

Financials

Treasury Income (INRb)	1QFY23
AXSB	-6.7
HDFCB	-13.1
ICICIBC	0.4
IIB	1.5
KMB	-4.1
FB	0.3
RBK	0.8
AUBANK	-0.6
Total Private Banks	-21.6

Treasury Income (INRb)	1QFY23
BoB	-7.7
BoI	-1.5
CBK	8.9
INBK	-1.3
PNB	-8.4
SBIN	-65.5
UNBK	1.7
Total PSU Banks	-73.8

Bond Yields (%)	4Q FY22	1Q FY23	2Q FY23	Current
Govt. Securities				
Gvt 1 Yr Yield	4.7	6.2	6.7	6.8
Gvt 3 Yr Yield	5.8	7.0	7.1	7.1
Gvt 5 Yr Yield	6.3	7.3	7.3	7.3
Gvt 10 Yr Yield	6.8	7.4	7.4	7.4
Corporate Bonds				
AAA Bond 1Yr Rate	5.0	6.6	7.3	7.1
AAA Bond 3Yr Rate	6.0	7.4	7.4	7.8
AAA Bond 5Yr Rate	6.4	7.5	7.6	7.7
AAA Bond 10Yr Rate	7.2	7.8	7.8	7.9
AA Bond 1Yr Rate	5.5	7.4	7.9	7.7
AA Bond 3Yr Rate	6.7	8.1	8.0	8.5
AA Bond 5Yr Rate	7.1	8.2	8.3	8.5
AA Bond 10Yr Rate	7.9	8.5	8.5	8.6

Treasury losses set to moderate

Sharp rise in short-term yields; yield curve slope witnessing normalization

- In 1QFY23, our banking coverage universe reported treasury losses of INR95.4b, led by INR21.6b for Private Banks and INR73.8b for PSU banks.
- The losses were primarily due to a sharp 113bp/61bp increase in 3yr/10yr G-sec yields in 1QFY23. The increase in yields was partly led by the policy rate hikes by RBI as the central bank increased repo rate by 90bp in the same quarter.
- In 2QFY23, RBI further increased repo rate by 100bp, thus, taking the policy rate to 5.9%. However, the longer duration G-sec yields have been broadly stable in the quarter, with the same up -5bp/+49bp across tenors, while AAA-rated corporate bonds have increased -6bp/+69bp with higher increase in shorter maturity bonds.
- Although stability in bond-yields at medium to longer end of the curve will aid treasury performance of banks, the sharp rise in yields in shorter tenure bonds may drive MTM losses for select banks, though the same is likely to moderate sequentially. FB has recently reported treasury gain of INR700m in 2QFY23, BOM reported gains of INR360m (vs loss of INR920m in 1QFY23), while HDFCB reported controlled loss of INR2.5b, primarily in the shorter duration bonds. We seek some comfort as we note that AFS + HFT book stands at 19-42% of total investments for PSBs with a reduced modified duration of 0.9-2.1 years.
- With continued monetary tightening and our assumption of 6.5% terminal repo rate, we remain watchful of further hardening of yields (AA/AAA-rated corporate bond yields have increased up to 45bp in Oct'22), which could have an adverse impact on treasury performance, especially PSU banks.

PSU/Private banks reported treasury loss of INR73.8b/INR21.6b in 1QFY23

Over 1QFY23, private banks under our coverage reported treasury losses of INR21.6b, while PSU banks reported treasury losses of INR73.8b. Within PSU banks, SBIN, PNB, and BoB reported treasury losses of INR65.5b, INR8.4b, and INR7.7b, while BOI/INBK reported modest losses of INR1.5b/INR1.3b. Surprisingly, CBK and UNBK reported treasury gains of INR8.9b and INR1.7b. Among private banks, HDFCB, AXSB, and KMB reported treasury losses of INR13.1b, INR6.7b, and INR4.1b, while AUBANK reported a loss of INR0.6b. However, other private banks reported gains with IIB at INR1.5b, RBK at INR0.8b, and ICICIB/FB at ~INR0.3-0.4b.

2QFY23: Divergent trend in G-sec yields across tenor

G-sec yields have reacted sharply to ongoing policy measures with 10-yr yields moving up 56bp to 7.4% in 1HFY23. We note that 1yr/3yr/5yr G-sec yields have increased 203bp/126bp/99bp in 1HFY23 vs 36bp-92bp increase in FY22. This had an adverse impact on the bank's treasury performance as top PSU banks reported treasury losses of INR73.8b in 1QFY23 (INR95.4b loss by our banking sector coverage). However, we note that over 2QFY23, the yields have been broadly stable with a 5bp decline for 10Yr G-Sec, while 3Yr/5Yr G-sec yields witnessed a marginal increase of 14bp/6b. However, 1Yr Treasury bond yields increased a sharp 49bp.

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AAA bond yields up -6bp/+69bp in 2QFY23; AA bond yield up -4bp/+51bp

AAA corporate bond yields have also reacted sharply with 10yr AAA bond yields moving up 60bp to 7.8% over 1HFY23. We note that 1yr/3yr/5yr AAA bond yields have increased 238bp/139bp/112bp in 1HFY23 vs 16bp-80bp increase in FY22. Over 2QFY23, the bond yields have been broadly stable in the -6bp/+1bp range, barring 1yr AAA bond yield, which increased 69bp. Similarly, AA bond yields have also been stable in -4bp/+6bp range, barring 1yr AA bond yield, which increased 51bp.

AFS + HFT book forms 19-42%; lower duration provides further comfort

We note that many PSU banks have reduced their mix of AFS book and are focused on reducing the duration of investment portfolio to limit the adverse impact of interest rate increase on their bond portfolio. The AFS+HFT book stands at 19-42% of total investment across banks with the highest for SBIN and BoB, while lower for CBK and PNB. Further, the modified duration for most of the PSU bank bonds stand at 1.4-2.1 years range, barring UNBK, which has the lowest duration at 0.9 years. On the other hand, BOI has a much higher duration of 3.6 years. Thus, with a gradual moderation in duration of the investment book, we believe incremental losses will be controlled.

3M/6M T-Bill yield up 93bp/75bp over 2QFY23

We further note that three-month Treasury bill yield has increased 93bp to ~6.04% over 2QFY23, while the 6-month Treasury bill yield has increased 75bp to ~6.5%. The increase has been much sharper at ~230bp over 1HFY23. We thus remain watchful of select private banks, which have a high proportion of low duration investment assets in their AFS portfolio. Further, our analysis for a 25bp increase in yield suggests that SBIN, PNB, and BoB could be more impacted while UNBK and INB are relatively less vulnerable. Overall, we do not expect banks to report any material treasury losses over 2QFY23, though underlying gains are likely to remain muted. FB in its 2QFY23 results has reported a treasury gain of INR700m, BOM reported gains of INR360m (vs loss of INR920m in 1QFY23), while HDFCB reported controlled losses of INR2.5b, primarily in the shorter duration bonds.

Remain watchful of further yield hardening; prefer ICICIB, SBIN, IIB and FB

The treasury portfolio of banks is protected up to a 10yr yield of ~7.4%, which is where the bonds traded at end-1QFY23 and many banks have indicated that incremental losses are likely to be controlled as they have moved their securities to HTM in April and reduced the AFS duration. However, with continued monetary tightening and our assumption of 6.5% terminal repo rate, we remain watchful of further hardening of yields (AA/AAA-rated corporate bond yields have increased up to 45bp in Oct'22), which could have an adverse impact on treasury performance of PSU banks in the coming quarters. However, improvement in operating earnings (moderation in slippages, improving loan growth, and margins) would enable some absorption of these treasury losses. Our top picks in the sector are **ICICIB, SBIN, IIB and FB**.

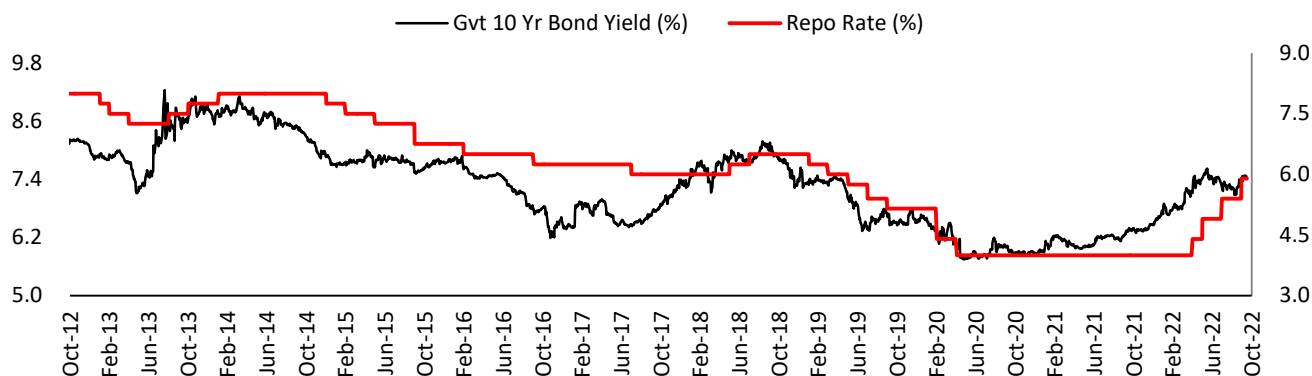
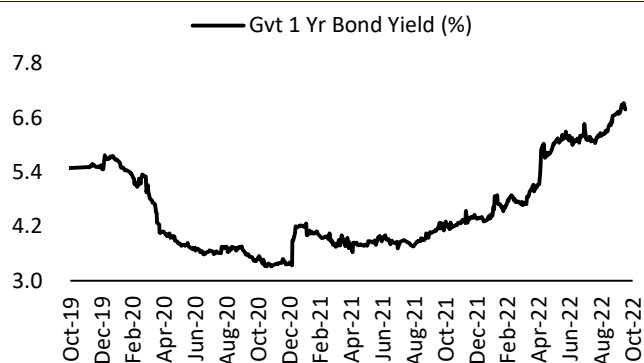
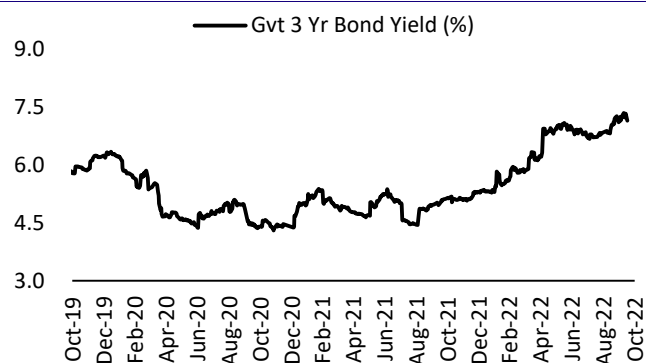
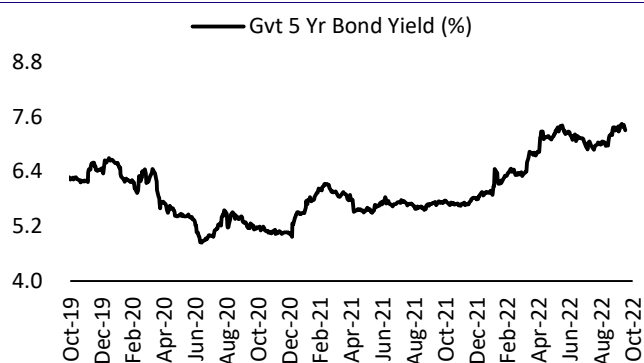
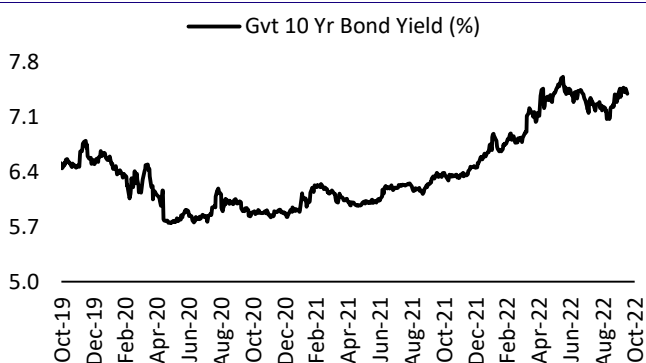
Exhibit 1: RBI increased the repo rate to 5.9% (+190bp in FY23YTD); G-Sec yields increased 57bp over the period**Exhibit 2: 1-year G-Sec yield increased 49bp over 2QFY23 (further 8bp over Oct'22)****Exhibit 3: 3-year G-Sec yield increased 14bp over 2QFY23 (further 4bp over Oct'22)****Exhibit 4: 5-year G-Sec yield increased 6bp over 2QFY23 (stable over Oct'22)****Exhibit 5: 10-year G-Sec yield moderated 5bp over 2QFY23 (stable over Oct'22)**

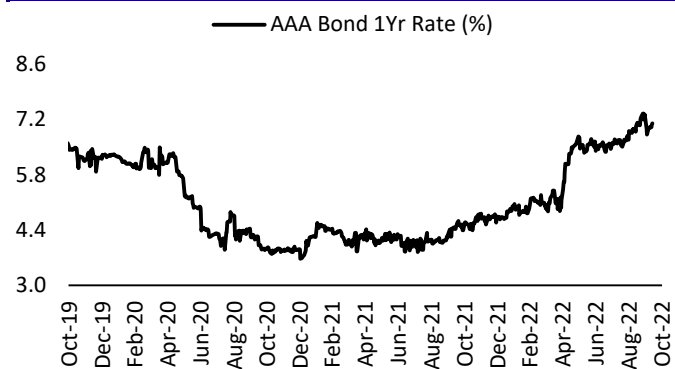
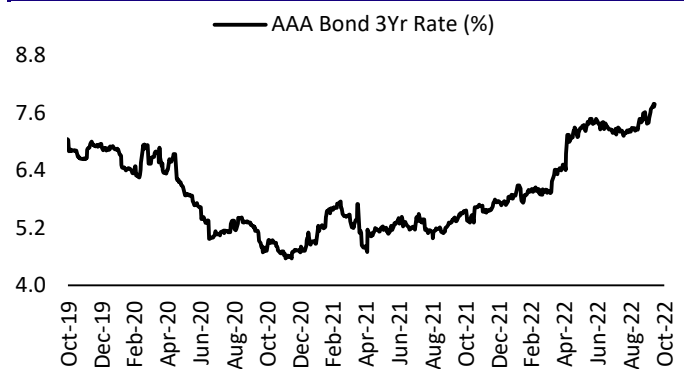
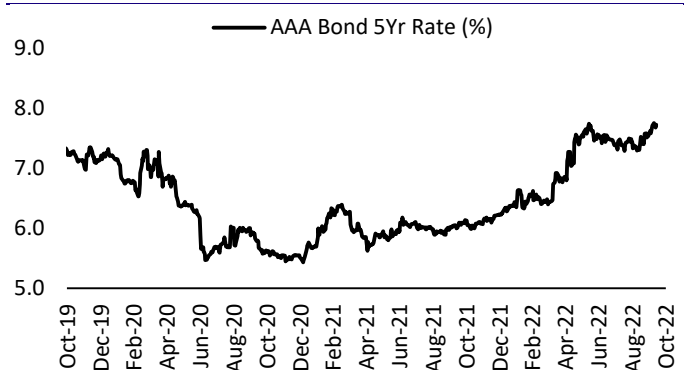
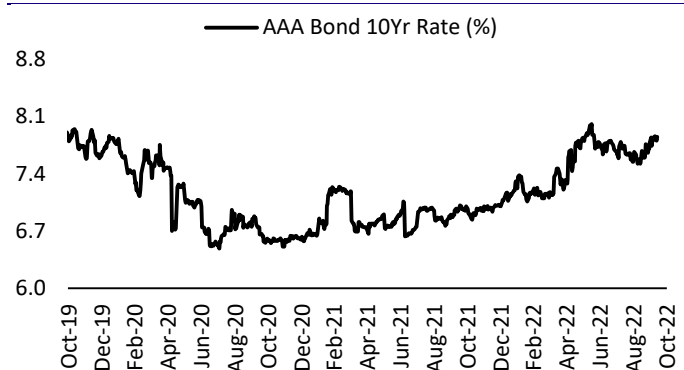
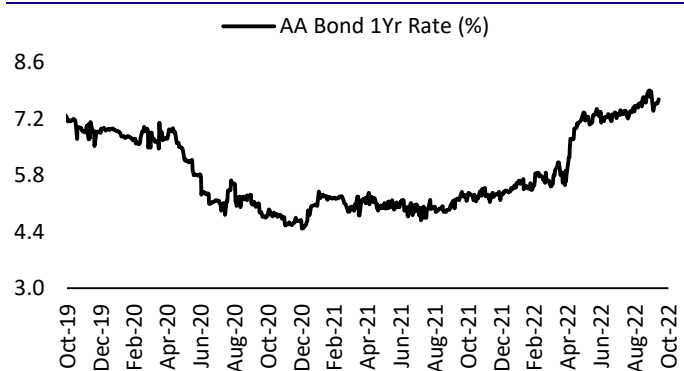
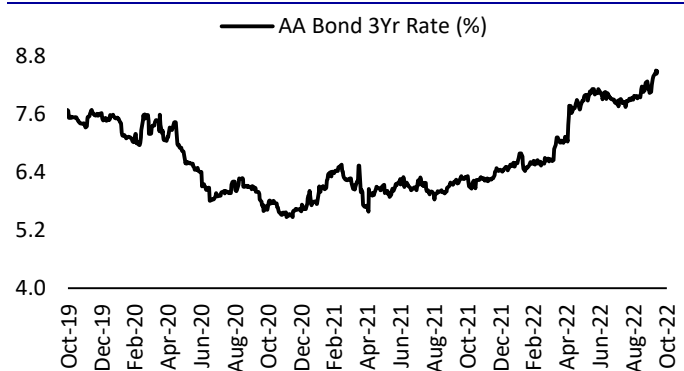
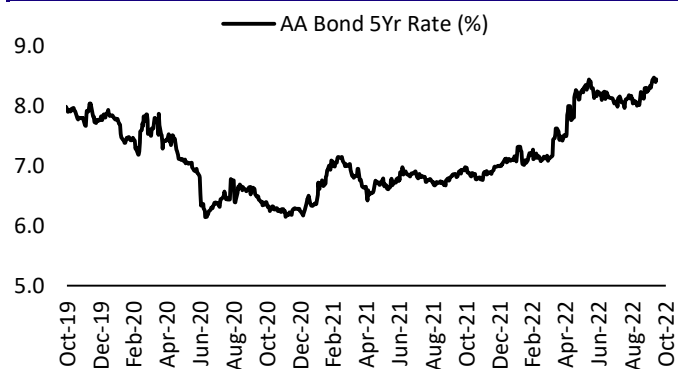
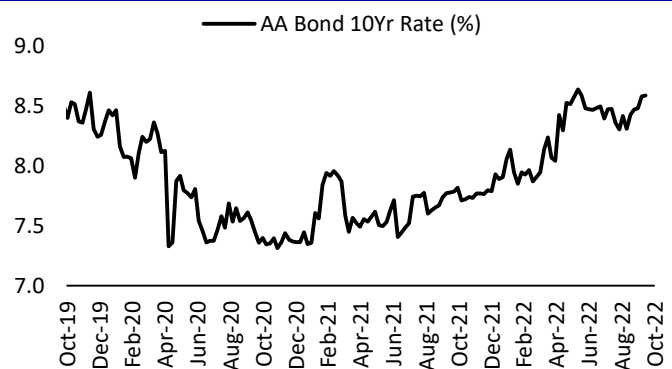
Exhibit 6: 1-year AAA bond yield increased 69bp over 2QFY23; however moderated 23bp over Oct'22**Exhibit 7: 3-year AAA bond yield moderated 6bp over 2QFY23; however, increased sharply by 40bp over Oct'22****Exhibit 8: 5-year AAA bond yield stood stable over 2QFY23; however, increased 18bp over Oct'22****Exhibit 9: 10-year AAA bond yield broadly stable over 2QFY23; increased 8bp over Oct'22****Exhibit 10: 1-year AA bond yields increased 51bp over 2QFY23; though moderated 20bp over Oct'22****Exhibit 11: 3-year AA bond yields moderated 4bp over 2QFY23; however, increased sharply by 45bp over Oct'22**

Exhibit 12: 5-year AA bond yields increased 6bp over 2QFY23 (further 18bp over Oct'22)

Sources: MOFSL, company reports

Exhibit 13: 10-year AA bond yields stood stable over 2QFY23; increased 11bp over Oct'22

Sources: MOFSL, company reports

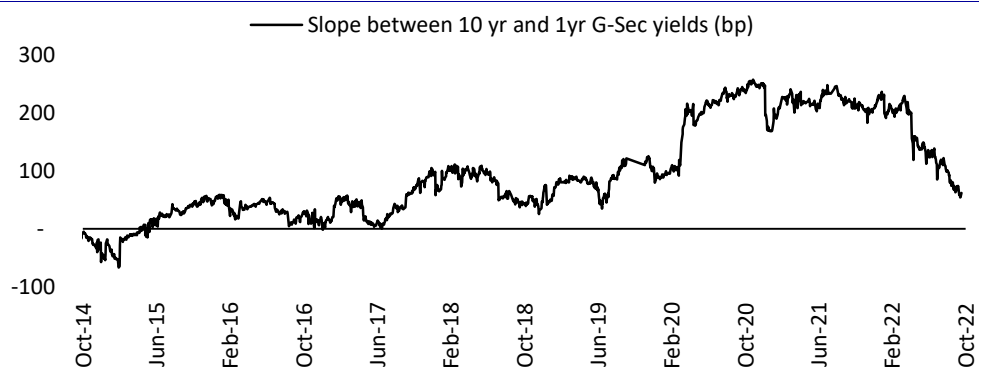
Exhibit 14: Movement in yields across G-Sec and corporate bonds of different maturities over the past 2-3 years

Bond Yields (%)	4QFY20	1QFY21	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23	2QFY23	Current
Govt. Securities												
G-Sec 1Yr Yield	5.0	3.7	3.7	3.4	3.7	3.9	4.0	4.4	4.7	6.2	6.7	6.8
G-Sec 3Yr Yield	5.4	4.4	4.9	4.4	4.9	5.2	4.9	5.3	5.8	7.0	7.1	7.1
G-Sec 5Yr Yield	6.2	5.3	5.4	5.0	6.0	5.7	5.7	5.8	6.3	7.3	7.3	7.3
G-Sec 10Yr Yield	6.1	5.9	6.0	5.9	6.2	6.1	6.2	6.5	6.8	7.4	7.4	7.4
Corporate Bond												
AAA 1Yr Yield	6.0	5.0	4.4	3.9	4.2	4.3	4.2	4.7	5.0	6.6	7.3	7.1
AAA 3Yr Yield	6.5	5.6	5.3	4.7	5.5	5.4	5.3	5.8	6.0	7.4	7.4	7.8
AAA 5Yr Yield	7.0	6.2	6.0	5.5	6.3	6.0	6.0	6.2	6.4	7.5	7.6	7.7
AAA 10Yr Yield	7.5	7.1	6.8	6.6	7.2	6.9	6.9	7.0	7.2	7.8	7.8	7.9
AA 1Yr Yield	6.5	5.8	5.3	4.7	5.0	5.1	5.0	5.3	5.5	7.4	7.9	7.7
AA 3Yr Yield	7.2	6.4	6.1	5.6	6.3	6.3	6.2	6.5	6.7	8.1	8.0	8.5
AA 5Yr Yield	7.6	6.8	6.6	6.2	7.0	6.8	6.8	7.0	7.1	8.2	8.3	8.5
AA 10Yr Yield	8.2	7.5	7.6	7.4	7.6	7.7	7.7	7.8	7.9	8.5	8.5	8.6

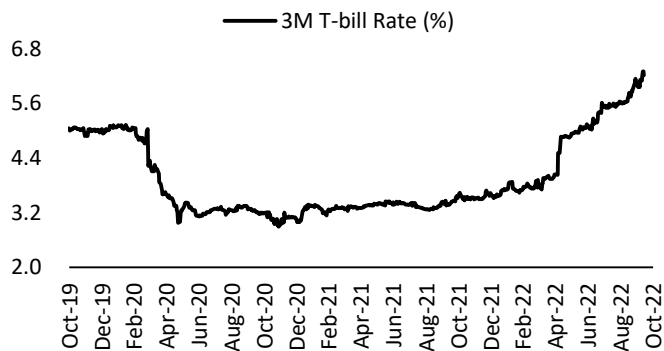
Sources: MOFSL, Bloomberg estimates

We note that the gap between 10yr and 1yr G-Sec yield is witnessing normalization.

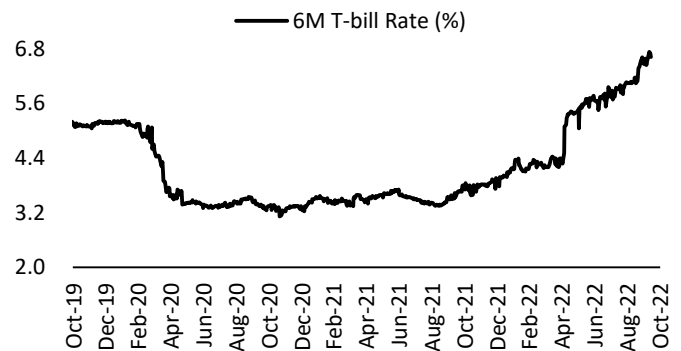
The same has moderated to 62bp currently vs ~250bp/~230bp in Aug'21/Apr'22

Exhibit 15: Yield curve slope undergoing normalization

Sources: MOFSL, company reports

Exhibit 16: 3-month T-bill yield increased 93bp over 2QFY23 (further 18bp over Oct'22)

Sources: MOFSL, company reports

Exhibit 17: 6-month T-bill yield increased 75bp over 2QFY23 (further 14bp over Oct'22)

Sources: MOFSL, company reports

Over 1QFY23, private banks under our coverage reported treasury losses of INR21.6b, while PSU banks reported treasury losses of INR73.8b

Treasury income comprised 71%/27% of total PAT over FY21/FY22. Reported losses over 1QFY23, however, it remained under control

Exhibit 18: Trend in treasury profits over the past few quarters

Treasury Profits (INRb)	1QFY21	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23
BOB	5.4	10.1	9.3	8.7	8.4	12.2	4.5	-6.8	-7.7
BOI	9.1	2.6	6.5	0.7	8.8	4.3	2.1	-1.1	-1.5
CBK	10.0	9.0	15.1	1.8	6.2	11.3	3.2	5.2	8.9
INBK	6.3	5.8	1.5	2.9	5.6	4.0	2.5	0.8	-1.3
PNB	13.2	6.5	9.9	9.8	14.2	8.8	6.3	0.1	-8.4
SBIN*	24.4	10.8	9.6	-0.4	21.0	4.3	5.1	1.8	-65.5
UNBK	5.2	10.3	12.8	6.5	9.9	8.0	5.8	9.4	1.7

*Excludes stake sale gain of INR15.9b from SBI Life in 1QFY21

Sources: MOFSL, company reports

Exhibit 19: Trends in aggregate treasury income vs aggregate profits for PSBs

PSBs (INRb)	FY18	FY19	FY20	FY21	FY22	1QFY23
Treasury Income	224.4	33.9	171.6	239.2	165.8	-73.8
Net Profits	-355.2	-165.1	80.3	338.9	606.7	139.0
Treasury Income as % of PAT	NA	NA	214%	71%	27%	NA

Sources: MOFSL, company reports

Exhibit 20: Investment and duration profile of key banks

Data as on 1QFY23 in (INRb)	HTM	AFS	HFT	AFS+HFT as % of Investment	Investments	SLR	Modified duration
BOB	2,074	1,129	1	35	3,204	2,674	1.4
BOI	1,298	451	1	26	1,750	1,339	3.6
CBK	2,498	595	1	19	3,095	2,696	NA
INBK	1,319	529	0	29	1,848	1,466	1.9
PNB	3,010	799	1	21	3,810	2,748	2.1
SBIN	8,621	6,315	-3	42	14,934	12,022	2.1
UNBK	NA	895	NA	25	3,556	2,703	0.9

Sources: MOFSL, company reports

UNBK, BOB, and INBK have the lowest modified duration of their AFS Portfolio

SBI has the highest share of AFS/HFT portfolio at 42% of total investments

Exhibit 21: Treasury losses of PSBs arising from 25bp/50bp increase in portfolio yields

Banks (INRb)	25bps	50bps
BOB	4.0	7.9
BOI	4.1	8.2
CBK	NA	NA
INBK	2.5	5.1
PNB	4.3	8.6
SBIN	32.8	65.6
UNBK	2.0	4.0

Sources: MOFSL, company reports

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Investment Rating	Expected return (over 12-month)
BUY	>=15%
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