Economic Alert iQ

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Economic Alert: Moody's Upgrades Four Indian Financial Institutions' Ratings

- Moody's Investors Service has upgraded the long-term ratings of four Indian financial institutions to Baa2 from Baa3.
- The four are: (1) Export-Import Bank of India (EXIM India), (2) HDFC Bank Limited (HDFC Bank), (3) Indian Railway Finance Corporation Limited (IRFC), and (4) State Bank of India (SBI).
- In the case of HDFC Bank, Moody's has also upgraded the bank's baseline credit assessment (BCA) and adjusted BCA to baa2 from baa3.
- Moody's rating actions follow the upgrade of the Government of India's local and foreign currency issuer ratings to Baa2 from Baa3.
- The government's credit strength is an important input in Moody's deposit and debt ratings for financial institutions, because it impacts Moody's assessment of the government's capacity to provide support in times of stress. As such, an improvement in the government's own creditworthiness, as measured by its sovereign rating, has lifted the supported ratings for EXIM India, IRFC and SBI.
- Moody's continues to assess India's Macro Profile (operating environment for the banks) as Moderate.
- The assessment incorporates the weak, but stable credit conditions in the country, with such a situation representing the key risk to the banks' balance sheets. Corporate leverage has started to fall and asset quality deterioration for the banks has peaked.
- Furthermore, the clean-up of balance sheets is underway, with the latest effort being the asset quality review conducted by the Reserve Bank of India in December 2015 and the declaration of the Insolvency and Bankruptcy Code 2016.
- The capitalization profile of the public sector banks, a segment which accounts for nearly 70% of total banking system assets, remains far below that of their private sector peers.
- To a large extent, the capital shortfall has been addressed by the government's announcement on 24 October 2017 of a recapitalization plan for public sector banks, which should help facilitate these banks in writing down bad loans.

- Funding remains a credit strength for Indian banks. The banks' funding and liquidity profiles which are largely funded by customer deposits with limited reliance on confidence sensitive market funding have remained stable.
- Namely, of particular mention, EXIM India, which in addition to servicing the needs of export-oriented companies and promoting the government's external trade policy objectives, plays a part in executing the government's foreign policy goals.
- Roughly half of its loan book is composed of extending credit lines for projects which had been agreed upon in bilateral agreements between the Government of India and the beneficiary country, indicating the close alignment of the bank with one of the very important functions of the government. By law, the government has to own a 100% stake in the bank.
- Looking at the State Bank of India (SBI), the bank’s long-term deposit rating of Baa2 is underpinned by the bank's BCA of ba1 and a very high probability of government support for SBI, in the event of stress, given the bank's status as the largest commercial bank in India, with a sizeable 23% share of total system deposits and 20% of system loans as of 30 September 2017.
- The government owns a 57% stake in SBI and is visibly involved in the management of the bank, including the appointment of senior managers and setting of key performance indicators.
- SBI's BCA of ba1 incorporates the stable but weak asset quality metrics of the bank with such metrics deteriorating significantly after the merger with associate banks and also because of the economic disruptions in the last few quarters.
- These risks are largely mitigated, given the bank's loss absorbing buffers; specifically, it’s improving capitalization and loan loss reserves. The bank's strong funding and liquidity profiles represent its key credit strengths.