Share Department, Board & Co-Ordination Division, HO Plot No.4 Sector 10, Dwarka, New Delhi-110075
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Scrip Code : PNB	**Scrip Code : 532461**
The Asstt. Vice President National Stock Exchange of India Limited "Exchange Plaza" Bandra – Kurla Complex, Bandra (E) **Mumbai – 400 051**	The Dy General Manager Bombay Stock Exchange Limited 1st Floor, Phiroze Jeejeebhoy Towers, Dalal Street, **Mumbai – 400 001**

Date: 03.12.2020

Dear Sir (s),

Reg.: Rating Action by Fitch Ratings.

The Exchange is hereby informed that Fitch Ratings has vide its rating action dated 03.12.2020 affirmed PNB's Long-Term Issuer Default Rating (IDR) at 'BBB-', with a Negative Outlook. The agency has also affirmed the Bank's Viability Rating (VR) at 'b', Support Rating Floor at 'BBB-' and Support Rating at '2'. A copy of the Rating Action is enclosed herewith.

This is in compliance with Regulation 30 of SEBI (LODR) Regulations, 2015.

Thanking you

Yours faithfully,

(Ekta Pasricha)
Company Secretary

पंजाब नैशनल बैंक P.N.B. शेयर विभाग बोर्ड व समन्वय प्रभाग Board & Coord. Division Share Department H.O. New Delhi-110075 प्र. का. नई दिल्ली-110075

Encl.: as above

FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Punjab National Bank at 'BBB-'; Outlook Negative

Thu 03 Dec, 2020 - 6:22 AM ET

Fitch Ratings - Singapore/Mumbai - 03 Dec 2020: Fitch Ratings has affirmed Punjab National Bank's (PNB) Long-Term Issuer Default Rating (IDR) at 'BBB-', with a Negative Outlook. The agency has also affirmed the bank's Viability Rating (VR) at 'b', Support Rating Floor at 'BBB-' and Support Rating at '2'. A full list of rating actions is at the end of this commentary.

The Negative Outlook on the IDR mirrors the Outlook on India's 'BBB-' sovereign rating, which was revised to Negative from Stable on 18 June 2020 due to the impact of the escalating coronavirus pandemic on India's economy. For more details on the sovereign rating action, please see "Fitch Revises India's Outlook to Negative, Affirms IDR at 'BBB-'" at https://www.fitchratings.com/site/pr/10126674.

The operating environment for Indian banks remains challenging despite a moderate revival in economic activity due to a gradual easing of the lockdown since May 2020. Fitch revised India's real GDP growth for the year ending March 2021 (FY21) to -10.5% from -5% in September 2020, but expects a rebound to 11% in FY22 although GDP is not expected to return to its 2019 level until 1QFY22, and will remain permanently below its pre-COVID-19 path due to the lasting scars left by the crisis. The economic contraction is likely to result in protracted weakness in the asset-quality cycle, which could potentially manifest significantly in higher stressed loans and ultimately more write-offs over the next few years, even though Indian banks' latest 2QFY21 earnings present a more benign picture (see Indian Banks to Face Tough Times at https://www.fitchratings.com/site/re/10137748).

Fitch believes a speedy economic recovery is critical for the sector to rebound meaningfully, without which we expect a moderately worse landscape for the Indian banking sector in 2021 on the back of weak prospects for new business and revenue generation.

KEY RATING DRIVERS

IDR, SUPPORT RATING AND SUPPORT RATING FLOOR

PNB's Long-Term IDR of 'BBB-' is driven by its Support Rating of '2' and Support Rating Floor of 'BBB-'. It reflects Fitch's expectation of a high probability of extraordinary government support, if required, due to the bank's high systemic importance and state linkages. This is driven by its significant market share (around 7% and 8% of sector assets and deposits, respectively, following a merger), an adequate pan-India franchise, and 85.6% state ownership. Large state-owned banks such as PNB also play an important policy role in furthering the state's social lending objectives and thus are also important from a financial inclusion perspective. Fitch believes a default by a large bank such as PNB would result in a general loss of confidence in the sector and pose potentially high reputational risks for the state.

VIABILITY RATING

PNB's VR is three notches below our assessment of the banking system's operating environment score. It reflects the bank's weaker-than-peer financial metrics, including its less-than-satisfactory capital buffers, which are vulnerable to even moderate stress. PNB's weak intrinsic risk profile also factors in its high impaired loans and consistent losses in the last three years. The bank's performance improved slightly in 1HFY21 but we believe there is still downside to the VR in consideration of the risks that even moderate asset-quality deterioration can pose to PNB's limited capital buffers under the currently challenging business and economic conditions.

The bank's common equity Tier 1 (CET1) ratio took a hit following its merger with two mid-sized state banks in April 2020. The CET1 ratio dropped to 9.5% at 1HFYE21 from 10.7% in FY20, only 153bp above the regulatory minimum requirement of 8%, which has been postponed to April 2021 due to the pandemic. The limited available capital buffer and a high net impaired loan/CET1 ratio of 52.3% means the bank's core capitalisation is vulnerable to even moderate shocks, which justifies our negative outlook on capitalisation. Capital augmentation is considered important as income buffers are not adequate to absorb heightened credit costs should stress levels increase. PNB's board-approved plan to raise capital of INR70 billion (113bp of risk-weighted assets in 1HFY21) in FY21 is therefore modest relative to potential risks although there is uncertainty over PNB's ability to raise the intended amount in full. It underscores the challenges we believe state banks in general face due to their highly discounted equity valuation (PNB: 0.3x), thus resulting in high dependence on the state for a large portion of their capital needs.

The impaired-loan ratio improved (1HFY21: 13.4%, FY20: 14.2%) on the back of lower slippages, which were partly due to a loan moratorium, and continued write-offs. However, impaired loans do not fully reflect potential stress as PNB had nearly 33% of loans under moratorium at 1HFYE21. Fitch believes the risk of asset-quality deterioration is high over the medium term starting 3QFY21, although not all stress will be recognised as impaired loans. The one-time loan restructuring scheme for COVID-19-related stress and the availability of refinancing from banks could structurally delay recognition of potential stress as non-performing loans (NPL), and Fitch expects the full extent of stress to materialise over the next two years. However, Fitch will continue to treat restructured loans as stressed loans.

Risks are heightened in PNB's SME and retail loan book (1HFY21: 17% and 18% of loans, respectively). SME loans are affected by structural demand challenges and cash flow disruptions, but the risks from retail loans may be higher due to their lower seasoning from the fast growth in recent years. However, we think retail loans are more resilient while imminent stress in SME loans may not surface immediately due to refinancing under government-sponsored schemes. Stressed corporate sectors such as non-bank financial institutions, infrastructure, auto, construction, real estate and engineering are also at risk as they cumulatively constituted nearly 32% of total loans at 1QFYE21. The share of corporate loans locally rated below investment grade increased to 29% at 1HFYE21 (FY20: 23%), an indication of stress. PNB's loan-loss cover improved moderately (1HFY20: 68%, FY20: 63%) but it was largely due to NPL ageing and partly because of significant provisioning by merging entities. However, pandemic-related provision of an additional cover of 1% is not sufficient to shield the loan-loss cover from falling once slippages start rising from 3QFY21, which we believe is likely.

The improvement in operating profit/risk-weighted assets (1HFY21: 0.5%, FY20: 0.2%) is in line with peers but is unlikely to be sustained if increased asset-quality stress results in higher fresh slippages and loan-impairment charges (1HFY21: 2.7%, FY20: 3.1%). The available buffers are thin as loan and securities impairment charges were around 86% of pre-provision profits at 1HFYE21. This reflects the continued structural weakness of PNB's earnings as it faces a high risk of losses even under moderate stress.

The VR also factors in PNB's stable funding profile, which is underpinned by its wide reach and close government links, although their influence on the VR is lower than the financial profile factors above. PNB's deposit share has remained steady in the current uncertain environment, which reflects continued depositor confidence, driven by state ownership. Its low-cost deposit ratio improved further (1HFY21: 43% of deposits, FY20: 42%) while stable liquidity is reflected in its liquidity-coverage ratio (1QFY21: 172%).

RATING SENSITIVITIES

IDRS, SUPPORT RATING, SUPPORT RATING FLOOR Factors that could, individually or collectively, lead to negative rating action/downgrade: The Support Rating and Support Rating Floor are most sensitive to the agency's assessment of the government's propensity and ability to support the bank, based on its size, systemic importance and linkage to the state. Weakening of the government's ability to provide extraordinary support - reflected by negative action on India's sovereign ratings - would lead to negative action on the IDRs. Negative action on the IDR is also likely should Fitch perceive any reduction in the government's propensity to extend timely support, in which case the agency will reassess the Support Rating and Support Rating Floor, and in turn, the bank's IDR and senior debt ratings, although that is not our base case. Factors that could, individually or collectively, lead to positive rating action/upgrade: PNB's IDR is driven by its Support Rating Floor. A revision of the sovereign rating Outlook to Stable would lead to a corresponding IDR Outlook revision, provided the sovereign's propensity to support remains unchanged. An upgrade to PNB's Support Rating Floor could occur in the event of a sovereign upgrade if Fitch believes that the sovereign's ability and propensity to support the bank has improved. However, an upgrade of the sovereign rating appears less certain in the near term. A revision in the VR is unlikely to affect the IDR as the IDR is five notches above the VR. VR Factors that could, individually or collectively, lead to negative rating action/downgrade: PNB's VR could be downgraded to 'b-' if we see further significant weakening of the bank's loan quality (impaired + restructured loan ratio approaching 20% from 13.4% impaired-loan ratio at 1HFY21) and impairment charges, which would imply another protracted asset quality cycle for PNB. It would put further pressure on PNB's structurally weak earnings leading to higher-than-expected losses and further affecting a weakened CET1 ratio, pushing it towards the minimum regulatory threshold of 8%. A downgrade of the VR to the 'ccc' category or lower is likely if weak asset quality (stressed-asset ratio well above

20% from 13.4% impaired-loan ratio at 1HFY21) and a resurgence of losses, in the absence of ordinary state support, compromise the bank's core capital position and increase the prospects of extraordinary support. Fitch believes the bank's measures to help clients through the downturn will become less effective the longer the downturn lasts, which is likely to limit the speed of recovery after the pandemic has been brought under control. Factors that could, individually or collectively, lead to positive rating action/upgrade: A VR upgrade is unlikely in the near term in light of the risks to the bank's intrinsic profile from rising external pressures due to the challenging operating environment. However, pressure on the VR would ease if an economic recovery is faster than our expectations, as it would return the bank's asset quality and capitalisation towards a path of sustainable improvement. The bank's capitalisation and profitability, including the ability to sustain a higher CET1 ratio of close to 12%, along with sustainable improvement in asset quality (stressed-asset ratio well below 10%) and earnings, will be important considerations for an upgrade.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

PNB has an ESG Relevance Score of 4 for Governance Structure. This reflects our assessment that key governance aspects, in particular board independence and effectiveness, ownership concentration and protection of creditor or stakeholder rights, have a moderate and negative influence on the VR. We think its less-developed governance is evident from weak underwriting, resulting in high levels of poorly performing loans and credit losses. The boards are dominated by government appointees while its business models often focus on supporting government strategy with lending directed towards promoting socioeconomic and macroeconomic policies, which may include lending to government-owned companies. These factors also drive our view of the bank's state linkages that affect support prospects and drive the long-term ratings.

PNB also has an ESG Relevance Score of 4 for Financial Transparency. This reflects our assessment that the quality and frequency of financial reporting and the auditing process are a moderate influence on the VR. It is a negative influence as these factors have become more prominent in the past few years because of the sharp financial deterioration at state banks and the wide reported divergence in NPL recognition between the banks and the regulator, although these incidences have fallen in recent years. Financial transparency is considered pivotal for general business and depositor confidence and can lead to significant reputational risk if not managed well.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Punjab National Bank	LT IDR	BBB- Rating Outlook Negative	Affirmed	BBB- Rating Outlook Negative
	ST IDR	F3	Affirmed	F3
	Viability	b	Affirmed	b
	Support	2	Affirmed	2
	Support Floor	BBB-	Affirmed	BBB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Bank of Baroda	EU Endorsed
Bank of Baroda (New Zealand) Limited	EU Endorsed
Bank of India	EU Endorsed
IDBI Bank Limited	EU Endorsed
Punjab National Bank	EU Endorsed
State Bank of India	EU Endorsed

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