PRESS RELEASE

December 27, 2023

Indian banking sector to remain resilient as performance normalises after the highs seen in FY2023-24; outlook remains Positive: ICRA

- **Pressure on NIMs expected to continue, driven by rising deposit costs in FY2024 and thereafter by a likely cut in Repo rates**
- **Credit growth of 12-13% in FY2025 will drive steady operating profits amid pressure on NIMs**
- **Headline asset quality metrics to maintain improving trajectory with GNPAs and NNPAs declining to 2.1-2.5% and 0.5-0.6%, respectively, by March 2025**

ICRA maintains its positive outlook on the banking sector, driven by comfortable asset quality levels, with both corporate and retail portfolios performing well in terms of delinquencies, resulting in limited net-NPA additions. Furthermore, credit growth is expected to remain healthy at 12-13% in FY2025 (16.5% YoY as on December 1, 2023 and +15.4% in FY2023), driven by strong demand in the services and the retail segments.

These factors are likely to be offset by the continued upward repricing of the deposit base in H2 FY2024, leading to compression in interest margins. While this repricing is likely to mostly happen by the end of FY2024, the expectations of a rate cut from August 2024 could start a downward pressure on lending yields and hence pressure on interest margins may continue during FY2025. Despite this, we expect the operating profits for banks to remain steady supported by the loan growth, however, operating profitability levels would witness a mild moderation and stabilise at 1.8-2.0% in FY2024-FY2025 compared to 2.2% in FY2023.

Commenting further, **Mr. Aashay Choksey, Vice President, ICRA** said*: "Incremental credit expansion has been robust so far at Rs. 15.5 trillion (for FY2024 till December 1, 2023), against Rs.18.2 trillion in FY2023. However, as we look beyond this year, credit growth is likely to come off as tight liquidity conditions would eventually weigh down on growth. Besides this, factors including weaker credit demand in the agriculture segment, subdued export demand as well as the recent increase in risk-weights to the unsecured consumer lending & the NBFC segments would ~~also~~ collectively temper credit traction".*

Further, the gross-fresh NPA generation for the banking system is expected to witness a mild increase in FY2025 as portfolios gradually season, although the corporate book asset quality is expected to hold up and slippages are likely to remain granular. Despite the increase, the headline metrics of the banking sector would maintain an improving trajectory on steady recoverability and credit growth. Accordingly, ICRA expects the gross NPAs (GNPAs) and the net NPAs (NNPAs) to decline to 2.1-2.5% and 0.5-0.6%, respectively, by March 2025 from 2.8-3.1% and 0.7%, respectively, expected as on March 31, 2024 (GNPA and NNPA at 4.0% and 1.0% respectively as on March 31, 2023).

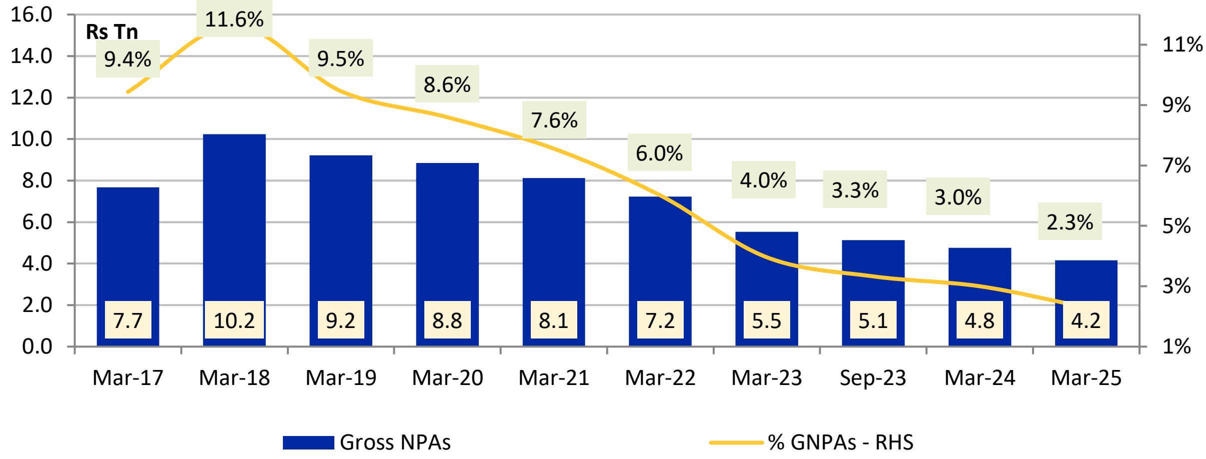
Accordingly, credit costs are estimated to remain benign at 0.7-0.8% of advances in FY2024-FY2025, in line with FY2023. This should allow banks to comfortably maintain their return on assets (RoAs) at 1.0-1.2% in FY2024-FY2025 (1.1% in FY2023). While the RoE is projected to moderate, it is likely to remain healthy at 11.5-12.7% in FY2025 (13.7-14.6% in FY2024E, 13.8% in FY2023), thus meeting a meaningful share of banks' growth capital requirements in FY2025.

While recent regulatory actions like an increase in risk weights for exposure towards unsecured loans and non-banking financial companies, and an eventual transition to the estimate credit loss (ECL)-based framework could have a negative impact on the reported capitalisation levels, however, the capital position for most constituent banks remains comfortable and well placed to absorb these impacts while continuing to grow their respective portfolios at a reasonable pace.

Mr. Choksey added: *"As a result of healthy profitability levels and controlled net-NPA additions, the capitalisation and solvency profile for private and public sector banks continued to improve in H1 FY2024. ICRA estimates that despite recent regulatory changes around increase in risk weights for exposure/lending to unsecured consumer credit and the NBFC segments, capitalisation levels would remain comfortable with Tier-I capital of the banking sector at 14.5-14.9% as on March 2025 (14.4-14.6% E as of March 2024, 14.4% as on March 2023), while improvement in solvency levels would flatten out to 4-6% in F2024-FY2025 (8% as of March 2023)"*

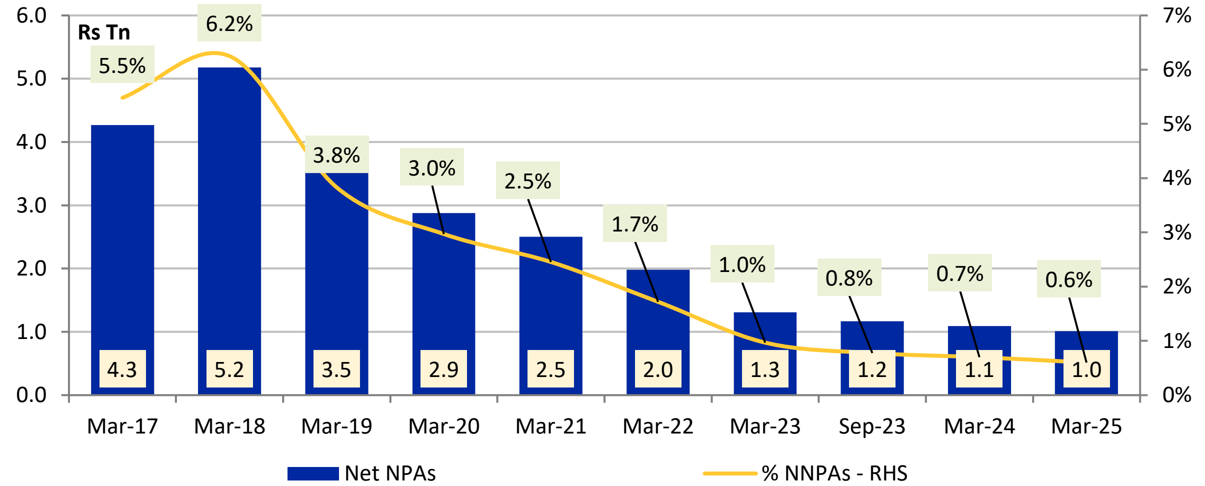
ICRA, however, remains cautious over any material weakening in asset quality levels amid higher interest rates or an unanticipated impact from regulatory changes on banks, in addition to a slowing global growth, which can have a spillover effect on certain export-oriented sectors of the economy, and a tighter liquidity environment, which might exert higher-than-expected moderation in profitability margins.

Exhibit: Gross NPAs – Public + Private sector banks



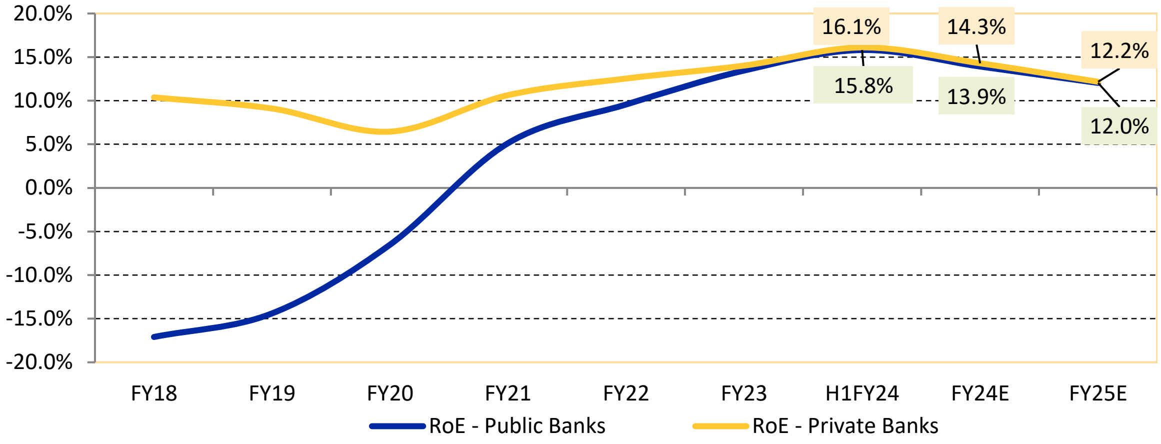
Source: Aggregate of 13 PSBs (including IDBI Bank) and 18 private banks, ICRA Research

Exhibit: Net NPAs – Public + Private sector banks



Source: Aggregate of 13 PSBs (including IDBI Bank) and 18 private banks, ICRA Research

Exhibit: Return on equity – Public and private sector banks



Source: Aggregate of 13 PSBs (including IDBI Bank) and 18 private banks, ICRA Research

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