Robust Growth for Net Interest Margin Continues, Improves by 46 bps in Q4

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Synopsis

- Net Interest Income (NII) of Scheduled Commercial Banks (SCBs) grew by 29.5% year-on-year (y-o-y) to Rs.1.83 lakh crore in Q4FY23 due to healthy loan growth and a higher yield on advances over the year-ago period.
- The Net Interest Margin (NIM) of Scheduled Commercial Banks (SCBs) witnessed a year-on-year improvement of 46 basis points (bps), reaching 3.3% in Q4FY23. This enhancement can be attributed to the faster repricing of loans, whereas deposit rates have not yet reflected the increased interest rates. The anticipated rise in deposit costs, which is expected to be a lag effect, is likely to be counterbalanced by the withdrawal of Rs 2000 denomination banknotes in Q1FY23.
- SCBs reported a robust rise in advances at 17.3% y-o-y in Q4FY23 mainly driven by personal loans, NBFCs, and MSMEs with similar growth for private sector banks (PVBs) and public sector banks (PSBs).

NII and NIM Movement

- NII of PSBs and PVBs grew by 31.6% and 28.2% y-o-y, respectively, in Q4FY23 due to robust loan growth and higher yields on advances.
  - Interest income of SCBs rose by 32.1% y-o-y in Q4FY23 wherein PVBs rose by 32.6% and PSBs grew at 31.7% in the quarter. This was based on an increase in advances by 17.3% y-o-y and an increase in yields by 130 bps y-o-y (from 7.5% in Q4FY22 to 8.8% in Q4FY23)
  - Interest expenses of SCBs rose by 34.3% y-o-y in Q4FY23, wherein PVBs rose by 37.5% and PSBs by 32.6% in the same period. It rose due to a rise in deposit rates driven by an increase in policy rates which led to an increase in the cost of funds by 77 bps y-o-y. PVBs' interest expenses increased at a higher pace compared to PSBs due to a higher increase in the mobilisation of deposits.
  - PVBs' deposits rose by 15.5% y-o-y in Q4FY23 while PSBs registered at a slower pace of 9.3% in the same period.

Figure 1: NII Trend (Rs. Lakh Cr.)

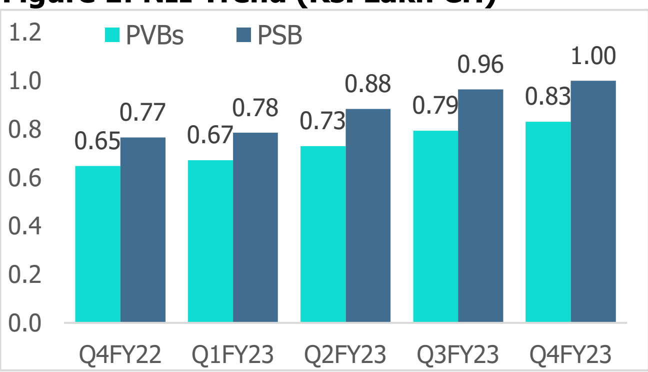


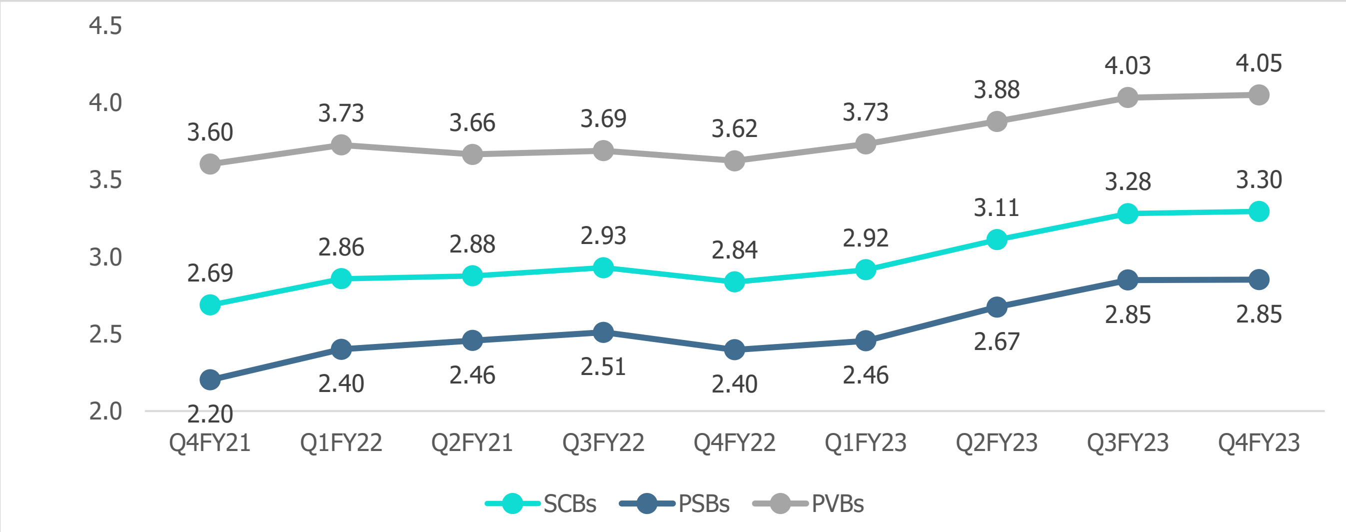
Figure 2: Deposit Growth (Rs. Lakh Cr.)

Deposits	March 31, 2022	March 31, 2023	Y-o-Y (Growth, %)
PVBs	53.9	62.2	15.4
PSBs	107.2	117.1	9.3
SCBs	**161.1**	**179.3**	**11.3**

Source: Ace Equity and Banks Filing, Note: Includes 12 PSBs and 18 PVBs

- NIM of SCBs improved by 46 bps y-o-y at 3.3% in the quarter, within this, PSBs improved by 46 bps at 2.85%, whereas PVBs rose by 43 bps at 4.05%.

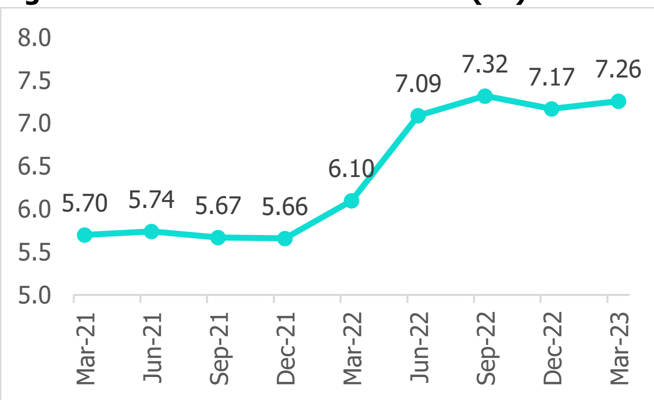
Figure 3: NIM Movement (%)



Source: Ace Equity and Banks Filing, Note: Includes 12 PSBs and 18 PVBs

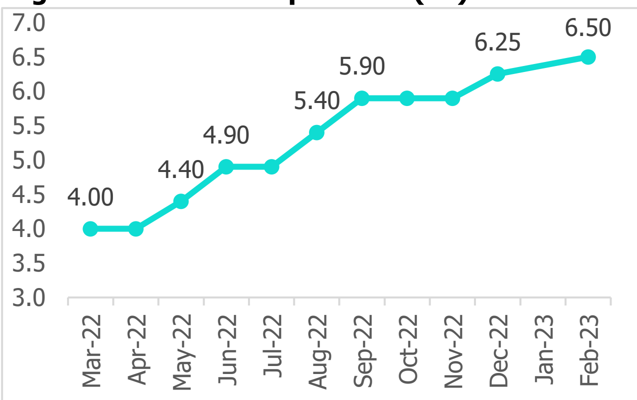
- RBI has announced the withdrawal of Rs.2,000 denomination notes which will increase the liquidity in the banking system over the next two quarters. It is also likely to reduce the banking sector's dependence on short-term bulk deposits in the near term. Hence, the rate on short-term deposits is expected to be benign in Q1FY23 and Q2Y23.

Figure 4: 5-Year G-Sec Yield Trend (%)



Source: CMIE, Note – Yield as of closing date of the quarter

Figure 5: Trend in Repo Rates (%)



Source: RBI

On a cumulative basis, RBI has increased the repo rate by 250 bps to 6.5% in FY23 which was accompanied by an increase in interest rates in the debt market. Accordingly, banks have realigned the interest rates which were usually reset within one year window and that has been reflected in lending rates. However, it has not fully reflected in deposit rates since these are usually not reset before maturity.

- Yield on 5-year G-sec rose by 120 bps to 7.3% in March 2023 over a year ago due to an increase in the policy rates. The rise was lower than the repo rate of 250 bps. Nevertheless, if we compare this from December 2020, it rose by 223 bps meanwhile the repo increased by 250 bps.

Conclusion

Credit offtake experienced a robust growth of 15.0% in FY23 and is projected to moderate in FY24. This moderation can be attributed to the anticipated slowdown in GDP growth, lower working capital requirements resulting from an expected drop in inflation, and a higher base effect. RBI has announced the withdrawal of Rs 2,000 denomination notes, with these banknotes' total value in circulation amounting to Rs.3.62 lakh crore as of March 31, 2023. These additions are expected to represent approximately 0.5% to 1% of overall deposits in the banking sector. As of April 2023, the banking system liquidity was already in surplus. Over a period of four months (June 2023 to September 2023), an additional infusion of Rs.1.0 lakh crore to Rs.1.8 lakh crore is anticipated. This injection of significant short-term liquidity into the banking sector over the next two quarters is expected to reduce the sector's reliance on short-term bulk deposits in the near term. Consequently, there may be a slight easing of short-term deposit rates in the near future.

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