PRESS RELEASE

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Indian Banking Sector - Credit growth to remain subdued for FY2026: ICRA

- ***ICRA revises its credit growth estimate downwards to 10.5-11.0% for FY2025 from its earlier estimate of 11.6-12.5% in FY2025; projects growth at 9.7-10.3% for FY2026***
- ***Though profitability may trend downwards in FY2025 and FY2026, the return indicators are expected to remain comfortable, leading to ICRA's Stable outlook for the sector***

ICRA has revised its credit growth estimate downwards to 10.5-11.0% for FY2025 from its earlier estimate of 11.6-12.5% for FY2025. In its recent report, ICRA highlighted that with the banks focusing on reducing their credit-to-deposit (CD) ratio and reducing their exposures to unsecured retail and non-banking financial companies (NBFCs), the overall credit growth has moderated in the past few months. Consequently, credit and deposit growth has almost aligned with each other and ICRA expects the trend to continue. Further, for FY2026, credit growth may ease to 9.7-10.3%, weighed down by the persisting high CD ratio and implementation of the proposed changes in the liquidity coverage ratio (LCR) framework.

Sachin Sachdeva, Vice President & Sector Head – Financial Sector Ratings, ICRA said*: "The persisting high interest rates and the slowdown in credit growth (especially towards high-yielding advances) would impact the margins of the banking sector. In addition, the rate transmission on yields is estimated to be faster as and when the rate cut cycle begins, which would further compress the margins. Nevertheless, the return indicators are likely to remain healthy with return on assets (RoA) estimated at 1.1-1.2% for FY2026 and at 1.2-1.3% for FY2025 compared to 1.3% in FY2024. With slower credit growth, this is likely to improve the loss-absorption cushions for banks, while remaining sufficient to meet the growth requirements."*

The capital ratios of several banks remain comfortable, and no major growth-related capital requirement is expected for FY2026. Nevertheless, the implementation of the expected credit loss (ECL) framework and increased provisioning for project finance in the medium term is likely to be monitorable.

Raising deposits remains a challenging and costly proposition with the growth in deposits being driven by the expanding term deposits. At the same time, the certificates of deposit outstanding stood at its decadal peak at Rs. 4.9 trillion as on November 29, 2024, higher than the earlier peak of Rs. 4.5 trillion in April 2011. Despite the increase, these remain lower at ~2.5% of total deposits compared to the peak of ~8% of total deposits in the past.

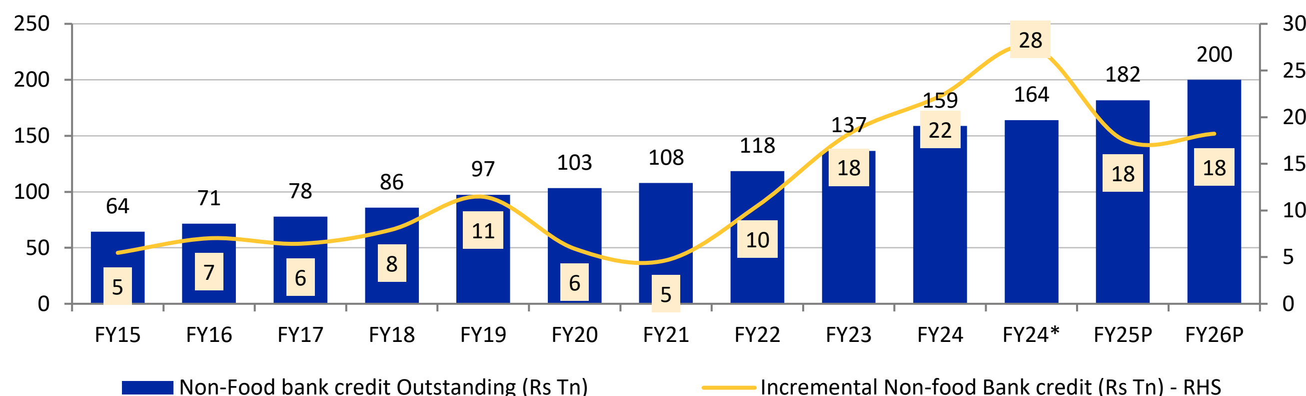
"With the persisting challenges in deposit mobilisation, the bond issuances by banks are expected to surpass previous high and may touch Rs. 1.3 trillion for FY2025 (Rs. 1.09 trillion in 9M FY2025) compared to Rs. 1.02 trillion in FY2024 (Rs. 1.13 trillion in FY2023)," **Sachdeva** added.

On the asset quality front, net additions to non-performing advances (NPAs) remain low, which has helped the sector witness steady reduction in headline asset quality numbers. However, with the retail sector facing increasing stress, the overall fresh slippages are expected to rise, and recoveries/upgrades are likely to gradually taper. The gross fresh NPA generation for all banks for FY2025, is expected to marginally rise to 1.6% in FY2025, from 1.5% in FY2024, though remaining lower than the previous years (2.0% in FY2023, 3.1% in FY2022). The trend is expected to continue in FY2026. Consequently, the quantum of gross NPAs (GNPAs) would rise, although the GNPA ratio is estimated to trend range-bound by March 2025. Thereafter, even the GNPA ratio is likely to inch up in FY2026.

"Though fresh NPA generation rate is expected to see a relative increase in FY2025 and FY2026, the credit costs would see only a mild rise because of lower legacy net NPAs. Moreover, with the existing high provision coverage

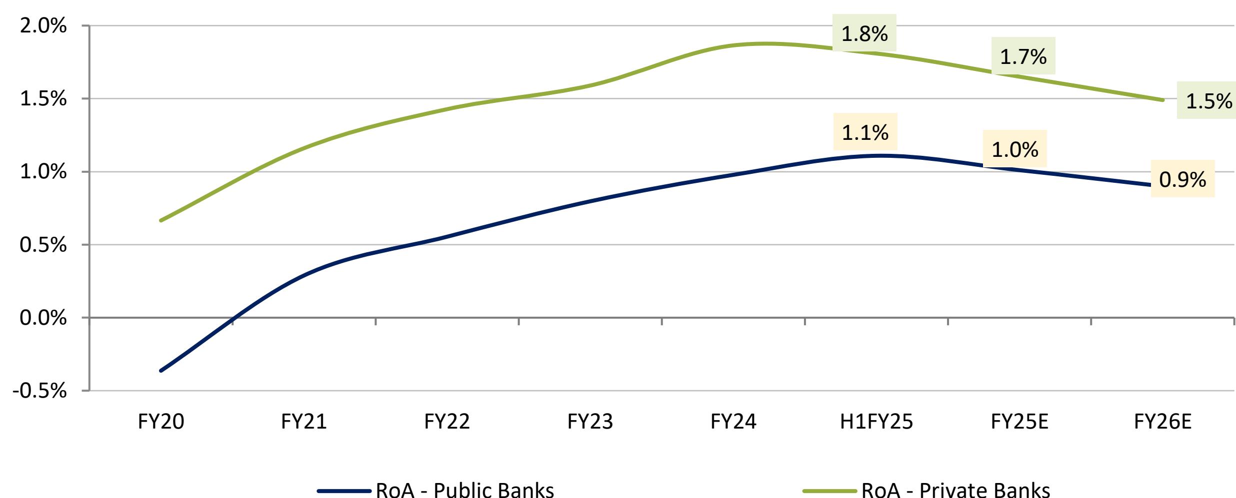
ratio (PCR), banks would have room to take lower incremental provisioning to manage the bottom line. ICRA estimates the credit costs to account for 21-23% of the operating profit of the banking system in FY2025 and 27-30% in FY2026 (~21% in FY2024), compared to 100-150% in FY2018-FY2020," **Sachdeva** added.

Exhibit 1: Credit growth trend



Source: RBI, ICRA Research; FY24 – Excluding impact of HDFC merger; FY24, FY25P and FY26P include impact of HDFC merger*

Exhibit 2: Outlook on RoA



Source: Banks (13 public sector banks including IDBI and 19 large private banks), ICRA Research; E – estimated

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