ICRA

FINANCIAL MARKETS & BANKING UPDATE VOL. 1: FY2025-FY2026

Bank credit growth moderated, while bond issuances scaled new highs in Q1 FY2026; latter likely to ease in H2 FY2026

JULY 2025

Abbreviations

AUM: Assets Under Management	FY: Financial Year	NBFC: Non-Banking Financial Company
BSNL: Bharat Sanchar Nigam Limited	G-Sec: Government Securities	NSDL: National Securities Depository Limited
CASA: Current and Savings Account Ratio	GDP: Gross Domestic Product	NSO: National Statistical Office
CAD: Current Account Deficit	GFCE: Government Final Consumption Expenditure	OMO: Open Market Operations
CD: Certificates of Deposit	GFCF: Gross Fixed Capital Consumption	PFCE: Private Final Consumption Expenditure
CDSL: Central Depository Services (India) Limited	GoI: Government of India	PSB: Public Sector Bank
CEA: Central Electricity Authority	GST: Goods and Services Tax	PVB: Private Sector Bank
CIC: Currency in Circulation	GVA: Gross Value Added	QoQ: Quarter on Quarter
CP: Commercial Paper	HFC: Housing Finance Company	RBI: Reserve Bank of India
CPI: Consumer Price Index	IDBI: The Industrial Development Bank of India	RDB: Rupee Denominated Borrowings
CMB: Cash Management Bills	IIP: Index of Industrial Production	SIAM: Society of Indian Automobile Manufacturers
CRR: Cash Reserve Ratio	IPO: Initial Public Offer	SIDBI: Small Industries Development Bank of India
CWP: Currency with Public	IMD: Indian Meteorological Department	SCB: Schedule Commercial Bank
CY: Calendar Year	INR: Indian National Rupee	SDL: State Development Loans
DII: Domestic Institutional Investors	JV: Joint Venture	SLR: Statutory Liquidity Ratio
DIPP: Department of Industrial Policy and Promotion	LAF: Liquidity Adjustment Facility	TLTRO: Targeted long-term repo operations
ECBs: External Commercial Borrowings	LIBOR: London Interbank Offered Rate	T-Bill: Treasury Bill
EM: Emerging Markets	LPA: Long Period Average	TTM: Trailing Twelve Months
FAR: Fully Accessible Route	LRS: Liberalised Remittance Scheme	UAE: United Arab Emirates
FCCBs: Foreign Currency Convertible Bonds	LTRO: Long-term repo operations	$: United States Dollar
FCI: Food Corporation of India	MGNREGA: Mahatma Gandhi National Rural Employment Guarantee Act	VRR: Variable Rate Repo
FDI: Foreign Direct Investment	MPC: Monetary Policy Committee	VRRR: Variable Rate Reverse Repo
FII: Foreign institutional Investment	MSCI: Morgan Stanley Capital International	WoS: Wholly Owned Subsidiary
FPI: Foreign Portfolio Investment	MSF: Marginal Standing Facility	WPI: Wholesale Price Index
FPO: Follow on Public Offer	NABARD: National Bank for Agriculture & Rural Development	WACR: Weighted Average Call Rates
FSB: Fully Serviced Bonds	NDTL: Net Demand & Time Liabilities	YTD: Year to Date

Agenda

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3 Inflation

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5 Money Supply, Liquidity, and Yields

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Highlights – I

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The 10-year G-Sec yield is likely to trade at 6.15-6.35% in the remainder of CY2025.

FPIs turned net buyers in the Indian markets, with inflows amounting to a marginal $0.4 billion in Q1 FY2026; ICRA remains circumspect around FPI flows in FY2026, amid heightened uncertainty owing to geopolitical tensions and reciprocal tariff negotiations with the US.

- **India's yield curve steepens at the end of June 2025:** The 10-year G-Sec yield eased in April and May 2025, declining to 6.22% as on May 30, 2025 (from 6.36% as on April 30, 2025), down from 6.58% as on March 31, 2025. Despite another rate cut by the RBI in its June 2025 policy, the 10-year G-Sec yield firmed up in June, closing at 6.32% as on June 30, 2025, as the Central Bank reverted its stance to 'neutral', dampening market expectations of further rate cuts. The 91-day T-Bill continued to soften during Q1 FY2026 and closed at 5.41% as on June 30, 2025 (5.63% as on May 31, 2025, 5.93% as on April 30, 2025, 6.37% as on March 31, 2025). Following the marginally lower-than-projected CPI inflation print for Q1 FY2026, ICRA expects the Q2 FY2026 print to materially undershoot the MPC's current forecast of 3.4% amid a benign outlook for July 2025, setting the stage for a 25 bps rate cut in August 2025. Looking ahead, we expect the 10-year G-Sec yield to trade at 6.15-6.35% in the remainder of CY2025, presuming a rate cut in August 2025.

- **Bond issuances scaled new highs in Q1 FY2026:** The bond issuances usually remain weak in Q1; however, Q1 FY2026 witnessed strong issuances of Rs. 3.6 trillion (Rs. 2.7 trillion in Q4 FY2025, Rs. 1.8 trillion in Q1 FY2025). The sharp fall in bond yields amid a slower pass-through of repo cuts to banks' lending rates led to higher bond issuances and slow bank credit accretion in Q1 FY2026. Of the issuances in Q1 FY2026, the share of NBFCs, corporates and banks stood at 53%, 39% and 8%, respectively. Looking ahead, the bond issuances are likely to be driven by NBFCs given the still cautious approach of the banks towards funding to them along with the yields remaining attractive. ICRA expects the conditions to remain conducive for bond issuances and, hence, estimates bond issuances to remain healthy at Rs. 11.1-11.7 trillion in FY2026.

- **India saw marginal net FPI inflows of $0.4 billion in Q1 FY2026, led by the equity segment:** After remaining net sellers in the last two quarters of FY2025, FPIs turned net buyers in the Indian markets (equity, debt and hybrid) in Q1 FY2026; albeit with inflows amounting to a muted $0.4 billion in the quarter. The turnaround in aggregate FPI flows in Q1 FY2026 mainly stemmed from the equity segment that recorded inflows of $4.5 billion (-$13.4 billion in Q4 FY2025), with the temporary pause in reciprocal tariffs and the rising expectation of finalisation of trade deal between India and the US boosting investor confidence in the latter part of the quarter. However, the debt segment saw outflows of $4.1 billion in Q1 FY2026 (over +$5.6 billion in Q4 FY2025). Looking ahead, ICRA remains circumspect around FPI inflows in FY2026, amid heightened uncertainty from geopolitical tensions, and reciprocal tariff negotiations of the US with other countries.

Highlights – II

Net FDI inflows for FY2025 close out positive for \$2.3 billion (\$10.1 billion in FY2024) due to the push in Q4 FY2025, which alone garnered \$0.7 billion in the tally.

LRS remittances pick up pace in Q4 FY2025 but remain 7% lower than FY2024.

Gross ECB approvals cross \$60 billion in FY2025 due to sizeable approvals in Q4 FY2025.

India's GDP growth is expected to moderate to 6.1-6.5% in Q1 FY2026 from 7.4% in Q4 FY2025, amid early onset of the monsoon and escalation of geopolitical tensions; GDP growth in FY2026 is expected to ease to 6.2% from 6.5% in FY2025.

- **Net FDI inflows (incl. reinvested earnings) turned positive in Q4 FY2025:** Net FDI inflows moderated to \$2.3 billion during FY2025 compared to \$10.1 billion in FY2024 (\$28.0 billion in FY2023). There was a surge in the gross FDI inflows to India during Q4 FY2025 while the repatriations reached the highest tally in the recent years. Excluding the effects of reinvested earnings, the net FDI flows recorded an outflow of \$14.7 billion in FY2025 compared to outflow of \$3.9 billion in FY2024 (net inflow of \$13.3 billion in FY2023). Trade and tariff dynamics along with geopolitical tensions have cast a shadow of uncertainty for FDI expectations in FY2026.
- **LRS outflows in FY2025 set aside their record-breaking streak:** Remittances under the LRS witnessed moderation during FY2025, easing to \$29.6 billion from \$31.7 billion in FY2024. Nonetheless, remittances for Q4 FY2025 were \$7.3 billion, 5% higher YoY than \$6.9 billion in Q4 FY2024, indicating a resurgence after the dampening related to tax changes seen in the preceding few quarters.
- **ECB approvals remained sizeable in FY2025:** Gross ECB approvals for FY2025 totalled \$61.2 billion with the addition of \$17.9 billion in Q4 FY2025. ECB approvals (net of refinancing) stood at \$51.2 billion for FY2025, breaching the \$43.2 billion registered in FY2024. ICRA estimates gross ECB approvals at \$50-55 billion for FY2026 amid the subdued incremental lending to NBFCs by the banks even as softened domestic yields sweeten the deal for INR-borrowings.
- **India's GDP growth likely to weaken to 6.1-6.5% in Q1 FY2026:** While the rabi output and summer crop sowing was healthy, the industrial volume growth eased in April-May 2025 over Q4 FY2025, partly owing to an early onset of the monsoon and excess rainfall. Moreover, the performance of service sector indicators was mixed during this period. Additionally, trends for investment activity remained muted in Q1 FY2026, amid escalation of geopolitical tensions. Based on these trends, ICRA anticipates the GDP growth to decelerate to 6.1-6.5% in Q1 FY2026 from 7.4% in Q4 FY2025. Looking ahead, the outlook for private consumption and Government investment appears relatively sanguine. However, that for merchandise and IT exports, and private capex, seems muted; although the relative tariff scenario will evolve as the year progresses. Overall, ICRA estimates the GDP to grow by 6.2% (+6.5% in FY2025) and GVA at basic prices to rise by 6.0% (+6.4% in FY2025) in FY2026.

Highlights – III

CPI inflation moderated to 2.7% in Q1 FY2026, the lowest quarterly reading since Q1 FY2020, aided by cooling in food items, especially vegetables.

ICRA expects CPI inflation in Q2 FY2026 to undershoot MPC's estimate of 3.4%, which would prompt them to pare its FY2026 forecast further from 3.7%. We anticipate a rate cut of 25 bps in the August 2025 policy.

Liquidity conditions turned favourable in Q1 FY2026, aided by injection measures taken by the RBI, dividend pay-out to GoI and capital inflows.

The phased 100 bps reduction in CRR, will support liquidity conditions in the near term.

- **CPI inflation cooled to 2.7% in Q1 FY2026, undershooting MPC's estimate of 2.9%:** The headline CPI inflation dipped to 2.7% in Q1 FY2026 (the lowest since Q1 FY2020) from 3.7% in Q4 FY2025, falling below the MPC's June 2025 forecast of 2.9% for the quarter. This was largely led by the food and beverages (F&B) segment (to +1.1% in Q1 FY2026 from +4.1% in Q4 FY2025), amid deflation in vegetables (-14.8% over +1.1%) and pulses (-8.4% over -0.2%). Kharif sowing has progressed healthily so far, with the area sown growing by 6.6% YoY as on July 11, 2025. Looking ahead, the IMD's forecast of above normal rainfall in July 2025 augurs well for the progression of kharif sowing, given that nearly ~50% of overall sowing typically takes place in July. However, ICRA remains watchful of heavy rainfall and flooding events across some states, which could damage already sown crops and consequently impact food prices.
- **Benign domestic CPI prints to create space for final 25 bps rate cut in August 2025 policy:** Following the marginally lower-than-projected CPI inflation print for Q1 FY2026, ICRA expects the Q2 FY2026 print to materially undershoot the MPC's current forecast of 3.4% amid the benign outlook for July 2025 (~1.9%), which is likely to prompt the MPC to cut its FY2026 CPI inflation projections further from 3.7% currently. While we expect the GDP growth to decelerate sharply in Q1 FY2026, this data will only be available at end-August 2025, i.e., after the MPC's meeting. Overall, we anticipate a final 25 bps rate cut in the August 2025 meeting, carrying forward the front-loading seen in June 2025.
- **Surplus liquidity to prevail in near term:** The average systemic liquidity transited to a surplus of Rs. 2.0 trillion (+0.8% of NDTL) in Q1 FY2026 from the deficit of Rs. 1.6 trillion in Q4 FY2025 (-0.7% of NDTL). This was driven by the sizeable liquidity infusion measures undertaken by the RBI, a turnaround to dollar inflows (net FPI flows: to +$0.4 billion in Q1 FY2026 from -$7.8 billion in Q4 FY2025), a decline in the GoI's cash balances (to Rs. 2.9 trillion on June 27, 2025 from Rs. 3.5 trillion on March 21, 2025), and a record RBI dividend pay-out of Rs. 2.7 trillion to the GoI. As on June 27, 2025, durable liquidity surplus stood at an elevated Rs. 5.8 trillion or 2.4% of NDTL. Going forward, currency with the public is likely to moderate in the ongoing quarter, owing to seasonality. Additionally, the phased reduction in CRR by 100 bps to 3.00% of NDTL during September-November 2025, the busy season, is likely to inject primary liquidity of Rs. 2.5 trillion, which is expected to support the liquidity conditions in the near term.

Highlights – IV

YoY deposit growth is estimated at 10.5-11.3% in FY2026. Incremental deposits are projected at Rs. 23.8-25.5 trillion in FY2026 (including the HDFC merger).

Incremental credit expansion is projected at Rs. 19.0-20.5 trillion in FY2026 translating to a YoY growth of 10.4-11.3% in FY2026.

- **Deposit accretion remained healthy in Q1 FY2026:** The deposit accretion remained strong at Rs. 8.5 trillion in Q1 FY2026 as on June 27, 2025. The outstanding deposits of the banking system rose to Rs. 234.3 trillion (+10.1% YoY growth) as on June 27, 2025 from Rs. 212.9 trillion as on June 28, 2024 (+11.1% YoY growth). Excluding the HDFC Ltd–HDFC Bank merger, the outstanding deposits stood at Rs. 233.7 trillion as on June 28, 2025 (+10.3% YoY growth). The CD outstanding stood at Rs. 5.1 trillion as on June 27, 2025 (Rs. 5.3 trillion as on March 21, 2025, Rs. 4.1 trillion as on June 28, 2024). Despite surplus liquidity in the system in Q1 FY2026, the CD remained elevated, which could indicate expectation of pickup in credit growth by the banks. While the CD outstanding as a percentage of total deposits declined to 2.2% as on June 27, 2025 from 2.4% as on March 21, 2025, it was higher than 1.9% as on June 28, 2024. ICRA estimates deposit accretion at Rs. 23.8-25.5 trillion (10.5-11.3% growth) in FY2026 while outstanding deposit (including the impact of the HDFC merger) is estimated at Rs. 249.6-251.3 trillion by March 2026.

- **Credit accretion in Q1 FY2026 weakest since Q2 FY2022:** Incremental NFBC expansion stood at Rs. 2.1 trillion in Q1 FY2026 (till June 27, 2025); and was significantly weaker than Rs. 4.6 trillion in Q4 FY2025 (till March 21, 2025) and Rs. 4.4 trillion in Q1 FY2025 (till June 28, 2024). The credit accretion in Q1 FY2026 was weakest since Q2 FY2022 (Rs. 1.0 trillion). Excluding the merger, incremental credit expansion for Q1 FY2026 stood at Rs. 2.4 trillion, which was significantly weaker than Rs. 4.8 trillion in Q4 FY2025 (till March 22, 2025) and Rs. 4.7 trillion in Q1 FY2025 (till June 28, 2024). Including the merger of HDFC Ltd., credit outstanding stood at Rs. 184.2 trillion as on June 27, 2025 (9.3% YoY over Rs. 168.5 trillion as on June 28, 2024, +1.2% QoQ over Rs. 182.1 trillion as on March 21, 2025). Repo rate cuts by the RBI and other measures, like the cut in the CRR, the revised liquidity coverage ratio (LCR) norms and the rollback of increased risk weights on lending to NBFCs, are expected to facilitate credit growth. ICRA anticipates credit expansion of Rs. 19.0-20.5 trillion, clocking a growth rate of 10.4-11.3% in FY2026 over credit expansion of Rs. 18.0 trillion or a 10.9% growth rate in FY2025. Accordingly, ICRA forecasts credit outstanding at Rs. 201.1-202.6 trillion by March 2026, including the HDFC merger.

Note: Data for Q4 FY2025 is from December 27, 2024 to March 21, 2025, data for Q3 FY2025 is from October 4 to December 27, 2024*

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Thank You!