

A STUDY ON NON-PERFORMING ASSETS (NPA) CRISIS AND ITS IMPACT ON CREDIT GROWTH IN INDIA

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ABSTRACT

Non-Performing Assets (NPA) have emerged as a critical issue and also most significant challenges facing India's banking sector, particularly after the mid-2000s credit boom. It directly affected banks' ability to lend, thereby slowing overall economic growth and poor project execution, the crisis led to a sharp increase in stressed assets, particularly within Public Sector of India through measures such as the Asset Quality Review brought greater transparency, revealing the true extent of the problem. This study examines the causes and evolution of the NPA crisis and analyzes its adverse impact on credit growth in India. High levels of NPAs eroded bank profitability, weakened capital position and reduced the capacity of financial institutions to extend fresh credit. Consequently, banks adopted risk-averse lending practices, leading to a slowdown in credit flow, especially to key productive sector such as infrastructure and MSMEs this contraction in credit adversely affected private investment, employment generation and overall economic momentum.

Keywords: Non-Performing Assets (NPAs), Indian Banking Sector, Financial Inclusion

1. INTRODUCTION

The Indian banking sector plays a pivotal role in driving the nation's economic growth by mobilising savings, extending credit, and ensuring the stability of financial intermediation. Over the past three decades, the sector has witnessed several reforms—from the post-liberalisation phase of the 1990s to the recent digital transformation era. Yet, despite the progressive reforms, one of the most persistent and complex challenges that continues to undermine the financial health of Indian banks is the growing burden of Non-Performing Assets (NPAs). The term "NPA" refers to loans or advances where interest or principal payments remain overdue for more than 90 days. These assets not only reflect the inefficiency of banks in managing credit risk but also act as a mirror of the underlying weaknesses in the economic and regulatory framework.

The phenomenon of NPAs in India cannot be analysed in isolation; it is deeply intertwined with macroeconomic cycles, governance failures, sectoral vulnerabilities, and the broader policy environment. In the Indian context, NPAs have been both a symptom and a cause of financial distress. When the economic environment deteriorates—such as during industrial slowdowns, agricultural distress, or global crises—borrowers struggle to service their loans, leading to a surge in NPAs. Conversely, a high level of NPAs restricts banks' lending capacity, affecting economic recovery and growth. Thus, the relationship between NPAs and the financial health of banks forms a vicious cycle that policymakers have been trying to break since the 1990s.

Historically, the roots of India's NPA problem trace back to the pre-liberalisation period, when public sector banks were primarily used as instruments of social and developmental policy rather than commercial enterprises. Directed lending to priority sectors such as agriculture and small-scale industries, often influenced by political considerations, resulted in

poor credit discipline and weak recovery mechanisms. The liberalisation of the 1990s exposed Indian banks to competitive pressures and greater scrutiny. However, the legacy of poor governance, inadequate risk management practices, and a lack of accountability continued to persist, paving the way for recurrent waves of NPA accumulation.

The seriousness of the problem was first officially acknowledged when the Narasimham Committee (1991) recommended the recognition and reduction of NPAs as a key reform priority. It led to the introduction of prudential norms in 1992–93, which redefined asset classification and provisioning standards in line with international practices. The subsequent years saw the creation of institutional frameworks such as the Debt Recovery Tribunals (DRTs) in 1993, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act in 2002, and, most notably, the Insolvency and Bankruptcy Code (IBC) in 2016. Each of these interventions sought to strengthen the mechanisms for loan recovery, improve credit discipline, and restore the financial soundness of banks.

Despite these efforts, NPAs have remained a chronic issue, particularly within the Public Sector Banks (PSBs), which dominate the Indian banking landscape with nearly 60–65% of total banking assets. According to the Reserve Bank of India's Financial Stability Report (2022), the Gross NPA ratio of scheduled commercial banks, which had peaked at 11.2% in March 2018, declined to 5.9% by March 2022 due to proactive recognition, provisioning, and resolution efforts. However, this decline, while significant, masks several underlying concerns. The reduction was largely driven by large-scale write-offs and restructuring rather than actual recoveries. Moreover, the COVID-19 pandemic and subsequent economic disruptions have again raised fears of a potential resurgence in stressed assets, particularly among small and medium enterprises (SMEs) and retail borrowers.

The financial health of banks, in the context of NPAs, can be understood through several interconnected parameters: profitability, capital adequacy, liquidity, and credit growth. A rise in NPAs directly impacts banks' profitability by reducing interest income and increasing provisioning requirements. It also erodes the capital base, as higher provisions reduce the net worth, thereby affecting the Capital Adequacy Ratio (CAR). In turn, weak capital adequacy restricts the ability of banks to expand their lending operations, leading to a slowdown in credit growth and economic activity. From a systemic perspective, the persistence of high NPAs undermines depositor confidence, increases the cost of borrowing, and can potentially trigger contagion effects across the financial system.

The issue of NPAs is not merely financial but also structural and behavioral. Several studies have attributed the rise of NPAs to poor credit appraisal systems, inadequate post disbursement monitoring, political interference in lending decisions, and moral hazard arising from repeated government bailouts. The Corporate Debt Restructuring (CDR) and Strategic Debt Restructuring (SDR) mechanisms introduced in the 2000s and 2010s, though well-intentioned, often led to "ever greening" of loans—where bad loans were rolled over to avoid recognition as NPAs. Such practices delayed the recognition of stress and aggravated the problem in the long term.

From a macroeconomic standpoint, the accumulation of NPAs has a multiplier effect. It not only weakens the financial sector but also constrains the overall investment climate. Empirical evidence from Indian and international studies has shown that banking crises induced by high NPAs tend to reduce GDP growth by up to 1–2 percentage points annually, primarily through their adverse impact on credit availability to productive sectors.

This creates a dual challenge for policymakers: ensuring the stability of the financial system while maintaining credit flow to sustain growth.

In the post-2016 period, the Indian government and the RBI adopted a more assertive stance toward resolving NPAs through the Asset Quality Review (AQR), the Prompt Corrective Action (PCA) framework, and the IBC. These measures brought greater transparency and accountability into the system, forcing banks to recognise bad assets earlier and take corrective actions. Yet, despite the progress, the challenge remains structurally rooted in governance deficiencies, sectoral concentration risks (especially in infrastructure, power, and steel), and cyclical economic shocks.

2. SCALE OF THE CRISIS

The scale of India's Non-Performing Assets (NPA) crisis was historically defined by the "**Twin Balance Sheet**" challenge, where both bank and corporate balance sheets were severely stressed. At its peak in **March 2018**, the crisis reached a staggering **₹10.36 lakh crore** in gross NPAs, representing a system-wide **GNPA ratio of 11.46%**.

Peak vs. Current Scale

The crisis was primarily concentrated in Public Sector Banks (PSBs), which bore the brunt of aggressive lending to infrastructure and industrial sectors between 2010 and 2014.

2.1 . Magnitude at Peak (March 2018):

- **Total Gross NPAs:** Peak of ₹10.36 lakh crore.
- **GNPA Ratio (SCBs):** Reached 11.46%.
- **PSB-Specific Stress:** The GNPA ratio for Public Sector Banks peaked even higher at 14.58%.
- **Concentration:** Just 100 companies accounted for approximately 43% (₹4.02 lakh crore) of total NPAs as of March 2019.

2.2. Current Scale (as of September 2025):

- **Total Gross NPAs:** Reduced significantly to ₹4.32 lakh crore.
- **GNPA Ratio (SCBs):** Dropped to a multi-decadal low of 2.1% to 2.15%.
- **Net NPA Ratio:** Fell to a record low of 0.5%, indicating that banks have successfully provisioned for the majority of their remaining bad loans.

3. IMPACTS OF NPA CRISIS ON CREDIT GROWTH

The Non-Performing Assets (NPA) crisis in India, peaking after 2013 and 2018, severely restricted credit growth by eroding bank profitability and capital, forcing banks to adopt risk-averse lending. High NPAs led to increased provisions, reducing funds available for fresh lending, specifically hurting infrastructure and industrial sectors. This resulted in a "credit crunch," restricting economic growth and reducing the capacity for new industrial investment.

- ❖ **Reduction in Lending Capacity:** As NPAs rise, banks must allocate more capital to provisioning (setting aside funds for bad loans). This reduces their profitability and their ability to lend fresh capita

- ❖ **Risk-Averse Lending (Credit Crunch):** Banks become highly cautious, slowing down the loan approval process, especially for corporate and infrastructure projects, slowing down credit growth.
- ❖ **Sectoral Impact:** Industries like iron and steel, textiles, mining, and aviation experienced severe funding issues due to the high concentration of bad loans in these sectors.
- ❖ **Impact on Bank Valuation and Capital:** The accumulated losses from bad loans undermine the financial stability of Public Sector Banks (PSBs), hindering their ability to raise fresh capital from the market.
- ❖ **Policy Response:** The RBI has taken various measures to combat this, including restructuring, Asset Quality Reviews (AQR), and the implementation of the Insolvency and Bankruptcy Code (IBC).

Causes of the NPA Crisis

- **Economic Slowdown:** Reduced economic activity, lower demand, and poor business performance have made it difficult for companies to repay loans.
- **Poor Credit Appraisal:** Inadequate monitoring of loan accounts and weak risk management practices.
- **Structural Bottlenecks:** Delays in project implementation and legal bottlenecks in the debt recovery process.

4. MACROECONOMIC CONSEQUENCES

- a. Slower industrial growth
- b. Stagnation in job creation
- c. Banking sector instability
- d. Increased fiscal burden due to bank recapitalization.

5. POLICY RESPONSES

Policy responses to the non-performing assets (NPA) crisis in India have evolved from crisis management to a proactive, forward-looking regulatory framework. By early 2026, these measures have successfully driven the Gross NPA ratio to a historic low of approximately **2.1% to 2.15%**.

5.1 Legislative & Institutional Frameworks

- ❖ **Insolvency and Bankruptcy Code (IBC), 2016:** Remains the cornerstone of resolution. As of September 2025, over **8,600 cases** were admitted, with creditors realizing approximately **₹3.99 lakh crore** through approved plans. A 2025 amendment bill further aims to accelerate timelines and introduce "creditor-led" insolvency.
- ❖ **National Asset Reconstruction Company Ltd (NARCL):** Known as the "Bad Bank," it was established to take over and resolve stressed debt worth **₹2 lakh crore**. By December 2025, it had acquired **30 borrower entities** with an aggregate debt exposure of **₹1.63 lakh crore**.
- ❖ **SARFAESI Act, 2002:** Continues to empower banks to seize and auction pledged assets without court intervention for loans above ₹1 lakh. Recent updates require banks to publicly disclose information on repossessed assets to enhance transparency.

- ❖ **Fugitive Economic Offenders Act:** Strengthened to enable the seizure and repatriation of assets from high-profile defaulters who flee the country.

5.2 RBI Regulatory Reforms

- **Expected Credit Loss (ECL) Framework:** In a landmark shift from the "incurred-loss" model, the RBI issued draft directions in late 2025 requiring banks to provide for potential future losses. Full implementation is slated for **April 1, 2027**.
- **Prompt Corrective Action (PCA) Extension:** The PCA framework, which restricts weak banks from certain activities, was extended to **Government NBFCs** (effective October 2024) and **Urban Cooperative Banks** (effective April 2025) to ensure early intervention.
- **Risk-Based Deposit Insurance:** Starting in late 2025, the uniform premium for deposit insurance was replaced with a **risk-based structure**, where stronger banks with better asset quality pay lower premiums.
- **Prudential Framework (2019):** This ongoing framework mandates early recognition and reporting of stress (even one-day defaults) and requires a time-bound resolution plan.

5.3 Government Strategy (The "4R's")

The government's comprehensive **4R's Strategy** continues to guide the sector's health:

- Recognition:** Transparently identifying bad loans through the Asset Quality Review (AQR).
- Resolution:** Using the IBC and Debt Recovery Tribunals (DRTs) for recovery.
- Recapitalisation:** Infusing capital into Public Sector Banks (PSBs) to maintain Capital Adequacy Ratios (CRAR).
- Reforms:** Implementing the **EASE (Enhanced Access and Service Excellence)** agenda, currently at version **7.0**, which focuses on risk assessment and digital transformation.

5.4 Emerging Structural Changes (Budget 2026)

- **Banking Committee for Viksit Bharat:** Announced in the 2026 Union Budget to recommend structural reforms, including potential **further consolidation (mergers)** of PSU banks to achieve global scale.
- **NBFC Overhaul:** New market reforms aimed at simplifying the tariff structure and supporting domestic manufacturing

6. THE NON-PERFORMING ASSETS (NPA) CRISIS IN INDIA

Undergone a significant transformation, moving from a peak "Twin Balance Sheet" crisis in 2018 to a period of historic resilience by early 2026. While high NPAs historically acted as a major drag on credit growth, the recent clean-up has paved the way for robust, though now moderating, lending activity.

6.1 Current NPA Status and Trends (2025–2026)

- Historic Lows:** As of September 2025, the Gross NPA (GNPA) ratio for Scheduled Commercial Banks (SCBs) reached a **multi-decadal low of 2.1% to 2.15%**, down from a peak of 11.5% in March 2018.

- b) **Net NPAs:** The Net NPA (NNPA) ratio, reflecting actual risk after provisions, fell to **0.5%** by March 2025.
- c) **Public vs. Private:** Public Sector Banks (PSBs) saw the most dramatic recovery, with GNPA's dropping from 9.11% in 2021 to **2.5%** by Q1 FY2026. Private banks maintained even healthier ratios at approximately **1.8%**.
- d) **Future Outlook:** Projections suggest NPAs may have bottomed out; the GNPA ratio is expected to stay range-bound between **2.3% and 2.5%** through March 2026.

6.2 Impact on Credit Growth

The relationship between NPAs and credit growth in India is historically inverse: high bad loans lead to risk aversion and "credit shocks," while lower NPAs enable expansion.

- a. **Recovery-Led Expansion:** Following the balance sheet clean-up, credit nearly tripled between 2015 and 2025, reaching **₹181.34 lakh crore**.
- b. **Current Growth Rates:** Credit growth remained healthy at **11.4% in FY2025** and is projected at **10.8% for FY2026**.
- c. **Converging Trends:** In 2025, credit and deposit growth began to converge (both around 10%), reducing the pressure on banks to hike deposit rates to fund aggressive lending.
- d. **Shift in Leadership:** For the first time in 14 years, **PSU banks overtook private banks** in credit growth during 2025, driven by competitive pricing and retail expansion.

7. RECENT TRENDS POST 2020

Post 2020, the Indian banking sector transitioned from a "Twin Balance Sheet" crisis to a period of historic resilience. Recent trends (2021–2026) are defined by a sharp reduction in legacy bad loans, robust credit expansion, and emerging risks in the retail and finch segments.

7.1 Significant Decline in NPA Ratios

- **Multi-Decade Lows:** The Gross NPA (GNPA) ratio of Scheduled Commercial Banks (SCBs) fell from a peak of 11.5% in 2018 to a historic low of **2.1% to 2.2% by September 2025**.
- **Net NPA Improvement:** The Net NPA (NNPA) ratio reached a record low of **0.5% to 0.6%** in 2025.
- **Public Sector Bank (PSB) Turnaround:** PSBs saw the most dramatic recovery, with GNPA's dropping from **9.11% in March 2021 to 2.5% in early 2026**.

7.2 Credit Growth and Sectoral Shifts

- **Expansion Phase:** Domestic credit nearly tripled between 2015 and 2025, reaching **₹181.34 lakh crore** by March 2025.
- **Retail Dominance:** Retail loans have surpassed industrial and service loans as the largest component of lending portfolios (32.9% in 2024).
- **MSME Resilience:** NPAs in the MSME segment declined from **8.7% in 2021 to 3.6% in March 2025**, supported by government guarantee schemes like ECLGS.

7.3 Emerging Risks and Regulatory Vigilance

- **Unsecured Loan Stress:** The RBI flagged rising slippages in the **unsecured retail segment** (credit cards, personal loans), which accounted for nearly **40% of fresh NPAs** in FY2024.
- **Fintech & Digital Lending:** Rapid growth in app-based lending led to a debt trap for younger borrowers, with delinquency rates reaching **5% for those under 25**.
- **Write-off Trends:** While GNPA ratios are low, critics note that part of the decline is driven by **aggressive write-offs** (₹1.58 lakh crore in FY2025 alone) and loan sales to Asset Reconstruction Companies (ARCs).

7.4 Strengthening Financial Buffers

- **Capital Adequacy:** The Capital to Risk-Weighted Assets Ratio (CRAR) rose to **17.36%** by March 2025, ensuring banks have enough capital to handle potential macroeconomic shocks.
- **Profitability Highs:** Net profits for SCBs hit an all-time high of **₹4.01 lakh crore** in FY2024-25, a significant jump from ₹2.63 lakh crore in FY2022-23.

Key Data Summary (2018 vs. 2025/26)

Metric	2018 (Peak Crisis)	2025/2026 (Recent Trend)
Gross NPA Ratio	11.5%	2.1% – 2.3%
Net NPA Ratio	~6.0%	0.5% – 0.6%
SCB Net Profit	Systemic Loss	₹4.01 lakh crore (FY25)
Capital Adequacy (CRAR)	12.9%	17.36%

8. CRITICAL EVALUATION

A critical evaluation of India's post-2020 NPA management reveals a transition from **systemic instability** to **structural resilience**, though not without lingering shadows. The sharp decline in GNPA ratios to **2.1%** is a triumph of the "4R" strategy and the **IBC framework**, which successfully shifted the power balance from dominant debtors to creditors. However, this statistical recovery is partially curated; a significant portion of the reduction stems from **aggressive write-offs**—exceeding **₹1.5 lakh crore** annually—rather than pure recoveries, which raises questions about long-term capital efficiency. Furthermore, while the corporate "Twin Balance Sheet" crisis has subsided, a new vulnerability is emerging in **unsecured retail credit** and **micro-lending**, where rapid digitalization has outpaced traditional risk assessment. The shift from an "incurred loss" to an "**expected credit loss**" (ECL) model marks a sophisticated regulatory evolution, yet its implementation will test the bottom lines of smaller banks. Ultimately, while the banking sector is currently its strongest in a decade, its future stability depends on whether it can manage the **fragmented stress** of millions of small retail borrowers as effectively as it did the concentrated defaults of a few large industrial houses.

9. FUTURE OUTLOOK

To effectively manage NPAs, it's imperative for regulatory authorities to continue refining the regulatory framework and legal processes. This includes improving the insolvency and bankruptcy framework, streamlining legal procedures for loan recovery, and introducing reforms that expedite the resolution of stressed assets. By enhancing the regulatory environment, the banking sector can benefit from a more efficient and transparent mechanism to deal with NPAs. Transparency in financial reporting and ethical business practices are essential to prevent NPAs. Banks should disclose accurate and timely information about their asset quality, provisioning, and loan portfolios. Simultaneously, borrowers must adhere to ethical conduct and provide accurate financial information to banks. Encouraging a culture of transparency and accountability can reduce instances of willful default and diversion of funds.

10. CONCLUSION

The NPA crisis revealed deep structural issues in India's banking and corporate sectors. Its impact on credit growth was severe, leading to reduce investment and slower economic momentum. While reforms like the IBC and regulatory tightening have improved the situation, ensuring sustainable credit growth requires continued vigilance, better governance and stronger financial discipline.

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