PRESS RELEASE

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Regulatory easing to support credit growth of ~10.8% in FY2026; asset quality remains monitorable

- ***Incremental credit projected at Rs. 19.0-20.5 trillion in FY2026***
- ***Margins, profitability to be dampened by likely increase in slippage rate leading to high credit cost***
- ***Net interest margins for the banks to decline by 15-17 bps during FY2026***

ICRA expects the regulatory easing seen in the recent months to support a credit expansion of ~10.8 % in FY2026. Such measures include the repo rate cut, deferment of proposed changes in the liquidity coverage ratio (LCR) framework and additional provisions on infra projects, along with the roll-back of increased risk weights on lending to unsecured consumer credit and non-banking financial companies (NBFCs). Besides this, the durable liquidity infusion by the Reserve Bank of India (RBI) through open market operations (OMO) by way of purchases of Government bonds and forex swaps with banks, would aid the liquidity and faster transmission of the ongoing cut in policy rates. Nevertheless, the persisting challenges in deposit mobilisation, high credit-deposit (CD) ratio and rising stress in the unsecured retail and small business loans would remain a drag on credit growth and accordingly the pace of credit expansion is expected to trail the recent highs seen in FY2024.

Commenting further, **Sachin Sachdeva, Vice President & Sector Head, ICRA** said*: "The pro-growth regulatory stance has revived the lenders' appetite for credit growth in Q4 FY2025 after a brief period of slow incremental credit growth in the initial period of FY2025. Accordingly, ICRA estimates the incremental credit expansion to be around Rs. 19.0-20.5 trillion, clocking a growth rate of ~10.8% in FY2026 compared to credit expansion of Rs. 18.0 trillion or a 10.9% growth rate in FY2025."*

The recent announcements of liquidity injections by the RBI are likely intended to nudge a faster transmission of rate cuts. One of the key challenges, which the banking sector has been facing in the last few years is raising deposits at competitive pricing, especially the retail deposits, given the pressure on the LCR. The increasing competition from other investment avenues and the investors' preference for term deposits have led to a reduction in the share of low-cost current and savings account (CASA) balances, impacting the banks' cost of funds. The challenges are likely to persist in the near term, which is likely to delay the transmission of rate cuts by the RBI to banks' cost of funds, in spite of the recent liquidity measures, thereby impacting the banks' margins.

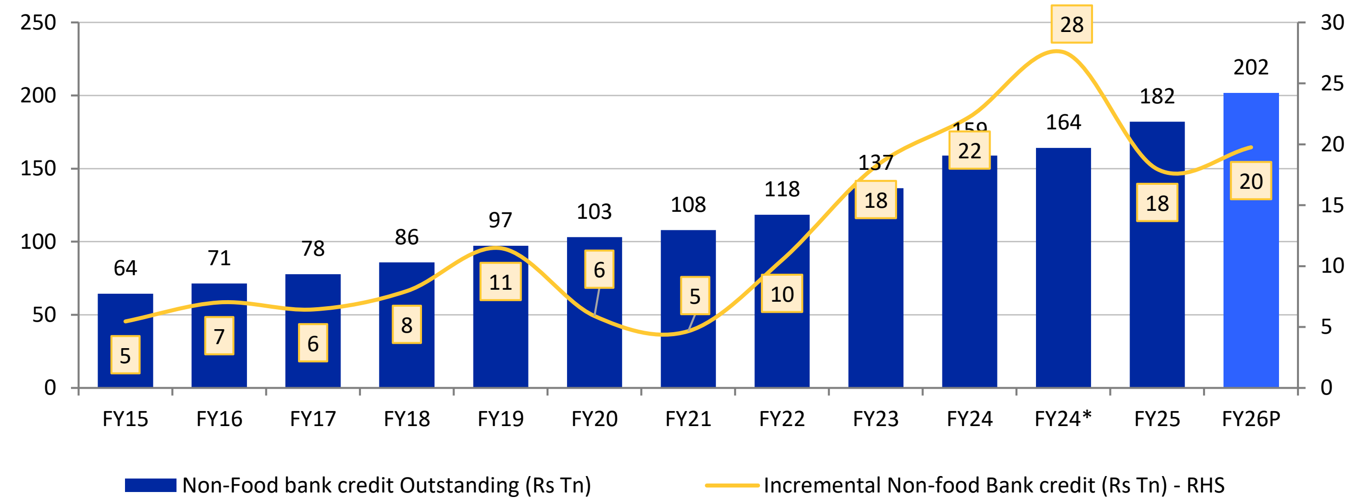
In addition, with the elevated CD ratio, the banking sector's reliance on wholesale deposits has increased, leading to a steady decline in the average LCR of the sector. Though the same remains comfortably above the required level of 100%, it limits the banks' ability to pursue credit growth and necessitates the chasing of retail deposits. Hence while the wholesale deposit rates may decline faster amid liquidity infusion measures undertaken by the RBI, it may still be a challenge for the banks to pass on the rate cuts on retail deposits and lower the cost of deposit meaningfully.

"With an elevated CD ratio, the competition for deposit mobilisation is likely to remain high even during FY2026, which will limit the banks' ability to cut their deposit rates. The lending rates may, however, remain under pressure because of the decline in the external benchmark-linked loans and competition from debt capital markets. With expectations of a cumulative 75 basis points (bps) cut in repo rates from February 2025 onwards, we expect the net interest margins (NIMs) for the banks to decline by 15-17 bps during FY2026," **Sachdeva** added**.**

Asset quality remains monitorable amid broader macro-economic developments and the fresh non-performing advances (NPAs) generation rate is expected to rise in the next few quarters, while the recoveries and upgrades are likely to moderate. Consequently, the quantum of gross NPAs (GNPAs) and credit loss provisions would rise; although the GNPA ratio is estimated to remain range-bound by March 2025 and rise in FY2026. The capital ratios of most banks remain comfortable, with no major growth-related capital requirement in FY2025 and FY2026. Furthermore, supported by internal capital generation and lower net NPA levels, the capitalisation and solvency profiles of banks would remain comfortable.

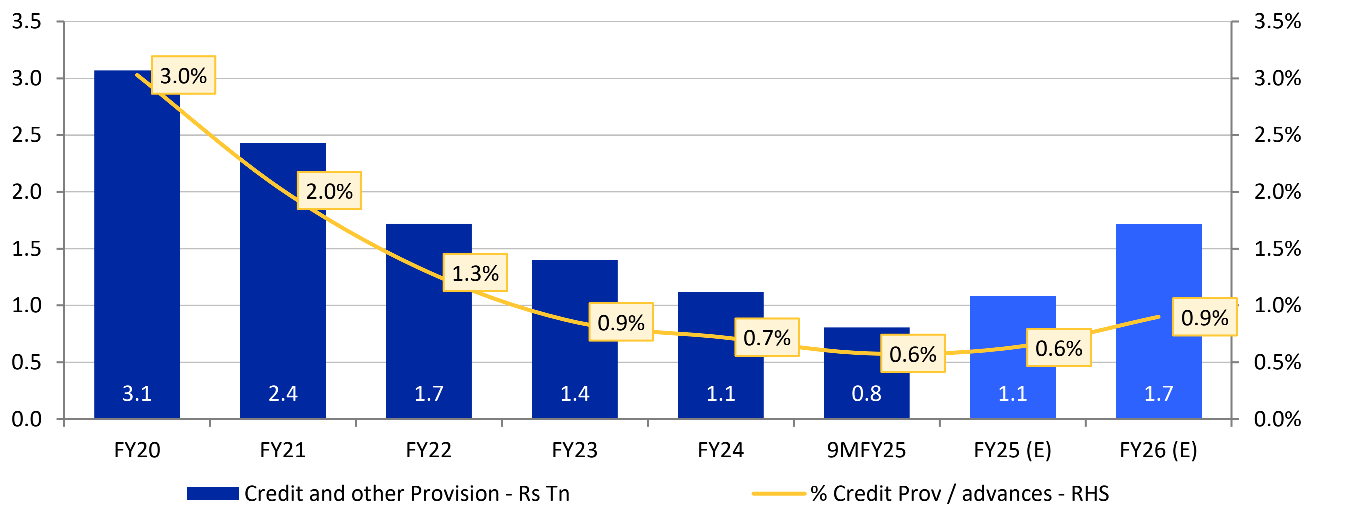
"Though ICRA expects the profitability to trend downwards in FY2026 with the return on assets (ROA) and return on equity (RoE) at 1.1-1.2% and 12.1-13.4% in FY2026 respectively, the same are estimated to remain comfortable for the projected growth without a significant reliance of fresh capital requirements, leading to ICRA's Stable outlook for the sector", added **Sachdeva**.

Exhibit: Credit growth trends



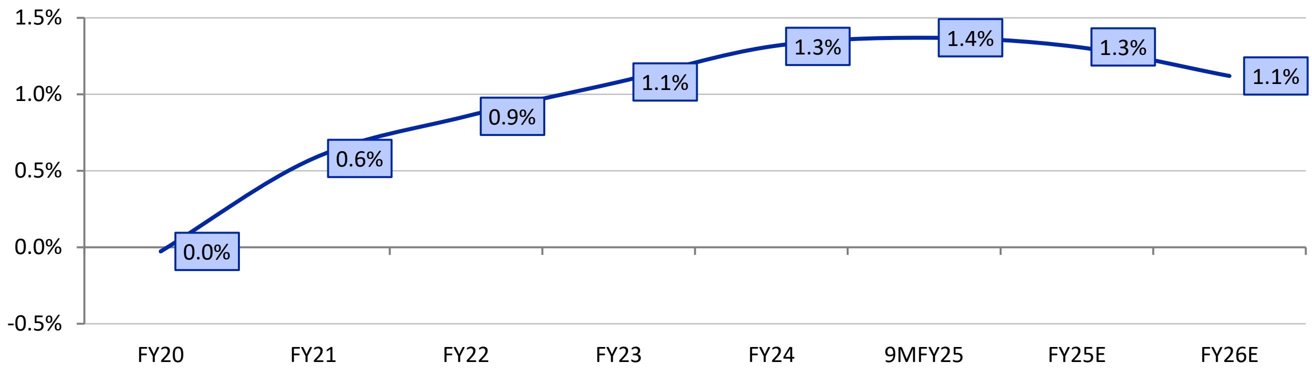
Source: ICRA Research, RBI; FY24 and onwards is including the impact of HDFC merger*

Exhibit: Credit cost to rise slightly in FY2026



Source: Aggregate of 13 PSBs (including IDBI Bank) and 19 private banks, ICRA Research; 9M FY25 % is annualised

Exhibit: Outlook on Return on Assets



Source: Aggregate of 13 PSBs (including IDBI Bank) and 19 private banks, ICRA Research; 9MFY25 is annualised

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