered Corporates Persists:

Ind-Ra expects the impaired asset ratio of the banking system to inch up to 12.5% (including ARC receipts but excluding Discom bonds) by FY17 (FY16E: 12%, FY15 :10.8%). Overall credit costs (P&L NPL provisions) are likely to remain high (120bp for FY17), given the low provision coverage as well as the recent push by RBI to recognize the stress from levered corporates.

Ind-Ra estimates about one third of the corporate sector borrowing from banks to be stressed (totalling to 21% of bank credit) of which about half has been recognized currently as impaired in the books (NPLs and restructured). While schemes like 5:25, strategic debt restructuring and the recent Discom restructuring package are likely to help contain headline impaired asset ratios, Ind-Ra expects the stress from highly levered corporates to persist over the next few years.

Figure 5



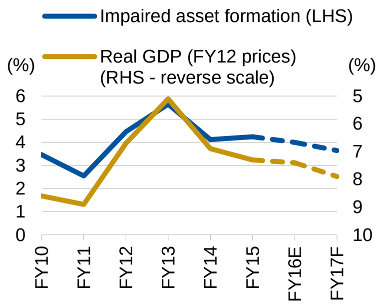
While the impaired asset formation ratio is likely to moderate, and schemes like 5:25 will provide liquidity in the near term, Ind-Ra believes Indian banks may need up to INR1trn over and above their Basel-III capital requirements to manage the concentration risks arising out of their exposure to highly levered and large stressed corporates. Of this, public sector banks (PSBs) will need INR930bn, which is equivalent to an equity write-down of about 1.7% of the banks' RWA, and represents the loan haircut that banks may face to revive the financial viability of distressed accounts. All these exposures are currently treated as performing and carry a minimal loan loss provision of 5% or less. RBI has already asked banks to recognise some of these deeply stressed assets as non-performing and to make prudent provisions for them.

The shortfall may significantly increase the government's equity injection requirement compared to the INR700bn announced on 31 July 2015. The access to equity will be a critical input to Ind-Ra's rating of AT1 bonds, as these instruments carry loss triggers linked to the bank's CET 1 ratio.

Ind-Ra analysed 30 large, stressed corporates, each with aggregate bank debt of over INR50bn, totalling to about 8%-9% of the overall bank credit. Bank loans to all these corporates are accounted as performing (most of them figure as SMA1: principal or interest payment overdue between 31-60 days/SMA2: 61-90 days accounts). The power and other infrastructure

Figure 6

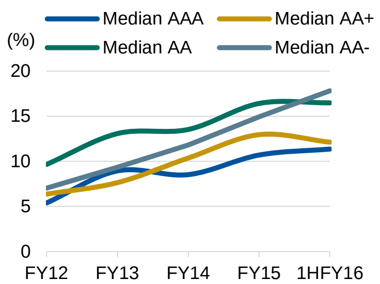
Impaired Asset Formation Ratio



Source: RBI; CSO; Ind-Ra's estimate

Figure 7

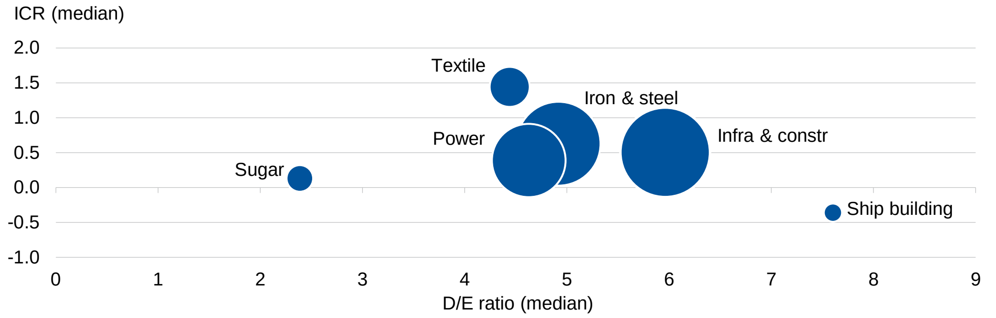
Impaired Asset Ratio Remains Elevated



Source: Bank annual reports and investor presentations sectors account for 50% of this exposure while the iron & steel sector accounts for another 32%. Aviation, ship-building, sugar and textile form the balance. These sectors have seen a significant increase in their leverage over the last few years during a period of weak operating environment. The median debt-to-equity ratio for this set increased to 4x-6x in FY15 from under 2x in FY10 while the median market-cap-to-debt ratio contracted to 5%-7% from 35%-50%.

Figure 8

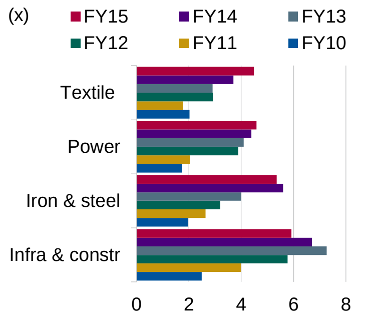
Debt to Equity and ICR Across Stressed Corporates by Sector



Source: Ind-Ra's estimates, Ace Equity. Size of bubble represents bank debt amount

Figure 9

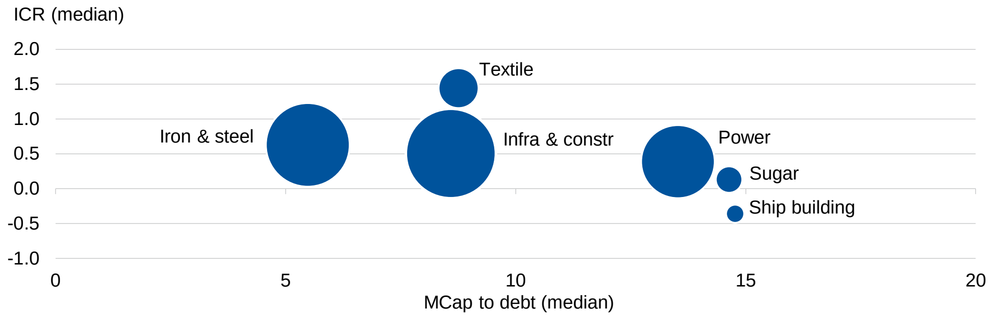
Median D/E Ratio for Stressed Corporates



Source: Ace Equity; Ind-Ra

Figure 10

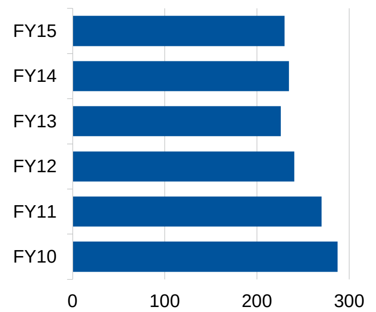
Market Cap to Debt and ICR Across Stressed Corporates by Sector



Source: Ind-Ra's estimates, Ace Equity. Size of bubble represents bank debt amount

Figure 11

Top 20 Exposure to Equity

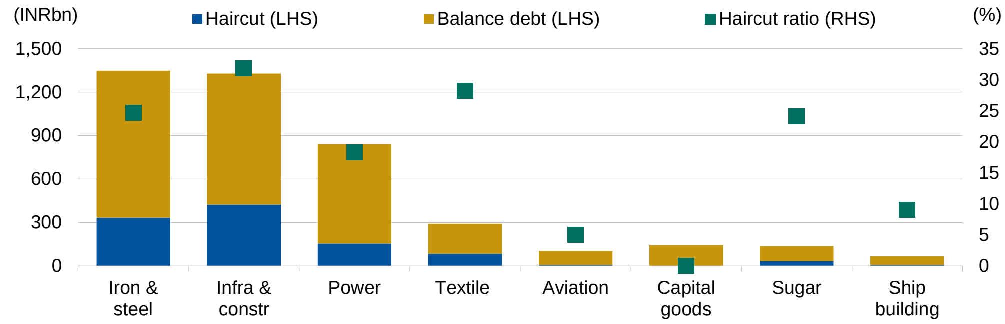


Source: Ind-Ra

Ind-Ra's analysis attempts at estimating a viable leverage level for these exposures. The analysis takes the current enterprise value for these corporates as a starting point and assumes a pick-up in the operating performance close to their respective peak capacity utilisation. This is to estimate the level of debt these corporates will be able to service even when the macro environment picks up. The study reveals that banks would need an average 24% reduction in their current exposure to ensure reasonable debt servicing (1.5x interest coverage: ICR) by these corporates on a sustained basis.

Figure 12

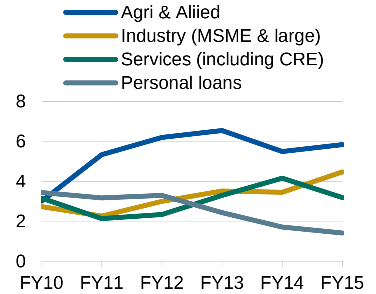
Amount and Ratio of Potential Haircut Needed in Each Sector



Source: Ind-Ra's estimates

Figure 13

Movement of Sector-wise GNPA – % (Top 5 Banks)



Source: Annual reports, Ace Equity

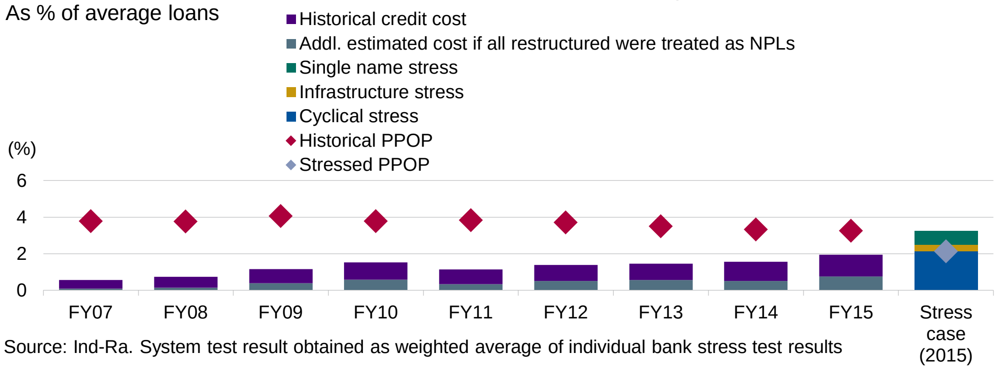
As the trends above suggest, any sharp pullback in delinquencies is unlikely in the near term. This is because corporate leverage today is significantly higher than in 2008. Also, unlike the cyclical recovery seen from FY02-FY07, it may take a few years of elevated growth before leverage turns comfortable. Even in a highly optimistic scenario, it will take about three years for the leverage levels to reduce to the FY10-FY11 levels. Delinquency levels, therefore, are likely to recover only over the medium-term. Additionally, while retail asset quality remains robust, agri NPLs are likely to trend up further, reflecting the impact of successive crop cycle failures across most geographies.

Banking Stress Test Reveals Potential Impact from Concentration Risk

Banks' stress tolerance capability has come under pressure over the last few years. At a system level, Ind-Ra's stress test output expects some erosion in CET-I. The credit profiles of most government banks remain vulnerable to elevated single-name and sector concentrations. Most private banks have created stronger buffers on improved funding from wider branch expansion.

Figure 14

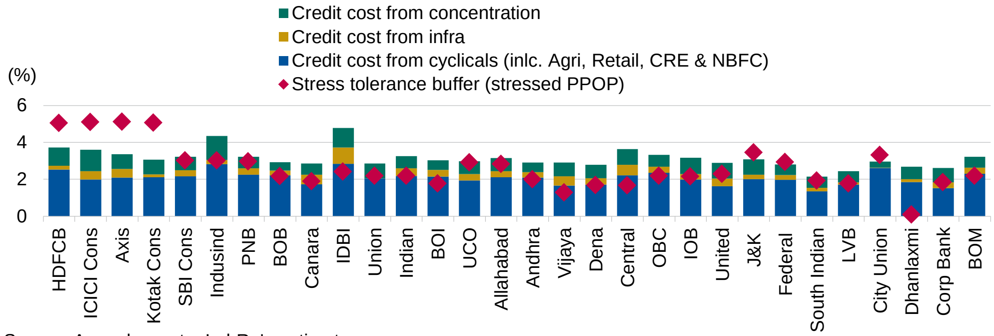
Stress Test Result of Banks Point to Stress from Single Name Concentration



Source: Ind-Ra. System test result obtained as weighted average of individual bank stress test results

Figure 15

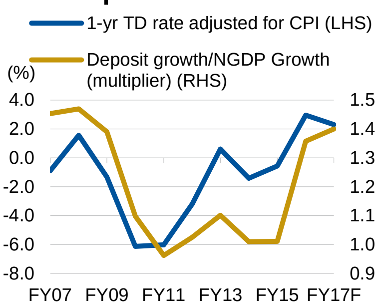
Ind-Ra Stress Test: Stressed Credit Costs and PPOP



Source: Annual reports, Ind-Ra's estimates

Figure 16

Deposit Multiplier vs Real Deposit Rate



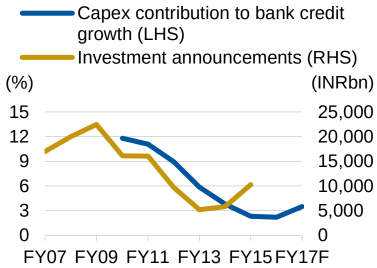
Source: CSO; RBI; Ind-Ra's estimate

Macro Tailwinds Point to Credit Pickup:

Ind-Ra forecasts GDP growth in FY17 to improve to 7.9% from 7.4% in FY16. All major sectors namely agriculture, industry and services are expected to contribute to the GVA growth. Industrial GVA is likely to grow at 7.6% in FY17 as against 7.3% in FY16. A number of factors are driving the incipient industrial recovery. Various announcements made in the FY15 and FY16 budgets to address the structural issues plaguing the industrial and infrastructure sectors are gradually gaining traction on the ground.

Figure 18

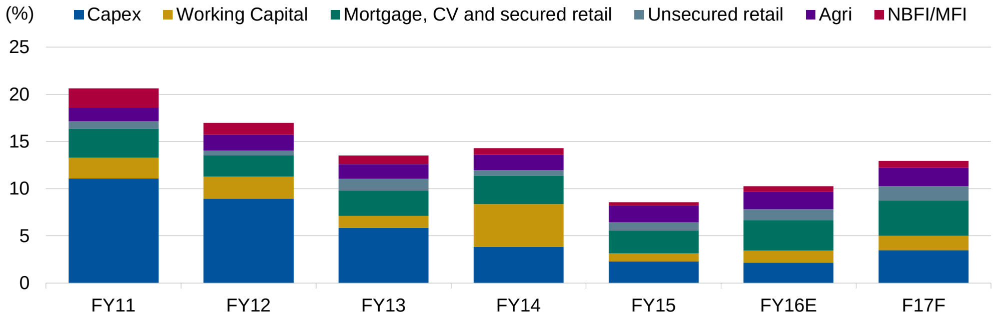
Capex Contribution to Bank Credit vs Investment Announcement



Source: CMIE; RBI; Ind-Ra's estimate

Figure 17

Bank Credit Growth by Sectors



Source: RBI; Ind-Ra's estimate

Ind-Ra expects credit growth to pick up to 13.5% in FY17 (FY16E:10.7). While this is premised on a nominal GDP uptick in FY17, the deposit multiplier has also started expanding backed by continuous monetary easing. On the demand front, while greenfield capex still remains sometime away, an increase in investment announcements after six years in FY15 could potentially start showing in corporate credit pickup for FY17. Ind-Ra expects retail credit growth to remain strong driven by mortgage and unsecured loans.

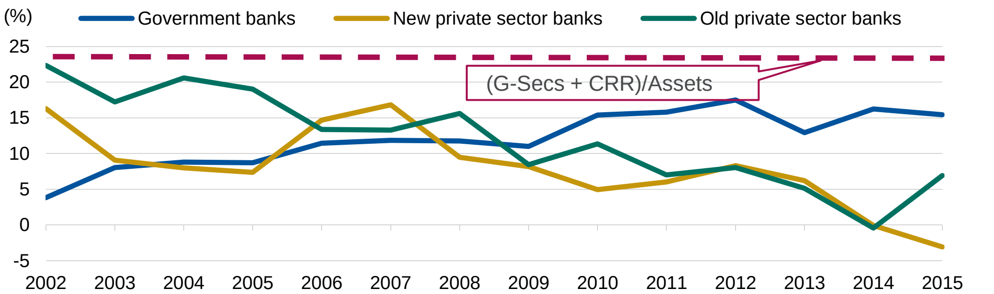
Funding Challenges Remain; LCR and MCLR to Increase Pressure on Banks with High ALM Gaps

Most private sector banks continued to improve their funding profile while PSBs reported high ALM gaps in FY15 and continue to show similar trends as per latest data into FY16.

Figure 19

Ratio of Short-Term Funding Gap to Total Assets

(Deposits & borrowings maturing in 1 year - Loans and investments maturing in 1 year)/total assets



Source: Ind-Ra, RBI. CRR: Cash Reserve Ratio. Data for end-March

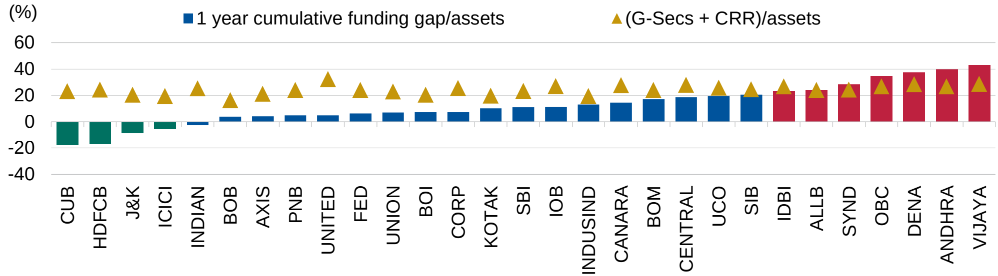
Ind-Ra believes that the refinancing capability of government banks' remains strong, based on the strengths of their granular deposit bases and funding franchises.

Banks with large ALM gaps may however witness higher funding costs due to elevated refinancing pressure, compromising their capability to effectively transmit monetary easing.

Figure 20

Funding Gaps Indian Banks in 2015

1 year cumulative funding gap/assets (%) as on end-March 2015

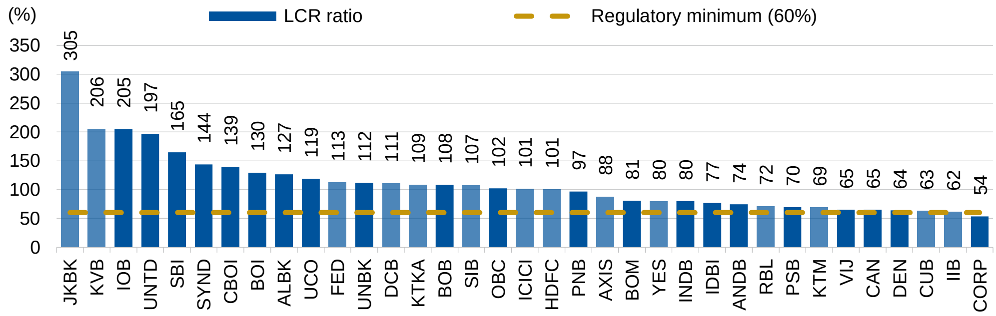


Funding gap = (Deposits and borrowings maturing in 1 year - Loans and investments maturing in 1 year - Unencumbered cash and Interbank assets)/total assets. Source: Annual reports, Ind-Ra

The focus on compliance towards LCR would further start impacting margins for banks with high ALM gaps. Banks will need to bring their LCR ratios above 100% by March 2019. This could be achieved by either reducing outflows from the liability side by garnering more stable deposits (such as those from retail and SME clients and any non-callable deposits, which have lower runoff rates) or increasing the asset side high quality liquid assets (HQLA) component (cash in hand, excess cash reserve ratio: CRR and excess statutory liquidity ratio: SLR securities) which comes with its own drag on margins. However, improvements on the liability side may take time to materialise depending upon the pace of retail deposit accretion. Banks that have been losing retail deposit market share over the last few years or the ones running high ALM mismatches in the short-term buckets would be compelled to keep a high proportion of HQLA to manage their LCRs. This will be a drag on their profitability.

Figure 21

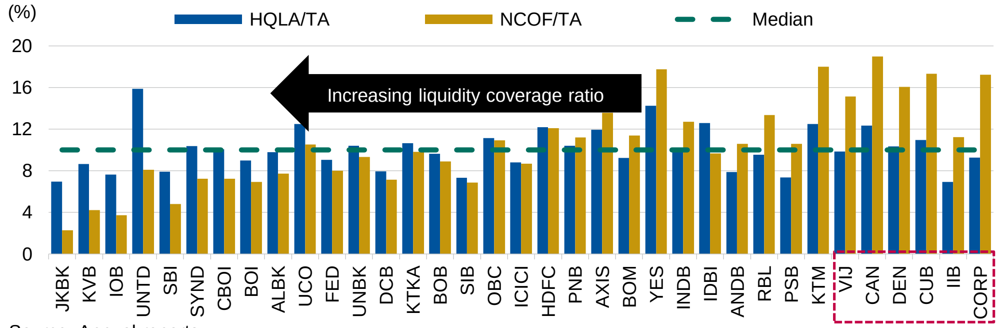
LCR Ratios for Indian Banks (Mar 15)



Source: Annual reports. Lighter shade represents private sector

Figure 22

LCR Breakup – Indian Banks – FY15

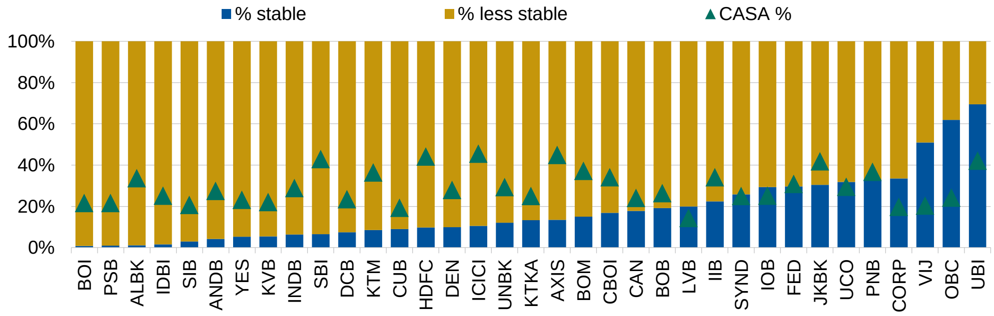


Source: Annual reports

- Classification of stable and less stable deposits (within retail and SME deposits) indicates why a high CASA ratio does not directly imply more stable deposits

Figure 23

Stable and Less Stable Classification of Outflows – LCR – FY15



Source: Annual reports

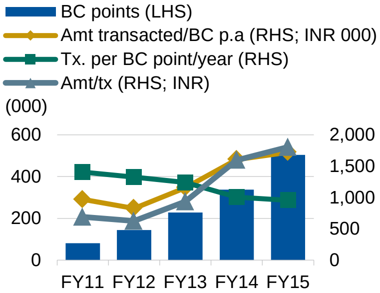
Banks with LCR below 100% will need, on average, to increase HQLA by 4% of the total FY15 assets or 4.5% of NDTL. This ranges as high as 8% for some banks and would imply that some banks would need to raise SLR levels to above 30%. This would imply a return on assets impact of 6-8bp up-till FY19.

The MCLR ratio will also increase the focus on ALM management by banks and could potentially incentivise shoring up of long tenor bonds like infrastructure bonds as a tool to reduce volatility. Banks with higher mix of senior bonds could see lower volatility on MCLR both on account of better matched tenors and average cost of borrowing calculated on the entire borrowing profile.

Small Finance Banks and Payments Banks to Start Changing the Landscape:

Figure 24

BC Channel Size and Throughput



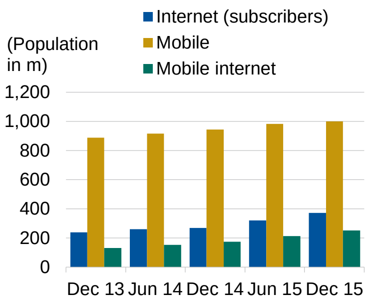
Source: RBI

Most of the recently announced SFBs and PBs will meaningfully commence banking operations only from FY18, Ind-Ra believes the landscape particularly on the liability side has started to shift, with rapid expansion in digital platforms and BC channels. Ind-Ra has also initiated coverage of the SFB segment with a stable outlook.

In FY16 RBI has, attempted to introduce differentiated banks to serve the financially underserved micro, small and medium enterprises and individuals. Ind-Ra had pointed out in the report 'Microfinance: Strong Comeback' that large diversified micro finance institutions (MFIs) or smaller but geographically concentrated entities will be the best suited to operate as an SFB and the 10 entities referred above broadly fulfil the criteria. The payment bank licenses also aim at transforming the payment landscape by bringing cash lying outside the banking channels into the system through convenient and safer digital platforms. In the agency's opinion, most of these entities will collaborate in the near term with other PBs, SFBs, Scheduled commercial banks, BCs, telecom companies and white label ATM providers to evolve the eco-system.

Figure 25

Mobile and Internet Subscribers



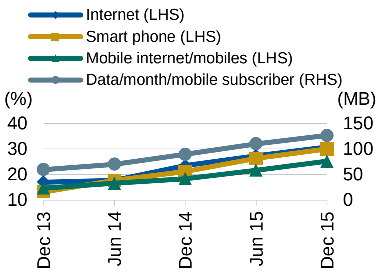
Source: TRAI, Ind-Ra estimates

In addition, both the SFBs and PBs will require feet-on-the ground and hence partner with BCs. Although their efficiency and role has been limited till date, (some studies have shown that only 50% of the BC points are operational), we believe that the entry of these 21 private entities will increase the throughput of the BC channel significantly and increase the sustainability of the client service points of the BCs.

Although India has the second highest number of internet users in the world in FY16, the internet penetration is still lower than many developing countries. However the pace of increase in internet penetration, data usage and smart phone penetration indicates that 'digital literacy' is a possibility in 5-10 years. Internet and mobile association of India expects the smart phone penetration to increase from 30% in FY16 to 70% by FY19-FY20 and this could play a larger role in familiarising PB and SFB customers with 'app' based systems. In addition, e-Know your customer and Adhaar adoption and verification, digitisation and digital payment systems (Aadhar enabled payment systems, IMPS, NEFT, SMS Banking) and extensive use of credit bureaus (now mandatory even for Bank self-help group programs) indicate that the regulatory bodies and other intermediaries are preparing for the digital transition.

Figure 26

Internet and Smartphone Penetration



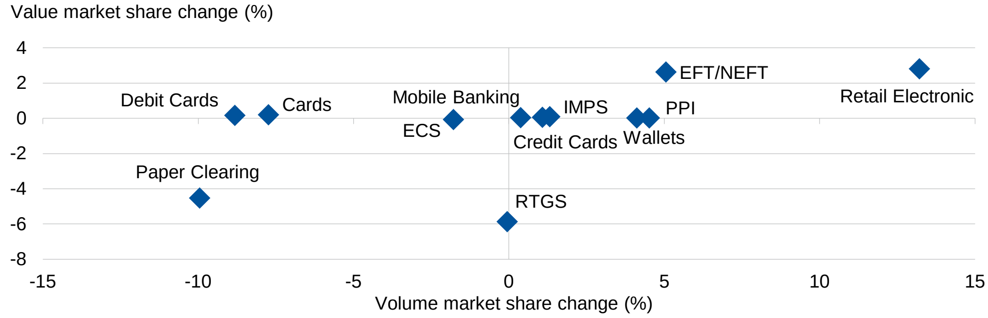
Source:Track.in, TRAI, IAMAI (Mobile internet in India 2014'), Gartner, Ind-Ra's estimates

Payment Banks

The payment system in India is undergoing a change towards electronic and digital transactions. Paper based clearing systems have seen a drop of 10% in transactional volume share between FY12-FY16 (till date) while wallets and mobile banking have gained 4.5% in the same period. In terms of value, the larger ticket size transactions still follow NEFT route while relatively smaller transactions have moved to wallets, credit cards and mobile banking channels. The pace of change in preference of mode of transaction has increased especially in FY16 and we expect the trends to continue given the systemic push by all participants in the financial market and mobile and internet penetration.

Figure 27

Market Share Changes – Payment Systems – FY12-FY16



Source: RBI payment system statistics. data for FY16 till Nov 15

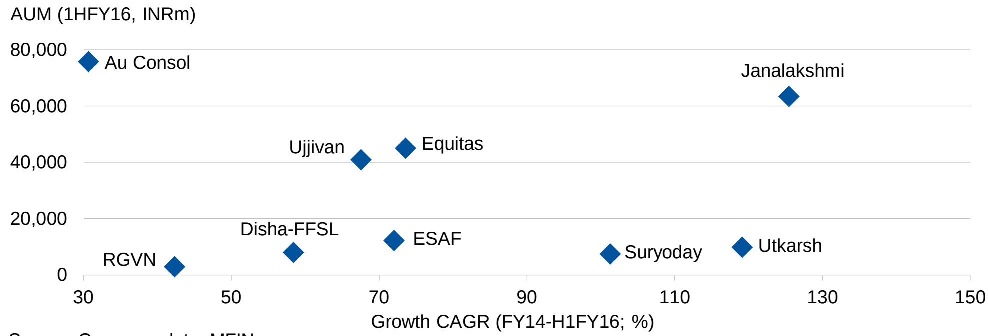
Although the payment banks may not be able to provide a compelling value proposition at present to customers who are well acquainted with digital channels (adequately served by independent wallets and banks), they could drive up volumes of transaction from those unfamiliar with digital banking. Most banks have also developed their own wallet products, but if the user base does not expand, the smaller payments could move to independent wallets or innovative payment banks.

Small Finance Banks

The combined loan assets of the SFBs (including their key operating subsidiaries) stood at INR134bn in FY14 and INR215bn in FY15 (60% yoy growth). Equitas Holdings, AU Financiers and Capital Local Area Bank are diversified financiers while others are primarily NBFC-MFIs.

Figure 28

SFB – Loan Assets and Growth



Source: Company data, MFIN

In addition to deposit services, the SFBs would look to provide diverse credit products to their customer like loans for affordable housing, small business loans, gold loans, vehicles and loan against property. However SFBs will need to upgrade their technological platforms and collaborate with credit bureaus, regulatory bodies and other financial institutions to prevent overleveraging and frauds.

The SFBs need to deploy resources to garner deposits from individuals and corporate entities. For retail liabilities, they will compete with the payment banks, Scheduled commercial banks, regional rural banks, LABs and co-operative banks. Our analysis of a set of efficient co-operative banks revealed median current account savings account (CASA) ratio at 15-20% of deposits where the deposit base has already grown to 85-90% of total liabilities. We expect that the steady level of CASA ratio for SFBs could be 10-15% of total liabilities (Bank self-help group program has maintained savings to credit ratio of about 20%). The SFBs would need to depend on BCs and other platforms to mobilise deposits (since the combined branch network of the SFBs is approximately equivalent to Allahabad Bank's ('IND AA'/Stable) in H1FY16).

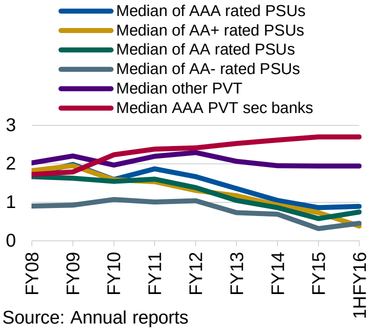
We expect that the systemic risk and geo-political risks faced by MFIs would reduce with their transformation into SFBs. However, on the flip side SFB-MFIs could see erosion in RoAs (currently ranging at 3%-5%) as they will incur costs towards developing banking infrastructure, creating liability franchisee, maintaining CRR and SLR deposits. As the share of non-group loans increase, their bad loans and as a result credit cost may reach similar levels as diversified NBFCs.

Profitability to be under severe pressure particularly for PSBs

The profitability (ROA) of government banks will continue to see the impact of high credit costs while large ALM gaps run by most mid-sized PSBs will continue to impact their margins under the new LCR and MCLR regime.

Figure 29

PPOP – Credit Cost as % of Average Assets

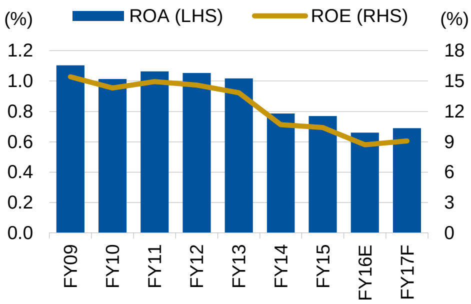


Source: Annual reports

Figure 30

Key Performance Trends

Return on assets & return on equity

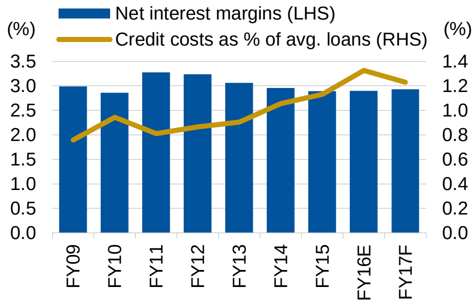


Source: Ind-Ra, RBI

Figure 31

Key Performance Trends

Net interest margin and credit costs

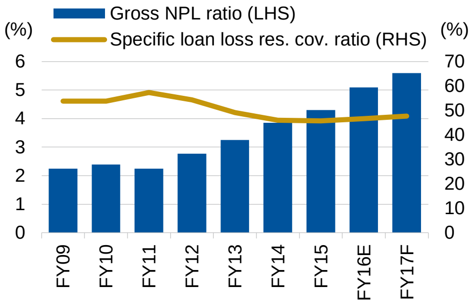


Source: Ind-Ra, RBI

Figure 32

Key Performance Trends

Asset quality – Gross NPL ratio and LLR

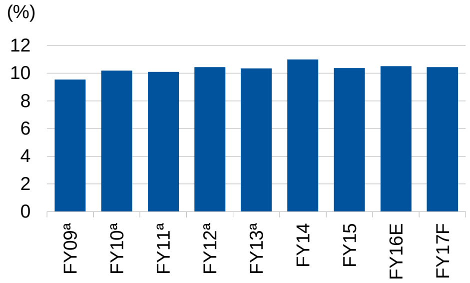


Source: Ind-Ra, RBI

Figure 33

Key Performance Trends

Tier 1 ratios



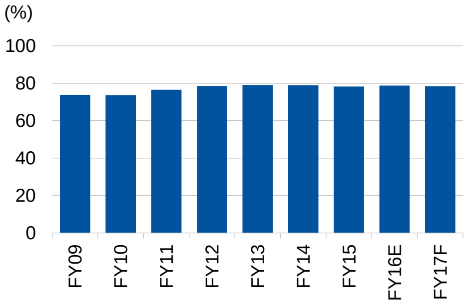
[a] Ratios under Basel II

Source: Ind-Ra, RBI

Figure 34

Key Performance Trends

Loan-to-deposit ratio

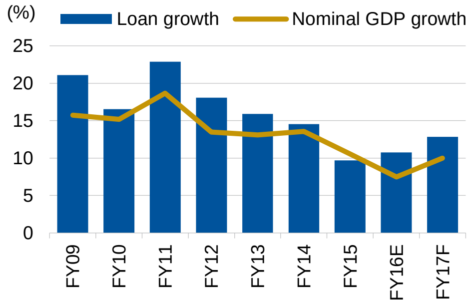


Source: Ind-Ra, RBI

Figure 35

Key Performance Trends

Loan growth and nominal GDP growth



Source: Ind-Ra, RBI

The profitability of banks is likely to witness another year of pressure as credit costs remain elevated, with higher write-offs accompanying high delinquency. For FY17, net interest margins would be flat despite the steep fall in cost of funds on account of higher impairment, and lower loan to deposit ratio. Capital levels of banks may remain stable in FY17, despite the prospect of higher capital injection by the government due to their lower internal accruals.

Appendix 1

Figure 36
Bank Ratings

Bank	Long-Term Issuer Rating/Outlook	AT1 Issuance Rating	Perpetual Tier I/Upper Tier II Rating (Basel 2)
Allahabad Bank	IND AA/Stable		
Andhra Bank	IND AA/Stable		
Axis Bank	IND AAA/Stable		IND AA+
Bank of Baroda	IND AAA/Stable	IND AA+	
Canara Bank	IND AAA/Stable	IND AA	
Catholic Syrian Bank	IND BBB(Withdrawn)		
Central Bank of India	IND AA/ Stable		
City Union Bank	IND A+/Stable		
Corporation Bank	IND AA+/Stable	IND AA-	
Dena Bank	IND AA-/Stable		
Federal Bank	IND AA-/Stable		
HDFC Bank	IND AAA/Stable		
IDBI Bank	IND AA+/Stable	IND AA-	IND AA-
Indian Bank	IND AA+/Stable		
IndusInd Bank	IND AA+/Stable		IND AA
ING Vysya Bank	IND AAA(Withdrawn)		
Jammu and Kashmir Bank	IND AA/Stable		
Kotak Mahindra Bank	IND AAA/Stable		IND AA+
Lakshmi Vilas Bank	IND BBB+/Stable		
Punjab National Bank	IND AAA/Stable	IND AA+	
South Indian Bank	IND A+/Stable		
State Bank of India	IND AAA/Stable		
UCO Bank	IND AA/Stable		IND A+
Union Bank of India	IND AA+/Stable		IND AA
United Bank of India	IND AA-/Stable	IND A-/Negative	
Vijaya Bank	IND AA-/Stable		IND A-

Source: Ind-Ra