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Banks' profitability may take a hit in FY26 amid NIM pressure and credit cost rise

Return on total assets (RoTA), a key metric of profitability, is expected to decline by 12–15 bps to around 1.15% in FY26 from 1.34% in FY25.

ETBFSI Research ETBFSI
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Indian banks are likely to face a dent in profitability in FY26 as net interest margins (NIMs) come under pressure and credit costs edge up. The sector is bracing for a 20–25 basis point (bps) decline in NIMs, primarily due to falling lending yields outpacing the reduction in deposit costs amid an easing interest rate environment, according to projections by CareEdge Ratings.

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Return on total assets (RoTA), a key metric of profitability, is expected to decline by 12–15 bps to around 1.15% in FY26 from 1.34% in FY25. This comes even as banks contend with continued investments in branch expansion, technology, and rising employee costs, which will keep the cost-to-income ratio elevated at 49–51%, broadly in line with FY25 levels.

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The Reserve Bank of India (RBI) has already cut the repo rate by 100 bps in 2025, triggering a decline in external benchmark lending rate (EBLR)-linked loan yields. Private sector banks (PVBs), which have a higher proportion of such loans (~86% as of December 2024), are expected to be more affected than public sector banks (PSBs), which have a larger share of MCLR-linked loans (~51%).

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Yield on advances for the sector is projected to decline by 48–50 bps in FY26. The slowdown in disbursals to unsecured lending segments — which previously boosted yields — and rising competition for quality borrowers are adding to the pressure.

Cost of funds

While lending rates are falling, the cost of funds remains elevated. A shift by depositors from low-cost current and savings accounts (CASA) to higher-yielding term deposits has increased funding costs. The tight liquidity conditions in FY25 pushed banks to rely more on bulk deposits and certificates of deposit (CDs), which are more expensive.

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Although some reduction in deposit rates is anticipated by the end of FY26, the lag in transmission is expected to prolong margin compression. PVBs, in particular, are likely to feel the squeeze more acutely due to their higher credit-to-deposit ratios and reliance on costlier sources of funds.

Banks are expected to see a rise in non-interest income, particularly from fee-based services and treasury gains, which may offer some offset to shrinking margins. Fee-based income now accounts for nearly 58% of non-interest income, up from 52% in FY22. Recoveries from written-off accounts and mark-to-market (MTM) gains from bond holdings, amid falling yields, are also expected to support non-interest revenue.

Credit costs, which have supported profitability over the past few years due to strong recoveries and low slippages, are expected to rise marginally in FY26. This is attributed to ageing provisions and continued caution around unsecured lending. While provision coverage remains adequate — with PVBs at 70–75% and PSBs at 75–80% — the sector may see increased provisioning, especially with reduced benefits from recoveries of older NPAs.

Despite stable operating metrics and adequate buffers, the sector faces a challenging FY26 with profitability metrics expected to moderate. With slowing credit growth, persistent cost pressures, and yield compression from monetary easing, banks may have to increasingly rely on cost controls and non-interest income streams to preserve earnings.

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Insurance firms tell IRDAI gram panchayats not interested in insurance outreach

In a review meeting with 55 insurance companies held virtually in the last week of May 2025, chaired by IRDAI ED (Life) Meena Kumari, insurers told the regulator they are facing hurdles in rural outreach and that they are not being entertained. "Gram panchayats are not interested in insurance because they don't know what is to be done," a senior executive told ETBFSI who attended the meeting. Also adding that IRDAI had not formally communicated or sensitised gram panchayat authorities about it.

Amol Dethe & Shrishti Sharma ETBFSI

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