Operating Margins Moderate as Costs Spike for SCBs in Q3

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Synopsis

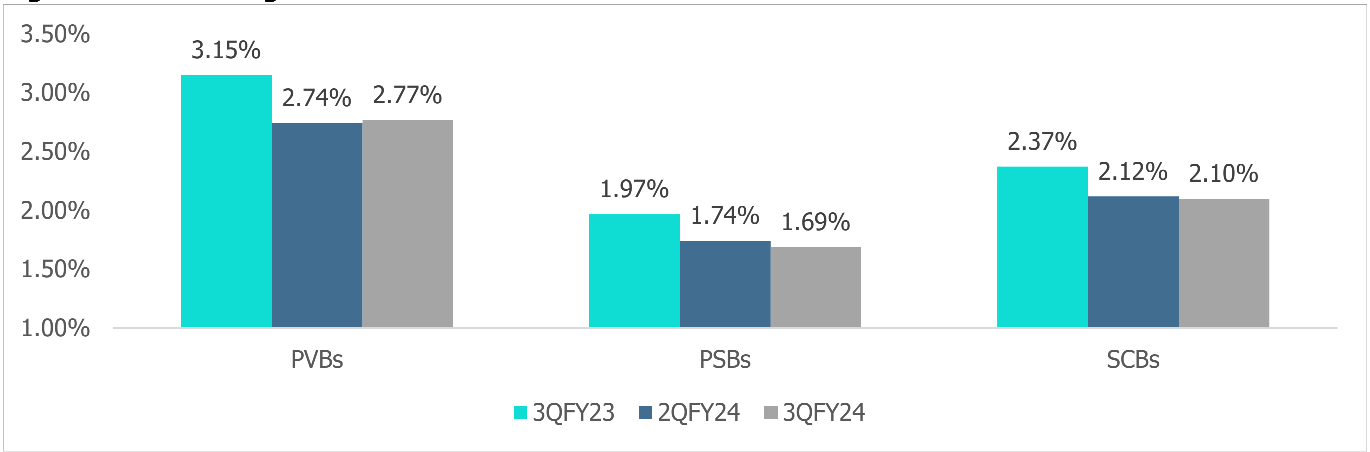
- Scheduled Commercial Banks' (SCBs) Pre-Provisioning Operating Profit (PPOP) grew by a moderate 2.7% year-on-year (y-o-y) to Rs 1.29 lakh crore driven by growth in Net Interest Income (NII), which was offset by higher operating cost (opex). This was despite total income growth of 25.1%.
- The cost-to-income ratio of SCBs surged by 430 bps y-o-y to 50.6% in Q3FY24 due to higher growth in opex (19.8% growth) compared to NII (9.7% growth) this was impacted majorly due to higher employee cost due to revised negotiation for PSB employee.
- Meanwhile, PPOP increased marginally by 1.3% on a sequential basis. However, the PPOP margin shrank by 27 bps from 2.37 % in 3QFY23 to 2.10 % in 3QFY24, as we saw higher employee cost impacted in addition to employee provision cost increase, driven by PSBs.

Figure 1: PPOP Rises on a y-o-y basis, while Margins reduce Marginally

	(Rs. Lakh Crore)		
	Q2FY24	**y-o-y**	**q-o-q**
Large PSBs	0.45	-11.2	-2.2
Other PSBs	0.20	8.6	1.6
PSBs	**0.65**	**-5.8**	**-1.0**
Large PVBs	0.48	14.3	4.3
Other PVBs	0.17	9.3	2.5
PVBs	**0.65**	**12.9**	**3.8**
SCBs	**1.29**	**2.7**	**1.3**

Source: Ace Equity, Bank Filings, CareEdge Calculations

Figure 2: PPOP Margin Down



Source: Ace Equity, Bank Filings, CareEdge Calculations

- In Q3FY24 (on a y-o-y basis), the total income of SCBs grew by 25.1%. The NII was lower at 9.7%. Further, PPOP grew by only 2.7% during the period.

- The Net Interest Margin (NIM) of SCBs witnessed a y-o-y decline of 16 basis points (bps), reaching 3.14% in Q3FY24. Meanwhile, the non-interest income of SCBs grew by 9.2% y-o-y in the quarter (Driven majorly by HDFC merger impact).
- PPOP of SCBs grew by 2.7% y-o-y to Rs. 1.29 lakh crore in Q3Y24, while the PPOP margin declined by 27 bps y-o-y to 2.10% in Q2FY24.
  - PPOP of PSBs declined by 5.8% y-o-y in the quarter (compared uptick of to 17.9% last year) due to higher growth in Interest expenses (As banks have transmitted interest rates on deposits), coupled with higher employee costs. Large PSBs' PPOP witnessed a drop of 11.2% in the quarter, driven by a drop in non-interest income.
  - Meanwhile Private Sector Banks (PVBs) reported a PPOP growth of 12.9% y-o-y in the quarter driven by mergers and growth in non-interest income.
  - PSBs' PPOP margin dropped by 28 bps to 1.69% in Q3FY24, meanwhile PVBs dropped by 38 bps y-o-y to 2.77% in the quarter. In terms of sequential performance, SCBs' PPOP margin declined due to a decline in net interest margin (NIM) and higher salary costs and other opex.
  - Sequentially, we saw a divergence in trend for PPOP where PVBs have seen an uptick of 3.8% (mainly driven by merger impact) whereas PPOP for PSBs dropped 1.0%.

Figure 3: Cost to Income Ratio Increases Across the Board as Employee Costs Bite

	FY22		FY23				FY24			y-o-y (Bps)	q-o-q (bps)
	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q		
Large PSBs	50.7	51.3	54.2	49.7	47.9	51.7	48.7	54.2	55.2	738	102
Other PSBs	56.0	49.6	52.8	46.7	47.8	49.5	45.9	49.4	49.5	171	7
PSBs	**52.2**	**50.9**	**53.8**	**48.8**	**47.8**	**51.0**	**47.9**	**52.9**	**53.6**	**577**	**73**
Large PVBs	41.3	41.8	43.7	41.4	39.8	41.8	43.3	42.7	42.4	255	-33
Other PVBs	54.3	52.2	55.0	53.8	53.7	52.2	53.7	55.4	57.6	392	222
PVBs	**45.5**	**45.3**	**47.5**	**45.5**	**44.4**	**45.3**	**46.7**	**46.8**	**47.2**	**285**	**47**
SCBs	**49.3**	**48.5**	**50.9**	**47.4**	**46.3**	**48.6**	**47.4**	**50.1**	**50.6**	**430**	**57**

Source: Ace Equity, Bank Filings, CareEdge Calculations

- Cost to Income ratio of SCBs increased by 430 bps y-o-y to 50.6% in Q3FY24 due to higher growth in opex compared to NII growth (however number may not be comparable due to HDFC merger). They were elevated on account of wage and pension provisions for PSBs and continued investments in branch expansion and technological upgradation. A part of the elevated employee costs of PSBs will subside in subsequent quarters as pending wage revision provisions are completed.
- Sequentially as well, SCBs' cost-to-income ratio increased at 57 bps mainly driven by PSBs as their opex increased in the quarter.

Income (Rs. Lakh, Cr.)

Figure 4: Interest Income

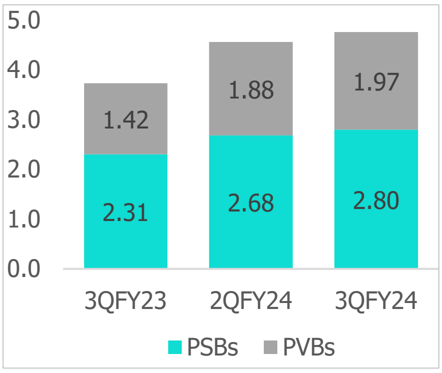


Figure 5: Non-Interest Income

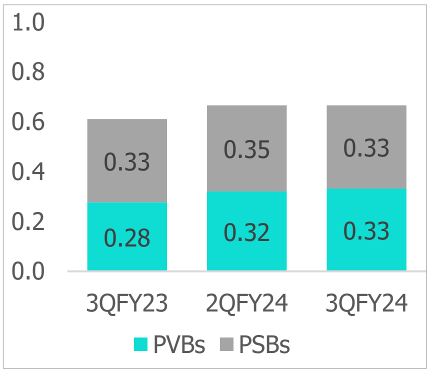
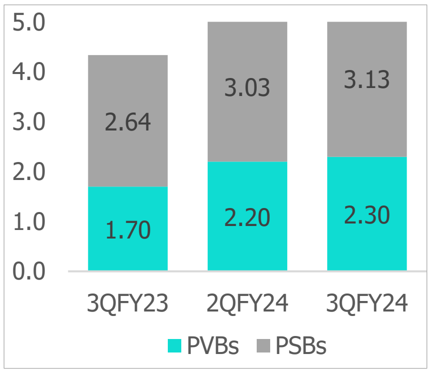


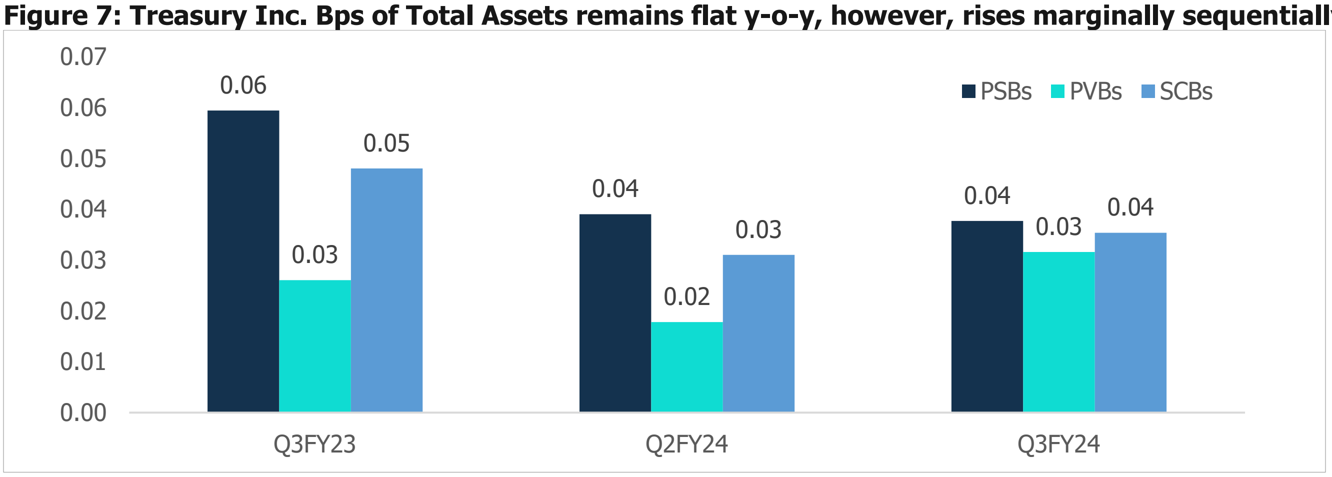
Figure 6: Total Income



Source: Ace Equity, Bank Filings, CareEdge Calculations; Note: Includes 12 PSBs and 18 PVBs

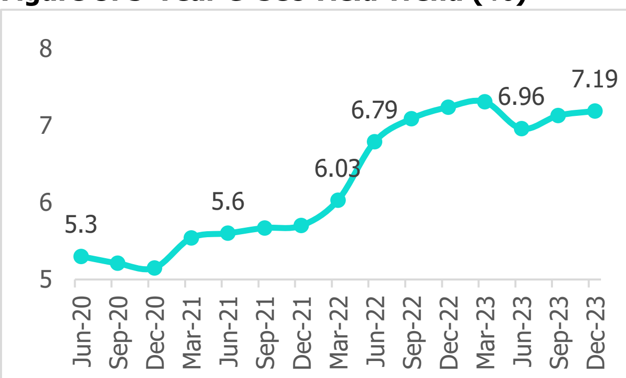
- Total income of SCBs grew by 25.1% y-o-y to Rs. 5.43 lakh crore in Q3FY24 due to robust growth in advances, rise in the yield due to repricing of loans and growth in non-interest income. Advances to Personal loans and Non-Banking Financial Services (NBFCs), Micro Small and Medium Enterprises (MSMEs) reported growth in Q3FY24. Interest income of SCBs grew by 27.7% y-o-y to Rs.4.76 lakh crore in Q3FY24, with growth in advances by 20.1% on a y-o-y basis and a rise in the yield on advances to 9.31% in Q3FY24.

Figure 7: Treasury Inc. Bps of Total Assets remains flat y-o-y, however, rises marginally sequentially



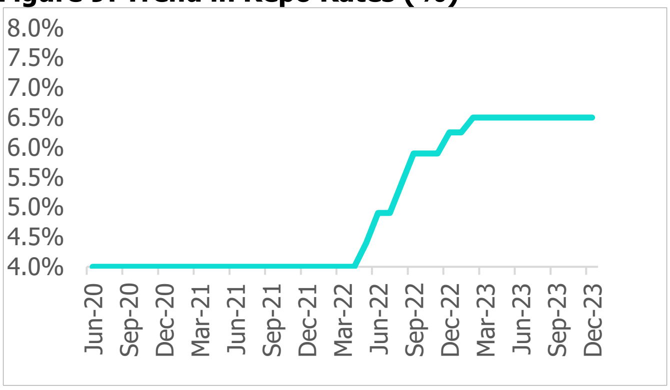
Source: Ace Equity, Bank Filings, CareEdge Calculations; Note: Includes 12 PSBs and 13 PVBs

Figure 8: 5-Year G-Sec Yield Trend (%)



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

Figure 9: Trend in Repo Rates (%)



Source: RBI

- Sequentially we saw a divergence in PPOP trend for PVBs and PSBs this can be majorly attributed to merger impact along with high deposit cost for PSBs.
- Yield on 5-year G-sec yield dropped marginally by 5 bps at 7.19% as of Dec 2023 over a year ago. The G-Sec trend was flattish compared to the repo rate rise of 60 bps y-o-y. Nevertheless, if we compare this from December 2020, it rose by 210 bps.

Figure 10: Yield on Advances – PSBs (%)

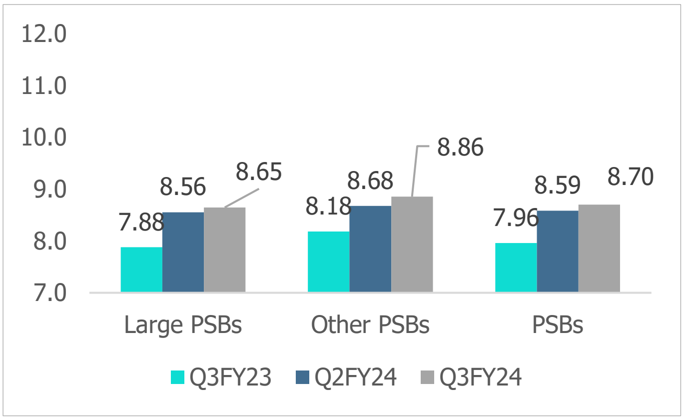
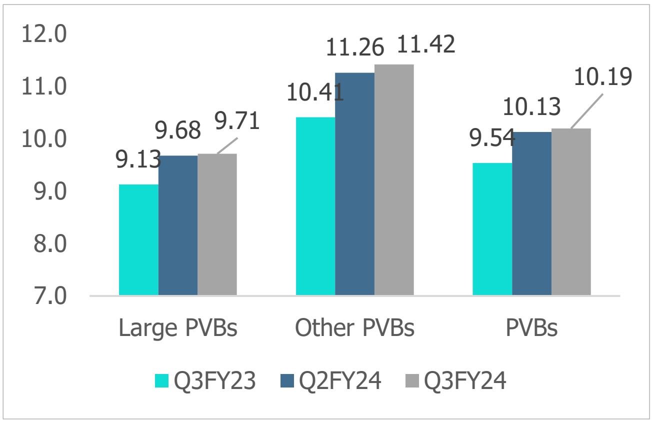


Figure 11: Yield on Advances – PVBs (%)



Source: Ace Equity, Bank Filings, CareEdge Calculations
Note: HDFC Ltd numbers is used in Q3FY24 analysis

Figure 12: Cost of Funds – PSBs (%)

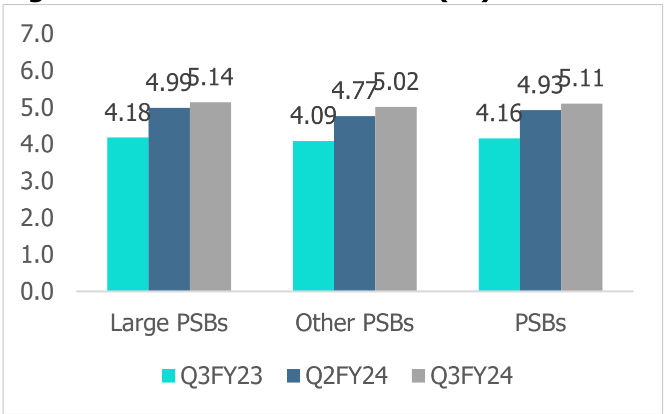
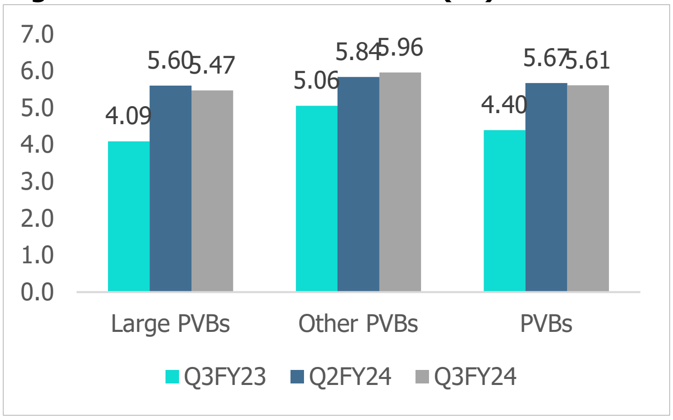


Figure 13: Cost of Funds – PVBs (%)



Source: Ace Equity, Bank Filings, CareEdge Calculations
Note: HDFC Ltd numbers is used in Q3FY24 analysis

Figure 14: 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	77	9	96	15
Other PSBs	68	18	93	25
PSBs	**74**	**12**	**95**	**18**
Large PVBs	59	3	138	-13
Other PVBs	101	16	90	12
PVBs	**66**	**7**	**121**	**-6**
SCBs	**76**	**10**	**105**	**10**

Source: Ace Equity, Bank Filings, CareEdge Calculations
Note: HDFC Ltd numbers is used in Q3FY24 analysis

- PSBs total income grew by 18.6% y-o-y to Rs.3.03 lakh crore in Q3FY24.
    - Interest income of PSBs grew by 18.6% y-o-y to Rs. 3.13 lakh crore, meanwhile, advances rose by 13.8% y-o-y in the quarter. The yield on advances rose by 74 bps y-o-y to 8.70% in Q3FY24 from 7.96% in Q3FY23.
    - Non-interest income of PSBs increased by 0.2% y-o-y as one of deals on sale of Investments was absent in the current quarter.
- PVBs total income grew by 35.2% y-o-y to Rs.2.30 lakh crore in Q3FY24.
    - PVBs reported robust growth in interest income at 38.2% y-o-y in Q3FY24 driven by 31.5% growth in advances and a rise in the yield on advances by 66 bps y-o-y to 10.2%.

Operating Expenses (Rs. Lakh – Cr.)

Figure 15: Employee Expenses

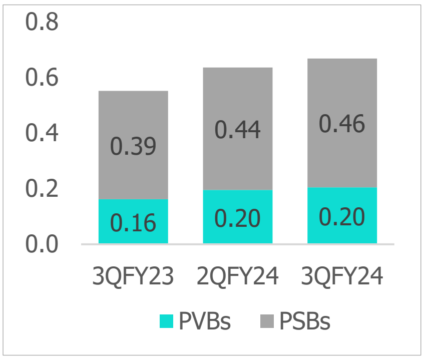


Figure 16: Other Op. Expenses

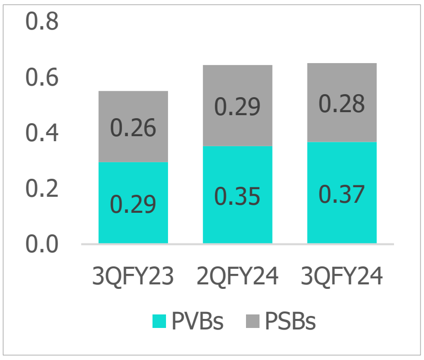
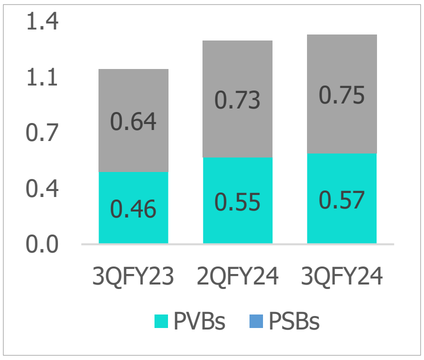


Figure 17: Total Op. Expenses



Source: Ace Equity, Bank Filings, CareEdge Calculations; Note: Includes 12 PSBs and 18 PVBs

- The opex of SCBs rose by 19.8% y-o-y to Rs. 1.32 lakh crore in Q3FY24, within this employee expenses rose by 21.3% y-o-y while other opex rose by 18.3% y-o-y.
    - PSBs' employee expenses rose by 19.2% y-o-y driven by bipartite wage provisions and additional provisions for pensions.
    - PVB employee expenses rose by 28.4% y-o-y in the quarter due to higher headcounts and wage inflation.
    - Other expenses of SCBs rose by 21.2% in the quarter driven by other operating expenses attributed to the addition of branches. PVBs reported a much higher rise in other opex at 26.8% in the quarter as compared to 15.0% by PSBs due to rising distribution costs, rise in business volume and continued IT spending.

Conclusion

In Q3FY24, there was a quarter-over-quarter moderation in NIMs, but they remained flat on a year-over-year basis. NII growth moderated YoY across the board as cost of funds continued to inch up, exerting pressure on NII, and we expect the trend to continue in 4QFY24. This trend is attributed to the delayed impact of deposit repricing combined with a decrease in the proportion of low-cost CASA deposits.

Healthy fee income, along with muted treasury gains, led to largely flat PPOP. Margins were also pressured as Total Assets saw a strong double-digit growth driven by merger impact. The trajectory of margins has shifted and is expected to continue in this direction, leading to a sequential reduction in PPOP margin. This reduction is due to the pressures on NIMs and increased operating expenses, largely attributed to wage inflation, going forward wage revision provisions will not be required in PSBs.

Note: Analysis based on 30 scheduled commercial banks (14 PSBs, and 16 PVBs)

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	IDBI Bank	UCO Bank	Union Bank of India
	Jammu & Kashmir Bank	Punjab & Sind Bank					
PSBs	**Large PSBs and Others PSBs (Total 14 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	DCB Bank	Bandhan Bank	City Union Bank	Karur Vysya Bank	
PVBs	**Large PVBs and Others PVBs (Total 16 Banks)**						
SCBs	**PSBs + PVBs (Total 30 Banks)**						

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