kotak Institutional Equities

UPDATE

Banks
India

Sector View: **Attractive** NIFTY-50**: 20,938** **December 07, 2023**

Repricing of loans appears to have peaked

We look at the RBI disclosure on interest rates to understand the recent transmission of interest rates from a segment, ownership, type of loan and ticket size perspective. Looking at the headline rates offered by banks, it does suggest further repricing has to mostly come from the corporate segment. Public banks appear to have better headroom on passthrough as compared to private banks. As discussed previously, our outlook on near-term NIM would be a decline, given the nature of the repricing ahead and the competitive environment.

Loan repricing is slowing down or unchanged in most segments

The following are the key takeaways from the RBI report on interest rates: (1) 35% of the loans are still <8%. (2) These segments are largely dominated by the financial sector exposure of banks or the corporate sector. (3) There is a higher share of shorter-duration loans (demand loans or medium-term loans) at <8% interest rates. (4) Private banks have a ~45% share in outstanding loans but are represented in the higher interest rate buckets. (5) Passthrough of interest rates has been the strongest in the Rs2.5-40 mn ticket size. Higher-ticket-size loans are witnessing a transfer of higher interest rates with a lag.

Fewer repricing opportunities left from hereon

The recent data and conversations with lenders suggest that the scope for further repricing looks limited. The recent RBI circular on increasing risk weights can probably be an opportunity to increase yields in this segment, but lenders are looking to focus more on segments where the opportunity to originate PSL loans is higher (lower interest rate segments within financials) and scale back lending in the non-PSL segment (higher-yielding segment within financials). On the other hand, banks are likely to slow down growth in unsecured loans, which has been a driver of marginal growth for most banks. A more conservative approach is to build a thesis that loan yields have peaked for the system. The last leg of the repricing of loans is likely to be led by loan mix and changes to MCLR, which has slowed in recent months. The recent mix preferences toward mid-market/SME/commercial loans can partly offset the pressure on NIM, but it entails a higher level of risk as well.

Near-term outlook on NIM remains unfavorable; still higher than long-term average levels

We are not changing our outlook on NIM based on this report. Interest rates on loans are more sensitive to policy actions and our forecasts are not for a reversal at this stage. We would have to monitor the deposit mobilization patterns as the competitive intensity is high, given the limited headroom available for private banks as well as the recent merger of HDFC group where the demand for deposits is high. The quality of deposits that are being originated has not been attractive from a NIM perspective as it has a higher share of term deposits or is coming from wholesale segments where the ability to deploy it is constrained from an LCR perspective.

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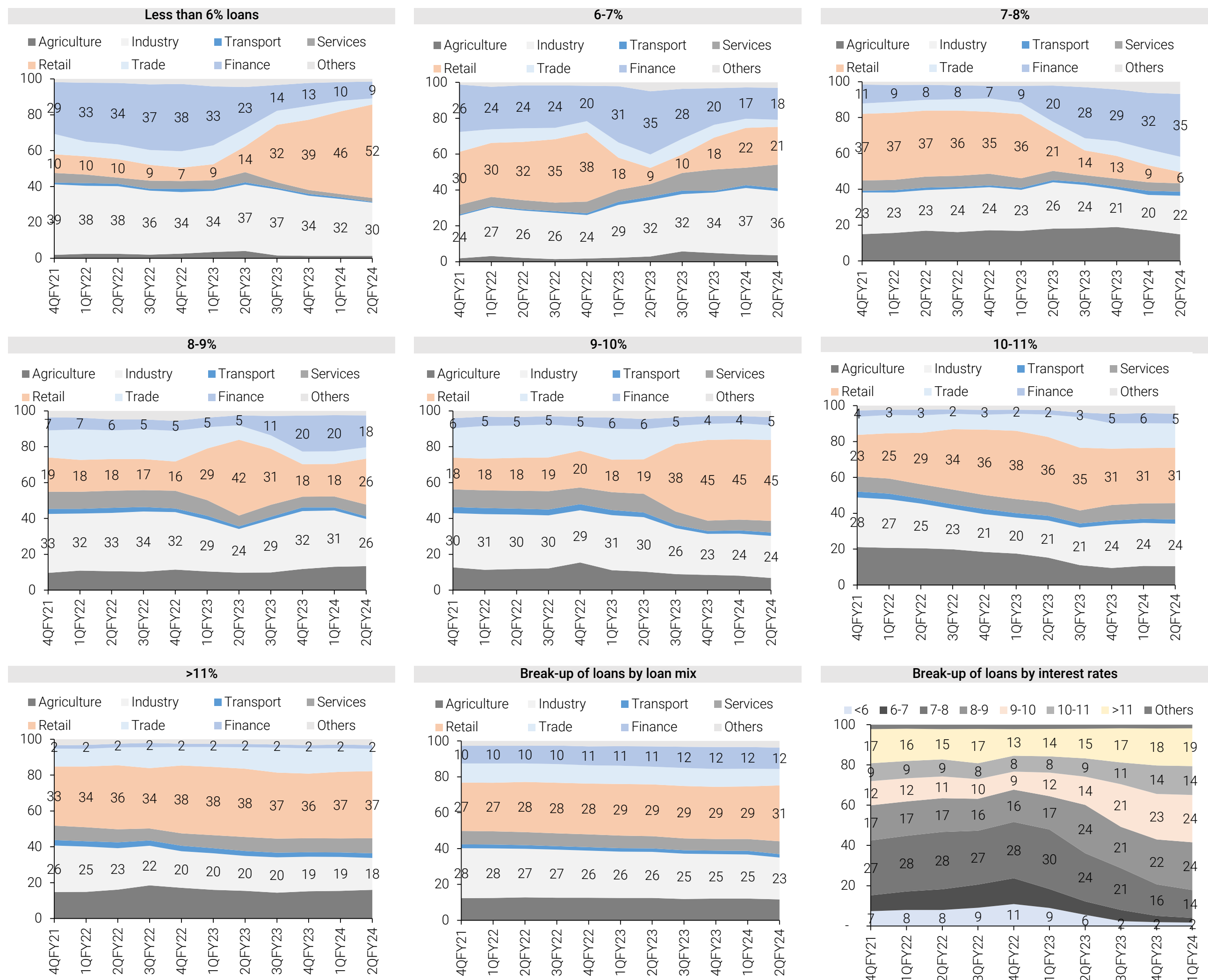
Exhibit 1 shows the break-up of loans across interest rates and loan segments. The loan book is broadly split ~25% each in the 8-9% and 9-10% buckets. In FY2022, ~50% of the loan book was <8%. The first leg of repricing has been completed in the retail portfolio. There is ~35-40% of the loan portfolio, which is in the 6-8% buckets where the scope of re-pricing is still high. However, we should note that the book which constitutes this segment is either in the corporate sector or in the financial sector. The bulk of these loans are probably still linked to MCLR as compared to EBLR suggesting that there is scope for repricing of this portfolio.

Transmission of interest rates is closer to peak levels with fewer sectors left to repriced upward

Exhibit 1: Break-up of loans across interest rates and loan segments, March fiscal year-ends, 4QFY21-2QFY24 (%)

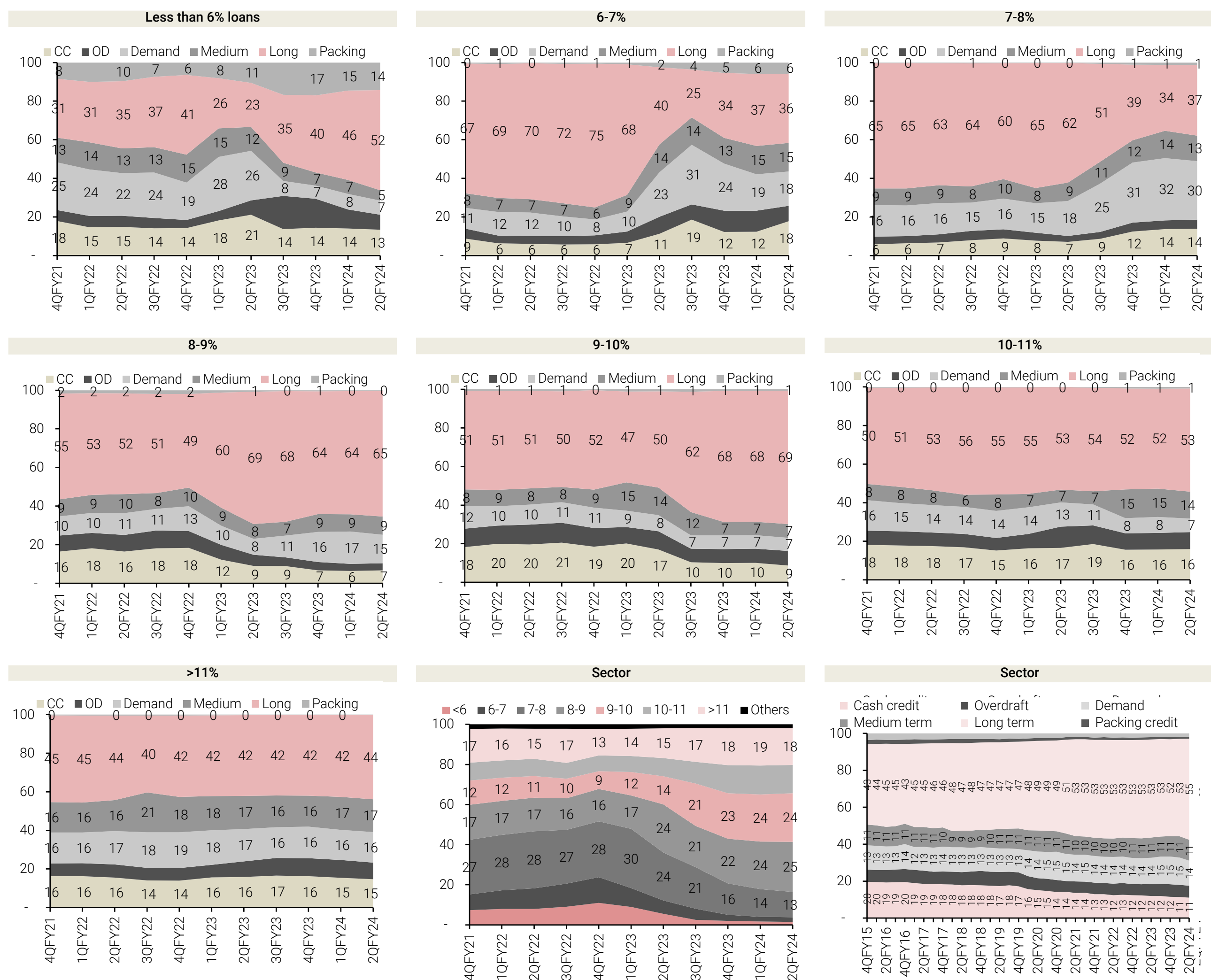


Source: RBI, Kotak Institutional Equities

Exhibit 2 shows another cut to the interest rate buckets by product types. The book that is largely <8% is mostly in demand loans and long-term loans. We are seeing passthrough of interest rates in the 6-7% for long-term loans. We could see this shifting toward 7-8% buckets in the next few quarters.

Some of these loans are short-term products (demand and overdraft products) that are <8% loan buckets

Exhibit 2: Break-up of loans by interest rate and product type, March fiscal year-ends, 4QFY21-2QFY24 (%)

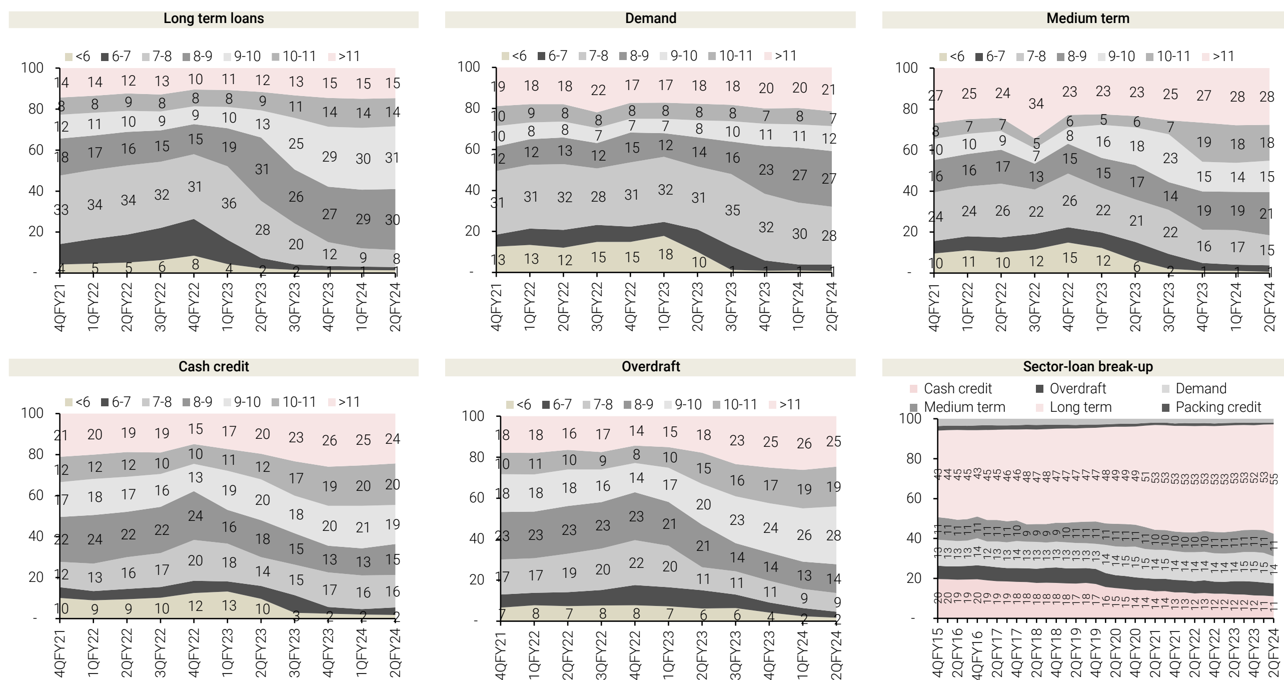


Source: RBI, Kotak Institutional Equities

Exhibit 3 shows the other side of the same data that we have in the previous exhibit. Here when we look at the interest rate buckets that is available. Note that the long-term loans that is driven from the retail segment appears to be largely complete, which implies that the long-term loans in the corporate segment is probably the only segment that is still yet to fully reprice. However, given the competitive intensity in this segment, the probability of rate passthrough in this segment is likely to be incomplete. The recent move from the RBI to increase risk weights in select product may probably aid this last leg of transmission but we are less certain of the quantum and impact perspective.

About 30% of the long-term loans have some scope of repricing left though trends suggests it would be challenging to fully reprice

Exhibit 3: Break-up of loans by interest rates, March fiscal year-ends, 4QFY21-2QFY24 (%)

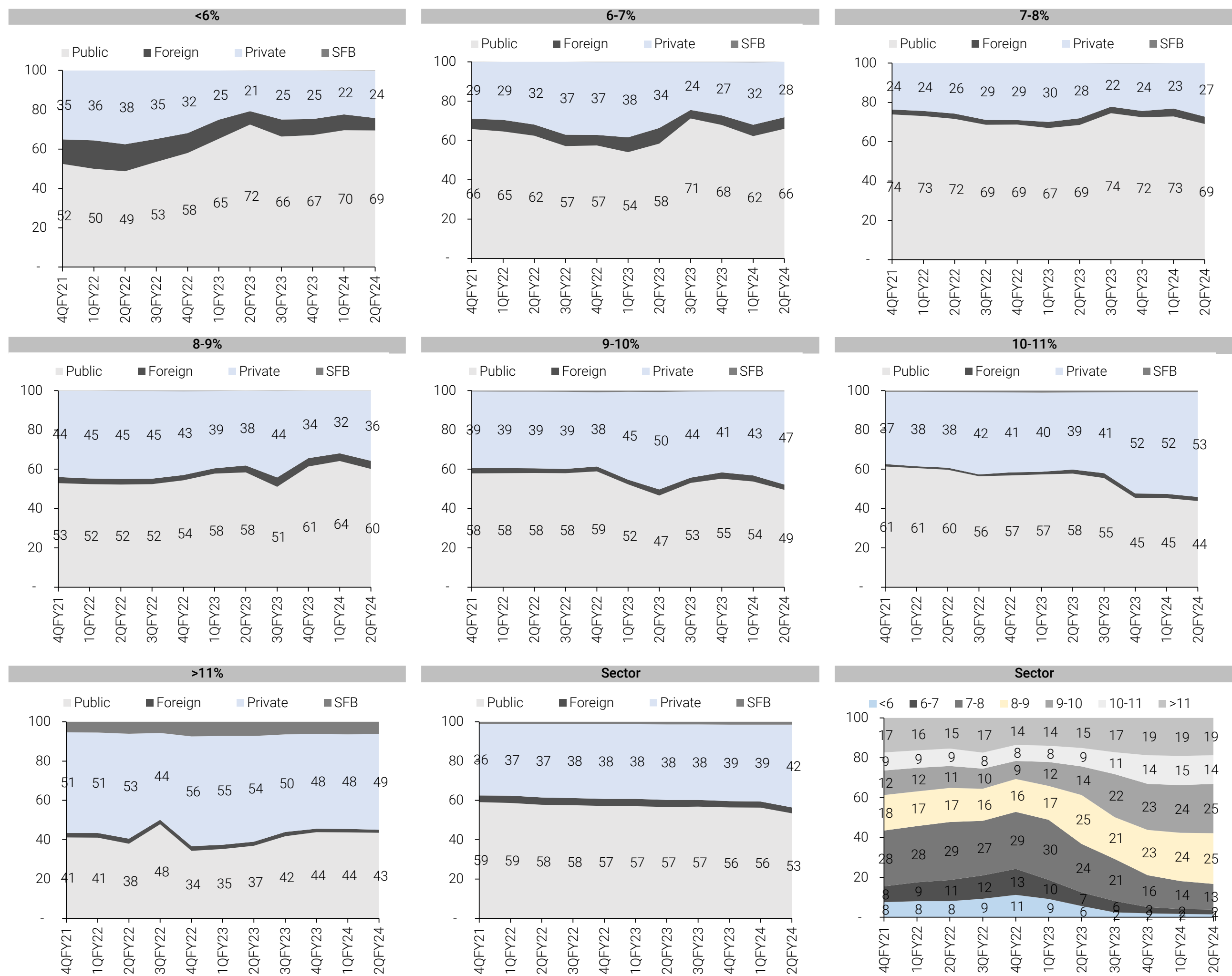


Source: RBI, Kotak Institutional Equities

Exhibit 4 shows the break-up of interest rates based on types of banks. From a loan market share perspective, private banks have 45% share and public banks have a 55% market share. The loan yield mix shows a variation to this market share. Private banks have a much higher share >10% interest rate products while public banks have a higher share of in the <9% interest rate products. As discussed, previously looking at the loan segments, the probability of interest rates on loans moving higher for public banks still appears to be a high probability event. Exhibit 5 shows the break-up of loans that is linked across benchmarks. Private banks have moved a major share of their loan portfolio to an external benchmark where the loan re-pricing is likely to be lower. They do have ~25% of loans that are linked to MCLR, but the ability to pass through would be a function of the competitive environment, given that public banks are reasonably active in that space.

Public banks have a higher scope for repricing considering their loan mix and yield segments at which they are operating

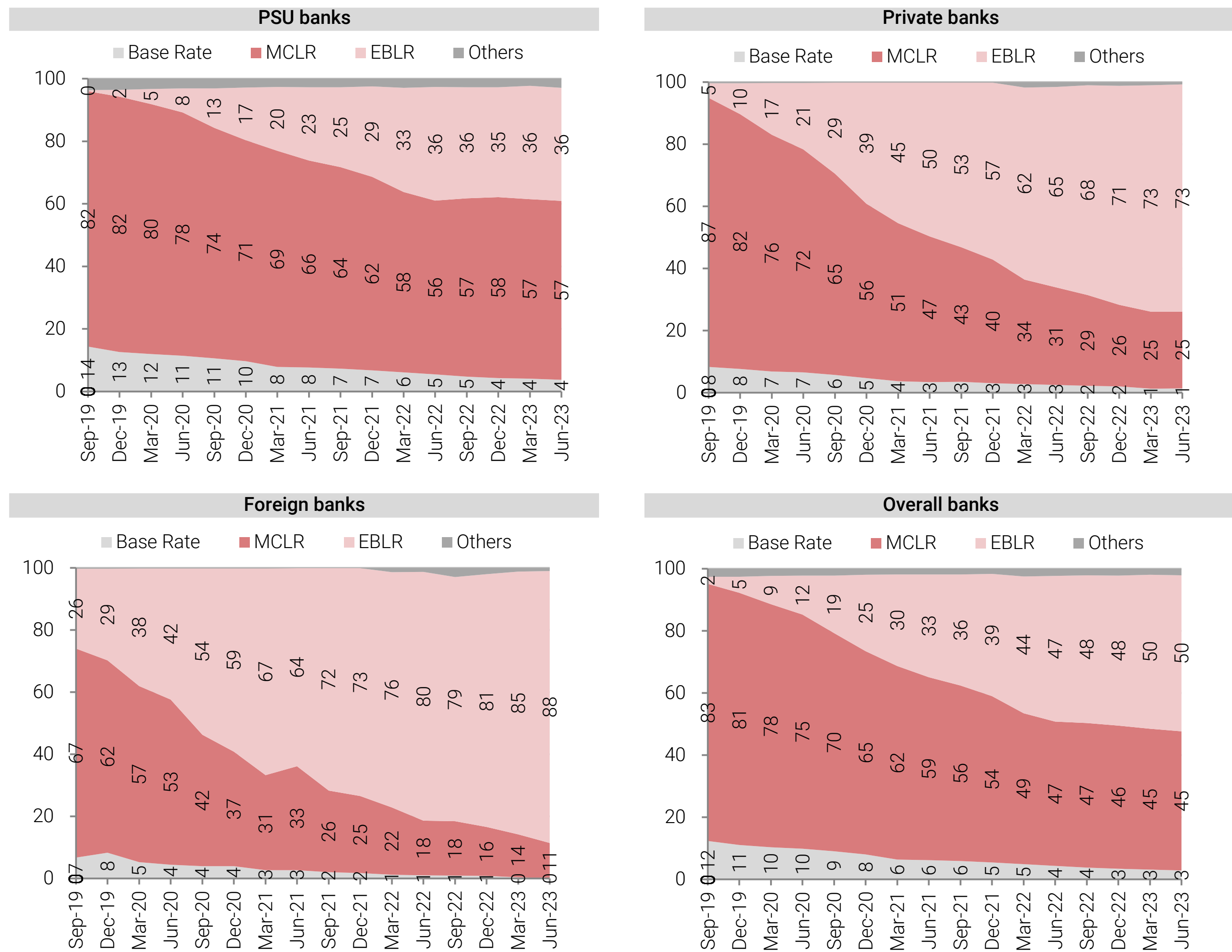
Exhibit 4: Break-up of interest rates by bank types, March fiscal year-ends, 4QFY21-2QFY24 (%)



Source: RBI, Kotak Institutional Equities

Private banks have ~75% of their loans while public banks have ~35% of loans linked to an external benchmark

Exhibit 5: Break-up of loans by interest rate benchmarks across banks, March fiscal year-ends, 2QFY20-2QFY24 (%)

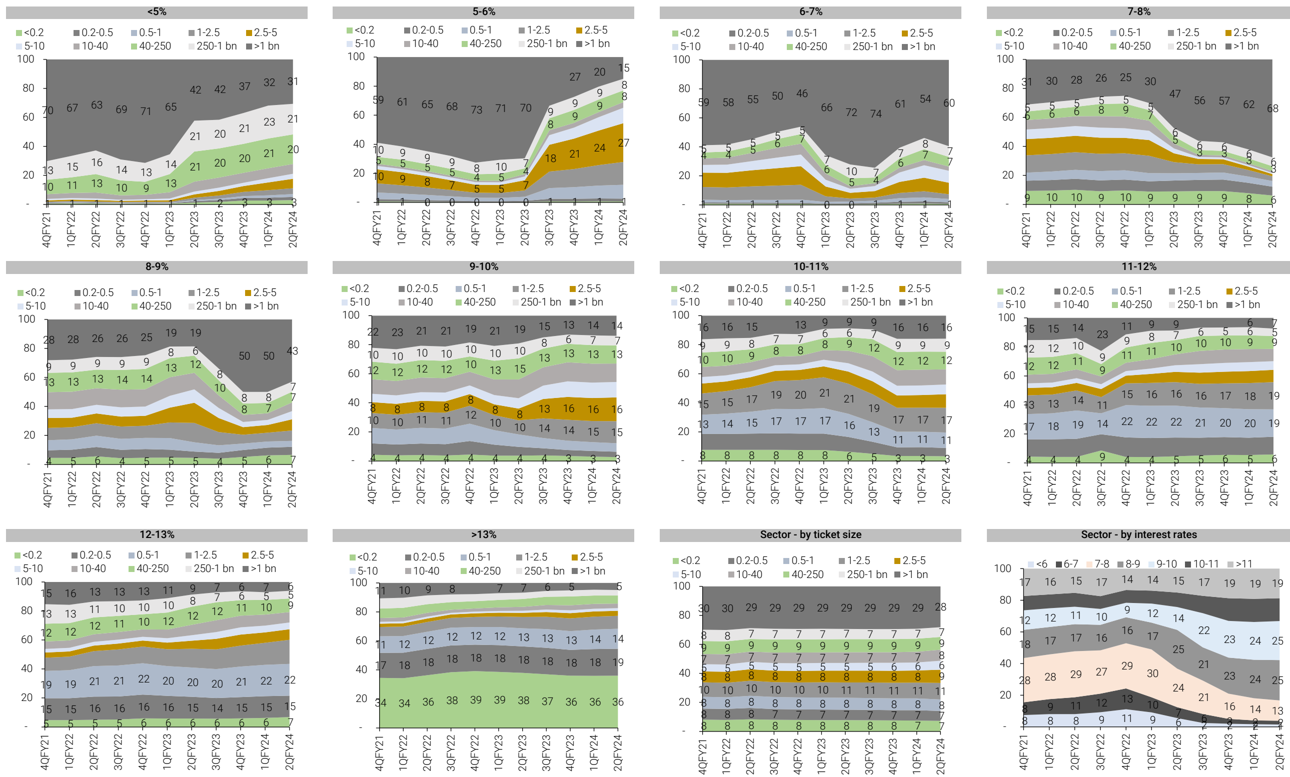


Source: RBI, Kotak Institutional Equities

Exhibit 6 and 7 shows the break-up of interest rates by various ticket sizes. We have provided two different ways to look at the data. For each interest rate bucket, we have given the composition of loans by ticket size and for every interest rate the composition of the loan ticket size. Note that these are loans at the point of sanction and does not represent the loan outstanding. In a less-tightly defined framework interest rates should ideally be inversely correlated to ticket size as the cost of operations and credit costs are higher as the ticket size declines. However, given the risk default framework and the outcomes that lenders are looking from a growth and profitability standpoint, there would be fair amount of deviation from this framework. We have seen a better passthrough of interest rates in the Rs2.5-40 mn ticket size buckets. The passthrough in the smaller ticket sizes (<Rs 1 mn) has been the least. This could probably be a reflection of the nature of the loan segments, which tends to be mostly retail that have fixed-rate loans. On the other hand, the loans with ticket size >Rs 1bn have seen passthrough of interest rates with a lag as compared to the lower-ticket-size loans.

A larger share of the movement that we are now seeing is the higher ticket size segments

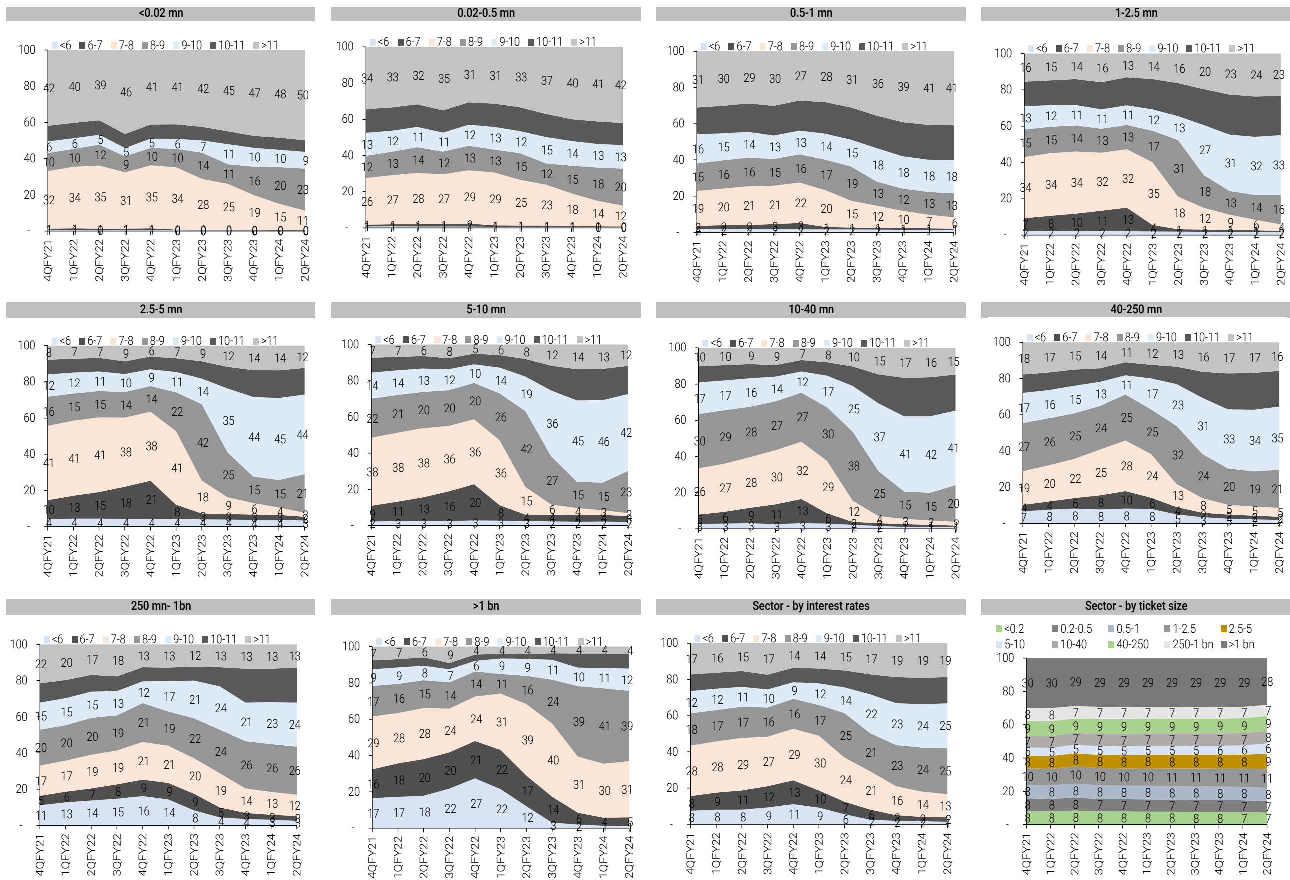
Exhibit 6: Break-up of interest rates by ticket size (sanction), March fiscal year-ends, 1QFY21-2QFY24 (%)



Source: RBI, Kotak Institutional Equities

We are seeing faster transmission in the Rs2.5-40 mn ticket size loans

Exhibit 7: Break-up of ticket size (sanction) by interest rates, March fiscal year-ends, 4QFY21-2QFY24 (%)



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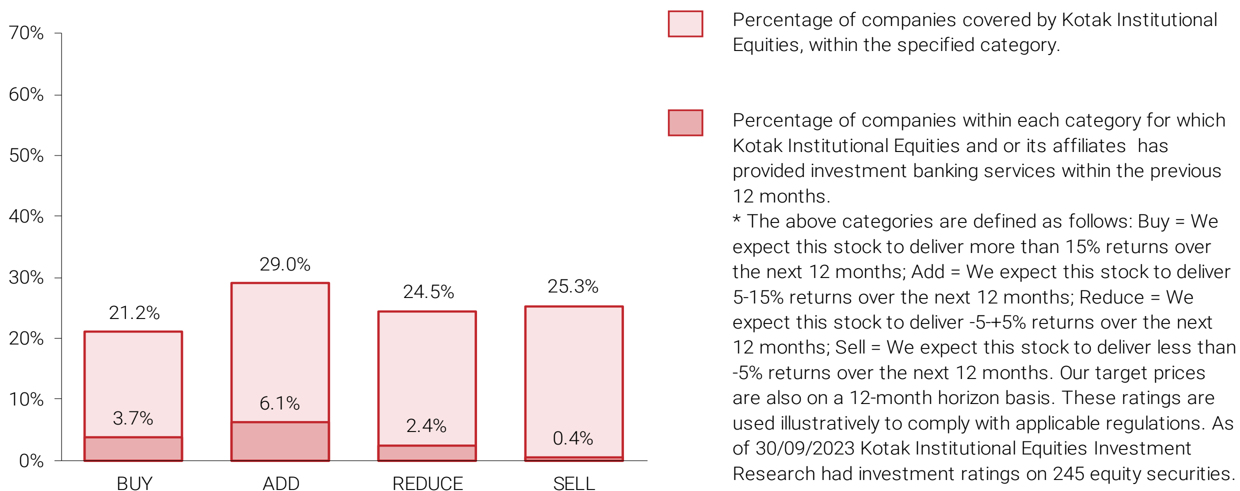

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