PRESS RELEASE

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Credit growth to moderate, asset quality pressure to rise: ICRA

- *Credit growth for banks to moderate to 12% for FY2025*
- *NBFCs to also see moderation in growth in AUMs, driven by a slew of regulatory actions*
- *Spillover of stress from unsecured segment to secured segments having similar borrower profile, remains a key monitorable*

Ratings agency ICRA anticipates the slew of regulatory measures and tighter funding conditions in the domestic markets to result in a steady slowdown in credit growth for the lenders, i.e. banks and non-bank financial companies (NBFCs). ICRA estimates the incremental bank credit growth to slow down to Rs. 19.0-20.5 trillion[1] in FY2025, which will translate into a YoY growth of around 12%, compared to Rs. 22.3 trillion[2] in FY2024 (YoY growth of 16.3%). For the NBFCs[3], the growth in assets under management (AUMs) is expected to slow down sharply to 16-18% in FY2025 from 25% in FY2024. The recent regulatory actions on certain entities are expected to push others to adjust their business practices and models, which shall also have a bearing on near-term growth.

The share of the retail segment and the NBFCs in the incremental credit flow of banks declined to 42.9% in 12 months ending August 2024 from 48.9% for the corresponding period of the previous year, driven by slower flow of credit to the NBFCs. As a sizeable portion of bank credit flow to the NBFCs is towards on-lending to the retail segments, overall credit to the retail segment may slow down in the next 12-18 months. While ICRA believes that the demand for retail credit remains strong, the regulatory nudge to prevent overheating in certain segments in the retail space is the key factor driving slower growth. The latter shall moderate the NBFC sector's funding requirement as well, which shall ensure adequate funding available to the players in the space. However, NBFC's cost of funds is expected to remain elevated, considering the high dependence on bank credit.

Anil Gupta, Senior Vice President & Co-Group Head – Financial Sector Ratings, ICRA said*: "The regulatory measures to slow down bank credit growth will be crucial for banks to cut their deposit rates, once the rate cut cycle starts. This will especially be important for maintaining the margins, as the cut in policy rates expected in H1 CY2025 will exert a downward pressure on lending rates. However, the proposed changes in guidelines for liquidity coverage ratio could mean that the immediate cut in deposit rates may not be very substantial, resulting in delayed transmission."*

The high credit growth during the last two years in the retail segment, across the lenders, has potentially resulted in over leveraging in some asset segments, and a slower credit growth can impair the refinancing ability of some these borrowers, as the lenders become risk averse. Such tightening often results in weaker borrowers falling behind in their repayments schedule, thereby increasing the asset quality pressure for the lenders. Loan segments, which have high lending rates or marginal borrower profiles, like microfinance, personal loans, credit cards or unsecured business loans, are already showing rise in delinquencies. ICRA expects these segments, which are largely unsecured, to continue to be a source of stress in the near term, and the spillover to secured asset classes, like micro and small mortgage loans, used vehicles and other small-ticket loans remains a near-term monitorable.

"*As bank funds constitute a larger share in the overall funding of NBFCs, a slower credit flow from banks to the NBFCs will also compress their AUM growth. The NBFCs in unsecured and digital lending businesses shall face a*

[1] Includes the impact of merger of HDFC Limited and HDFC Bank

[2] Excluding the impact of merger of HDFC Limited and HDFC Bank

[3] Retail loans of NBFCs (including Housing Finance companies (HFCs))

higher squeeze in funding compared to others," **A M Karthik, Senior Vice President & Co-Group Head – Financial Sector Ratings, ICRA** said.

Amid concerns on overleveraging, ICRA expects the AUM growth in microfinance loans and unsecured (personal and business) loans by the NBFCs to moderate to 10-12% and 19-21%, respectively, in FY2025 compared to 30% and 38%, respectively, in FY2024. Given the risk aversion of lenders in the unsecured space, the credit demand of the borrowers seems to have shifted towards gold loans, thereby resulting in a higher 18% YoY growth (Q1 FY2025 and FY2024) in gold loans vis-a-vis 12% in FY2023. This growth is also aided by the rise in gold prices, and ICRA expects a similar strong growth in bank AUMs.

"The RBI's recent notification of the deficiencies observed in the gold loans by regulated entities is a push for all the players to tighten their governance practices and processes, with a possible expectation that gold loan demand shall increase as unsecured loans become scarcer," **Karthik** reiterated.

Despite a moderation in growth and asset quality, the risk profiles of the NBFCs shall be supported by the expectation of an adequate liquidity, as growth slows, and the capital profile of the players, which shall offset the risks arising from the uptick in loan quality concerns. The earnings shall remain healthy, notwithstanding the moderation from the high levels witnessed in the last fiscal.

For further information, please contact:

Media Contacts:	
Naznin Prodhani Group - Head Media & Communications ICRA Ltd Tel: + (91 124) 4545300, Dir - 4545860 Email: naznin.prodhani@icraindia.com	**Saheb Singh Chadda** Deputy Manager - Media & Communications ICRA Ltd Mob: +91- 9833669052 Email: saheb.chadda@icraindia.com

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