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Rally in bank stocks may have run its course

Lower-Than-Expected Hike Seen As Positive, But Fresh Position In Banks Unlikely

Harish Rao
MUMBAI

BANK shares rose on Tuesday after the Reserve Bank of India (RBI) raised key policy rates lesser than what analysts expected it to. However, market watchers expect the stocks to underperform in the short term, as the unexpected 25 basis point hike in the cash reserve ratio (CRR), will leave banks with lesser money to lend. CRR is the zero-interest deposits that banks keep with RBI.

The BSE Bankex, which represents the banking sector, gained 1.5% over its previous close to finish at 10679.61. In comparison, the broad-based 30-share Sensex surrendered early gains to close at 17,460.58, up 0.3% over the previous close. Shares of State Bank of India rose 3.2% to close at Rs 2,098.05 and were the best performers in the sector.

RBI in its monetary policy review, raised the repo and reverse repo rates by 25 basis points each. Repo is the rate at which banks borrow from the RBI and reverse repo is the rate at which banks lend to RBI.

Some analysts feel banks may not have to raise their lending rates immediately to offset the increase in CRR.

"As there is surplus liquidity in the system, there is no pressure on the banks to raise lending rates in the short term," said Sanjeev Patni, president & head-institutional equities, Prabhudas Liladhar.

"But the medium-term outlook remains good, as we see credit growth picking up in the second half of the year," he said.

Banking analysts said it would be unwise for banks to increase interest rates at this juncture as credit growth is just showing signs of revival. Any increase may dampen demand and hurt banks' profitability, they said.

Bank shares have outperformed the BSE Sensex by 4 percentage points in 2010 so far, and are no longer cheap, market participants point out. So investors may be wary of increasing their exposure to the sector in the short term. Most domestic fund houses are overweight on the sector, as banks are the best proxy on the economy.

NO ENTRY

With the domestic economy gathering steam, brokers expect banks to do well in the medium term.

"The CRR hike could have been avoided due to the volatility in surplus liquidity in the system and expected a pick-up in credit demand due to rise in capex, higher oil prices increasing under-recoveries of down-stream oil companies and rising consumer demand," said Vikram Kotak, chief investment officer, Birla Sun Life Insurance.

Some analysts feel banks may actually gain if interest rates rise in the short term.

"We maintain a positive bias on the sector with a medium-to-long term perspective based on expectations of improving credit growth and stable margins," said Dipen Shah, senior vice-president-PCG, Kotak Securities.

"Also in an increasing interest-rate scenario banks will tend to gain in the short term, as advances get repriced immediately," he said.

STRATEGY: Traders bullish on SBI can go in for an options strategy known as short strangle. This strategy can be entered into by selling an out-of-the-money call at 2150 for a premium of Rs 15 and an out-of-the-money put at 2050 for a premium of Rs 16. The lot size for SBI in the futures and options segment is 132. The net premium received by the investor in this strategy would be Rs 4,092 (31*132) and that would also get in maximum profit. The trader will benefit the most if the price at expiration will be between the two strike prices. Losses will have to be incurred if the strike price goes below (2019) on the downside and (2181) on the upside at expiration.

harish.rao@timesgroup.com