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LOSING CHARM Spreads between NBFCs' rates and benchmark widen while banks' shrink amid rise in demand

NBFCs can be the Worst Casualty of Rising Rates

Our Bureau

Mumbai: Non-Banking Finance Companies could be the worst hit in the rising interest rate scenario as the spreads between their rates and the benchmark widen while bank rates shrink amid a rise in demand from customers. Their profit margins which drew investors in hordes, could shrink as they would not be able to pass on the entire rise in costs.

With the rising interest rate scenario, NBFCs and HFCs are expected to see an increase the cost of funds. In the rising interest rate scenario, HFCs are moving towards borrowing in the shorter tenure as they were unable to pass on the rate hike to borrowers.

Yield on government 10-year bonds has been hovering around 8% for a few days now.

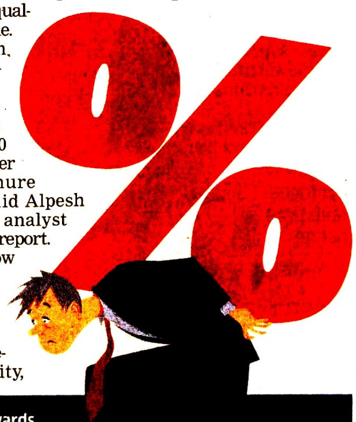
"Some larger HFCs are also planning to meet part of their funding requirements through retail bond issuances during the year where interest rated offered are generally higher by 25-75 bps," said Supreeta Nijjar, vice-president and sector head, financial sector ratings, ICRA.

The shift in portfolio mix to higher yielding non-housing loans helped HFCs to partly offset the pressure on yields in the housing loan segment last year.

"Increasing share of non-housing loans are likely to support yields. However, interest spreads may shrink as lenders may not be able to fully pass on the increase in their cost of funds to the end borrowers," said Nijjar. "RoE from core lending business is expected to moderate to 15-16% at gearing of 8 times. However, HFCs which have avenues to earn fee-based income have the potential to earn better returns. Icra expects HFCs to report ROEs of 16-18% for FY2019."

The last financial year was good for most NBFCs as they came out of the demonetisation lows, showed strong growth and asset quality remained stable.

"To maintain spreads, HFCs resorted to shorter-tenure borrowings, which are generally 50-100 basis points cheaper than longer-tenure borrowings," said Alpesh Mehta research analyst Motilal Oswal in a report. "While the 'borrow short and lend long' strategy would work in times of abundant liquidity (because on maturity, one could easily refinance the borrowing), we believe it would be tough in times of tightening liquidity." RBI relaxed the norms for ECBs and this will enable HFCs to diversify their funding mix.



Tough Times Ahead

- NBFCs profit margins may shrink as they would not be able to pass on the entire rise in costs
- NBFCs and HFCs are expected to see an increase the cost of funds
- HFCs are moving towards borrowing in shorter tenure as they were unable to pass on the rate hike to borrowers