SBI RESEARCH

ECOWRAP

RBI TEMPLATE OF COLLABORATIVE ECOSYSTEM FOSTERED BY CHAMPION BANKS & SUPPORTED BY INDIAN GOVERNMENT ROBUST DEPOSIT INSURANCE MUST BE THE CUT, COPY & PASTE TEMPLATE FOR CENTRAL BANKS WORLD-WIDE: INDIAN BANKS ARE EPITOME OF RESILIENCE IN TERMS OF GLOBAL CLAIMS

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The recent rise in policy rate of 50 bps by ECB, a not so conspicuous response to unabating prices print across 20-member nations, could not have been more counter-intuitive, coming amidst the mayhem that sparked a massive sell-off in the pack of banks, including SIBs (Systemically Important Banks) from EU and UK, eroding $ 60 billion in a single day on March 15 alone. **However, if history had any rear-view mirror, the quantum of unsynchronized rate decisions by ECB in the last 25 years pre and post the GFC is looking grossly mis-timed**. **We hope forthcoming decision of Fed on March 22nd should avoid such rampant use of rear view mirror.**

We pose a simple question: Could the myopic view of the larger Central Banks, with a zeal to contain inflation alone after ignoring it, will exacerbate the downward spiral evident in banking domain?

First, can the mid-tier banks (whose ability to raise and sustain deposits during periods of rigor is always, at best, questionable as collaborating literature shows us) withstand the market meltdown, especially considering their investment book? Second, **how strong the supposedly comfortable level of larger banks' CET (Common Equity Tier 1) is TODAY** when juxtaposed against the continuing avalanche of contagion of banks failures proliferating , fastened by depleted trust of the common depositors? **We feel the fissures of the present shock, after a year of war and three years of pandemic, may prove to be quite a costly affair for the health of beleaguered European banking system** going forward even as ECB continues branding Euro area banking sector as resilient, with strong capital and liquidity positions (as on Sep'22) not factoring the rise in borrowing costs and the resultant decline in demand, along with tighter credit standards, all leading to a vortex. **Clearly, Central banks can not be *alpha* centric, but have to consider systemic *beta* more in their policy experiments/ responses.** We take a cue from former RBI governor Y V Reddy; many central banks in the developed world focus only on containing inflation, and not maintaining the stability of the financial system! Balance should tilt towards systemic stability.

Analysis of insured customer deposits across multiple geographies initiated in the wake of bank runs across developed economies reveal **USA's top 10 Banks deposits are insured in the range of 38.4% to 66%**. **Another interesting trend that has been observed in USA is that Top Banks deposits, on an average, have been insured to the tune of around 50-55%, while their Smaller Bank deposits are insured in the range of 30-45% only. In contrast, Smaller Bank Deposits in India such as Regional Rural Banks, Co-operative Banks, and Local Area Banks are better protected at 82.9%, 66.5%, and 76.4% respectively. For Cross Country Deposit Insurance (DI) coverage & per capita income, ratio of DI cover and Per capita income is 2.53 for India, one of the highest. It may be noted that the Government of India has notified a revised, incremental deposit insurance in 2020, after 27 years!**

Separately, the short term borrowing like uninsured deposits by FRB (First Republic Bank), of $30 Billion from a suite of 11 different US based banks, for an ultra short term period of 90 days, is shortsighted if we compare such packages in India in 2008 and 2020 when the consortium of banks or **champion banks** handheld the ailing banks for a multi year period (**for example in 2020, it was for at least 3 years**!). **We also find the US 'investment' pattern inconsistent, non-secular with asset sizes of participating banks**! As many banks in the list are predominantly investment banks, having secured funds from diverse clients (and, not customers or depositors in common sense) with a clear mandate to generate alpha *a la* hedge funds, we are apprehensive of another ALM mismatch, this time possibly for larger players if select clients question the wisdom behind the move. **We are convinced that the playbook adopted by the Mint Street in times of crises, front led by Champion Banks without ulterior motives, is more suitable for cut, copy, paste by DMs!**

Indian Banks are the epitome of resilience. Foreign Claims on India are $104.2 bn on Immediate Counterparty basis, and $ 81.5 bn as Guarantor Basis. **When compared with other major countries, India has least Foreign Claims, both as counterparty basis, and also as guarantor basis**. **Further, our ratio of Foreign claim to Domestic claims is also least among countries signifying that our banking and financial system is very disciplined and no international balance sheet contagion can start from India. Maturity wise also, International claims on India are the least among major countries.**

An incisive Stress Test of Banks, more of SIBs, could be pertinent for AE regulators to restore market faith in Banks!

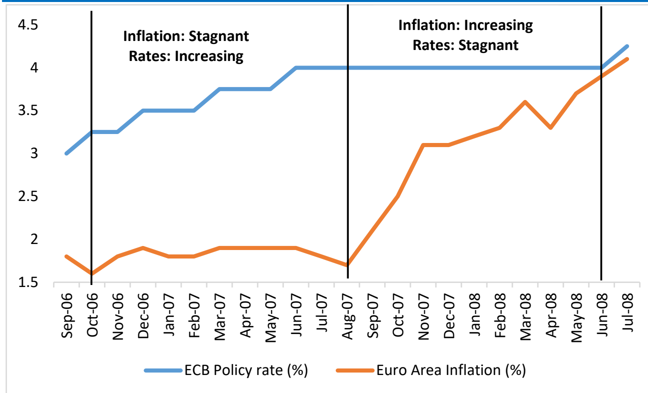
ECB ACTIONS: MOSTLY ILL-TIMED

- **The past trends of ECB rate actions indicate that ECB grossly mis-timed its decision**. When inflation increased by ~10-30 bps between Oct'06-Mar'07, ECB increased rates by 75 bps while when inflation increased more than double to near 4% (Aug'07-Jun'08), first it kept its policy rate constant & then increased it by only 25 bps.
- Recently ECB increased rates by 50 bps. While inflation in Euro Area is still above the 2% target, it decelerated by more than 200 bps to 8.5% in past five months (ECB expects inflation averaging 5.3% in 2023, 2.9% in 2024 and 2.1% in 2025). We believe that in the current times when banking crisis hovering over US and Europe, the ECB decision to target inflation and not financial stability will do more harm than good.

ECB RATE HIKE IMPACT ON EURO AREA

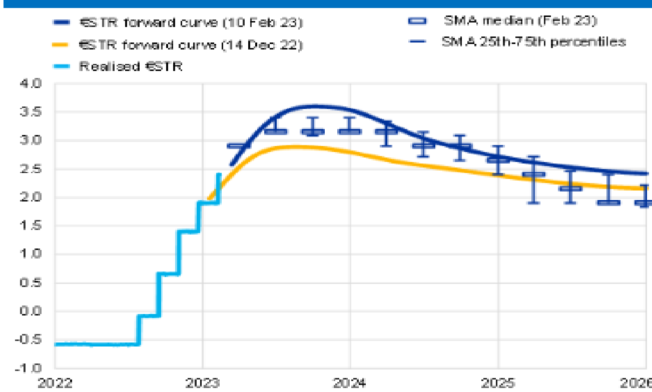
- Dec'21 onwards, ECB has reduced pace of asset purchase, and concluded it in Jun'22. Jul'22 onwards, ECB has started raising key interest rate and raised it up by 350 basis points to ensure inflation returns to 2%.
- Due to market expectation of policy normalization, €-STR (Euro Short term rate) forward curve (benchmark of overnight lending) started shifting up in Dec 21. Market expects €-STR to settle at around 2% when inflation comes within comfortable range.
- Banks funding costs are rising steadily and the costs are being passed over to borrowers. Expensive credit is downgrading the sustainability prospects of industries/ sectors running on thin margin.
- Due to rising interest rate expectations, consumers are discretionary consumption. Constrains in financing are also increasing debt servicing costs. Euro area economy stagnated in Q4 2022. Private consumption and investment, fell by 0.9 % and 3.6 % respectively. Employment grew by only 0.3%. Credit to firms has weakened due to lower demand and tighter credit supply conditions. Household borrowing has become expensive owing to higher mortgage rates.
- Rise in borrowing costs and the resultant decline in demand, along with tighter credit standards, have led to a further slowdown in the growth of loans. Common Equity Tier 1 (CET 1) of 103 Euro area institutions, is at around 15% in Q3 2022 signifying resilient banking sector, and it can also provide cushion even in monetary tightening.

ECB: Inflation and Policy Rate



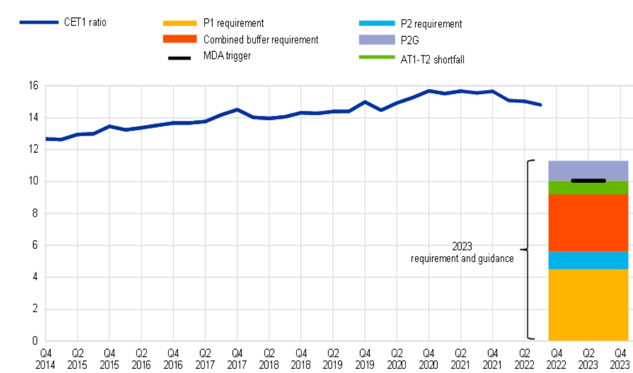
Source: SBI Research

Euro Area Short term interest rate forward curve



Source: ECB

Euro Area CET 1 ratio

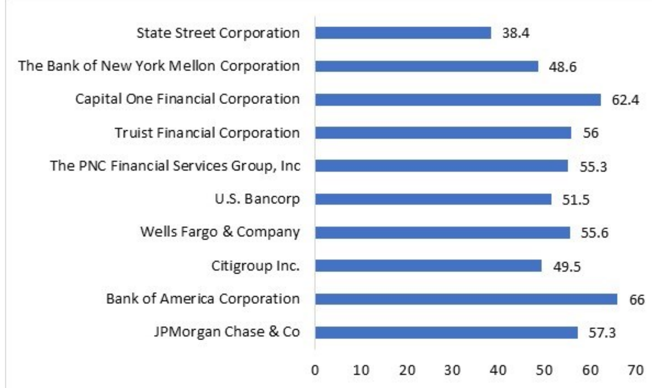


Source: ECB

UNINSURED DEPOSITS IN USA AND INDIA

- **As per the research of Raymond James and Associates**, USA's top 10 Banks deposits are insured in the range of 38.4% to 66%. **When it comes to India, as of Q3 2022 98% of the deposit accounts are insured with the insured deposits to total assessable deposits for Regional Rural Banks, Co-operative banks, and Local Area banks are at 82.9%, 66.5%, and 76.4% respectively .**
- Another interesting trend that has been observed in USA is that, top Banks deposits on an average has been insured of around 50-55%, **but their smaller Banks deposits are insured in the range of 30-45% only.** In contrast our smaller banks such as Regional Rural Banks, Co-operative banks, and Local Area banks are better protected with deposit insurance than our top PSBs.
- When it comes to Cross Country Deposit Insurance coverage & per capita income, ratio of DI cover and Per capita income (PCI) is 2.53, which is one of the highest among countries. Brazil has one of the highest ratio of DI cover and Per capita income which is 6.87. DI cover to PCI ratio for Italy, Norway and France is 3.43, 2.83, and 2.71 respectively.
- **Further, Signature Bank and SVB Financial Bank deposits are insured of only 10.7% and 13.6% only. So the risk of contagion spread from these Banks on international economy, even after FDIC insurance protection, is very high.**

Insured Deposits of USA Top 10 banks



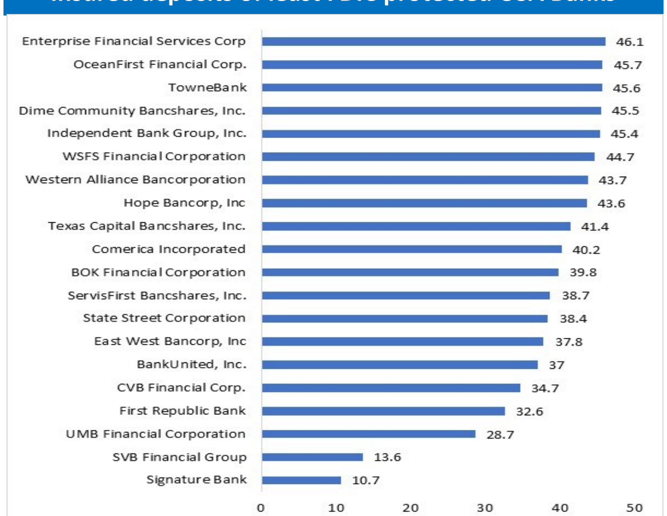
Source: Raymond James, SBI Research

Cross Country Deposit Insurance (DI) Coverage & Per capita Income (in $)

Country	DI Cover ($)	Per Capita Income (PCI) in $	DI Cover / PCI
Brazil	48,136	7,011	6.87
US	2,50,000	69,375	3.60
Italy	1,22,160	35,585	3.43
Norway	2,32,566	82,244	2.83
France	1,22,160	45,028	2.71
India	**6,250**	**2,468**	**2.53**
UK	1,16,215	46,200	2.52
Germany	1,22,160	50,788	2.41
Japan	96,862	40,704	2.38
Sweden	1,27,467	58,639	2.17
Turkey	20,165	9,327	2.16
Russia	18,933	11,654	1.62
Canada	78,555	52,791	1.49
South Korea	46,041	35,196	1.31
Singapore	56,732	66,263	0.86

Source: DICGC, SBI Research

Insured deposits of least FDIC protected USA Banks



Source: Raymond James, SBI Research

INTERCONNECTIONS OF CROSS BORDER ASSETS AND LIABILITIES

- Forward guidance of low interest rates has encouraged investors to take more risk . However, now with the onset of monetary policy normalization, firms and banks running without sustainable business model and only due to cheap credit will be out of market.
- Investment books of banks are showing large losses due to rising bond yields creating unrealized losses in their balance sheet, and falling valuations of new age tech companies. Collapse of SVB and Signature Bank can spread the inter bank and cross country contagion.

INDIAN BANKS ARE THE EPITOME OF RESILIENCE

- In case of crisis, and spread of balance sheet contagion, countries with limited direct and indirect exposure will remain resilient.
- Foreign Claims on India are $104.2 bn on Immediate Counterparty basis, and $ 81.5 bn as Guarantor Basis. When compared with other major countries, India has least Foreign Claims, both as counterparty basis, and also as guarantor basis. Further, our ratio of Foreign claim to Domestic claims is also least among countries signifying that our banking and financial system is very disciplined and no international balance sheet contagion can start from India.
- Highest Foreign Claims are on USA with $4345 Billion on Immediate counterparty basis, and $4296.3 Billion as Guarantor basis. UK is the second most foreign exposed country after USA with foreign claims of $4039.3 Billion on Immediate counterparty basis and $4032.1 Billion as guarantor basis. Out of $104.2 Billion Immediate counterparty foreign claims on India, $26 Billions are in local currency (INR) only. International claims (Foreign claims— local currency claims) on India are $78.1 Billions only, which is again least among the major countries.
- When it comes to maturity of these claims, out of $78.1 Billion international claims, $59 Billion has to be paid in one year (by Sep 23), $3.6 Billion has maturity of one to two years, and only $14.9 Billion has maturity of over two years. **Maturity wise again, International claims on India are the least among major countries.**

Q3 2022 Outstanding by nationality of Banks ($Billion)

	Foreign claims		Domestic claims		Ratio of Foreign to Domestic Claims	
Q3 2022	Immediate counterparty	Guarantor basis	Immediate counterparty	Guarantor basis	Immediate counterparty	Guarantor basis
All bank nationalities	32695.5	29560.3	65664.3	65055.4	49.79	45.44
Australia	745.3	744	2348.1	2349.5	31.74	31.67
Austria	445.9	439.1	466.9	473.7	95.50	92.70
Belgium	263.8	263.4	462.1	462.5	57.09	56.95
Canada	2415.4	2403.2	2749.7	2761.9	87.84	87.01
Chinese Taipei	431.1	414.6	1474.4	1490.9	29.24	27.81
Finland	423.8	424	303.2	303.1	139.78	139.89
France	3089.7	3072.5	4886	4903.1	63.24	62.66
Germany	1913	1670.7	5636.9	5879.2	33.94	28.42
India	104.2	81.5	2640.6	2663.3	3.95	3.06
Italy	924.9	918.2	2338.9	2345.5	39.54	39.15
Japan	4692	4537.5	14301.6	14456.2	32.81	31.39
Korea	262.4	252.6	2064.5	2074.3	12.71	12.18
Netherlands	1408.4	1410	1382.2	1380.6	101.90	102.13
Singapore	649.3	657.5	479.5	471.3	135.41	139.51
Spain	1903	1881	1785.4	1807.3	106.59	104.08
Sweden	403.8	390.6	634	647.2	63.69	60.35
Switzerland	1504.4	1162.4	1865.4	1921.7	80.65	60.49
United Kingdom	4039.3	4032.1	2856.4	2863.5	141.41	140.81
United States	4345	4296.3	14108.4	14166.2	30.80	30.33

Source: BIS, SBI Research

Q3 2022 Foreign Claims by nationality of Banks (Immediate Counterparty basis) - ($Billions)

		International claims				Local Currency Claims
			By remaining maturity			
	Foreign claims	Total	Up to one year	one year to two years	Over two years	
Australia	745.3	282.4	200.4	18.2	57.7	462.9
Austria	445.9	216.6	77.5	21.5	115.6	229.3
Belgium	263.8	130.4	70	7.4	51.4	133.5
Canada	2415.4	905.5	404.4	58.3	330.5	1509.9
Chinese Taipei	431.1	315.1	121	31.4	159.6	116
France	3089.7	1593.3	799	110.9	544.2	1496.4
Germany	1913	1427.2	571		390.7	485.8
India	104.2	78.1	59	3.6	14.9	26
Italy	924.9	511.3	152.6	40.7	260.1	413.5
Japan	4692	3546.6	465.4	182.6	1545	1145.4
Korea	262.4	209.4	108.3	16.8	77.1	53
Netherlands	1408.4	692.5	466.5	34.5	175.6	715.9
Singapore	649.3	349.9				299.4
Spain	1903	570.2	275	57.3	220.6	1332.7
Sweden	403.8	141.2	95.5	7.7	33.6	262.6
Switzerland	1504.4	1000	662.1	64.2	218.9	500.6
United Kingdom	4039.3	1991.6	1274.8	74.8	178.9	2047.7
United States	4345	2708.2	2042.3		666	1636.7

Source: BIS

SAFETY OF INDIAN CROSS BORDER ASSETS

- Our Cross Border Assets, as of Q3 2022, is around $119.67 Billion. Out of which, major stakeholders are UK with $39.88 Billions, USA with $26.16 Billions, Hong Kong with $12.65 Billions, France with $5.11 Billions, Australia with $2.82 Billions, Japan with $2.3 Billions and Switzerland with $1.3 Billions.
- As can be seen, failing of banks with Swiss nationality can't have much impact on India as our Cross Border Assets on Switzerland are only $1.3 Billions.
- In such scenario, Major source of contagion spread over India through balance sheet channel can come from UK and USA. Banks will be majorly impacted in comparison with NBFCs in such cases, as out of $39.88 Billions UK Assets, $36.5 Billions are with banks and only $ 3.38 Billions are with Non Banks. In USA also, out of $26.16 Billion cross Border assets, $23.98 Billions are with Banks and only $2.18 Billions are with Non Banks.
- **The hurried coming together of a consortium of 11 major US banks, injecting uninsured deposits for an ultra short term period, presumably to calm the frayed nerves of the jittery markets seems inconsistent, non-secular investment grade with asset sizes of banks!**
- Investment Banks like Goldman Sachs and Morgan Stanley have pumped more than a PNC or Truist. But, given the huge MTM losses being run by a PNC or Truist on its bonds/treasuries portfolio, they probably could not have lent more, for a longer period. **We fail to see any long term market stabilizing tactical planning in the move, particularly when juxtaposed against confidence building measures taken at systemic level by RBI that has gone a long way in taking Indian banking system to new, and sound highs.**

Foreign Banks Cross Border Positions on India Q3 2022 ($Millions)

	Assets					
	All sectors		Banks		Non-banks	
	All instruments	Of which: loans and deposits	All instruments	Of which: loans and deposits	All instruments	Of which: loans and deposits
Australia	2819	2345	2500	2035	319	310
Austria	32	32	13	13	19	19
Belgium	680	568	596	544	84	24
Canada	873	798	343	268	530	530
Chinese Taipei	49	47	8	7	41	40
Denmark	24	24	12	12	12	12
Finland	0	0	-11	-11	11	11
France	5117	3639	4944	3494	173	145
Germany	1672	0	1672	0	0	0
Hong Kong SAR	12659	10957	12132	10570	527	387
Ireland	48	17	36	5	12	12
Italy	31	31	9	9	22	22
Japan	2300	0	2227	0	73	0
Korea	328	328	25	25	303	303
Luxembourg	133	132	121	120	12	12
Netherlands	0	0	0	0	0	0
Philippines	29	13	10	0	19	13
South Africa	274	143	242	111	32	32
Spain	25	24	3	2	22	22
Sweden	107	107	98	98	9	9
Switzerland	1302	1250	1173	1146	129	104
United Kingdom	39884	39884	36501	36501	3383	3383
United States	26165	26091	23981	23917	2184	2174
Total Cross-border positions	**119676**	**114755**	**106729**	**102152**	**12947**	**12603**

Source: BIS, SBI Research

FRB $30 Bn deposit flow from 11 US banks

Donor US Bank	Amount ($ Bn)	Domestic Assets of Bank ($ Bn)	RBI moves
Bank of America	5	2291	Pvt Bank in distress steadied through a consortium of Champion banks
Citigroup	5	1069	Financial Services Providers (including NBFCs) brought under IBC
JPMorgan Chase	5	3202	Cash run on select bank(s) during GFC averted through collaborative co-operation from bigger, champion banks
Wells Fargo	5	1693	slew of measures for banks during pandemic
Goldman Sachs	2.5	439	reduction in CRR for liquidity enhancement
Morgan Stanley	2.5	210	Enhancement in Banks' HTM limit
BNY-Mellon	1	237	50,000 cr to AIFIs for new lending in 2021-22
PNC Bank	1	551	Targeted Long-Term Repo Operations (TLTROs) and enhanced MSF for additional liquidity
State Street	1	209	Moratorium on Term Loans and Deferment of Interest on Working Capital Facilities
Truist	1	546	Support to Real Estate Sector
U S Bank	1	575	Permitting Banks to Deal in Offshore Non-Deliverable Rupee Derivative Markets (Offshore NDF Rupee Market)

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