ICRA

Indian Banking Sector

Margins to be under pressure given repo rate cuts; asset quality remains monitorable

JUNE 2025

Agenda

1 Repo Rate Cuts and NIMs

2 Credit and Deposit Growth Trends

3 Trend in Advances – PSBs & PVBs

4 Asset Quality and Profitability Trends

5 Capital Position and Requirements

6 ICRA's Outlook and Coverage on Banking Sector

Highlights

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ICRA estimates a decline of 10-15 basis points (bps) in NIMs in FY2026 owing to repo rate cuts.

ICRA expects the profitability to trend downwards in FY2026; however, the return indicators are likely to remain comfortable, leading to ICRA's Stable outlook for the sector.

Repo rate cuts by the Reserve Bank of India (RBI) along with other measures, like the cut in the cash reserve ratio (CRR), the revised liquidity coverage ratio (LCR) norms and the rollback of increased risk weights on lending to non-banking financial companies (NBFCs), are expected to facilitate credit expansion in the economy. However, the net interest margins (NIMs) of banks would face further pressure, given the high share of external benchmark lending rate (EBLR) linked loans. This would lead to the faster transmission of repo rate cuts on yields while the cost of funds takes time to adjust to the lower rates. Thus, ICRA estimates a decline of 10-15 basis points (bps) in the NIMs in FY2026.

ICRA expects credit expansion of Rs. 19.0-20.5 trillion (year-on-year (YoY) growth of 10.4-11.3%) in FY2026 compared to Rs. 18.0 trillion (YoY growth of 10.9%) in FY2025. The asset quality remains monitorable amid broader macroeconomic developments. The fresh non-performing advances (NPA) generation rate is expected to rise in the next few quarters while recoveries and upgrades are likely to moderate. Consequently, the quantum of gross NPAs (GNPAs) and credit loss provisions would increase, although the GNPA ratio is expected to remain range-bound as of March 2026 compared to March 2025 level. The capital ratios of most banks remain comfortable, with no major growth-related capital requirement in FY2026.

ICRA expects the profit margins to decrease in FY2026 owing to the likely decline in NIMs and the increase in credit costs. Nevertheless, the return indicators would remain healthy and sufficient to meet most of the growth requirements.

- The YoY credit growth was lower at 8.8% as on May 30, 2025 compared to 10.9% as on March 21, 2025, while YoY deposit growth stood at 9.9% as on the same date.
- The headline asset quality metrics continued to improve with the GNPA and net NPA (NNPA) at 2.3% and 0.5%, respectively, as on March 31, 2025 (2.8% and 0.6%, respectively, as on March 31, 2024).
- Profitability remained healthy on the back of benign credit costs, with the return on assets (RoA) at 1.4% in FY2025 (1.3% in FY2024).
- The solvency (NNPAs/core equity capital) level stood at 3.8% as on March 31, 2025 (5.1% as on March 31, 2024).
- The RBI's actions are likely to support liquidity and push credit expansion.

Key takeaways

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

Credit growth to remain moderate	▪ YoY credit growth moderated to 8.8% as on May 30, 2025 – the lowest level seen in three years (post March 2022); ICRA retains its credit growth estimate of 10.4-11.3% for FY2026 ▪ Challenges in mobilising deposits and stress in the retail unsecured segment to continue weighing down growth; while regulatory measures would support liquidity supply and credit growth
Asset quality to remain comfortable despite uptick in slippages	▪ Absolute GNPAs and NNPAs expected to witness YoY uptick ▪ Given moderate credit growth, headline asset quality metrics to stay range-bound despite increasing slippages ▪ However, these are likely to be granular, unlike bulky corporate slippages in the past
Manageable credit costs to support profitability	▪ NIMs to compress due to yield compression on repo rate cuts, while cost of funds taking time to adjust to lower levels. Slowdown in growth (primarily towards high-yielding unsecured advances) also to impact yields ▪ Banks may begin to cut down 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 ▪ Transition 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!