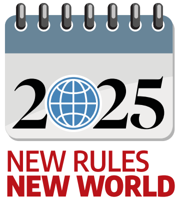
CRISIL ANALYSIS

Credit growth for banks, NBFCs to rise; asset quality, earnings seen range bound

Strong fundamentals will steer these sectors through the evolving regulatory, and macroeconomic landscape

Banks and non-banking financial companies (NBFCs) are poised for a slight uptick in growth this financial year, on the back of expected pickup in consumption demand in the second half driven by government and regulatory measures.

For banks, credit growth is estimated at 11-12 per cent this financial year — a tad higher than last year's 11 per cent. The expected reversal of corporate bond market substitution will also aid this growth. Confirming this trend, bank credit growth accelerated 93 basis points (bps) on-month to 11.3 per cent in October, snapping out of a lacklustre first half.



This growth is spearheaded by the retail portfolio with a boost to consumption from four fronts: Goods and services tax (GST) rationalisation, lower interest rates, benign inflation and personal tax cuts. Further support will come from the Reserve Bank of India's (RBI) measures to enhance systemic liquidity, including the cut in cash reserve ratio, revised liquidity coverage ratio norms, rollback of higher risk weights on bank lending to non-banking financial companies (NBFCs), and clearer project financing guidelines.

Growth in MSME and agricultural lending is expected to remain steady while on the corporate front, loan growth is likely to decline marginally from last financial year -- weighed down by a subdued first half.

Steady deposit growth is playing another supporting role, though household contributions are declining.

For NBFCs, growth in assets under management (AUM) is seen healthy at 18-19 per cent this financial year and the next, crossing the ₹50 lakh crore mark by March 2027. However, risk calibration and funding access dynamics will impact growth outlooks differently across entities and asset segments. While growth in vehicle finance and home loans will remain range bound amid intensifying competition, growth of unsecured loans, after falling sharply in the last financial year, is likely to improve this year as newer originations perform better. Unsecured MSME business loans, however, are expected to witness normalisation in growth this financial year. And lastly, gold loans and loans against property (LAP), should continue to outpace other asset classes.

Herein, NBFCs' access to bank funding remains important for growth. Despite the roll-back in risk weights effective April 2025, bank lending to NBFCs is yet to see a pick-up and thus far, has remained only marginally above the level seen a year ago. Larger NBFCs have accessed alternative funding avenues such as debt capital markets and external commercial borrowings. However, smaller ones have fewer alternatives, and their fortunes remain largely tied to the extent of rebound in bank funding.

Asset quality for banks as well as NBFCs is seen range bound across most segments.

For banks, gross non-performing assets (GNPAs) are likely to have bottomed out and are seen range-bound at 2.3-2.5 per cent until March 2026. Corporate NPAs will remain low due to strengthened risk mechanisms of banks and healthier balance sheets of India Inc, however MSME NPAs may see a cyclical uptick, particularly in export-oriented categories impacted by US tariffs.

Retail GNPAs for banks as well as NBFCs will remain steady, but delinquencies in the smaller ticket MSME loans, unsecured loans and microfinance loans warrant monitoring.

On profitability, return on assets (RoAs) for banks as well as NBFCs are expected to compress marginally this financial year.

For banks, this compression will almost entirely stem from the contraction in net interest margins (NIMs) due to a faster repricing of assets than liabilities — in a declining interest rate environment and, yield a return on assets (RoA) of 1.3 per cent this financial year, mildly lower than 1.4 per cent for last year. Still, this will be well above the sector's 20-year average RoA of 0.8 per cent.

For NBFCs, however, the impact of this will be nominal and would vary depending on the relative proportion of fixed versus floating rate liabilities and assets, as well as the type of benchmark-linkage. In addition, credit costs are expected to increase somewhat, resulting in a marginal decline in overall return on managed assets to 2.4 per cent in financial year 2027 from 2.5 last year.

In this milieu, RBI's recent measures will add to the structural strength of the sector by enhancing resilience and competitiveness.

Such measures for banks include, among others, the framework for expected credit loss-based provisioning and guidelines on forms of business undertaken by banks; for NBFCs — revision in loan-to-value on gold loans has been a key development.