

Banking: Failure on rate transmission could hit NIMs

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Private banks to face greater pressure; cyclical tailwinds will be more pronounced for corporate banks.



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Absence of effective rate transmission, we fear, could jeopardise banks' NIM trajectory due to incremental pressure on yields given: (i) spread between outstanding & fresh loan yields has widened to as high as >85bps; and (ii) transition to external benchmark rate regime will entail pressure given mere 49bps cut in MCLR amidst 135bps cut in repo rate (since January 2019). Furthermore, flexibility to tweak deposit rates will be limited given: (i) other attractive investment options (small savings schemes, etc) given prevailing higher-term premium (10 years over one year G-sec yield); and (ii) focus on scaling up retail TD. This could percolate into structural NIM pressure.

That said, cyclical tailwinds of resolution cycle playing through and pricing power amidst weak competition will outweigh structural drivers in the near term, though it will be more pronounced in case of corporate banks. Within groups, we perceive more pressure on retail private banks as: (i) transmission has been lower (MCLR cut of 13bps versus 40bps for PSU banks); & (ii) rising spreads (O/S loans less TD at 4.2% versus 3.2% for PSU banks), which we believe will narrow.

Lending yields: To be structurally under pressure

Over the past 11 months, average lending rate (on outstanding loans) has been broadly steady. More so, MCLR has dipped mere 49bps during the same period, widening the spread between outstanding and incremental yields (to >85bps). With transmission likely to increase and the fact that external-linked benchmark regime has already kicked in, we expect lending rates to be under pressure. The saving grace could be banks' ability to adjust spreads on external-linked benchmark, as was the case during earlier regimes.

Deposit rates: Limited room to tweak

Banks have started cutting deposit rates (reflected in 16bps decline in weighted average TD rate since January 2019 versus 37bps hike in deposit rates in 2018). Also, wholesale deposit rates have seen a much sharper decline—CD rates (12 months) have

plummeted >220bps during same period. However, the focus on scaling up retail TD and higher return on other investment options will prove to be a key deterrent. Hence, we expect structural pressure on banks' NIMs.

Cyclical tailwinds: More pronounced for corporate banks

While NIMs face structural pressure, we do see cyclical tailwinds in the form of: (i) resolution cycle playing through; and (ii) pricing power amidst weak competition. However, these cyclical tailwinds will be more pronounced in the case of corporate banks compared to retail banks. Within the banking group, we perceive more pressure points for private banks given lagging transmission—MCLR cut of 13bps since January 2019 versus 40bps by PSU banks. Consequently, spreads (O/S loans less TD) have been rising and the gap is widening between PSU and private banks.

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