

# India Banks

## A New Mindset

- **The new RBI Governor ... and a new mindset** — India's new RBI Governor Raghuram Rajan is seeking to change the landscape of the financial sector; opening up and easing restrictions for banks, warming up to financial markets and participants and appears in a hurry to change and kick-start things. While he's stayed silent on monetary policy (await 20<sup>th</sup> September), the start does look like a new mindset. And this could be big.
- **This is what the hype is about** — The RBI is a) abolishing branch licensing; b) will issue new bank licenses by Jan 2014 – open to the idea of on-tap licensing beyond; c) more foreign bank friendly; d) will look at lowering the SLR; e) encouraging of market trading/players; f) countering the currency challenge – by opening up FX markets/trading; and g) priority sector lending re-focusing. It goes beyond a wish list and some of the RBI's new but old ways ([Licensing all the way to a Bank](#)).
- **The new mindset** — Its essence: Growth/expansion/tight deadlines...over control/caution. This approach will carry its own risks: opposition (external/internal), execution, expectations and the odd blow-up. But in our view, the opportunity cost of too much conservatism has been high (for the broader economy and the financial sector)... the new mindset could change this.
- **More flexibility, higher growth...and more competition** — These changes should over time raise bank growth rates, newer biz opportunities, networks and expand the sector. But they would also raise competition (new banks), could impact profitability and raise some risks. This works best for the private banks – could have higher upside/downside for the mid-sized ones (Kotak/Yes/IIB), but over time would influence valuations too (anyone for large scarcity premiums!). It will change the long run.
- **A new mindset, but won't change today's asset quality, interest rates or the economic outlook...** — The landscape will change – but the banking sector's current asset quality and funding woes will not. We do see the banking sector (and the broader equity market) reacting positively to this 'new mindset' (and potentially expecting a new mindset for monetary policy too); but beyond that, the sector will more closely follow the asset quality/ economic cycle, which will likely remain sluggish. Maintain our neutral stance on banks in the India model portfolio.

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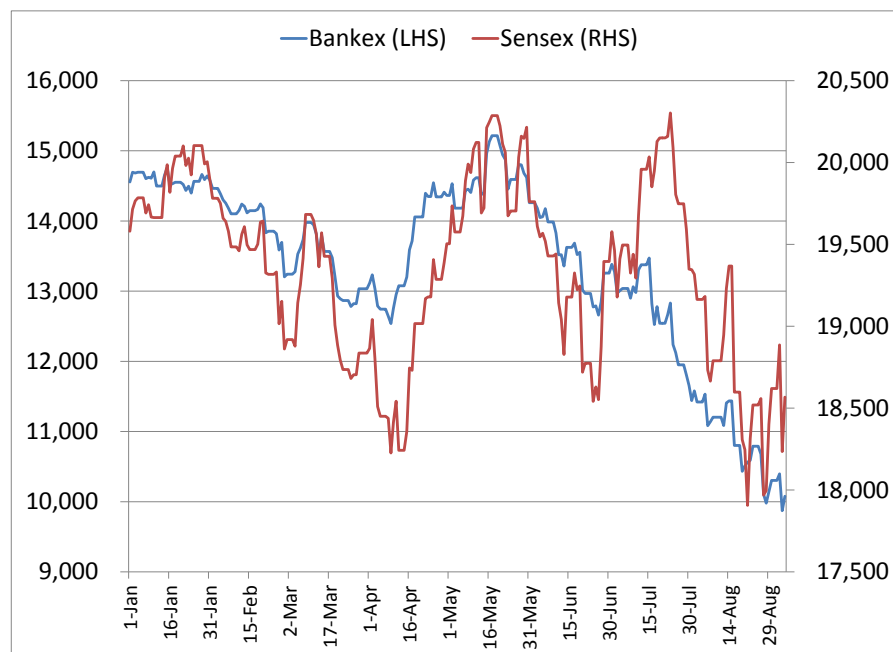
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Figure 1. RBI's List of Measures Announced

S. No.	Measure Announced		Previous Status	Timeline	Caveat/ Comment
BIG & NOW					
1	Bank Branch Licensing	Completely freed (with inclusion goals)	Restrictive - RBI approval had to be sought	Immediate	More flexible financial inclusion
2	New Bank Licenses	Committee has been formed under Bimal Jalan	Sluggish - 2 yrs from draft to potential candidates	Jan 2014	Defined, accelerated
3	Further New Bank Licenses	Possible on-tap; conversion of urban cooperative banks; differentiated licenses	Just a policy paper	None	Could substantially expand the banking sector - limit the current premia on new Bank licenses
4	Foreign Owned Banks	Near national treatment for wholly-owned subsidiary structure	Discussion paper	Only few pending issues	Could significantly expand the presence/competition from foreign banks - hitherto constrained
5	SLR Norm	Reduce G-Sec requirement for banks	SLR at 23%; has been declining but very gradually	None	Will be calibrated as Govt. finances improve; would free up BS's but unlikely near term
6	Priority Sector Lending	Adjust to needs of economy - review committee under Nachiket Mor formed	Fairly rigidly defined; consistently missed by several banks	None	More flexibility - less onerous, and potentially more productive
7	Financial Markets	Enhanced exporters re-book limit on FX to 50% of cancelled contracts and introduced up to 25% for Importers	Exporters re-book limit on FX at 25% of cancelled contracts; None for Importers	Immediate	Very positive - Recognizing market players/willingness to open up , benefit from market liquidity
8	Rupee Internationalization & Capital Inflows	Special concession to swap FCNR \$ deposits with min tenor 3 yrs at 3.5% fixed rate; Increased overseas borrowing limit to 100% of Tier I by banks	No dispensation on FCNR Dollar Deposits; Overseas borrowing limit at 50% of Tier I by banks	Till Nov, 2013	Seeking \$ inflows for currency support - with currency hedge and liquidity for raising banks
BIG, BUT OVER TIME					
9	Financial Infrastructure	Use Aadhaar to build credit history; build factoring exchanges for SME/MME; Improving debt recovery systems (DRTs, ARCs)	On-going but slower progress	None	Directionally strong - but execution some while away
10	NPA & Restructured Monitoring	Deputy Gov. Dr. Chakrabarty to examine rising trend; create a central shared repository of large exposures	No shared database of exposures	Shortly (not defined)	Greater focus - but it is an asset cycle
11	Households	Issue Inflation Indexed Savings Certificated linked to CPI for retail investors	Earlier inflation index bond offer aimed at institutions, WPI-linked	By Nov, 2013	Widening financial markets and savings avenues
12	Payments	Online Bill Payment System; White label POS and ATMs; Mobile Banking;			Financial inclusion reach - large potential

Source: Citi Research, RBI

Figure 2. India Banks – A Rough Run (YTD Performance)



Source: Citi Research, Bloomberg

Figure 3. Bank-wise branch network (Jun, 2013)

Branches	June'13
SBI	14,902
PNB	5,929
BOB	4,289
CNBK	3,770
UNBK	3,604
ICICI	3,350
HDBK	3,119
Axis	2,021
IIB	530
Yes	475
Kotak	445

Source: Citi Research, Company Data

## Appendix A-1

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