Banks’ Margin Trajectory Sees Strain in Q1 as Deposits Cost Rise Sequentially

CareEdge RATINGS

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Synopsis

- Net Interest Income (NII) of Scheduled Commercial Banks (SCBs) grew by 26.5% year-on-year (y-o-y) to Rs. 1.84 lakh crore in Q1FY24 due to healthy loan growth and a higher yield on advances over the year-ago period.
- The Net Interest Margin (NIM) of SCBs witnessed a year-on-year improvement of 36 basis points (bps), reaching 3.27% in Q1FY24. This enhancement can be attributed to the faster repricing of loans, whereas deposit rates have not yet reflected the increased interest rates. Besides, SCBs witnessed higher-than-expected deposit growth in the quarter. The anticipated rise in deposit costs, which is expected to be a lag effect, is likely to put continued pressure on NIM in Q2FY24.
- SCBs reported a robust rise in advances at 16.7% y-o-y in Q1FY24 mainly driven by personal loans, NBFCs and MSMEs, with similar growth for private sector banks (PVBs) and public sector banks (PSBs). SCBs witnessed a 13.5% y-o-y deposit growth in the quarter, within this PVBs’ deposits rose by 17.4% y-o-y in Q1FY24 while PSBs registered at a slower pace of 10.9% in the same period. Meanwhile, deposit growth lagged in credit growth with sluggish current account and saving account (CASA) growth. Other PSBs’ NIM expanded by 41 bps y-o-y at 2.85% in Q1FY24, outperforming large PSBs and PVBs.
- In terms of sequential performance, SCBs’ NIM contracted by 2 bps to 3.27% due to a drop in the NIM of large PSBs. Though, the NIM of Other PSBs and other PVBs expanded by 8 bps and 6 bps in the quarter.
- The Credit and Deposit (C/D) ratio stood at 75.1% as of July 01, 2023, expanding by ~210 bps y-o-y over a year ago due to faster y-oy growth in credit compared to deposits.

Figure 1: NIM Movement (%)

Group	NIM (Q1FY24)	Y-o-Y (bps)	Q-o-Q (bps)
Large PSBs	2.78	32	-10
Other PSBs	2.85	41	8
PSBs	**2.80**	**34**	**-5**
Large PVBs	3.95	35	1
Other PVBs	4.13	34	6
PVBs	**4.08**	**35**	**3**
SCBs	**3.27**	**36**	**-2**

Source: Ace Equity, Bank Filings, CareEdge Calculations

Movement in NII and NIM

Figure 2: NII (Rs. Lakh Cr.) and Growth (%)

NII	Q1FY24	Q1FY23 (y-o-y)	Q1FY24 (y-o-y)	Q1FY24 (q-o-q)
Large PSBs	0.74	11.3	25.3	-2.3
Other PSBs	0.25	13.7	29.3	3.8
PSBs	**0.99**	**11.9**	**26.3**	**-0.8**
Large PVBs	0.54	17.8	27.8	1.9
Other PVBs	0.31	16.4	24.9	3.6
PVBs	**0.85**	**17.3**	**26.7**	**2.5**
SCBs	**1.84**	**14.3**	**26.5**	**0.7**

Source: Ace Equity, Bank Filings, CareEdge Calculations

NII of PSBs and PVBs grew by 26.7% and 26.3% y-o-y, respectively, in Q1FY24. The growth was driven by robust loan growth and higher yields on advances; however, it was partially offset by a rise in the cost of deposits. Transmission for the May 2022 - June 2023 period has been uneven. The increases in Weighted Average Domestic Term Deposit Rates (WADTDR) on fresh rupee deposits and Weighted Average Lending Rates (WALR) on fresh rupee loans were higher in the case of PSBs, while the increases in WADTDR on outstanding deposits and WALR on outstanding loans were higher for PVBs.

Figure 3: Changes in Yield on Advances and Movement in Cost of Funds

	Change in Yields - bps (Advances)		Change in Cost of Funds – bps	
Group	**y-o-y**	**q-o-q**	**y-o-y**	**q-o-q**
Large PSBs	162	14	101	28
Other PSBs	140	24	89	22
PSBs	**157**	**17**	**98**	**26**
Large PVBs	165	28	109	39
Other PVBs	142	40	98	36
PVBs	**157**	**32**	**105**	**38**
SCBs	**157**	**23**	**101**	**30**

Source: Ace Equity, Bank Filings, CareEdge Calculations

Figure 4: Yield on Advances – PSBs (%)

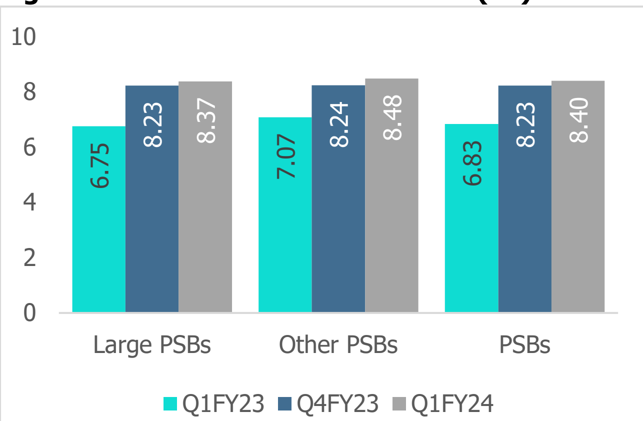
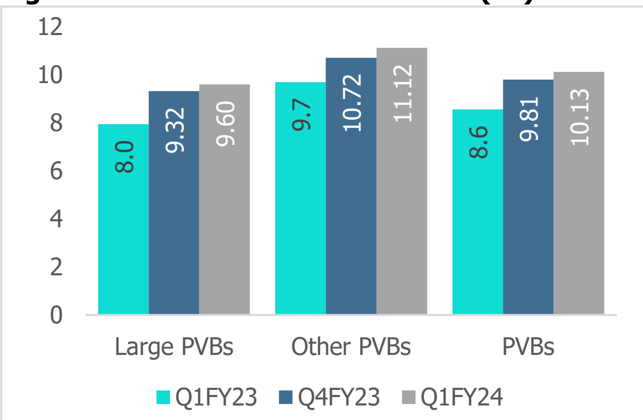


Figure 5: Yield on Advances – PVBs (%)



Source: Ace Equity, Bank Filings, CareEdge Calculations

Figure 6: Cost of Funds – PSBs (%)

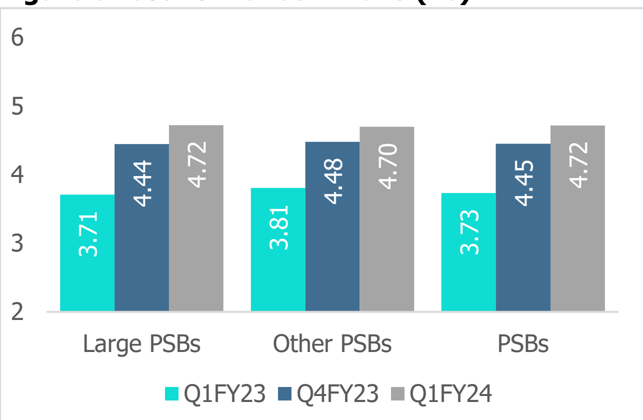
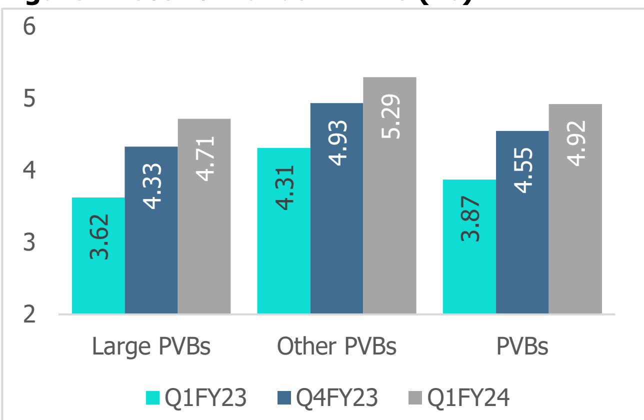


Figure 7: Cost of Funds – PVBs (%)



Source: Ace Equity, Bank Filings, CareEdge Calculations

- In terms of NII growth, "other/smaller PSBs" outperformed other segments in Q1FY24, registering a robust 29.3% y-o-y growth driven by a 16.4% y-o-y growth in advances.
  - Interest income of SCBs rose by 34.7% y-o-y in Q1FY24 wherein PVBs rose by 36.1% and PSBs grew at 33.7% in the quarter. This was based on SCB's increase in advances by 16.7% y-o-y and an increase in yields by 157 bps y-o-y (from 7.5% in Q1FY23 to 9.1% in Q1FY24).
  - Interest expenses of SCBs rose by 41.8% y-o-y in Q1FY24, wherein PVBs grew by 46.6% and PSBs by 39.1% in the same period. Deposits for SCBs grew by 13.5% y-o-y in the quarter, within this PVBs rose by 17.4% y-o-y while PSBs reported a slower growth at 10.9% y-o-y in the same period. The expansion in the cost of funds by 101 bps y-o-y (from 3.78% to 4.79%) can be attributed to a rise in deposit rates driven by an increase in policy rates along with a reduction in the CASA ratio (low-cost funds). PVBs' interest expenses increased at a higher pace compared to PSBs due to a higher increase in the mobilisation of deposits.
- NIM of SCBs improved by 36 bps y-o-y at 3.27% in Q1FY23, within this, PSBs improved by 34 bps at 2.80%, whereas PVBs expanded with a similar rate and reached 4.08% in the quarter. In terms of sequential performance, overall margins were steady.
- However, pressure on NIM can be seen due to an increase in the cost of deposits and is expected to continue in Q2FY24. SCBs' yield on advances rose by 23 bps to 9.07% q-o-q while the cost of funds increased by 30 bps to 4.79% in Q1FY24. The increase in cost of funds can also be attributed to muted CASA ratio which contributed to rising cost of funds.

Figure 8: SCBs - NIM Trend (%)

	Q1 FY22	Q2 FY21	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23	Q4 FY23	Q1 FY24	y-o-y	q-o-q
Large PSBs	2.43	2.47	2.53	2.45	2.46	2.66	2.85	2.88	2.78	0.32	-0.10
Other PSBs	2.32	2.42	2.46	2.25	2.44	2.71	2.84	2.77	2.85	0.41	0.08
PSBs	**2.40**	**2.46**	**2.51**	**2.40**	**2.46**	**2.67**	**2.85**	**2.85**	**2.80**	**0.34**	**-0.05**
Large PVBs	3.58	3.67	3.57	3.46	3.60	3.77	4.04	3.93	3.95	0.35	0.01
Other PVBs	3.61	3.47	3.71	3.74	3.79	3.89	4.01	4.07	4.13	0.34	0.06
PVBs	**3.73**	**3.66**	**3.69**	**3.62**	**3.73**	**3.88**	**4.03**	**4.05**	**4.08**	**0.35**	**0.03**
SCBs	**2.86**	**2.88**	**2.93**	**2.84**	**2.92**	**3.11**	**3.28**	**3.30**	**3.27**	**0.36**	**-0.02**

Source: Ace Equity, Bank Filings, CareEdge Calculations

- Within PSBs, NIM of smaller/other PSBs outperformed in terms of year-on and sequential performance. With improving assets quality and renewed business growth, NIM of other PSBs expanded by 41 bps y-o-y and 8 bps q-o-q to 2.85% in Q1FY24 whereas large PSBs rose by 32 bps y-o-y, while dropping by 10 bps q-o-q.
- NIM of PVBs expanded by 35 bps y-o-y and 3 bps q-o-q at 4.08% in Q1FY24 driven by strong NII growth, also aided by slower asset growth as compared to NII. Other PVBs NIM expanded by 6 bps at 4.13% in the quarter, expanding higher than PVBs.

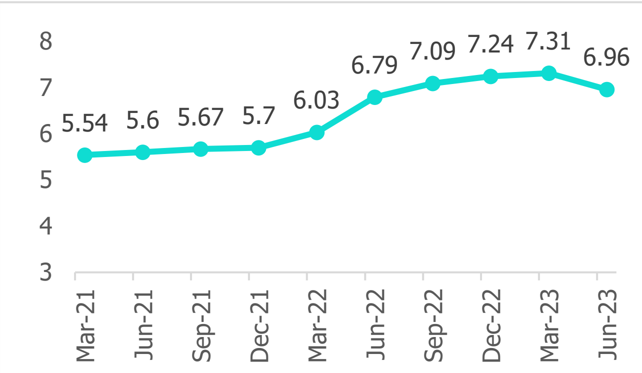
Figure 9: Movement in CASA Ratio (%)

CASA Ratio (%)	Q1FY23	Q4FY23	Q1FY24	y-o-y (Changes in bps)	q-o-q (Changes in bps)
Other PSBs	40.5	39.8	39.0	-146	-74
Large PSBs	41.5	39.9	38.8	-264	-101
PSBs	**41.2**	**39.8**	**38.9**	**-234**	**-94**
Large PVBs	45.6	45.5	43.4	219	-203
Other PVBs	44.3	41.9	40.5	-383	-142
PVBs	**45.2**	**44.2**	**42.4**	**-277**	**-182**
SCBs	**42.6**	**41.4**	**40.1**	**-244**	**-124**

Source: Ace Equity, Bank Filings, CareEdge Calculations

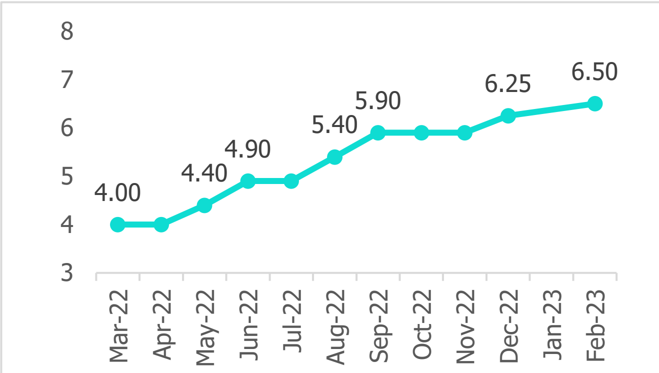
- RBI has announced the withdrawal of Rs. 2,000 denomination notes in May 2023. Overall Rs. 3.62 lakh crore notes were in circulation as of March 31, 2023, out of which around 76% of notes have come back into the banking system as of June 30, 2023. Thus, it increased the liquidity in the banking system, and 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 Q2Y23. However, the imposition of additional CRR requirements on incremental deposits to absorb liquidity could create pressure on short-term rates in the second quarter.

Figure 10: 5-Year G-Sec Yield Trend (%)



Source: CMIE, Note – Weightage Average Rate (Yield)

Figure 11: Trend in Repo Rates (%)



Source: RBI

Movement in 1-Year Median Marginal Cost of Funds Based Lending Rate

Figure 12: Movement in MCLR (%)

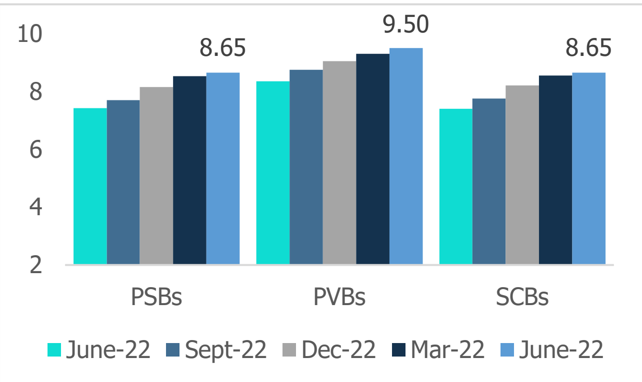
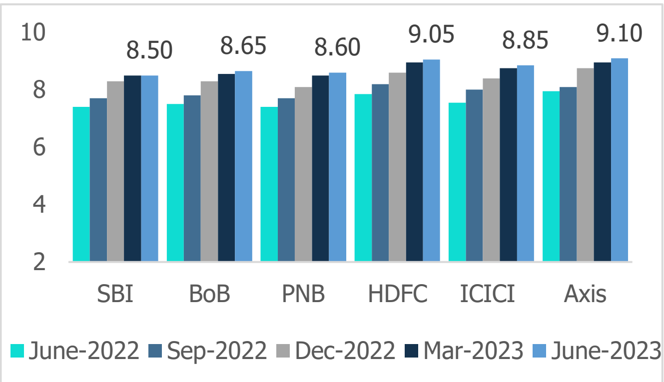


Figure 13: Movement in MCLR (%)



Source: RBI

Figure 14: Movement in Median MCLR changes

(changes)	SBI	BoB	PNB	PSBs	HDFC	ICICI	Axis	PVBs	SCBs
Median MCLR (%)	8.50	8.65	8.60	**8.65**	9.05	8.85	9.10	**9.50**	**8.65**
y-o-y (bps)	110	115	120	**123**	120	130	115	**115**	**125**
q-o-q (bps)	0	10	10	**13**	10	10	15	**20**	**10**

Source: RBI

- On a cumulative basis, RBI 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 17 bps y-o-y to 6.96% in June 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 181 bps.

Conclusion

Credit offtake experienced robust growth of 16.2% in Q1FY24 and the outlook remains positive for FY24, driven by economic expansion, increased capital expenditure, the implementation of the PLI scheme, and a push for retail credit. It is important to consider that this growth would be coming off a high base in FY23, which might have a marginal impact on the growth rate. CareEdge estimates that credit growth is likely to be in the range of 13.0%-13.5% for FY24, excluding the impact of the merger of HDFC with HDFC Bank. Furthermore, as the CD ratio remains elevated, growth in the liability franchise would play a significant role in sustaining loan growth. The competition for deposits is likely to intensify even further, resulting in a rise in funding costs in the coming quarters as rates rise and CASA share reduces. The margin trajectory could witness pressure in later part of FY24 as competition would also cap the interest rates charged at a certain level.

Annexure

Note: Analysis based on 30 scheduled commercial banks (12 PSBs, and 18 PVBs)

Group							
Large PSBs	Bank of Baroda	Canara Bank	Indian Bank	Punjab National Bank	State Bank of India		
Other PSBs	Bank Of India	Bank Of Maharashtra	Central Bank of India	Indian Overseas Bank	Punjab & Sind Bank	UCO Bank	Union Bank of India
PSBs	**Large PSBs and Others PSBs (Total 12 PSBs)**						
Large PVBs	HDFC Bank	ICICI Bank	Axis Bank				
Other PVBs	Yes Bank	IDFC First Bank	RBL Bank	Kotak Mahindra Bank	IndusInd Bank	Federal Bank	South India Bank
	Karnataka Bank	Dhanlaxmi Bank	IDBI Bank	Bandhan Bank	J&K Bank	City Union Bank	Karur Vysya Bank
	DCB Bank						
PVBs	**Large PVBs and Others PVBs (Total 18 Banks)**						
SCBs	**PSBs + PVBs (Total 30 Banks)**						

Contact

Sanjay Agarwal	Senior Director	sanjay.agarwal@careedge.in	+91 - 22 - 6754 3582 / +91-81080 07676
Saurabh Bhalerao	Associate Director – BFSI Research	saurabh.bhalerao@careedge.in	+91 - 22 - 6754 3519 / +91-90049 52514
Vijay Singh Gour	Lead Analyst – BFSI Research	vijay.gour@careedge.in	+91 - 22 - 6754 3630 / +91-98937 89622
Mradul Mishra	Media Relations	mradul.mishra@careedge.in	+91 - 22 - 6754 3596

CARE Ratings Limited
Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022
Phone : +91 - 22 - 6754 3456 I CIN: L67190MH1993PLC071691

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