State-run banks likely to see bad loan additions moderate: Morgan Stanley

Indian state-owned lenders are expected to see additions to bad loans moderate, but structural issues at the banks could cap returns on their stocks, Morgan Stanley said on Thursday.

Some of the country's state-owned banks have long struggled with a pile of bad loans, prompting the government to pump in more funds to shore up their balance sheets.

"Over the past few years, state-owned enterprise banks have seen significant capital infusion by the government, lower risk-weighted assets density, higher provisioning and some large recoveries," the brokerage said in a report, adding that as slippages moderate, fresh additions to bad loans, credit costs will also moderate over the next few years.

The brokerage preferred India's largest lender State Bank of India, as well as large private banks, expecting them to play a major role in the corporate recovery cycle.

In February, SBI said its asset quality has remained largely stable and the lender revised its credit cost guidance to lower than 2% for the financial year. A return to pre-pandemic levels of retail growth drove the bank's third-quarter profit well past estimates.

But weak underwriting practices, diminishing loan market and deposits share in the sector will weigh on the stocks of many other public sector banks even as cheap valuations make them look attractive, Morgan Stanley said.

"We think state-owned enterprise banks will continue to lose loan market share given technology changes, strong competition and a weak internal rate of capital generation," analysts at the brokerage said.

The Nifty public sector bank index was down 0.4% on Thursday. The index has risen nearly 39% so far this year against a drop of about 31% in 2020.

Morgan Stanley