Indian Banks stress test amidst Global Banks failure environment

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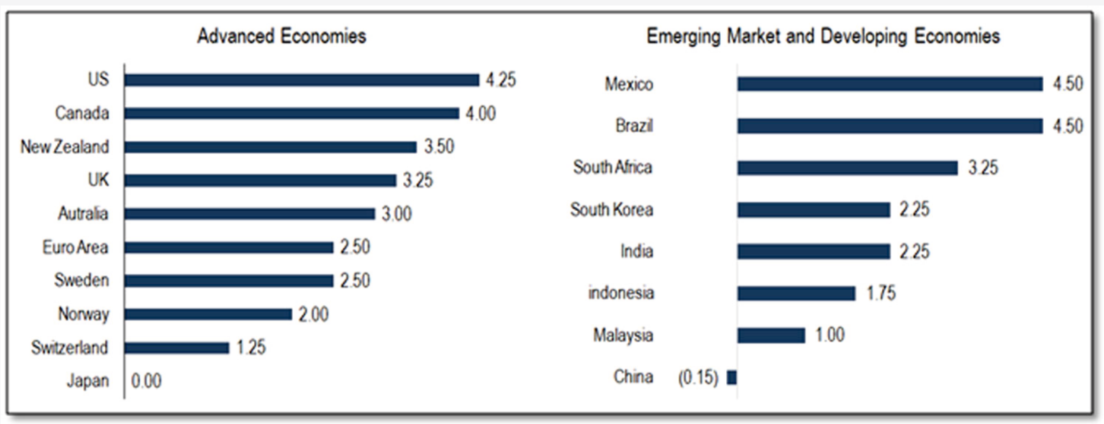
Banking is like the blood flow in a financial system. If the flow is good, we are confident of the prospects of the economy, but as the banking flow is disturbed, it creates an environment of fear and halt of economy. One very important parameter which governs the smooth flow of Banking System is their ability to meet demands from both providers and borrowers.

World economies are going through high Inflation environment post covid and this has aggravated post Russia Ukraine War led commodity price volatility. To counter this problem, Central Banks are hiking Interest rates and this has given birth to stress in certain Banks which were enjoying heightened benefits of Asset Liability mismatch thereby making high Net Interest margins and hence profits.

Recent Hikes in Central Bank Rates



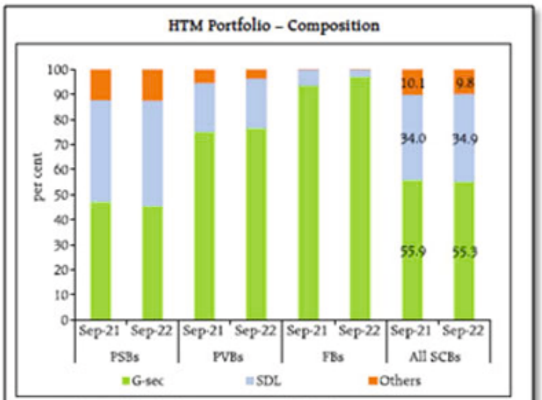
Source: Bloomberg/ RBI

Recent demise of recent Silicon Valley Bank and stress at Credit Suisse Bank has created fears for Banking System liquidity across globe. We have seen fall of Lehman Bros during 2008 crisis which impacted global markets and hence any new fear of banking collapse is weighed with great attention. While Lehman crisis was due to mortgage-backed securities that were mostly backed with subprime loans, the demise of Silicon Valley Bank wasn't driven by credit problems but by an old-fashioned mismatch of assets and liabilities and loss in Held to Maturity Investments.

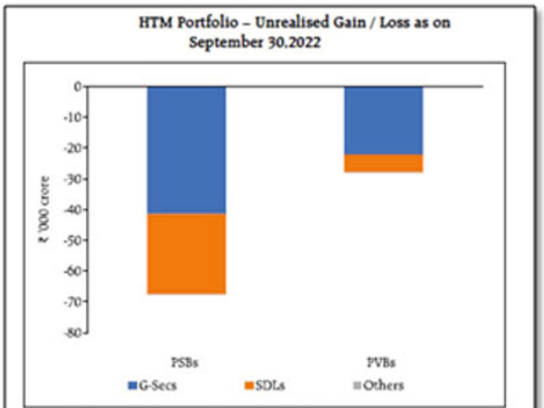
Key Risk: Higher 'Held to Maturity Investments'

Held to Maturity Investments are those that companies purchase and intend to hold until they mature. They are not susceptible to news events or industry trends since the returns on a bond are already pre-specified at the time of purchase but, Held to maturity securities bite into the company's liquidity. Since companies make the commitment to hold these securities until maturity, they cannot really count on these securities to be sold if cash is needed in the short term.

SVB had over 40% of its asset in 'held to maturity' category. For any fixed income investment, rising rates erodes market value. Banks try to save this by marking some of their assets to 'held to maturity' as then they do not need marking those investments to market rates. In current scenario, SVB had to incur this loss for liquidity reasons to pay of the deposits.



Source: Individual bank submissions and staff calculations.



Source: Individual bank submissions and staff calculations.

Source: RBI

Also, Unlike in US, In India RBI regulates the maximum % of HTM in total Investments.

Following is the list of top 25 banks of India and their exposure towards HTM Investments. The Highest HTM% are with Central bank 26%, UCO Bank 25% and PNB 23% - all being Public Sector undertaking

Bank Name	Net HTM Rs Cr	Total Assets Rs Cr	HTM as % of Total Assets
SBIN	8,80,773	49,87,595	18%
HDFCBANK	2,97,210	20,68,535	14%
ICICIBANK	2,06,666	14,11,298	15%
PNB	3,02,514	13,14,805	23%
BANKBARODA	2,01,323	12,78,000	16%
CANBK	2,38,615	12,26,980	19%
AXISBANK	1,92,818	11,75,178	16%
INDIANB	1,36,978	6,71,668	20%
KOTAKABANK	36,913	4,29,428	9%
INDUSINDBK	56,590	4,01,975	14%
CENTRALBK	1,00,804	3,86,566	26%
YESBANK	43,909	3,18,220	14%
UCOBANK	68,281	2,67,784	25%

Bank Name	Net HTM Rs Cr	Total Assets Rs Cr	HTM as % of Total Assets
FEDERALBNK	30,797	2,20,946	14%
IDFCFIRSTB	24,031	1,90,182	13%
BANDHANBNK	20,056	1,38,867	14%
RBLBANK	15,809	1,06,209	15%
SOUTHBANK	19,365	1,00,052	19%
KTKBANK	17,099	92,041	19%
KARURVYSYA	14,832	80,044	19%
AUBANK	10,251	69,078	15%
CUB	10,610	61,531	17%
DCBBANK	7,596	44,840	17%
EQUITASBNK	3,729	26,952	14%
UJJIVANSFB	3,518	23,604	15%

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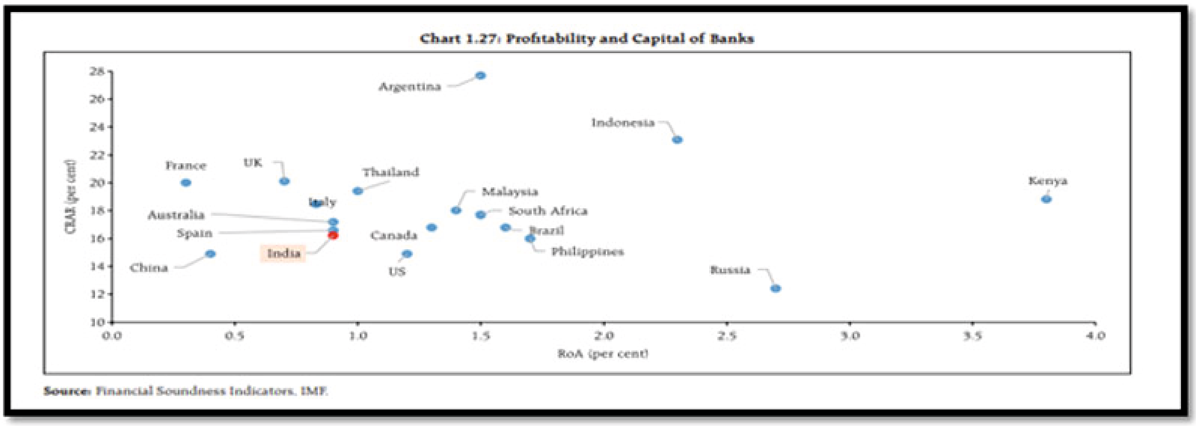
(Source: Companies, FY22 Annual Reports)

Banks Profitability and capital Structure- India and Others

Indian Banks are well capitalized. The Return on Assets on an average is 1%.

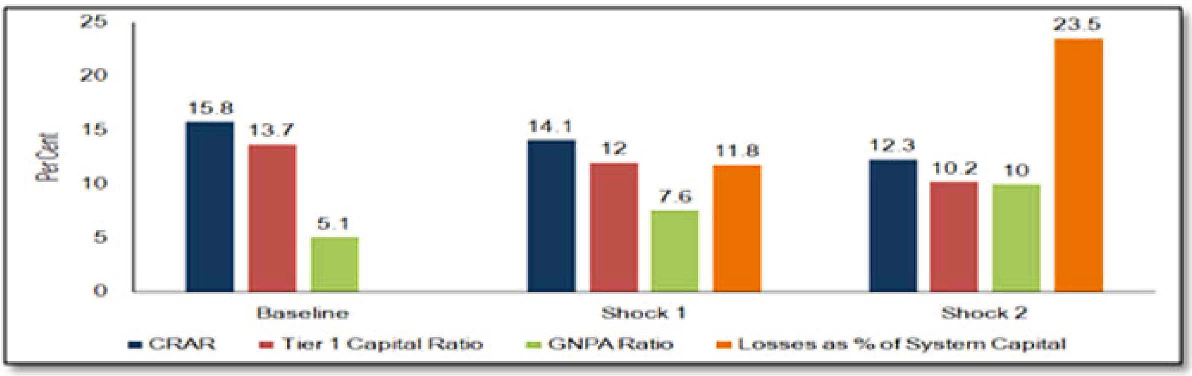
Country wise comparison of CRAR and Return on Assets of Banks



Source: RBI FSR Dec 22

India Capital risk weighted adequacy ratio is ~16%, the current GNPA being 5.1%. As per RBI's financial Stability report, even if the GNPA of Indian banks doubles to 10%, the CRAR will still be strong at 12.3%.

Base situation and implication of higher GNPA on CRAR



Source: RBI FSR Dec 22

Conclusion: Indian Banking Systems currently are far more resilient. A healthy credit cycle with NPA issue far behind make Indian Banking remains attractive for long term investment.

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