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Index (Part I)

Public Sector Banking Report

Introduction to Indian Banking Sector

Public Sector Banks (PSBs) are banks where a majority stake (i.e. more than 50%) is held by a government. The shares of these banks are listed on stock exchanges. There are a total of 21 PSBs in India(After the merger of SBI with its associate banks). The share of the banking sector held by the public banks continued to grow through the 1980s, and by 1991 the public sector banks accounted for 90% of the banking sector. A year later, in March, 1992, the combined total of branches held by public sector banks was 60,646 across India, and deposits accounted for Rs. 110000 Crs. The majority of these banks were profitable, with only one out of the 21 public sector banks reporting a loss. Problem was with nationalized banks reporting a combined loss of Rs. 1160 Crs. However, the early 2000s saw a reversal of this trend, such that in 2002-03 a profit of Rs. 7780 Crs by the public sector banks: a trend that continued throughout the decade, with a Rs. 16856 Crs profit in 2008-2009. Currently PSB are suffering and their statements show a total combined loss of 19333.54 Crs.

Evolution of Indian Banking Sector

1921
- **Closed Market**
- **State-owned Imperial Bank was the only existing bank**

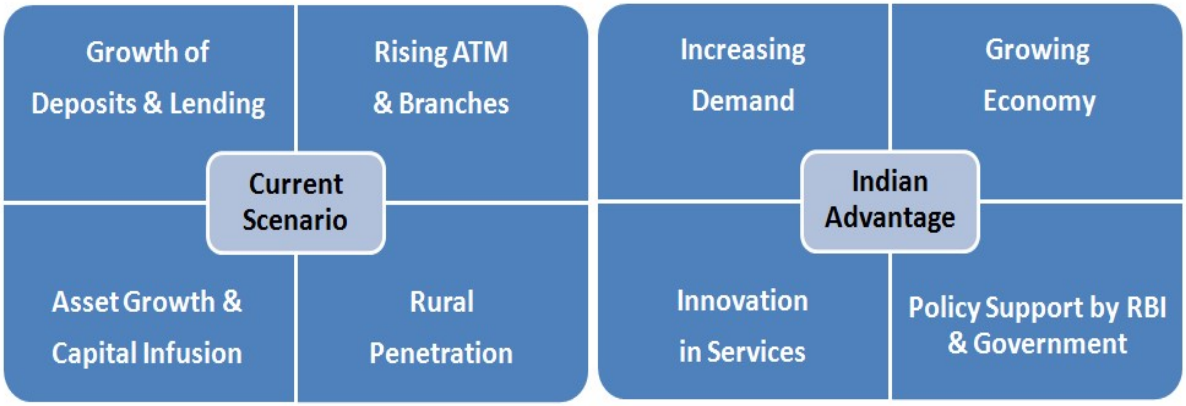
1935
- **RBI was established as central bank**
- **Quasi central banking role of Imperial Bank came to an end**

1936-1955
- **Network of Imperial Bank was expanded to 480 branches**
- **Imperial Bank was converted to State Bank of india**

1956-2000
- **20 commercial banks were nationalized till 1980**
- **Private players entered the market intensifying the competition**
- **Technology upgradation of PSU banks**

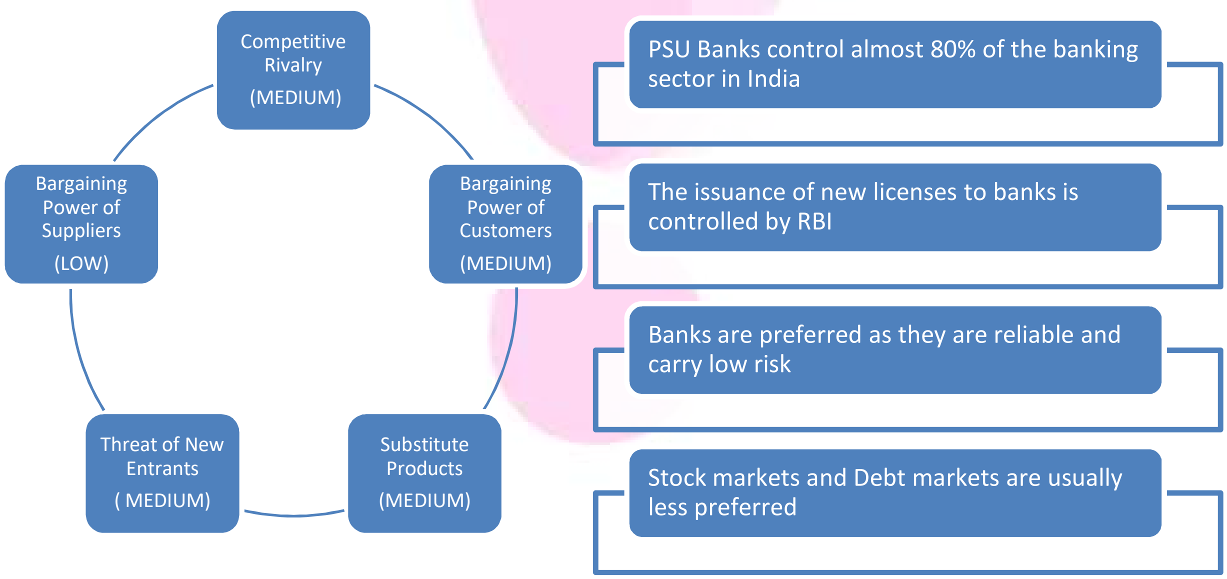
2000 & Further
- **RBI allowed foreign banks to invest in local private lenders and supranational institutions like LIC upto a limit of 10 %**
- **India recored foreign exchange reserves of approximately USD 363.14 billion which was the highest till now**

Current Scenario & Advantage in India



Porters Five Forces Analysis

Five Forces analysis of the Banking Industry along with some key points which are used for analyzing the competition in the industry and business strategy development.



Trends to watch out for in 2017

- Push towards a cashless economy by the government and its implementation by the banking system
- Several new entrants in the banking system. In 2015 2 new universal banks were born after a gap of 12 years. In 2017 10 small finance banks and eight payments banks are going to join the fray. The new entrants could intensify competition with new products and higher margins.
- SBI, nation's largest lender, will enter the world's top 50 banks list by assets in 2017 by merging its 5 associate banks with itself. SBI ranked 52nd in the world according to Bloomberg, if everything remains the same SBI will be ranked as 45th in the world after merger. Its success may also encourage the government to think about consolidation of other state owned banks in different context.

- RBI had asked all the banks to clean up their balance sheets by March 2017. Clearly we can see the NPA figures coming down along with capital infusion from the government. If the trend continues, we will see a better picture in 2017, but all the banks might not be able to bounce bank in the pink of health.
- Microfinance Industry (MFI) worth Rs.65000 Crs will change its ways of working in 2017, in the aftermath of ban on high value notes. Around 85% loan disbursement and 95% collections have traditionally been in cash. To survive and flourish, the MFI’s will make alliances with different banks as ‘Digital Wallet Service Providers’ and continue their operations through banking channels.
- Non Banking Financial Companies (NBFC) will also have to change their business model after suppression of cash. This sector had been growing at a fast pace but now things will change as most of their customers earn wages in cash and they will have to revamp their risk assessment process. Their most sought after product Loan Against Property (LAP) will have a tough time and they would need to find newer products to grow.
- We might see Banks loan Portfolio grow in 2017 with GST coming into picture and Demonetization showing its effects, the combination may change how things work. Armed with the insolvency law, the banking system may also be willing to take risk and lend.

Key Themes of Budget 2017

1.Recapitalization
2. Adressing Bad Loan Issue
3. Disinvestment Roadmap
4. Affordable Housing
5. Digital Push
6. Insurance Boost
7. Infra Bonds
8. Lower Gold Import Duty
9. Cut in Corporate Tax Rate
10. Higher Farm Credit Target

Budget 2017 & Banking

- Boost to affordable housing and a fiscal deficit target of 3.2% of GDP came as a big boost to banking sector.
- Tax concession on provisions for bad loans also came as a big sigh of relief for Indian banks which are currently struggling with huge NPA’s.
- Proposals to create more jobs and boost to infrastructure spending will help increase credit off take for banks. As banks have been already struggling with stressed cases in the infrastructure segment, fresh investments will help turn around some of the companies which have been defaulting.
- Credit growth boost with affordable housing projects and highest target for farm credit of Rs. 10 trillion. After demonetization banks credit growth had fallen to around 5, the lowest in couple of decades.
- Government’s announced net market borrowing figure of Rs. 3.48 trillion in 2017-18, as compared with Rs. 4.25 trillion in the current year is another positive news.
- Capital Expenditure data provided in the budget reveals a gross market borrowing set at Rs. 5.8 trillion for new financial year which is similar to the current year 2016-17.
- Proposed increase of allowable provision for Non-Performing Asset (NPA) from 7.5% to 8.5%.

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Public Sector Banks & Demonetization

Impact of Demonetization on Balance Sheet of Banks

- Large surge in bank deposits due to decline in currency in circulation
- Total currency in circulation declined by about Rs. 8800 billion which in turn led to sharp rise in bank deposits of about Rs. 6720 billion in aggregate deposits even after outflow in NRO deposits during the period
- Between end December 2016 and early March 2017, there was a net increase in currency in circulation by about Rs. 2600 billion and deposits with banks also declined moderately
- Deposits mobilized by banks have been deployed in Reverse repos of various tenors with the RBI and Cash management bills (CMB's) issued under the Market Stabilization Scheme.
- Loans and Advances increased by Rs. 1008 billion and the incremental credit ratio for the period was only 18.2%.
- Additional deposits mobilized by commercial banks have been largely deployed in liquid assets.

Impact of Demonetization on Profitability of Banks

- Banks net profits essentially reflect the difference between interest earned on loans and advances and interest paid on deposits and borrowings, adjusted for operating costs and provisions.
- Loans and advances and investments constitute for 85% of the sources of interest income.
- Banks have lowered the term deposit rate; the median term deposit rate declined by 38bps during November 2016-February 2017.
- Average deployment of about Rs. 6 trillion in a quarter under reverse repo and MSS securities, banks net interest income from deposits is estimated at about Rs.45 billion in the quarter after demonetization.
- The increase in net income would need to be adjusted for the cost of managing withdrawal and injection of new bank notes (such as cost of calibration of ATM machines etc), the exact details of which are not available at this stage.

Impact of Demonetization on Lending rates

- Excess Liquidity has helped the transmission of monetary policy to market interest rates. Post Demonetization several banks lowered their domestic term deposit rates and lending rates.
- The 1 year median MCLR has declined by a cumulative 70 bps since November 2016 even when the policy report rate was not changed. This is significant considering the 1 year median MCLR declined by only 15bps during preceding 7 months.

Impact of Demonetization on Jan Dhan Accounts

- After demonetization 2.33 Crs new accounts were opened under the Pradhan Mantri Jan Dhan Yojana (PMJDY), bulk of which (80%) were in Public sector banks
- The total balance in PMJDY deposit accounts peaked at Rs. 746 billion as on December 7, 2016 from Rs.456 billion as on November 9, 2016 an increase of 63.6%.

Public Sector Banks & NPA's

- Clearing up bad loans led to problems with the balance sheets of PSU banks
- Most of the problems lie in the state owned banks that account for 70% of the banking system by assets.
- RBI has given a deadline of March 2017 but most banks are not in a position to meet that deadline.
- This can be reflected in the latest Fortune India's PSU 50 list which ranks the country's top 50 public sector units by gross profit. Nine PSU banks dropped off the list this in the issue.
- Even the nine banks that remain have been scarred. For instance the country's largest lender, SBI's gross NPA's skyrocketed 147% from March 2012 to March 2016 forcing it to raise its provisions for bad loans and ultimately leading to a decrease in its profits.
- RoE & RoA the key things to consider are also falling and loan recovery hasn't kept pace with rising NPA's.
- Insolvency and Bankruptcy Code, 2016, passed in May last year, will give banks power take action against defaulters within 180 which is a huge boon for banks over existing legal procedures.
- Bankruptcy Law can help the banking sector catch up with a faster recovery rate.
- Asset Quality Review (AQR) was introduced in 2015-16 which led to increasing in provision requirements of banks.
- AQR forced banks to reclassify restructured loans that could have becomes NPA's which is an advantage but led to losses in that period.
- Fear of growing NPA's has reduced lending to corporate sector because 90% investment in the corporate sector is through banking channels. Corporate sector have limited financing options as corporate bond market is still not developed.
- As a major shareholder the government might have to bail out PSU banks and they have to act really fast. Two things are necessary: Clear out the bad debt so banks can start lending again and ensure that the happening should not be repeated.
- Basel III norms require banks to have capital desperately as promised to be adopted fully by 2019. The bigger and more profitable banks may be able to raise those funds but it would be difficult for others who might require capital infusion.
- According to the latest budget the government plans to infuse fresh capital of Rs. 10000 Crs in the FY 18 as compared to Rs. 25000 in the last year which looks to be quite insufficient.

This is Part one of the report. The Second part will be coming up very soon. Stay tuned.

Part II of the report will cover the following topics:

- Digitalization
- Bank Merger
- Key Developments
- ATM & Branch Stats
- Total Advances and NPA list
- Growth Drivers
- New Schemes
- GST implication and more.