PRESS RELEASE

April 23, 2025

NBFCs' adequate capital position and healthy earnings performance help absorb headwinds on loan quality and regulatory developments: ICRA

- ***Retail loans estimated to grow by 16-18% in FY2026, slower than the rate seen in previous few fiscals***
- ***Spillover of stress into secured asset segment remains a key monitorable***
- ***Earnings and capital profile lend support to risk profiles in an evolving regulatory environment***

Rating agency ICRA highlighted that non-banking financial companies (NBFCs) are experiencing a moderation in credit expansion at present. Growth in this segment is expected to ease to 13-15% in FY2025 and FY2026 from the 17% expansion witnessed in the previous two fiscals.

Overall, NBFC credit stood at about Rs. 52 trillion in December 2024 and it is set to exceed Rs. 60 trillion in FY2026. Within this, the retail assets, which accounted for 58% of the overall NBFC credit in December 2024, have been the key growth drivers, while other wholesale and infrastructure credit expanded at a stable rate of 10-12% during FY2023-FY2025. The retail assets of NFBCs expanded at compounded annual growth rate (CAGR) of 23% during FY2023-FY2024. ICRA expects this segment to grow at a relatively slower 16-18% CAGR during FY2025-FY2026, given the high base created in the post-Covid expansion of this segment, amid concerns of borrower overleveraging, which has impacted loan quality in some asset segments within this space.

"Some asset segments, largely unsecured loans, namely - microfinance, personal loans, credit cards and unsecured business loans (~28% of retail NBFC credit in December 2024) - have already witnessed higher stress in FY2025 leading to elevated delinquencies and write-offs. While the stress is largely confined to the unsecured loans at present, in a constricted credit flow environment, refinancing ability of some of the borrower segments shall get adversely impacted. Thus, performance-secured loans availed by these borrowers, namely small-ticket vehicle loans and micro and small-ticket mortgage loans etc. shall remain a key monitorable," said **Karthik Srinivasan, Group Head Financial Sector Ratings, ICRA Limited.**

A series of regulatory tightening and entity-specific actions in 2023 and 2024, had a sentimental impact on the various stakeholders and the NBFCs themselves, who began scaling down their growth ambitions and undertook various process-related and borrower-centric initiatives. The recent draft proposal from the regulator on co-lending is expected to expand the scope of such arrangements and improve transparency for borrowers, when implemented. However, it shall require significant changes for the existing arrangements. Similarly, the proposal for gold loans could impact near-term growth and increase competitive pressures for the NBFCs in the space, although it is a step towards improving borrower protection and harmonisation of regulations across players in this segment. Thus, while most of the regulatory actions are expected to have some near-term impact on growth, they augur well for the sector in the long term and most entities have the ability to absorb the near-term impact, if any, considering their strong balance sheets and healthy earnings profile.

" The regulator has been amenable in terms of timely actions when the trends turn favourable - the removal of higher risk weight for bank credit to NBFCs from April 2025 is one such act. The proposals on partial credit guarantee scheme and the securitisation of stressed assets are expected to improve lender/stakeholder diversity for the sector, which is still largely dependent on wholesale/bank funding at present," **Srinivasan** added.

Bank funding constitutes the largest share of the overall funding to NBFCs, thus a slower bank credit expansion shall warrant diversification to other sources. Entities leveraged the overseas funding route in the last fiscal and external commercial borrowing (ECB) approvals in FY2025 is estimated to be nearly twice as high as the previous fiscal. Debt issuances also improved in FY2025 and are expected to remain healthy in the current fiscal, supported by a favourable outlook on interest rate cuts. Moderate loan growth expectations, along with limited dependence on short-term funding at present, bodes well for sectoral liquidity, which is expected to remain adequate, but access to the commensurate funding remains key. ICRA projects the capital profile to remain adequate too; however, some large entities shall be raising capital for meeting regulatory listing requirements, while a few others may explore opportunities to raise capital for managing higher growth expectations.

Competitive pressures shall remain elevated, which will impact margins, notwithstanding the reduction in the cost of funds. ICRA anticipates the rise in credit costs in line with increasing delinquencies, especially in unsecured loan segments, as growth slows down. Overall, the profitability of NBFCs, barring housing finance companies (HFCs), shall witness some headwinds with return on average managed assets (RoMA) projected to decline by about 30-50 bps in FY2025-FY2026 vis-à-vis FY2024 levels. While the HFCs' performance has remained relatively stable, the impact of portfolio seasoning on credit cost remains to be seen.

Overall, ICRA has a stable outlook on the sector, barring NBFC-microfinance, which is expected to witness moderate growth and elevated credit costs even in FY2026, albeit better than FY2025 when it witnessed higher stress. The impact of tightening in microfinance credit norms on borrower leveraging, applicable in FY2026, remains to be seen.

Media Contacts:

Naznin Prodhani
Head Group Media & Corporate Communications
ICRA Ltd
Tel: + (91 124) 4545300,
Email:
naznin.prodhani@icraindia.com

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