ICRA

Indian Banking Sector

Regulatory easing to support credit growth in FY2026; though asset quality remains monitorable

MARCH 2025

Agenda

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1 **Credit and Deposit Growth Trends**

2 **Advances –PSBs Gained Market Share in Q3 FY2025 As Well**

3 **Asset Quality and Profitability Trends**

4 **Capital Position and Requirements**

5 **ICRA's Outlook on the Banking Sector**

6 **ICRA's Coverage on the Banking Sector and Sector Aggregates**

Highlights

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Though ICRA expects credit growth to remain moderate and profitability to trend downwards in FY2026, the return indicators are estimated to remain comfortable, leading to ICRA's Stable outlook for the sector.

Overall credit growth has moderated in the past few months with banks focusing on reducing their credit-to-deposit (CD) ratio and reducing their exposures to unsecured retail and non-banking financial companies (NBFCs). Nevertheless, the Reserve Bank of India (RBI) deferring the implementation of proposed changes in the liquidity coverage ratio (LCR) framework and rolling back the increase in risk weights on NBFCs and unsecured retail would help the sector inch-up the pace of credit expansion. Accordingly, ICRA has revised its credit growth estimates upwards to 10.8-11.5% for FY2025 and 10.4-11.2% for FY2026 from its earlier estimates of 10.5-11.0% and 9.7-10.3%, respectively.

Asset quality remains monitorable amid broader macro-economic developments and 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 trend rangebound 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.

ICRA expects the persisting high interest rates on deposits and decline in yields owing to repo rate cuts to impact profit margins. Nevertheless, the return indicators are likely to remain healthy and sufficient to meet most of the growth requirements.

- The YoY credit growth improved slightly to 11.0% on February 21, 2025 from lows of 10.6% as on November 29, 2024, while YoY deposits growth remained moderate at 10.6% as on the same date.
- The headline asset quality metrics continued to improve with the GNPA and net NPA (NNPA) at 2.5% and 0.6%, respectively, as on December 31, 2024 (2.8% and 0.6%, respectively, as on March 31, 2024).
- Profitability remained healthy on the back of benign credit costs, with annualised return on assets (RoA) at 1.4% in 9M FY2025 (1.3% in FY2024).
- The solvency (NNPAs/core equity capital) level stood at 4.5% as on December 31, 2024 (5.1% as on March 31, 2024).
- The RBI's actions are likely to support liquidity, which had been in deficit in the last few months.

Key takeaways

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Stable outlook reflects ICRA's expectation of comfortable asset quality, capital position and earnings

Credit growth expected to remain moderate	▪ The YoY credit growth improved slightly to 11.0% on February 21, 2025, up from recent lows of 10.6% as on November 29, 2024. ICRA revises credit growth estimates for FY2025 and FY2026 upwards slightly. ▪ Challenges in mobilising deposits and stress in the retail unsecured to continue weighing down growth
Asset quality to remain comfortable despite uptick in slippages	▪ Absolute GNPAs and NNPAs expected to decline YoY ▪ Given moderate credit growth, headline asset quality metrics to trend rangebound despite increasing slippages ▪ These though are likely to be granular, unlike bulky corporate slippages in the past
Manageable credit costs to support profitability	▪ Net interest margins (NIMs) to compress due to slowdown in growth (primarily towards high yielding unsecured advances), and yield compression on repo rate cut with cost of funds likely to remain high ▪ Banks may begin to cut down on discretionary operating expenses, though tech spends are expected to continue ▪ Credit provisions to rise but remain benign, which would help keep RoA/return on equity (RoE) at heathy levels
Incremental improvement in capital and solvency position to remain limited	▪ Limited regulatory or growth-led fresh capital requirements for most banks in FY2026 ▪ Capital cushions to remain healthy as slower credit growth would reduce growth led capital consumption ▪ Transitioning to expected credit loss (ECL) norms remains monitorable; however, no near-term implementation seen, thereby providing cushion to banks.

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Thank You!