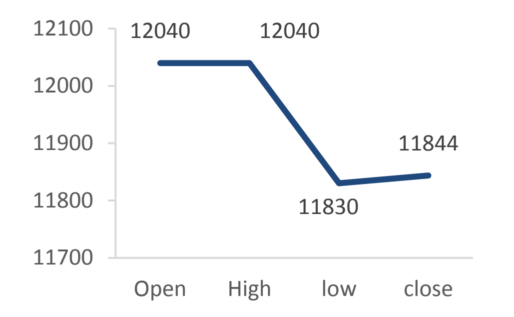
IIFL SECURITIES

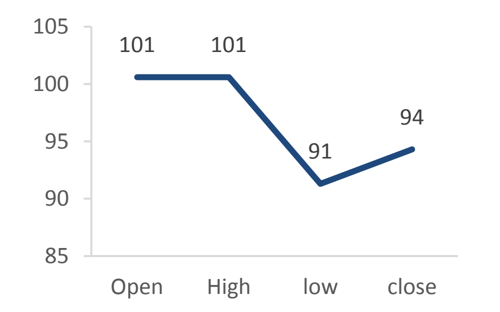
Reasons behind the fall in markets today

Nifty 50 Price performance



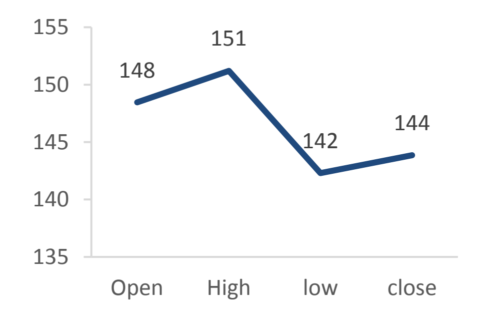
Source: IIFL Research

DHFL Price performance



Source: IIFL Research

Yes Bank Ltd. Price performance



Source: IIFL Research

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June 06, 2019

The downgrade of Dewan Housing Finance Corporation's (DHFL) Commercial Paper (CP) by Ratings agencies, was the primary reason for the steep correction in markets today. Notably, Nifty fell 1.48% while the Bank Nifty declined 2.32% on June 06, 2019, as the 25bps rate cut failed to cheer the market. Domestic rating agencies ICRA and Crisil downgraded rating on CP of DHFL from 'A4' to 'Default' followed by it missing interest payment of ₹960cr on due date i.e. June 04, 2019 and DHFL's worsening liquidity position. Amid liquidity crisis, downgrade of DHFL's paper could accentuate contagion risk, which can spread to other financial institutions including banks. DHFL's default can expose ₹1 lakh cr in borrowing to default risk. Banks, insurers and mutual funds have funded half of ~₹1 lakh cr to DHFL, with PSU banks having major contribution, beside some private banks like IndusInd Bank and Yes Bank also have meaningful exposure to DHFL. Secondly, the banks may also see MTM losses on DHFL's bond exposure, which may lower its earnings in coming quarters. Moreover, market was expecting 50bps repo rate cut, as against the actual cut of 25bps, which added to the negative sentiment. Further, the stocks of PSU banks and wholesale lending NBFCs have been affected the most.

Key takeaways from RBI's meeting today

- Repo rate lowered to 5.75% from 6%, which was on expected lines
- RBI is closely monitoring developments in NBFCs and HFCs. It further said that it will take appropriate action on liquidity as and when required
- Revised Feb 12 circular expected soon. New bad loan circular is expected in 3-4 days
- It expects the government to remain fiscally prudent
- The RBI revised its inflation forecast for April-September to 3-3.31%, up from 2.9-3% seen in April 2019, due to pick up in food prices. This is still lower
- Growth forecast for FY20E cut to 7% from April 7.2%
- The apex body said, sharp slowdown in investment activity and continuing moderation in economic activity is a cause of concern
- RBI has changed its stance from Neutral to Accommodative, meaning rate hike is off the table. The change in stance and lower growth forecast indicates that further rate cuts are possible in coming quarters.

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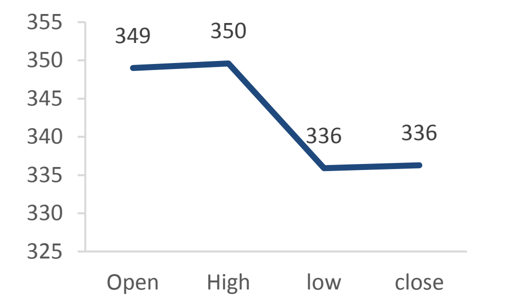
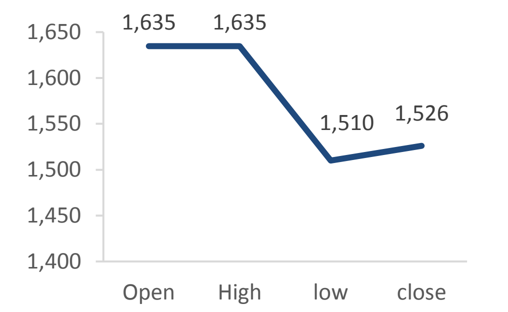
Reasons behind the fall in markets today

SBI Price performance



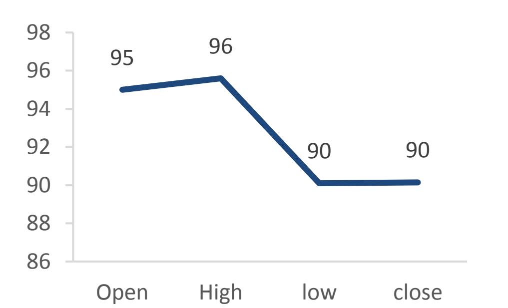
Source: IIFL Research

IndusInd Bank Price performance



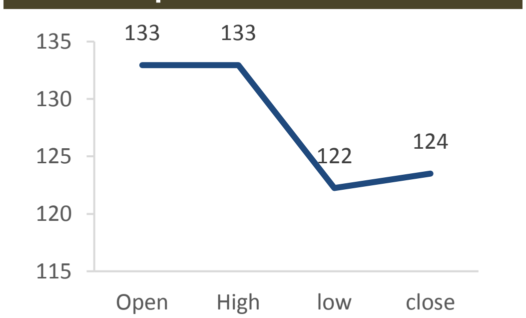
Source: IIFL Research

BoI Price performance



Source: IIFL Research

BoB Price performance



Source: IIFL Research

- RBI proposed to issue the Draft Guidelines for ‘on tap’ licensing of Small Finance Banks (SFB) by the end of August 2019. SFBs have achieved their priority sector targets and attained their mandate for furthering financial inclusion. Hence, RBI believes there is a case for more players to be included.
- RBI has decided to do away with the charges levied for transactions processed in the RTGS and NEFT systems. Banks will be required, in turn, to pass these benefits to their customers.
- A committee is expected to setup to examine the entire gamut of ATM charges and fees. This is in the backdrop of significantly growing use of ATMs by the public and demand to change the ATM charges and fees. The committee will be setup within a week and will submit its recommendations within 2-months of its first meeting.
- RBI has decided to increase the leverage ratio to 4.0% for Domestic Systemically Important Banks (D-SIBs) and 3.5% for other banks versus 3% for all banks earlier.
- The Basel disclosures for large banks show that their existing Leverage ratios are way higher than the regulatory prescription. Hence, no impact on capital position or RoE.

Leverage ratio of various banks

FY19	Leverage Ratio (%)	D-SIB	Required leverage ratio (%)		Leverage Ratio (%)	D-SIB	Required leverage ratio (%)
Private Banks				PSU Banks			
AXSB	7.7		3.5	**SBIN**	5.3	Yes	4.0
HDFCB	10.8	Yes	4.0	**BOB**	6.2		3.5
ICICIBC	9.3	Yes	4.0	**PNB***	4.5		3.5
IIB	8.4		3.5	**BOI***	4.6		3.5
KMB	13.2		3.5	**UNBK***	5.0		3.5
YES	7.4		3.5				
CUBK	10.0		3.5				
FB	7.4		3.5				
KVB	8.5		3.5				
RBK	7.6		3.5				

*Source: Basel III disclosures; *Data for PNB, BOI & UNBK is as of 3QFY19*

MPC cuts repo rate by 25bps as expected, more cuts down the line

The MPC has unanimously voted (6-0) for 25bps policy rate cut. This was in-line with consensus and our expectations. The repo rate is now reduced to 5.75% (reverse repo is 5.50%, Marginal Standing Facility Rate is revised down to 6.00%). The MPC, also, unanimously voted for changing the stance from 'Neutral' to 'Accommodative'. The RBI governor in his interactions with media mentioned that 'Accommodative' stance ruled out the possibility of the rate hike.

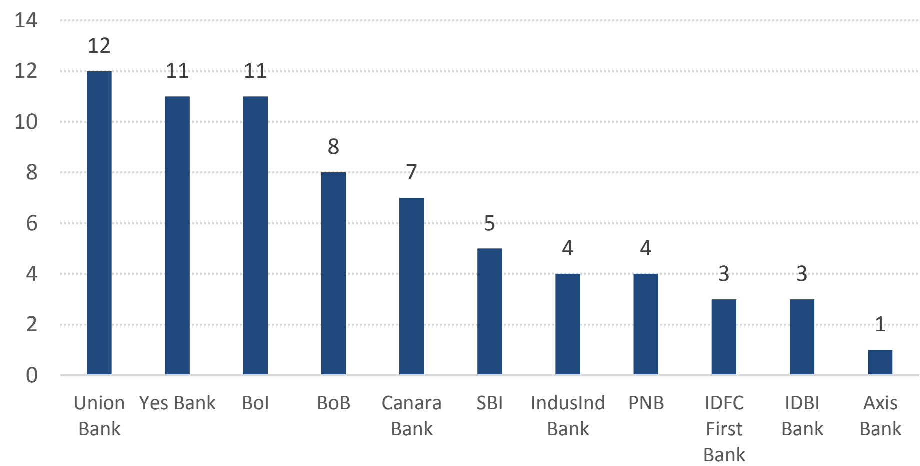
We believe that the transmission of policy rates so far has been weak. The interest rate on fresh rupee loans has declined by only 21bps (less than half the policy rate cut of 50bps) so far and the interest rate on outstanding rupee loans has actually increased by 4bps, even as the decline in money market rates has been broadly in-line with policy rate cuts. This is despite the fact that the RBI has taken several steps to ease liquidity (OMOs, currency swaps, etc.) along with policy rate cut. While we have been expecting a policy rate cut due to weakening growth momentum, we have been less optimistic about its effect on growth, due to poor transmission so far.

The MPC pointed to the IMD forecast of normal rainfall and broadly maintained its inflation outlook for FY20. The MPC acknowledged the pick-up in food inflation in recent months. However, it expects moderating core inflation to offset rising food inflation. While it has revised up its 1HFY20 inflation estimate to 3.0-3.1% yoy from 2.9-3.0% yoy earlier, the MPC has lowered its 2HFY20 estimate to 3.4-3.7% yoy from 3.5-3.8% yoy earlier.

The MPC also revised down its outlook on growth and it now expects GDP to grow by 7% yoy vs. the earlier estimate of 7.2% yoy. This downward revision is largely due to the expectation of weakness in 1HFY20. The MPC now expects GDP to grow by 6.4-6.7% yoy in 1HFY20 vs. earlier expectation of 6.8-7.1% yoy. Further, 2HFY20 growth expectation is broadly unchanged at 7.2-7.5% yoy (vs. 7.3-7.4% yoy earlier).

The MPC noted that the headline inflation is below the target level of 4% yoy and it expects inflation to remain below this target for the rest of FY20. Further, it remains concerned on weakening growth momentum. Given the above and the unambiguously more dovish stance of the RBI, we expect the stage is hence set for more rate cuts.

Banks' exposure to DHFL (% of networth)



Source: Industry, Media reports

Top DHFL exposure as on April 30, 2019

Scheme Name	% of AUM	Market Value (Cr.)
DHFL Pramerica Medium Term Fund-Reg(G)	37.4	12.9
DHFL Pramerica Floating Rate Fund(G)	31.9	4.2
DHFL Pramerica Short Maturity Fund(G)	30.5	91.4
Tata Corp Bond Fund-Reg(G)	28.2	51.9
JM Equity Hybrid Fund(G)	24.6	4.9
Baroda Treasury Adv Fund(G)	21.2	114.7
DHFL Pramerica Low Duration Fund(G)	20.1	62.2
Principal Low Duration Fund(G)	19.2	46.3
JM Low Duration Fund(G)	19.0	27.9
Edelweiss Corporate Bond Fund-Reg(G)	15.0	22.4

Source: Ace MF

In order to resolve the current crisis, DHFL needs to get a strategic investor at the earliest, which in turn will solve the liquidity concerns of the company to some extent. However, this could take longer than anticipated despite the company's on-going efforts to rope in a strategic buyer. Additionally, the intervention of government and RBI will also be crucial to ease the liquidity position, which in turn will help the NBFC sector to improve its disbursements and gain access to capital from financial institutions and re-gain the confidence of lenders.

Disclaimer

Recommendation Parameters for Fundamental/Technical Reports:

Buy – Absolute return of over +10%
Accumulate – Absolute return between 0% to +10%
Reduce – Absolute return between 0% to -10%
Sell – Absolute return below -10%

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