Indian Banking Sector: Resilience to Continue in FY27

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Overview

India's banking system demonstrated strong resilience in FY26, operating against a backdrop of a world economy navigating elevated tariff tensions, geopolitical disruptions stemming from the West Asia conflict, and pronounced financial market volatility. Despite this challenging external environment, India remained among the fastest-growing major economies globally, clocking GDP growth of 7.6% during FY26, an acceleration from 7.1% in the prior year, underpinned by robust private consumption, sustained investment activity, and a buoyant services sector, and improvement in industrial activity on the supply side. The financial sector's stability was further buttressed by improved NBFC balance sheets, steady bank profitability, and a forward-looking regulatory consolidation exercise that compressed over 11,000 circulars into 244 master directions, a landmark rationalisation of the banking rulebook. The improvement in financial conditions was also reflected in the broader credit ecosystem, with total outstanding (o/s) credit to the commercial sector rising 15.0% y-o-y during FY26, supported by stronger bank credit expansion and increased mobilisation through capital markets. Within market-based financing, the corporate bond market continued to play an important role, with moderation in yields and improved secondary market activity.

Synopsis

- In FY26, bank credit growth accelerated sharply to around 14.5% year-on-year (y-o-y), outpacing deposit growth of about 11.5%, leading to a higher loan-to-deposit (LDR) ratio (~81.4%). Credit expansion was broad-based, driven by retail loans, MSMEs, and NBFC lending, while deposits lagged as savings shifted toward equities, mutual funds, and alternative investments.
- Commercial sector financing rose sharply to Rs 47.0 lakh crore in FY26, led by strong non-food bank credit growth and resilient non-bank funding sources. The expansion reflects healthy credit demand, deeper capital market participation, and continued support from foreign capital inflows.
- Monetary easing and surplus liquidity supported lower lending rates and stronger transmission, boosting credit demand.
- Banks and NBFCs remained financially strong, with improved asset quality, robust capital buffers, and stable profitability, though margins saw some pressure.
- The corporate bond market remained resilient during FY26, supported by improved secondary market activity and continued investor participation. While primary issuances moderated and credit spreads widened, the market continued to play a key role in facilitating market-based funding for corporates amid evolving financial conditions.

Flow of Credit to the Commercial Sector

The flow of financial resources to the commercial sector accelerated significantly in FY26, rising to Rs 47.0 lakh crore from Rs 36.2 lakh crore in FY25, reflecting robust financing activity across both bank and non-bank channels. The increase was driven by stronger credit expansion by banks as well as sustained resource mobilisation through capital markets and foreign investments.

- Non-food bank credit remained the primary source of financing, accounting for nearly 62% of total resource flows during FY26, which increased significantly to Rs 29.2 lakh crore during FY26 from Rs 18.1 lakh crore

in FY25, reflecting resilient demand from retail borrowers, MSMEs, infrastructure projects and services sectors, supported by improving economic activity and sustained investment requirements.

- Non-bank funding grew at Rs 17.9 lakh crore during FY26. Within domestic sources, equity issuances by non-financial entities remained steady at Rs 3.6 lakh crore. Corporate bond issuances also strengthened considerably, rising to Rs 3.2 lakh crore from Rs 2.0 lakh crore in FY25, reflecting corporates' growing preference for market-based financing amid favourable funding conditions and deeper participation in the debt market. Foreign-source funding also remained strong, largely supported by higher FDI inflows and increased short-term credit from abroad. As a result, total o/s credit to the commercial sector grew by 15.0% y-o-y as of March 2026, indicating broad-based financing support from both banking and capital market channels.

Bank Credit Growth Outpaces Deposits, Pushes Loan-to-Deposit Ratio Higher in FY26

Figure 1: Aggregate Bank Deposit and Credit Growth (y-o-y %)

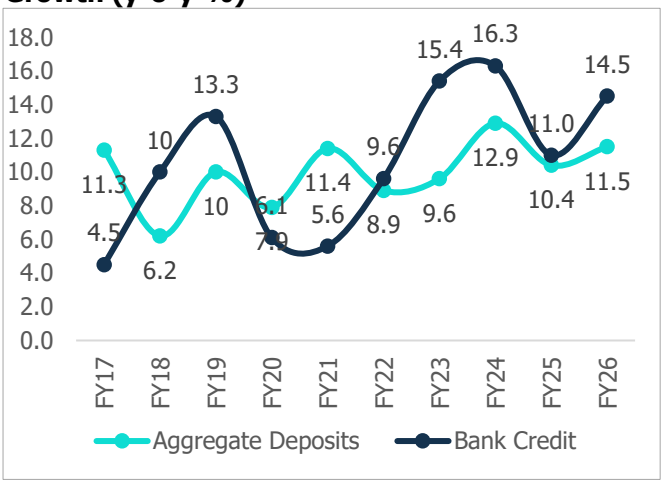
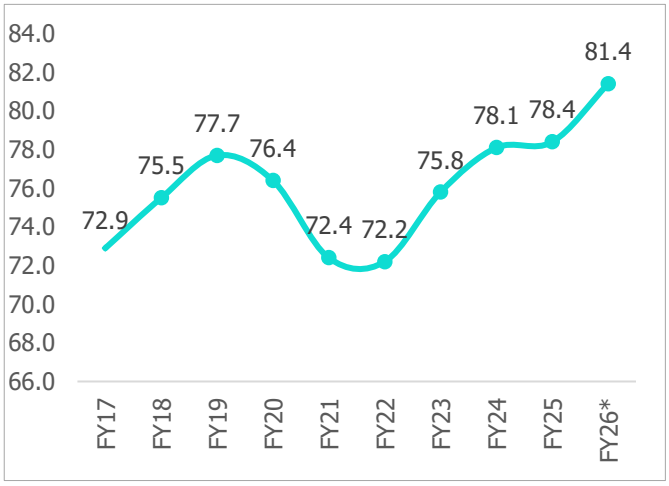


Figure 2: Loan-to-Deposit Ratio (%)



Source: RBI Annual Report, FSR, Fig: Excludes merger impact

During FY26, the Indian banking system witnessed continued strength in credit expansion, with SCBs recording credit growth of around 14.5% y-o-y, reflecting a broad-based and resilient demand environment and changes in banking laws. The nearly 500 bps acceleration in credit growth was broad-based, with momentum strengthening in the second half of FY26 as liquidity conditions eased and monetary policy transmission gained traction. Growth was underpinned by resilient retail lending, particularly in gold and vehicle loans, alongside sustained MSME credit demand, increased exposure to NBFCs, and some improvement in corporate and infra financing. Public sector banks (PSBs) outpaced private sector banks (PVBs) in credit growth for the second consecutive year. In contrast, overall deposit growth lagged at 11.5% y-o-y, despite showing some improvement in recent months compared to the previous year. As a result, the overall gap between credit and deposit growth persisted.

Consequently, the LDR continued its upward trajectory, rising to around 81.4% in FY26 from about 78.4% in FY25, reaching an elevated level by historical standards. The sustained divergence between credit and deposit growth increasingly led banks to rely on market-based funding sources to bridge the gap. Additionally, issuances of Certificates of Deposit (CDs) grew 15% to approximately Rs 13.68 lakh crore in FY26 (from Rs 11.9 lakh crore in FY25).

Figure 3: Sectoral Credit Growth of SCBs

Sectoral Credit Growth	March 25 (Y-o-Y growth %)	March 26 (Y-o-Y growth %)
Non-food Credit	**10.9**	**15.9**
Agriculture & Allied Activities	**10.4**	**15.7**
Industry (Micro & Small, Medium and Large)	**8.2**	**15.0**
Micro & Small	8.9	33.1
Medium	18.5	21.7
Large	6.9	8.9
Infrastructure	2.8	9.5
Services	**12.0**	**19.0**
NBFCs	7.4	26.3
Commercial Real Estate	13.7	19.9
Personal Loans	**11.7**	**16.2**

Source: RBI Annual Report

Credit offtake improved in March 2026, with non-food bank credit growth rising to 15.9% y-o-y, up from 10.9% in March 2025. Overall growth was broad-based, led by NBFCs and personal loans. Within services, momentum remained strong, supported by commercial real estate, trade, and robust NBFC borrowings, alongside a gradual revival in corporate credit demand. Industry credit was anchored by MSMEs, with micro and small enterprises recording strong double-digit growth, reflecting both sustained demand and policy support. Within retail lending, personal loans expanded steadily, with housing credit growing at a stable pace, while vehicle loans accelerated significantly in line with strong underlying demand, including record EV sales. Gold loans remained the standout segment, surging significantly amid elevated gold prices and increased reliance on collateral-backed borrowing. Notwithstanding the strong growth trajectory, banks remain vigilant to external risks, particularly geopolitical tensions, while policy support measures such as ECLGS 5.0 continue to provide an enabling backdrop for credit expansion.

Sector-wise Decline in Weighted Average Lending Rates (WALRs)

The RBI's accommodative monetary stance and cumulative rate cut during late FY25 and FY26 led to broad-based easing in lending rates across sectors. Transmission was more pronounced in fresh loans, reflecting the growing share of EBLR-linked lending and faster repricing by banks.

Figure 4: Sector-wise Movement in WALR (%)

	Fresh Rupee Loans			Outstanding Rupee Loans		
Sector	**Mar-25**	**Mar-26**	**Change (bps)**	**Mar-25**	**Mar-26**	**Change (bps)**
Large Industry	8.33	7.41	-92	8.45	7.57	-88
MSMEs	9.69	8.72	-97	10.02	9.17	-85
Infrastructure	8.56	7.76	-80	9.01	8.1	-91
Housing	8.55	7.63	-92	9.96	9.64	-32
Vehicle	10.37	9.57	-80	10.31	9.35	-96
Education	10.41	9.14	-127	11.31	10.63	-68
Other Personal Loans	10.87	10.07	-80	8.45	7.57	-88

Source: RBI Annual Report

Among fresh loans, the sharpest decline in WALRs was observed in education loans (-127 bps), followed by MSMEs (-97 bps), trade (-94 bps), large industry (-92 bps) and housing loans (-92 bps). This indicates stronger transmission in competitive retail and business lending segments. For o/s loans, repricing was relatively gradual due to legacy contracts. The largest decline was seen in trade (-100 bps) and housing loans (-99 bps), followed by education (-96 bps), infra (-91 bps), large industry (-88 bps) and MSMEs (-85 bps). Overall, it indicates that monetary transmission in FY26 was broad-based and effective, with new loan rates adjusting faster than o/s loan rates. The decline in borrowing costs across housing, MSME, trade and corporate segments supported credit demand and improved credit affordability amid surplus liquidity conditions.

Figure 5: Sector-wise Movement in WADTDR (%)

	Fresh Rupee Deposits			Outstanding Rupee Deposits		
Sector	**Mar-25**	**Mar-26**	**Change (bps)**	**Mar-25**	**Mar-26**	**Change (bps)**
PSBs	7.01	6.45	-56	7.16	6.68	-48
PVBs	6.90	6.26	-64	7.16	6.71	-45
SCBs	6.72	6.07	-65	7.11	6.62	-49

Source: RBI Annual Report, Care Ratings Calculation

Both o/s and fresh weighted average domestic term deposit rates (WADTDR) decline across bank groups in FY26, reflecting easing funding costs and improved transmission of monetary policy. For o/s deposits, all bank groups saw rates decline between March 2025 and March 2026. PSBs, PVBs, and SCBs all saw reductions, indicating a uniform repricing of the existing deposit base across the system. While the decline is more pronounced in fresh deposits, it indicates faster transmission of lower interest rate conditions into new deposit mobilisations. Fresh WADTDR fell by 56 bps for PSBs, 64 bps for PVBs, and 65 bps for SCBs. However, despite the moderation in deposit rates during FY26, funding pressures are likely to persist. Credit growth continued to outpace deposit mobilisation during most of the year, resulting in a widening gap between credit offtake and deposit growth. This imbalance has intensified competition among banks for retail deposits, particularly stable granular deposits. Consequently, while WADTDR has moderated, overall funding costs may remain relatively elevated compared to historical levels as banks continue to balance strong credit demand with the need to mobilise adequate deposit resources. Going forward, the trajectory of deposit growth will remain a key determinant of banks' funding costs, margins and lending capacity.

Liquidity Remained Surplus; Long-Term Yields Hardened

Figure 6: 10-Y G-sec Yield (%)

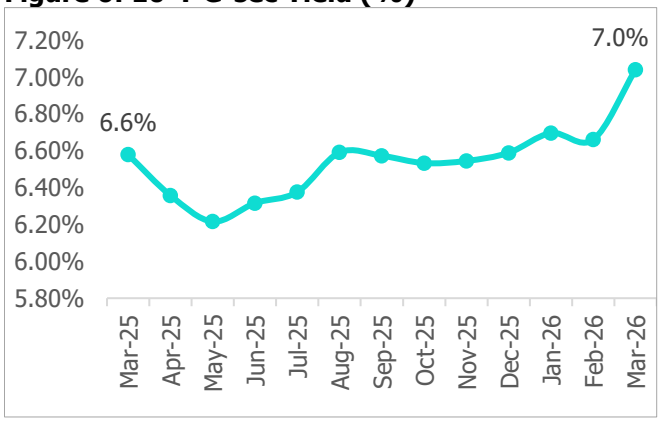
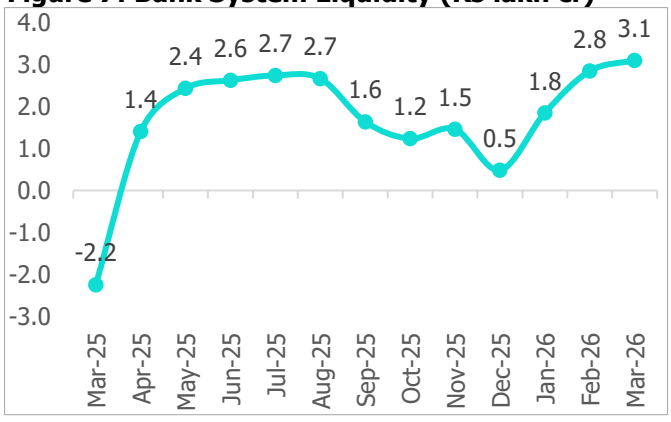


Figure 7: Bank System Liquidity (Rs lakh cr)



Source: Refinitiv, RBI, Note: Yields are as of the respective month-end dates.

Monetary conditions remained supportive in FY26, aided by easing inflation, policy rate cuts and sustained liquidity infusion by the RBI. Liquidity conditions remained comfortably surplus, with average daily net absorption under the Liquidity Adjustment Facility (LAF) surging to Rs 1.86 lakh crore from just Rs 1,605 crore a year earlier. Supported by RBI liquidity measures, including OMO purchases, USD/INR buy-sell swaps, longer-tenor VRR operations, and cumulative 100 bps CRR cuts, banking system liquidity remained in surplus throughout the year, averaging around Rs 3.1 lakh crore by March 2026. The cumulative 125-bps repo rate reduction since February 2025, coupled with surplus liquidity, strengthened monetary transmission, particularly through the growing share of EBLR-linked loans. By March 2026, o/s lending rates declined by 76 bps y-o-y to 8.99%, while deposit rates moderated gradually by 42 bps to 6.62%, reflecting continued competition for deposits and banks' efforts to protect margins. Fresh lending rates repriced more sharply, especially in lower-risk segments such as housing and highly rated corporates, reflecting easing funding costs. The one-year median MCLR declined by 60 bps y-o-y to 8.40%, with PVBs witnessing a decline (90 bps) than PSBs (33 bps).

The 10-year G-sec yield hardened from around 6.6% at the beginning of FY26 to 7.0% by March 2026. Yield pressures intensified during the second half of the year amid stronger-than-expected GDP growth, reduced expectations of further policy easing, higher government borrowing requirements and rising crude oil prices following geopolitical tensions in the Middle East.

Policy Measures to Strengthen External Stability and Capital Inflows

Domestic financial markets experienced intermittent upward pressure on bond yields and risk premia amid recent geopolitical uncertainties, particularly in West Asia, and trade-related uncertainties. However, the impact was contained by an accommodative monetary stance and liquidity support measures, which together helped preserve overall financial stability. To strengthen external sector resilience and attract foreign inflows, the RBI announced a series of targeted measures. The expansion of Government securities under the Fully Accessible Route (FAR) and the removal of certain investment limits for FPIs are expected to deepen foreign participation in domestic debt markets. Further, the easing of investment norms for NRIs, OCIs, and other Persons Resident Outside India (PROIs), along with the concessional forex swap facility for External Commercial Borrowings (ECBs), is aimed at augmenting foreign currency inflows and improving dollar liquidity. Additionally, support for FCNR(B) deposits and the restoration of the export proceeds realisation period to nine months are expected to further bolster external financing and foreign exchange inflows. Collectively, these measures are expected to support rupee stability and mitigate external sector vulnerabilities amid an uncertain global environment. (Refer RBI Policy Outcome - June 2026)

Incremental Savings Flowing Beyond Traditional Bank Deposits

Figure 8: Growth in Bank Time Deposits and Investments in Mutual Funds (AUM) (Rs lakh crore, y-o-y %)

	FY16	FY26	CAGR (%)
Debt Mutual Funds	7.8	16.7	7.9
Equity and Other Funds	4.5	57.0	28.9
Time Deposits	85.9	225.4	10.1

Source: SEBI, RBI; Note: Other Funds include equity, hybrid, solution-oriented, interval schemes and other schemes

Figure 9: Investments Made by AIFs (Rs lakh crore, y-o-y %)

	FY23	FY24	FY25	Dec 31, 2025
AIFs	3.4	4.1	5.4	6.5
y-o-y growth %	19.0	20.4	32.2	20.9

Source: SEBI

Bank time deposits remained the dominant savings channel, growing at a 10.1% CAGR from FY16 to FY26, broadly in line with the overall expansion in household financial savings. In contrast, the AUM of equity mutual funds recorded a significantly higher CAGR of 28.9%, rising from 4.5 lakh crore to 57.0 lakh crore in FY26, reflecting deepening retail participation and sustained SIP-led equity inflows. Meanwhile, the AUM of debt mutual funds grew at a relatively moderate 7.9% CAGR over the same period. A notable extension of this trend is visible in Alternative Investment Funds (AIFs), where investments nearly doubled from Rs 3.4 lakh crore in FY23 to Rs 6.5 lakh crore by December 2025, implying a sharp acceleration in growth momentum. This indicates increasing investor appetite for higher-yielding and less traditional asset classes, further broadening the spectrum of financial intermediation beyond conventional banking deposits. Importantly, the growth reflects a broader allocation of savings across different financial products, rather than a direct shift away from bank deposits. While time deposits continue to serve as the core low-risk savings anchor, incremental flows are increasingly getting distributed towards a wider set of financial assets. Simultaneously, rapid growth in AIFs underscores a parallel shift towards high-return investment avenues. For banks, this implies that while deposit dominance remains intact, competitive pressure is gradually emerging at the margin.

Asset Quality Improved in FY26

The financial stability assessment for FY26 remained strongly positive, supported by healthier bank balance sheets, robust capital buffers and sustained improvement in asset quality. The GNPA ratio declined to a multi-decadal low of 1.8%, and the NNPA ratio to 0.4%, in FY26, reflecting the culmination of years of balance sheet repair, including legacy stress resolution, improved credit discipline, and stronger underwriting standards. The continued economic expansion further strengthened borrowers' repayment capacity, contributing to lower slippages, which stand at 1.2% for FY26 and improved asset quality across the banking system.

Figure 10: SCBs – Gross NPAs and Net NPAs Ratio (%)

	March 25	March 26	(y-o-y, bps)	March 25	March 26	(y-o-y, bps)
	GNPA			NNPA		
PSBs	2.8	2.1	-70	0.6	0.4	-20
PVBs	1.8	1.5	-30	0.5	0.4	-10
SCBs	2.3	1.8	-50	0.5	0.4	-10

Source: RBI Annual Report, FSR, CareEdge Ratings Calculations

Figure 11: GNPA Across Major Economies

	USA	China	Germany	UK	France
2021	0.70	1.70	1.40	1.00	2.20
2024-25	0.96*	1.50^	1.89*	0.95*	2.09^

Source: IMF Financial sector stability, World Bank, CareEdge Ratings * 2025, ^ 2024

India's GNPA ratio has improved significantly from its earlier double-digit levels. It is now broadly aligned with major global economies, although it remains slightly higher than the UK and the US. Compared with Germany and

France, India's asset quality is now at comparable levels, reflecting the success of its banking-sector clean-up efforts.

Overall Capital Adequacy Continues to Exceed Regulatory Benchmarks

Capitalisation levels remained comfortable, with banks maintaining a Capital to Risk-Weighted Assets Ratio (CRAR) of 17.7%, well above regulatory requirements. In contrast, liquidity buffers remained strong, as reflected in an LCR of 124.2% and NSFR at 122.1%. RBI stress tests reaffirmed the resilience of the banking sector, indicating that even under adverse macroeconomic scenarios, banks would remain adequately capitalised and capable of absorbing potential shocks.

Figure 12: CET-1 and CAR Median Ratio (%)

	March 25	March 26	(y-o-y, bps)	March 25	March 26	(y-o-y, bps)
	CET1			CAR		
PSBs	12.6	13.5	90	16.1	16.6	50
PVBs	16.5	16.8	30	18.3	18.5	20
SCBs	14.7	15.3	60	17.3	17.7	40

Source: RBI Annual Report, FSR, CareEdge Ratings Calculations

Figure 13: CAR Ratio Across Major Economies (%)

	USA	China	Germany	UK	France
CAR (%)	16.72*	15.74^	20.45*	20.45*	19.78^

Source: IMF Financial sector stability, CareEdge Ratings * 2025, ^ 2024

India's banking system, with a CAR of about 17.7%, is well-capitalised and comfortably above the Basel III minimum requirement, reflecting strong resilience after years of balance-sheet repair. However, it still trails the UK (~20.45%), Germany (~20.45%), and France (~19.78%). Compared with the US (~16.72%) and China (~15.74%), India holds a higher capital cushion, indicating a more conservative approach to risk and stronger loss-absorption capacity relative to these large economies.

SCBs Sustain Profitability Amid Margin Compression

SCBs remained profitable in FY26, supported by healthy credit growth, stable operating performance, and continued benign asset quality. However, profitability moderated during the year, with net profit growth slowing to 6.0% (vs 14.7% in FY25), reflecting margin compression and evolving rate dynamics. NIM declined by 20 bps to 3.3%, driven by easing lending rates alongside elevated funding costs. Despite this, profitability indicators remained healthy, with annualised Return on Assets (RoA) at 1.3% and annualised Return on Equity (RoE) at 12.6% in FY26. Earnings were further supported by steady credit expansion, lower credit costs, and recoveries from written-off accounts, which helped partially offset the moderation in treasury income amid rising bond yields and volatile market conditions. PSBs continued to outperform PVBs in FY26, aided by a relatively lower CD ratio. The banking system also remained well-capitalised, supported by strong internal accruals and selective capital raising through bond issuances. However, pockets of stress persisted in select MSME and export-linked segments, reflecting weak external demand, elevated input costs, and stretched working capital cycles.

Figure 14: RoA Annualised (%)

	March 25	March 26	(y-o-y, bps)
PSBs	1.1	1.1	0
PVBs	1.7	1.6	-10
SCBs	1.4	1.3	-10

Source: RBI Annual Report, FSR, CareEdge Ratings Calculations

Figure 15: RoA Across Major Economies (%)

	USA	China	Germany	UK	France
RoA (%)	1.44*	0.63^	0.62*	0.68*	0.55^

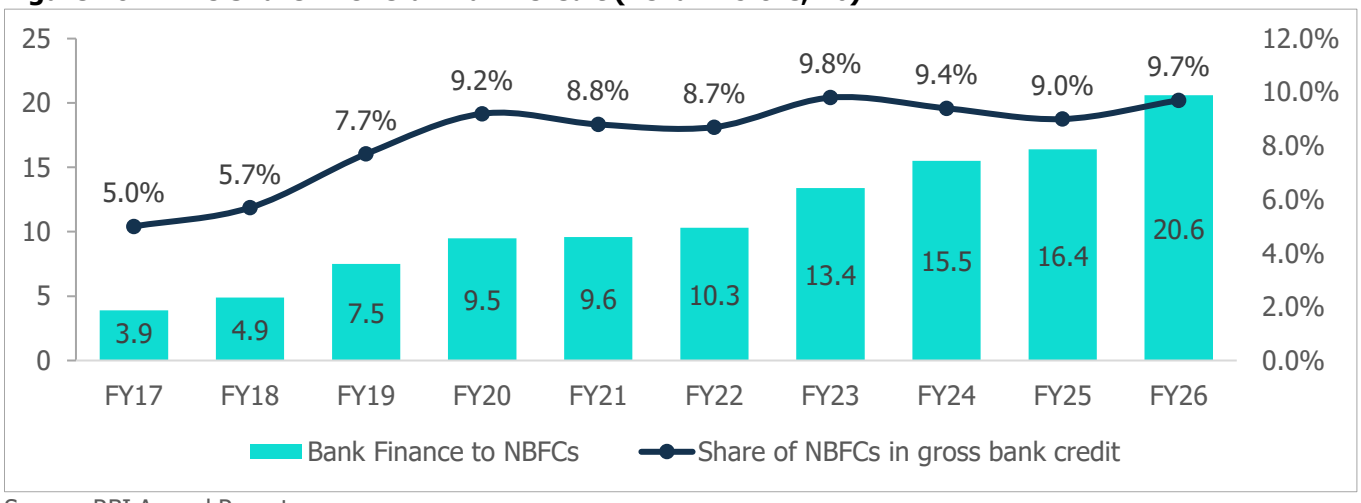
Source: IMF Financial sector stability, CareEdge Ratings * 2025, ^ 2024

India's banking sector, with an RoA of about 1.3%, stands out as one of the most profitable among major economies, outperforming most developed markets and broadly comparable to the US (~1.44%), reflecting higher margins, improving asset quality, and strong credit growth. In contrast, European banking systems such as Germany (~0.62%), the UK (~0.68), and France (~0.55%) exhibit lower profitability due to intense competition, high regulation, and lower net interest margins.

NBFCs' Strong Credit Intermediation Role Supported by Regulatory Easing

NBFC credit growth (upper and middle layers) moderated to 16.6% y-o-y in FY26 from 20.7% in FY25. Despite the moderation, NBFCs continued to play a key role in credit intermediation. The strong growth in FY25 was primarily driven by NBFC-ULs, which recorded strong credit growth of 40.8%, partly supported by the reclassification of an HFC into the Upper Layer and the merger of a Middle Layer NBFC with an Upper Layer NBFC. In comparison, NBFC-ML credit growth remained moderate at 13.4% in FY25, indicating that the overall acceleration was concentrated among larger NBFCs.

Figure 16: NBFC Share in Overall Bank Credit (Rs lakh crore, %)

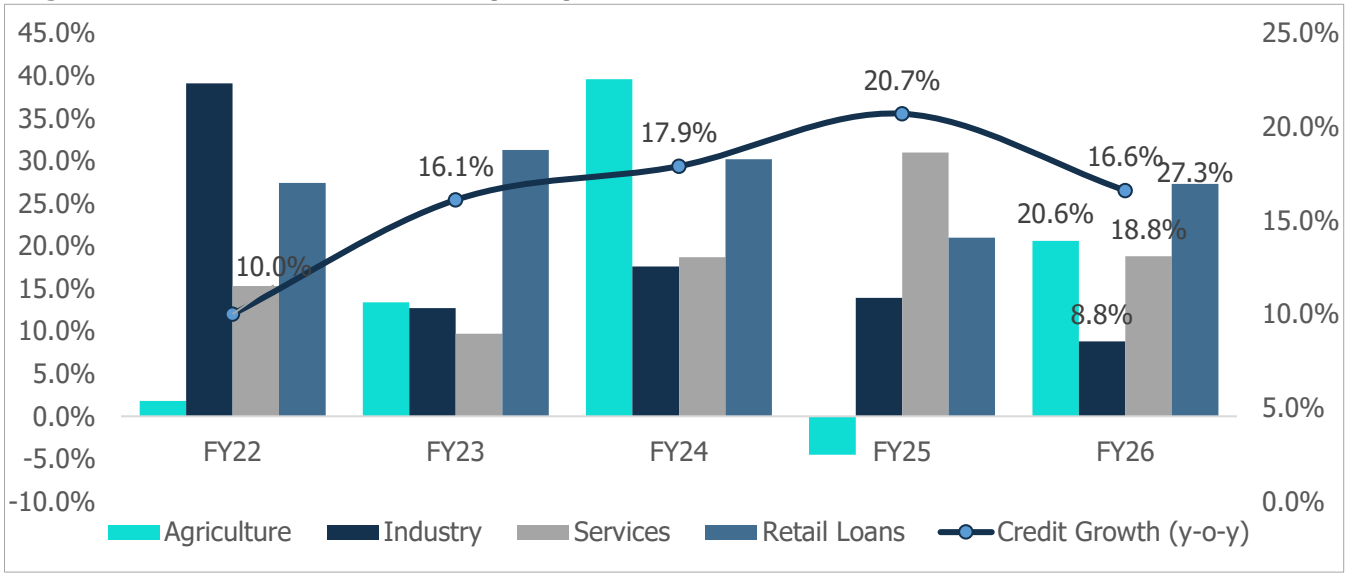


Source: RBI Annual Report

NBFCs continued to strengthen their role in India's credit ecosystem during FY26, supported by improving funding conditions and sustained demand for retail, MSME and infrastructure financing. Bank finance to NBFCs increased sharply to Rs 20.6 lakh crore in FY26 from Rs 16.4 lakh crore in FY25, while NBFCs' share in gross bank credit rose to 9.7%, similar to the peak levels seen in FY23. The rebound was aided by the RBI's April 2025 reversal of the

additional risk weights imposed on bank lending to NBFCs in November 2023, easing funding constraints and facilitating renewed bank credit to the sector. However, market-based funding remained relatively subdued, with slower growth in commercial paper and corporate bond markets amid elevated yields and cautious investor sentiment. As a result, NBFCs increasingly relied on bank borrowings to meet refinancing requirements and support incremental lending activity. Apart from direct bank credit, banks continued to provide support through investments in NCDs, CPs, and PTCs, as well as loan assignment arrangements. While this strengthened NBFC funding availability and supported credit expansion, the recent acceleration in NBFC borrowing appears to have been driven in part by funding substitution amid weaker alternative channels, rather than by a sharp improvement in underlying demand.

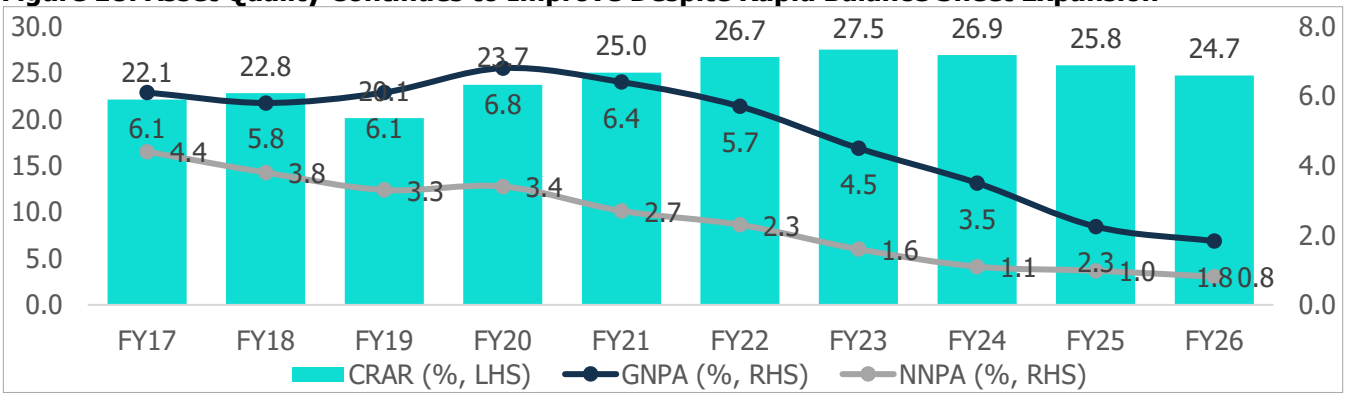
Figure 17: Sectoral Credit of NBFC (in %)



Source: RBI Annual Report, FSR

NBFC credit growth across sectors remained broad-based in FY26, although the pace moderated in certain segments following tighter regulatory norms. Credit to the services sector continued to grow robustly at 18.8%, reflecting sustained demand from commercial and financial services, while retail loans accelerated to 27.3% after easing in FY25. Agriculture credit rebounded sharply to 20.6% after contracting in FY25, indicating a recovery in rural credit disbursements and seasonal financing needs. Meanwhile, industry credit growth moderated to 8.8%.

Figure 18: Asset Quality Continues to Improve Despite Rapid Balance Sheet Expansion



Source: RBI Annual Report, FSR

The sector's asset quality remained resilient, reflecting the benefits of stronger underwriting standards, improved collection efficiencies and favourable macroeconomic conditions. GNPA ratio improved steadily from 6.8% in FY20 to 1.8% in FY26, while NNPA ratio also improved from 3.4% to 0.8% over the same period. The latest FY26 improvement was broad-based, with GNPA and NNPA ratios declining from 2.3% and 1.0%, respectively, in FY25. Improvement in asset quality was particularly visible among large PSBs' infrastructure financing entities, benefiting from healthier project cash flows and lower legacy stress. However, some moderation in asset quality was observed among retail-focused NBFCs amid normalisation of post-pandemic credit performance and rising unsecured retail exposures. Nevertheless, overall sectoral stress indicators remained at multi-year lows, underscoring the strengthening of NBFC balance sheets.

Figure 19: NBFCs Sources of Funds (in %)

Sectoral Credit Growth	Mar-21	Mar-22	Mar-23	Mar-24	Mar-25	Mar-26
1. Share Capital, Reserves & Surplus	**26.7**	**29.4**	**29.4**	**22.8**	**22.8**	**21.5**
2. Total Borrowings	**63.0**	**60.6**	**61.1**	**68.0**	**68.6**	**69.9**
From Banks (Total)	23.2	23.8	24.8	29.0	28.6	30.4
Borrowings from Banks	19.8	20.6	21.7	26.3	25.7	27.6
Debentures subscribed by Banks	3.0	2.9	2.7	2.4	2.4	2.4
CPs subscribed by Banks	0.4	0.4	0.3	0.3	0.4	0.4
Debentures (excluding those subscribed by banks)	22.8	20.4	19.4	21.8	21.6	21.5
Commercial Paper (excluding bank subscriptions)	1.6	1.4	1.5	1.7	1.9	1.8
3. Public Deposits	**–**	**–**	**–**	**2.1**	**2.1**	**2.0**
4. Provisions	**–**	**–**	**–**	**–**	**–**	**2.7**
5. Other Liabilities / Others	**10.2**	**10.0**	**9.6**	**7.1**	**6.6**	**3.8**

Source: RBI Annual Report, FSR

The overall funding profile of NBFCs remained broadly stable in FY26, with borrowings continuing to account for nearly two-thirds of total liabilities, reaching 69.9% in March 2026. Bank funding remained the largest source of borrowings, with its share increasing to 30.4% from 23.2% in March 2021. Debentures and CPs continued to be important funding sources, although their shares remained largely stable. The share of equity capital (share capital, reserves and surplus) moderated to 21.5% in March 2026, indicating that balance sheet growth continued to be supported primarily through borrowings rather than internal capital. Going forward, a benign interest-rate environment and softer bond yields are expected to improve access to market-based funding by lowering borrowing costs and supporting debt issuance. In contrast, bank borrowings are likely to remain the dominant source of funding.

Capital Position Remains Strong and Provides Growth Headroom

NBFCs maintained robust capital buffers despite strong credit growth. The sector's CRAR stood at 24.7% in FY26, comfortably above regulatory requirements, though below the peak of 27.5% recorded in FY23. Tier-I CRAR remained strong at 22.9%. Profitability moderated slightly, with Return on Assets (RoA) easing to 2.6% in FY26 from 2.9% in FY25, while NIM remained broadly stable at 4.6%. While asset quality remains high, geopolitical risks in West Asia warrant monitoring. A sustained rise in crude oil prices or trade disruptions could pressure borrower cash flows, particularly in retail and MSME segments, potentially slowing the pace of asset quality improvement.

Nevertheless, strong capital buffers and provisioning coverage provide NBFCs with resistance against such external shocks.

Regulatory Focus Shifts Towards Resilience and Risk Management

With NBFCs becoming increasingly systemically important, regulatory focus has progressively shifted from balance sheet repair towards strengthening resilience and risk management frameworks. During FY26, the RBI conducted a sectoral KYC/AML risk assessment of NBFCs and advanced the development of a dedicated liquidity stress-testing framework for the sector. Looking ahead, supervisory priorities for FY27 include strengthening credit and liquidity stress testing frameworks, expanding risk-based supervision for select NBFCs, conducting cyber-risk mapping exercises for Upper and Middle Layer NBFCs, and enhancing IT risk assessments. These measures, coupled with strong capital buffers and improved asset quality, are expected to support sustainable growth while enhancing the sector's resilience against future macro-financial and liquidity shocks.

Corporate Bond Market

Figure 20: AAA Rated – 3 Year Yield (%)

	March 25	March 26	(y-o-y, bps)
PSUs, FIs and Banks	7.48	7.33	-15
NBFCs	7.70	7.53	-17
Corporates	7.62	7.36	-26

Source: RBI; Note: Yields are computed as monthly averages

The corporate bond market witnessed a moderation in yields during FY26, although risk spreads hardened during the year. AAA-rated 3-year corporate bond yields declined across segments, with yields for corporates falling by 26 bps to 7.36%, followed by NBFCs (down 17 bps to 7.53%) and PSUs, financial institutions and banks (down 15 bps to 7.33%). Despite lower absolute yields, spreads over comparable G-sec yields widened.

Market activity remained supported, with secondary market turnover in corporate bonds increasing to Rs 7,100 crore in FY26 from Rs 6,200 crore in FY25, indicating improved trading activity and liquidity. However, primary issuances of listed corporate bonds moderated to Rs 9.1 lakh crore from Rs 9.9 lakh crore in the previous year. Private placements continued to dominate, accounting for nearly 99% of resources raised through the domestic corporate bond market. Foreign investor participation also improved during the year, with FPI investments in debt instruments increasing. However, the utilisation of approved corporate bond limits moderated marginally due to an increase in overall investment limits.

CareEdge Ratings View

The Indian banking system enters FY27 from a position of strength, supported by robust capital buffers, adequate liquidity, improving asset quality and sustained credit demand across segments. Credit growth remains broad-based, driven by retail, MSMEs, infrastructure and NBFCs. However, some part of the recent momentum reflected funding substitution as elevated bond yields prompted corporates and NBFCs to rely more on bank borrowings. During the year, the RBI also introduced a series of measures aimed at supporting the rupee, strengthening forex reserves and easing pressures on the external sector. A key component of these measures is the introduction of concessional USD-INR forex swap facilities to encourage banks to mobilise foreign currency resources, including a special window for fresh 3–5-year FCNR(B) deposits, as well as swap facilities for ECBs by public sector undertakings (PSUs) and overseas borrowings by banks. While ECBs could reduce the demand for domestic bank credit if corporates and PSUs increasingly access overseas funding, these measures also provide banks with an opportunity to diversify their liability profiles through relatively stable and cost-effective medium-term foreign-currency funding.

Although FCNR(B) deposits are expected to remain a small share of total deposits, they are likely to support incremental deposit mobilisation, partially narrow the credit-deposit gap and ease funding pressures in short-term money markets, particularly in the Certificates of Deposit (CD) segment.

Looking ahead, CareEdge Economics projects India's GDP growth at 6.7% in FY27, reflecting a calibrated outlook amid persistent global headwinds. Against this backdrop, we expect banking sector credit growth to moderate to 14.5%–15.5% in FY27 following the strong expansion witnessed in FY26. The moderation is likely to reflect the fading of the favourable base effect that supported credit growth in FY26, along with a gradual shift by large corporates and NBFCs towards market-based funding as financing conditions improve. Any easing in bond yields or improvement in capital market access could further encourage borrowers to increase reliance on bond market issuances and the ECBs, thereby moderating incremental bank credit growth. Nevertheless, credit growth is expected to remain healthy, supported by improving liquidity conditions, sustained government capital expenditure and resilient domestic economic activity. For SCBs, strong balance sheets and adequate capital buffers provide resilience, although margin compression and competitive pressures on deposit mobilisation will remain key areas to monitor.

The outlook for NBFCs also remains constructive, supported by stronger balance sheets, healthy credit demand and continued access to bank funding. However, increasing dependence on bank borrowings, relatively elevated funding costs and asset quality risks in unsecured retail and certain MSME segments warrant continued monitoring. Geopolitical developments in West Asia remain an important external risk, given their potential implications for crude oil prices, inflation and domestic financial conditions. Although concerns had eased temporarily following the US-Iran peace agreement and the moderation in crude oil prices, renewed regional tensions have reintroduced uncertainty. Nonetheless, strong capital buffers and prudent regulatory oversight position the banking sector well to absorb potential shocks.

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