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RESEARCH

BANKING | Q1FY26 REVIEW

Credit growth moderation and higher CC impacted profitability

SUMMARY

BANKING: Q1FY26 REVIEW

- Credit growth remains moderate; likely to be supported by retail and MSME segments
- Asset quality moderated; MFI stress likely to improve by H2FY26. Expect Pvt/PSU banks to report PAT CAGR of 16%/11% in FY25-FY28E
- Top picks: ICICIBC, HDFCB, KMB, and SBIN in large caps, while FB and IDFCBK in midcaps

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BANKING | Q1FY26 Review | 22 August 2025

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Credit offtake remains moderate: Credit growth was moderate for our coverage banks (+10.2% YoY; +1.1% QoQ) in Q1FY26 but was marginally above the system growth (+9.5% YoY). Loan growth was largely led by retail and MSME segments, while corporate credit demand remains muted, along with calibrated growth in the unsecured segment given the stress in MFI, PL and the CC space. Further, deposit accretion remains a challenge for coverage banks with growth of 12.4% YoY and 1.2% QoQ. IIB was the only bank under coverage to witness degrowth in both advances and deposits as of Jun'25. Deposit growth was also aided by higher CDs outstanding of Rs 5.2trn (+26% YoY) as of Jun'25. As a result, LDR ratio for most banks declined on a YoY basis. System liquidity eased, driven by RBI infusion of ~Rs. 8.2trn of liquidity since December'24. We expect credit offtake to stay moderate at 11-12% YoY in FY26, largely supported by the retail and MSME segments.

Asset quality moderated; MFI stress likely to improve by H2FY26: AQ moderated with GNPA ratio increasing across most of the banks under coverage on a sequential basis. This was mainly driven by higher slippage across most of the banks due to agri seasonality and stress witness by few banks in MFI, small ticket LAP and retail CV segments. AQ was largely stable in corporate advances. Credit costs (CC) for PSU banks were lower at 0.5%-0.9% vs private banks (0.5%-6.8%) in our coverage. Slippage and credit costs for the sector are expected to improve from H2FY26, given the signs of improvement in SMA portfolio. Further, the implementation of MFIN guardrails will likely reduce stress in MFI book, particularly in newer vintages.

NIMs pressure, elevated credit cost weighed on profitability: NIMs declined sequentially across our coverage universe, driven by decline in yield on advances on account of bank's transmission policy in terms of periodicity, share of fixed vs. floating loans, and falling share of MFI advances. Although banks reduced their savings and term deposit rates, the deposit repricing happens with lag. Profitability was supported by higher treasury profits and contained cost-to-income ratio, partially offset by high CCs. We expect NIMs to remain under pressure and CCs to be elevated till H1FY26 and improve gradually thereafter.

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