PL Capital
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Banks

Sector Update

June 23, 2025

RBI measures: a shot in the arm for banks

Based on recent RBI actions to boost liquidity and credit growth, we expect system loan growth for FY26/27E to be higher by 100bps each to 12.0% led by the pick-up in NBFC (60-65bps) and PL/CC (35-40bps). Incremental loan growth may be funded by surplus liquidity; hence, we trim aggregate liquidity by 154/204bps to ~29% and increase LDR by 121/173bps to 82.6%. Contrary to usual expectations of a cut in NIM following higher repo rate reduction due to lag effect in deposit repricing, we raise aggregate NIM by 2/4bps for FY26/27E to 3.11%/3.19% as WATD rates have declined at a faster pace by 66-123bps since Apr'25. We could see a credit upcycle from FY27E suggesting higher than expected loan growth. Sensitivity analysis indicates that if loan growth for FY27E is 210bps higher at 14.7% YoY, aggregate core PAT would be upgraded by 3.6%; sector would re-rate and multiples/TP could increase by 5.0-11.0%. However, in a credit upcycle, valuation discount of other banks to sector leaders like ICICB/HDFCB (6-7% upgrade) would narrow suggesting higher upgrades. From an alpha generation perspective, we would prefer players like AXSB and SBI that have levers to support credit growth.

- **RBI's focus to boost liquidity and growth:** System credit has been slowing down from 13.7% YoY in Jul'24 to 10.2% in Apr'25 led by slower accretion in housing, agri, NBFC, unsecured and services. To spur credit growth, RBI had changed its stance to accommodative since Dec'24 as suggested by (1) repo rate cut of 100bps over Feb'25 to Jun'25 (50bps in Jun'25), (2) CRR cut of 50bps in Dec'24 and 100bps announced till Nov'25, (3) relaxation in the new LCR framework, and (4) withdrawal of 25% risk weight increase on NBFCs credit. These measures would have a two-fold impact – on growth and margins. Our analysis of the top 12 banks suggests that credit accretion may improve from H2FY26 driven by NBFC (60-70bps) due to easing of supply-side constraints and unsecured credit (37bps) as stress is peaking out.

- **Deployment of surplus liquidity to cushion NIM:** We are factoring a 100bps increase in aggregate loan growth to ~12.5% in FY26/27E, which would be partly funded by balance sheet liquidity. This would reduce dependance on deposits and in turn increase LDR, supporting margins. Combined LCR of top banks was 127% as at Mar'25, which could moderate. Hence, we reduce total balance sheet liquidity for FY26/27E from ~31% of total assets to ~29%. As a result, banks' LDR would rise by 121/173bps to 82.6% each (82.0% in FY25). As banks have reduced WATD rates since Mar'25 by 66-123bps (more cuts may follow), rate transmission to liabilities could happen at a faster pace in this cycle, which may coincide with the fall in loan yields. As a result, while we envisage an 81bps fall in aggregate loan yields over FY25-27E, cost of funds would drop by 70bps. Our total NIM increases by 2/4bps to 3.11%/3.19%.

- **Players with loan growth levers to be top picks**: Loan growth could pick-up from H2FY26 and FY27E loan growth could be higher to our estimates of 12.6%. Sensitivity analysis indicates that, if aggregate credit growth increases by 210bps to 14.7% YoY, a re-rating is likely for the banking sector and total core earnings would get upgraded by 3.6%. Valuation discount of other banks to ICICIB/HDFCB would narrow suggesting higher upgrades. We would prefer

Exhibit 1: PL Universe

Banks	P/ABV	CMP (Rs)	TP (Rs)
SBI	1.0	796	960
BOB	0.8	234	275
Union	0.8	143	160
ICICI	2.3	1,427	1,700
HDFC	2.2	1,965	2,125
Kotak	2.1	2,170	2,400
Axis	1.6	1,221	1,500
Federal	1.3	208	220
CUBK	1.3	191	210
DCB	0.8	143	155

Source: PL

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AXSB among large PVBs since amid surplus liquidity and reduced interest rates, unsecured stress would moderate and raising deposits may not pose a challenge. Within PSUs, we would pick SBI since it would be able to balance growth and profitability given higher NBFC exposure (supporting growth) and relatively larger unsecured exposure (within PSUs) that would protect NIMs.

NBFC and unsecured credit may drive higher loan growth

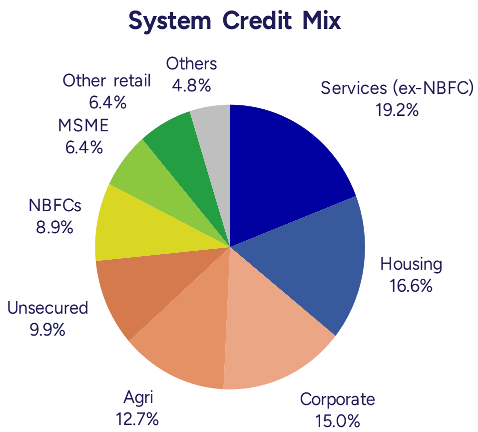
System credit (incl. HDFC) has been slowing down from 13.9% YoY in Jun'24 to 11.1% in Mar'25 and 10.2% in Apr'25 due to slower offtake in housing, agri, NBFC, and unsecured which make up for ~45% of system credit. However, loan offtake in segments like services (ex-NBFCs), MSME and other retail (ex-housing) is holding up well between 12-22%. Housing (contributes 16.6% overall credit) has been slowing down from 13.5% YoY in Jun'24 to 9.8% in Apr'25. Agri (share 12.7%) has been decelerating to 9.2% (17.4% in Jun'24) while NBFC growth has shrunk to 2.9% (share 8.9%) from 8.5% in Jun'24. Unsecured growth has contracted from 14.8% in Jun'24 to 9.2% in Apr'25.

Exhibit 2: System credit growth slows to 10% YoY as at Apr'25 driven by housing, agri, NBFC and unsecured

	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25	Q3FY25	Q4FY25	Apr'25
System Credit*	**13.8%**	**15.7%**	**15.3%**	**15.4%**	**16.3%**	**15.3%**	**15.8%**	**16.3%**	**13.9%**	**13.0%**	**11.1%**	**11.0%**	**10.2%**
Services	15.1%	19.9%	13.1%	15.1%	22.7%	21.5%	22.9%	23.8%	18.8%	15.8%	14.3%	15.8%	14.4%
Housing*	18.5%	19.3%	16.6%	15.5%	14.7%	13.1%	12.9%	13.4%	13.5%	12.6%	11.1%	10.7%	9.8%
Corporate	3.1%	7.5%	4.8%	2.6%	5.4%	4.6%	5.6%	5.7%	6.3%	6.5%	5.1%	6.2%	4.5%
Agri	15.6%	15.9%	11.5%	15.3%	19.7%	16.7%	19.4%	20.0%	17.4%	16.4%	12.5%	10.4%	9.2%
Unsecured	27.8%	28.8%	27.0%	28.9%	29.7%	24.7%	22.6%	19.6%	14.8%	12.4%	10.2%	8.3%	9.2%
NBFCs	19.2%	31.8%	34.0%	29.9%	34.7%	21.9%	15.0%	15.3%	8.5%	9.5%	6.7%	5.7%	2.9%
MSME	41.7%	36.5%	14.1%	12.8%	13.2%	9.7%	12.9%	14.3%	11.5%	15.5%	12.7%	11.8%	11.8%
Other retail	16.0%	20.9%	20.5%	23.4%	24.6%	19.5%	17.7%	15.5%	15.5%	17.4%	17.6%	20.0%	22.5%
Others	-9.1%	-27.6%	15.2%	13.3%	-17.5%	10.0%	14.2%	15.2%	11.3%	18.1%	16.7%	14.2%	17.3%

*Source: RBI, PL. *Includes HDFCL impact*

Exhibit 3: NBFC/unsecured slowing down; jointly contribute ~19.0% to credit

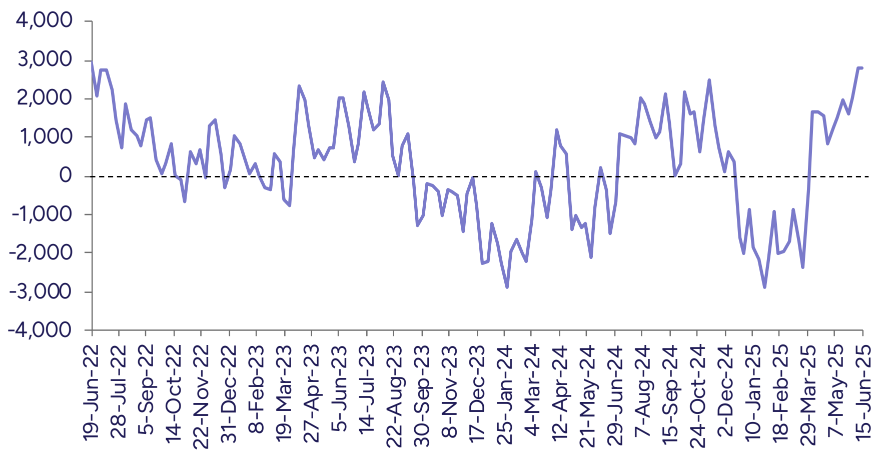


Source: RBI, PL

To spur credit growth, RBI had changed its stance to accommodative since Dec'24 as suggested by (1) CRR cut of 50bps in Dec'24, (2) repo rate cut of 50bps over Feb-Apr'25, (3) purchase of G-Secs by RBI to improve liquidity, (4) postponing the applicability of new LCR guidelines by a year to 1st Apr'26, and (5) relaxation in some requirements of the new LCR framework. Moreover, to enhance system credit flow, RBI, in Feb'25, withdrew the 25% risk weight increase on (1) exposure to NBFCs (w.e.f. 1st Apr'25) and (2) MFI loans by banks, incl. SFBs.

To provide further fillip to credit growth and address future shortfall, if any, in system liquidity, RBI, in its latest policy meet, (1) reduced repo rate by 50bps taking the overall reduction to 100bps since Feb'25, and (2) decided to reduce CRR by 100bps to 3.0% in 4 equal tranches of 25bps, each effective from the fortnight beginning 6th Sep'25, 4th Oct'25, 1st Nov'25 and 29th Nov'25. We have tried to analyze the impact of these measures on parameters of the top 12 banks for FY26/27E and aggregated the same to understand the overall sector impact.

Exhibit 4: System liquidity (Rs bn) has turned positive since Mar'25 end



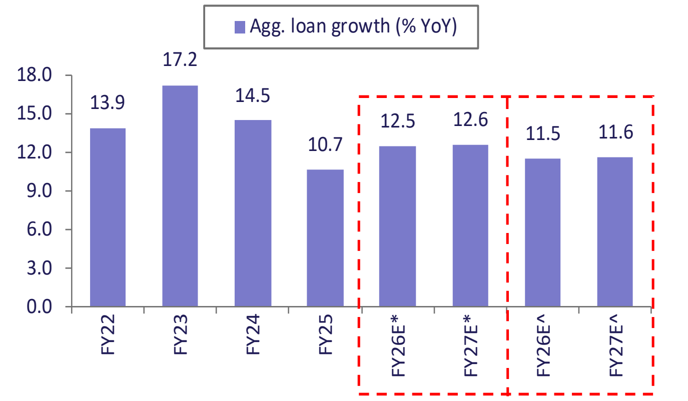
Source: RBI, PL

As a result of the RBI measures, liquidity has been positive since Mar'25 end. However, RBI, in its policy meet on 6th Jun'25, stated that it has changed its stance from accommodative to neutral implying that there may not be any further rate cuts unless domestic macros change materially.

Upgrade in loan growth; to be funded by surplus liquidity

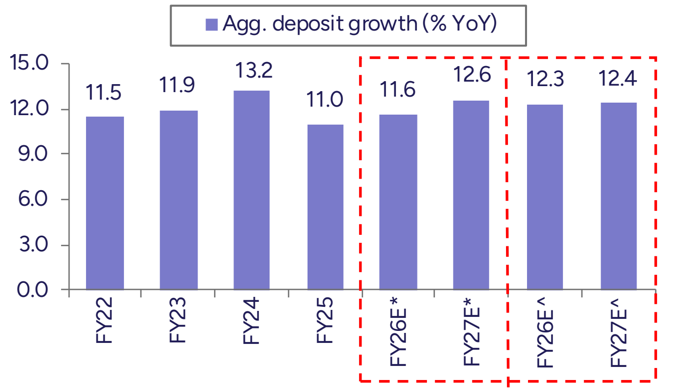
Credit growth has been slowing in the NBFC space (as shown in Exhibit 1) from 15.3% YoY in Mar'24 to 2.9% YoY in Apr'25. Reduction in NBFC risk weights coupled with lower repo rates and increased system liquidity could ease supply-side constraints and increase credit appetite for NBFCs; hence, deployment towards this sector could increase.

Exhibit 5: Agg. loan growth to rise by 100bps for FY26/27E



*Source: Company, PL. Note: *Current estimates ^Previous estimates*

Exhibit 6: Aggregate deposit growth for FY26 to fall by 67bps

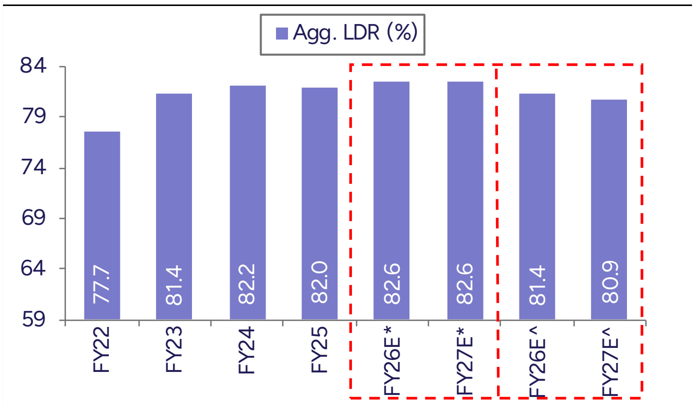


Source: Company, PL

Unlike NBFC credit, while RBI had kept unsecured credit outside the purview of the risk-weight reduction, banks' commentary suggests that stress in PL/CC has peaked. Moreover, increase in tax exemption limit in the recent budget from Rs0.7mn to Rs1.2mn could reduce delinquencies and spur demand. As a result, unsecured credit growth can also improve in FY26 and FY27.

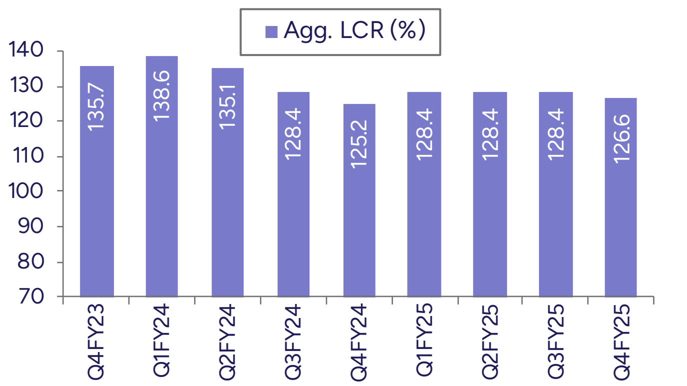
Hence, driven by better offtake in unsecured/NBFC, system credit growth can increase by 100bps to 12% YoY in FY26E/27E compared to 11% in Mar'25. Consequently, we raise credit growth for our coverage banks by 1% each in FY26E.

Exhibit 7: Aggregate LDR to rise by 121/173bps for FY26/27E



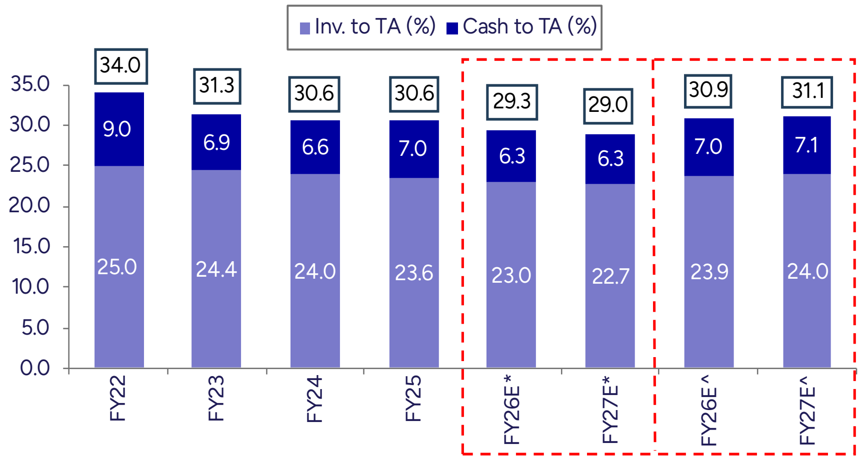
Source: Company, PL

Exhibit 8: Aggregate LCR at a surplus level of 126.6%



Source: Company, PL

Exhibit 9: Balance sheet liquidity to reduce by 154/204 bps to ~29.0%



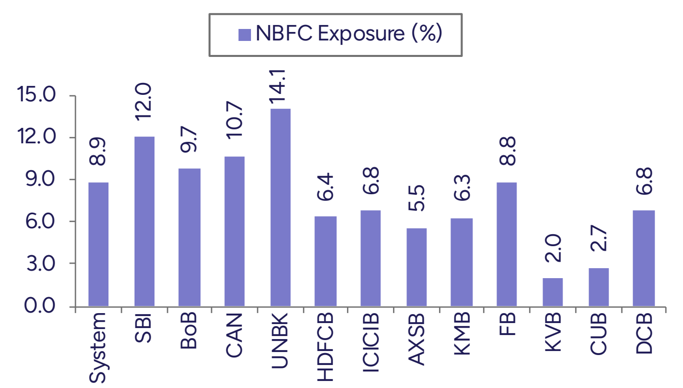
Source: Company, PL

The RBI measures suggest that system liquidity may continue to remain positive. Hence, banks would not be required to maintain higher levels of LCR as seen in FY25. Surplus liquidity could be utilized for loan growth, which would reduce the dependance on deposits and, in turn, increase LDR and cushion margins. Hence, we increase aggregate LDR by 121/173bps for FY26/27E while trim balance sheet liquidity by 154/204bps from ~31% of total assets to ~29%.

While we raise loan growth by 1% for FY26/27E, credit growth could be higher than our assumptions if (1) agri growth picks up owing to normal monsoons also led by enhancing agri-gold growth, and (2) corporate capex cycle improves driven by better utilization levels, which in turn could lead to higher corporate growth.

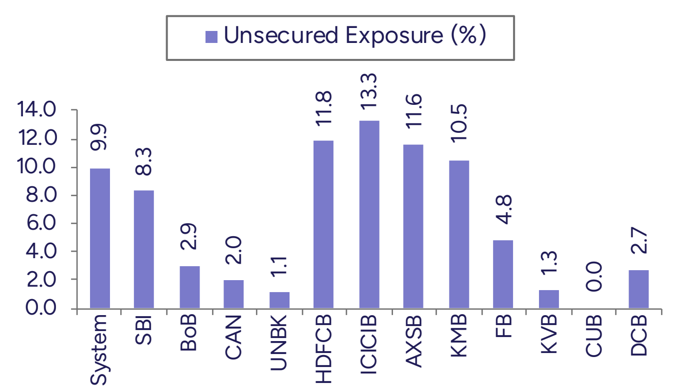
With reduction in risk weights and surplus liquidity, NBFC credit growth could rebound in FY26E. Driven by increase in tax exemption limit and likely decline in stress, unsecured credit could see a fillip. Hence, in the upcoming credit upcycle, players with higher NBFC and unsecured exposure would be preferred. While higher NBFC share would contribute materially to incremental growth owing to larger ticket size, higher unsecured growth would enhance margins.

Exhibit 10: NBFC exposure higher for PSUs vs private banks



Source: Company, PL

Exhibit 11: Unsecured exposure higher for large private banks

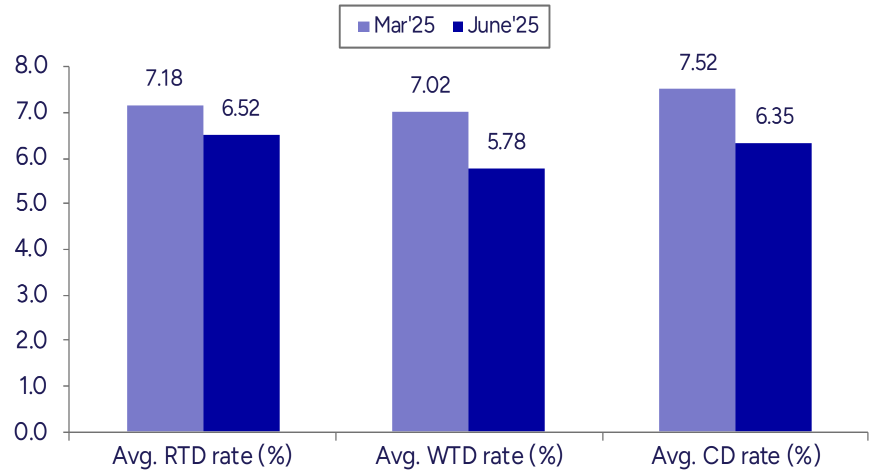


Source: Company, PL

Better profitability but no material change in core earnings

Our earlier estimates had factored a repo rate cut of 75bps: 50bps over Feb-Apr'25, 25bps anticipated in RBI's Aug'25 policy meet. However, RBI preponed the rate cut to Jun'25, and the reduction (50bps) was 25bps higher than our estimates. While prima facie it may seem that NIM estimates would be cut due to EBLR-linked loans for banks, we need to factor in the (1) pace of deposit rate cuts, (2) liquidity cushion due to CRR reduction, and (3) surplus system liquidity.

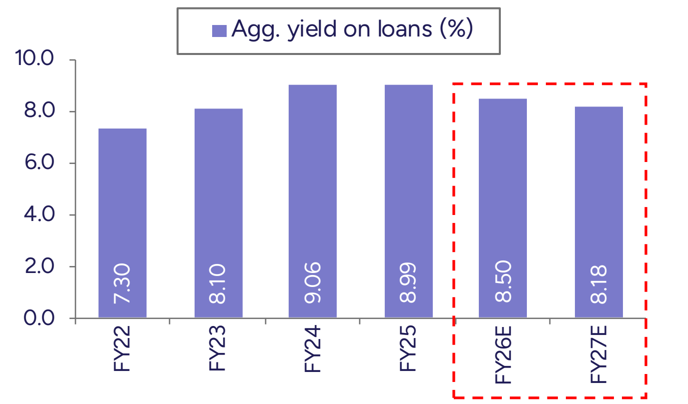
Exhibit 12: Sharp cut in bank deposit rates since Mar'25 by 66-123bps



Source: Company, RBI, PL

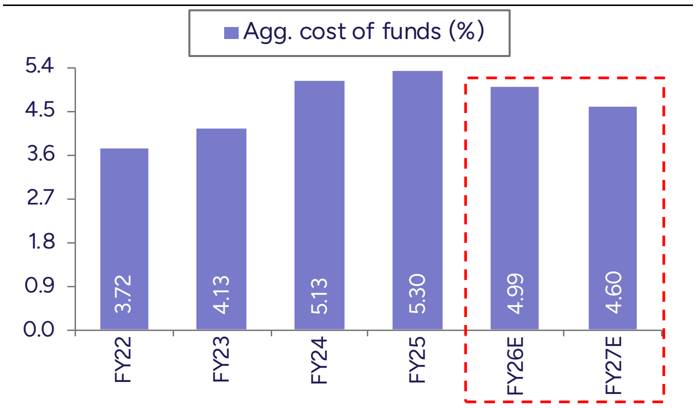
Banks have already cut TD rates sharply. Exhibit 11 suggests that WATD rates of top banks have decreased by 66-123bps, and further TD rate cuts cannot be ruled out. Hence, in the current interest rate cycle, rate decrease is likely to be transmitted to liabilities at a faster pace. Further, we expect reduction in cost of funds to coincide with the fall in loan yields.

Exhibit 13: Aggregate loan yields to fall by 81bps over FY25-27



Source: Company, PL

Exhibit 14: Fall in cost of funds (70bps) to coincide with yields

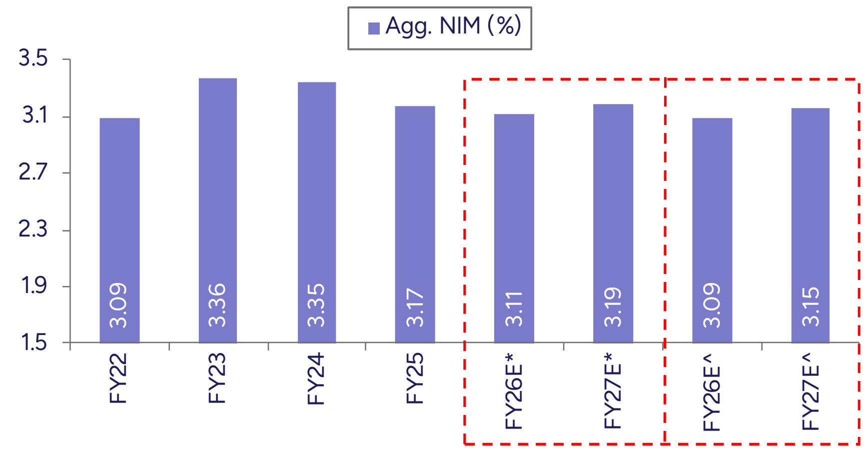


Source: Company, PL

While repo cuts could result in 81bps reduction in aggregate loan yields over FY25-27E, we expect overall cost of funds to decline by 70bps. Due to reduction in balance sheet liquidity and higher LDR, we raise aggregate NIM by 2/4bps for FY26/27E to 3.11%/3.19%. NIM for large banks is upgraded, while that of mid-cap banks is downgraded.

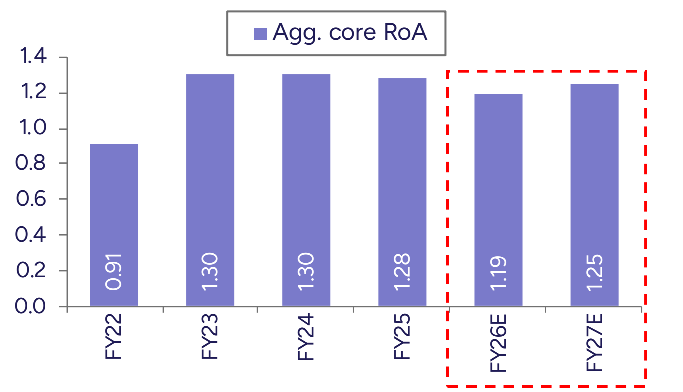
Since NIM is expected to remain soft in FY26, banks could spend lower on operations; however, we have not materially changed our opex estimates. Also, with better system liquidity and lower interest rates, unsecured stress could moderate, which may reduce provision estimates; however, we have kept our credit cost estimates unchanged.

Exhibit 15: Aggregate NIM increased by 2bps/4bps for FY26/27E



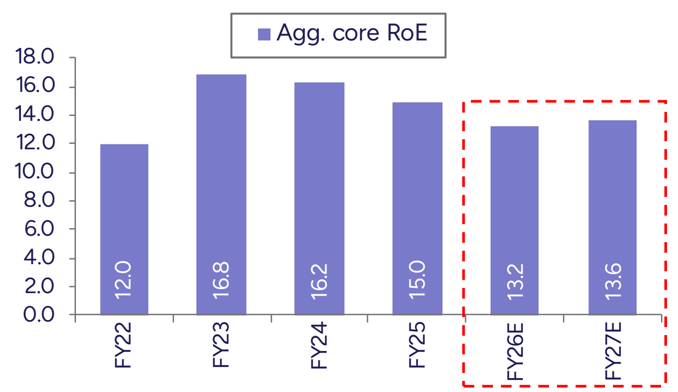
Source: Company, PL

Exhibit 16: Core RoA to rebound by 5bps to 1.25% in FY27E



Source: Company, PL

Exhibit 17: Agg. core RoE to inch up to 13.6% by FY27E



Source: Company, PL, RBI

Sensitivity analysis and our preferred picks

Based on likely sector fundamentals, we may see a pick-up in credit growth from H2FY26, and we may see a credit upcycle in FY27E which could lead to higher than estimated loan offtake. Sensitivity analysis indicates that in case loan growth at 14.7% YoY is 210bps higher than the base case estimates of 12.6%, aggregate core earnings would get upgraded by 3.6%; PSU banks may see a higher re-rating of 5.1%, while core earnings of large private banks could be upgraded by 2.6%.

Owing to higher system credit growth, a re-rating is likely for the banking sector, leading to upgrades in bank multiples. Based on our calculations, multiples and target prices could increase by 5.0-11.0%. Earnings and target price upgrades for PSU banks would be higher than that for larger private peers.

Being sector leaders in terms of fundamentals, HDFCB/ICICB would see upgrade of 6-7% in earnings/target prices; we envisage ICICIB's target multiple to increase to 3.1x from 2.9x. However, valuation discount of other players to ICICIB/HDFCB would narrow in a credit upcycle suggesting higher multiple/TP upgrades.

Exhibit 18: Bull case scenario for FY27E suggests that ~210bps upgrade in loan growth would increase aggregate earnings by 3.6%

Sensitivity	Base Case					Bull Case					
	Loan gr.	Core PAT change	Target multiple	TP (Rs)	*Upside (%)*	Loan gr.	Core PAT change	Target multiple	TP (Rs)	TP upgrade	*Upside (%)*
Aggregate	**12.6%**	**0.6%**				**14.7%**	**3.6%**				
SBI	13.0%	0.0%	1.3	960	*20.6%*	16.0%	6.1%	1.4	1,030	7.3%	*29.4%*
BoB	12.0%	1.5%	0.9	275	*17.4%*	15.0%	4.4%	1.0	290	5.3%	*23.7%*
UNBK	11.0%	-0.8%	0.9	160	*11.5%*	13.0%	4.2%	1.0	175	9.5%	*22.1%*
HDFCB	11.0%	2.7%	2.4	2,125	*8.1%*	13.0%	2.0%	2.6	2,265	6.9%	*15.3%*
ICICB	15.0%	-0.3%	2.9	1,700	*19.1%*	16.0%	1.9%	3.1	1,800	5.9%	*26.1%*
AXSB	13.0%	-1.4%	2.0	1,500	*22.9%*	14.0%	5.0%	2.2	1,670	11.4%	*36.8%*
KMB	16.0%	-1.5%	2.4	2,400	*10.6%*	17.0%	2.1%	2.7	2,600	8.3%	*19.8%*
FB	15.0%	-5.2%	1.3	220	*6.1%*	15.0%	3.0%	1.4	235	6.9%	*13.4%*
CUB	15.0%	1.7%	1.4	210	*10.0%*	16.0%	1.6%	1.5	230	9.5%	*20.5%*
DCB	18.0%	-6.2%	0.9	155	*8.6%*	19.0%	4.0%	0.9	170	9.5%	*19.0%*

Source: Company, PL

Hence, in a higher growth environment, among large private banks, we prefer AXSB owing to greater earnings upgrade. In an environment characterized by surplus liquidity and reduced interest rates, unsecured stress would moderate for AXSB and raising deposits may not pose a challenge.

Within PSUs, we prefer SBI since it would offer a balance between growth and profitability given its higher NBFC exposure (supporting growth) and relatively larger unsecured exposure (within PSUs) that would protect NIMs.

Change in target price

Union Bank: UNBK has consistently demonstrated superior earnings quality to peers in terms of core revenues (NIM/fees) and asset quality. It would continue to deliver steady earnings; we expect core RoA of 0.9% in FY27E. We slightly raise multiple from 0.8x to 0.9x on FY27ABV and increase TP to Rs160 from Rs145.

Exhibit 19: Coverage banks valuation table

Valuation Table	Loan growth		NIM		Provisions		Core RoA		Core RoE		P/ABV	
	FY26E	FY27E	FY26E	FY27E	FY26E	FY27E	FY26E	FY27E	FY26E	FY27E	FY26E	FY27E
SBI	13.0%	13.0%	2.78%	2.84%	0.45%	0.45%	0.84%	0.89%	14.1%	14.5%	1.1	1.0
BoB	12.0%	12.0%	2.71%	2.76%	0.61%	0.61%	0.79%	0.83%	11.2%	11.8%	0.9	0.8
UNBK	11.0%	11.0%	2.66%	2.72%	0.78%	0.79%	0.91%	0.91%	12.7%	12.3%	0.9	0.8
HDFCB	11.0%	11.0%	3.35%	3.46%	0.46%	0.46%	1.61%	1.71%	12.9%	13.6%	2.5	2.2
ICICB	15.0%	15.0%	4.09%	4.15%	0.43%	0.44%	2.06%	2.12%	15.6%	15.7%	2.7	2.3
AXSB	12.0%	13.0%	3.60%	3.66%	0.74%	0.71%	1.54%	1.63%	13.6%	13.8%	1.9	1.6
KMB	16.0%	16.0%	4.37%	4.46%	0.63%	0.58%	1.84%	1.91%	11.2%	11.7%	2.4	2.1
FB	14.0%	15.0%	2.95%	3.04%	0.40%	0.40%	0.96%	1.02%	10.5%	11.3%	1.4	1.3
CUB	14.0%	15.0%	3.28%	3.33%	0.55%	0.55%	1.42%	1.43%	11.7%	12.0%	1.4	1.3
DCB	18.0%	18.0%	3.03%	3.12%	0.50%	0.50%	0.62%	0.70%	8.6%	10.0%	0.8	0.8

Source: Company, PL

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	AAVAS Financiers	Accumulate	2,072	2,038
2	Axis Bank	BUY	1,500	1,207
3	Bank of Baroda	BUY	275	225
4	Can Fin Homes	BUY	860	723
5	City Union Bank	BUY	210	174
6	DCB Bank	BUY	155	113
7	Federal Bank	BUY	220	197
8	HDFC Asset Management Company	BUY	4,600	4,218
9	HDFC Bank	BUY	2,125	1,907
10	ICICI Bank	BUY	1,700	1,407
11	IndusInd Bank	Hold	780	770
12	Kotak Mahindra Bank	BUY	2,400	2,185
13	LIC Housing Finance	BUY	725	621
14	Nippon Life India Asset Management	BUY	700	638
15	State Bank of India	BUY	960	800
16	Union Bank of India	BUY	145	123
17	UTI Asset Management Company	BUY	1,300	1,019

PL's Recommendation Nomenclature

Buy : > 15%
Accumulate : 5% to 15%
Hold : +5% to -5%
Reduce : -5% to -15%
Sell : < -15%
Not Rated (NR) : No specific call on the stock
Under Review (UR) : Rating likely to change shortly

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