

Rate Hikes Bode Well for Banks Margins; Prefer Private Banks

With crude prices remaining firm and inflationary pressures continuing to linger, **the RBI's decision to hike repo rates was largely anticipated**. The regulator also decided to change the stance to 'Calibrated Tightening' from 'Neutral' earlier. With the RBI clearly signalling that rate cuts are completely ruled out, with current macro conditions either warranting a further rate hike or a pause, **we expect another 25bps rate hike to follow in the next MPC meeting**. A stronger-than-expected domestic economic activity and resilient Q1 growth prompted the regulator to increase its growth forecast by 40bps to 7.1% for FY27 vs 6.7% earlier. However, continued inflationary pressures compelled the RBI to increase the inflation forecast to 5.2% vs 5% earlier.

The RBI also outlined certain additional measures:

- ✓ **Measures to Enhance Customer Convenience through the Account Aggregator Framework:** To enhance customer convenience, the RBI has decided to implement interoperability among NBFC-Account Aggregators (NBFC-AA), enabling customers to access and share financial information across Financial Information Providers through any NBFC-AA of their choice. Depositories will also be facilitated to include bank deposit account information in their Consolidated Account Statement (CAS) through NBFC-AAs, allowing demat holders to view demat holdings and bank deposits in one place. Customers without demat accounts can continue to obtain and share a consolidated view of their financial information through NBFC-AAs. Both measures are expected to be implemented by December 31, 2026.
- ✓ **Constitution of a Technical Consultative Committee for Financial Markets:** Against the backdrop of rapidly evolving financial markets and infrastructure, the RBI has decided to constitute a Technical Consultative Committee for Financial Markets. The committee will serve as a forum for structured engagement with market participants and stakeholders by the Reserve Bank on policy and operational matters related to money, government securities and foreign exchange markets, as well as the respective derivative markets and infrastructure. The composition and the terms of reference for the Technical Consultative Committee shall be separately notified.

From a **banking sector perspective**, **all eyes will now be on Q2 earnings**, with focus remaining on margins, which appear to be the only pain point during the quarter, while growth holds firm and asset quality continues to remain resilient.

The provisional numbers reported by banks substantiate these growth trends. Credit growth has remained strong and is expected to be broad-based. We expect our coverage universe banks to report a solid +19/5% YoY/QoQ credit growth in Q2E. **Despite the rate hike, and given ample liquidity, we expect credit growth to remain buoyant in FY27E**. We expect our coverage universe banks to deliver a strong 16% CAGR growth over FY26-29E.

Deposit growth, which was lagging credit growth and hovering between 11-12% over the past few quarters, has picked up meaningfully with support from strong FCNR(B) inflows. However, CASA Ratios and margins for banks will remain under pressure in Q2.

With the start of the rate hike cycle, the outlook for NIMs turns constructive for H2, with rate hikes reflecting in EBLR-linked portfolios of banks. We believe private banks, especially larger private banks, would be bigger beneficiaries. Clearly, NIMs for banks will bottom out in Q2 and improve thereafter.

Asset Quality remains in a sweet spot, with no challenges visible from the prolonged West Asia conflict. Slippages should remain contained, and core credit costs should remain under control and range from steady to slightly declining during Q2. However, during the quarter, overall credit costs would see a slight inch-up from the standard asset provision on FCNR (B) loans.

We expect EPS upgrades amongst select banks. Moreover, following the sharp correction in banking stocks, valuations have turned attractive, especially given healthy growth prospects, resilient asset quality and improving earnings visibility.

*Stock Picks:

Banks: Kotak Mahindra Bank, ICICI Bank, HDFC Bank, SBI, Federal Bank, Karur Vysya Bank

(*Please note that these are event-based picks.)

Key Rates

	Current (%)	Previous (%)
Repo Rate	5.50	5.25
Reverse Repo Rate	3.35	3.35
MSF	5.75	5.50
SDF	5.25	5.00

GDP Growth Estimates

	Current (%)	Previous (%)
Q2FY27	7.2	6.4
Q3FY27	6.9	6.5
Q4FY27	6.8	6.8
FY27	7.1	6.7
Q1FY28	7.1	7.3

Inflation Estimates

	Current (%)	Previous (%)
Q2FY27	4.9	4.7
Q3FY27	6.0	5.9
Q4FY27	5.7	5.5
FY27	5.2	5.0
Q1FY28	5.6	5.3

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