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Banking update and Monetary Policy Expectations

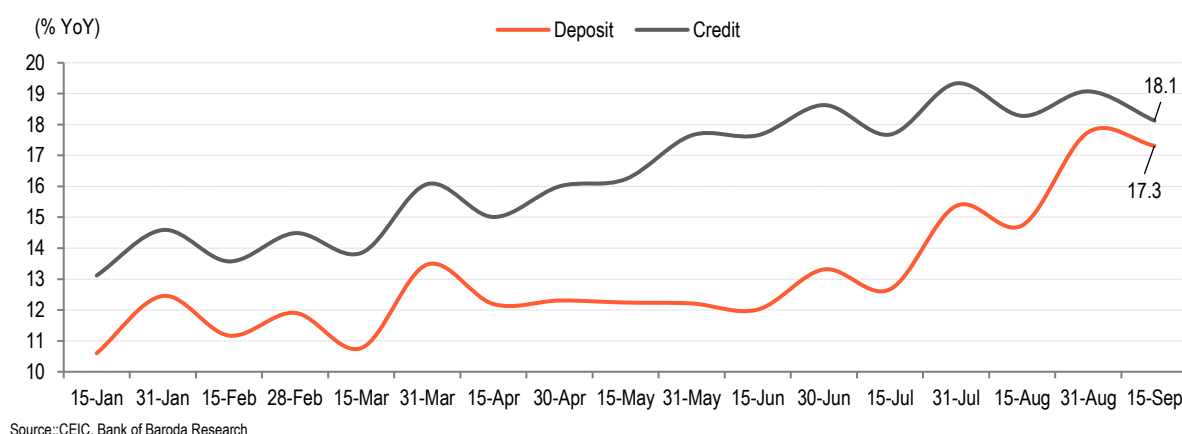
Credit deposit growth in India continues to remain buoyant. In recent times, the gap between credit-deposit growth has declined sharply driven by an increase in deposits, due to the surge in FCNR (B) deposits. On the credit side, growth has been broad-based, with industry and services growth outpacing the overall growth in credit. Within industry, infrastructure and export-oriented sectors continuing to outperform.

We expect the MPC to hold rates steady in this policy. The stance is also expected to be maintained at neutral with a cautious tone. Domestic growth has been strong. While inflation is seen inching up, the current print of 4.8% does not necessarily warrant a rate hike. While risks to the inflation outlook are tilted to the upside, the MPC can adopt a wait-and-watch approach to see if the risks materialise and to what extent. We expect the RBI to hike rates in Dec'26, with a cumulative 50-75bps rate hike expected in this cycle. This will also help support festive demand and soften bond yields.

Credit-Deposit growth rate:

Credit growth by SCBs remained buoyant at 18.1% as of 15 Sep 2026, compared with 10.4% in the same period last year. Deposit growth of SCBs has also shown significant traction at 17.3% as of 15 Sep 2026 versus 9.5% in the same period last year. Despite the pickup, credit growth continues to outpace the growth in deposits even though the gap has narrowed substantially. The credit/deposit ratio has declined from a high of 83.4% as of 15 Jun 2026 to 80.8% as of 15 Sep 2026.

Figure 1: Gap between credit and deposit growth has narrowed



However, in terms of incremental credit/deposit, while incremental credit in FYTD27 stands at Rs. 9.7 lakh crores, incremental deposits have been much higher at Rs. 13.9 lakh crores. The incremental credit/deposit ratio stands at ~70%.

Decomposition of deposits: In terms of breakup of deposits, both demand and time deposits have shown a remarkable growth of 16.6% and 17.4% respectively in Sep'26 versus 10.4% and 7.0%

respectively in the same period last year. However, on an incremental basis, while time deposits have increased by Rs. 17.5 lakh crores, demand deposits have declined by Rs. 3.5 lakh crores in the same period. A large part of the increase in time deposits can be attributed to the surge in FCNR (B) deposits, due to the concessional swap window provided by the RBI.

Sectoral Growth in credit:

Information on the sectoral credit growth is available till Aug'26, which has been presented in the Table below. The following points stand out:

- Credit growth has been broad-based with all sectors witnessing a steady improvement last year.
- Credit to agriculture has improved from 7.3% last year to 17% in the current year.
- Growth in credit to the industry has significantly accelerated to 20% this year from 6% last year. The increase is broad-based, with credit to both the MSME and large corporates expanding at a healthy pace. Most notably, there has been a substantial pickup in credit growth by large corporates to 17.7% compared with 1.6% last year.

Table 1: Sectoral credit composition in Aug'26

Sector	Outstanding credit as of Aug'26, Rs. Crore	Aug'25, % YoY	Aug'26, % YoY
I. Bank Credit (II + III)	2,23,87,567	10.3	19.1
II. Food Credit	1,12,042	112.0	145.8
III. Non-food Credit	2,22,75,525	10.2	18.8
1. Agriculture and Allied Activities	27,25,109	7.3	17.0
2. Industry	47,95,352	6.5	20.0
Micro and Small	11,15,359	20.9	22.6
Medium	4,88,702	15.0	30.5
Large	31,91,291	1.6	17.7
3. Services	62,97,792	10.3	24.3
--NBFCs	21,63,602	3.7	37.5
--Trade	14,17,710	12.3	20.1
--Other Services	12,84,672	16.4	15.4
--Commercial Real Estate	6,74,841	13.2	22.5
--Transport Operators	2,93,295	9.7	8.6
--Professional Services	2,27,714	13.5	15.5
--Tourism, Hotels and Restaurants	1,10,488	6.5	28.3
--Aviation	60,606	2.3	32.1
--Computer Software	53,660	35.2	41.8
--Shipping	11,203	23.0	25.6
4. Personal Loans	72,87,218	11.9	16.9
--Housing	34,54,820	9.7	11.1
--Other Personal Loans	17,95,851	7.6	15.0
--Vehicle Loans	7,75,704	8.7	19.7
--Loans against gold jewellery	5,59,468	130.2	83.2
--Credit Card Outstanding	2,99,201	4.4	3.6
--Advances against Fixed Deposits	2,04,273	16.9	43.2
--Education	1,63,555	14.6	13.2
--Consumer Durables	23,295	-5.8	2.4
--Advances to Ind. against share, bonds, etc.	11,050	0.9	12.7

Source:CEIC, Bank of Baroda Research

- Within industry, credit growth is being driven by the infrastructure segment, particularly power and road.

- Apart from this, export intensive sectors such as engineering, chemicals, textiles, gems and jewellery, pharma etc too recorded strong growth, largely reflecting the buoyancy in India's exports.
- Services sector credit growth continues to be underpinned by expanding credit offtake to the NBFCs sector. Bank credit to the NBFCs sector rose by 37.5% in Aug'26, the highest since Dec'19.
- Other segments of services i.e. trade, commercial real estate, tourism, hotels etc. and aviation also recorded a significant acceleration in credit growth.
- On the other hand, credit to transport operators has moderated in the current year.
- Growth in retail loans stood at 16.9% in Aug'26 compared with 11.9% in Aug'25.
- Within retail loans, significant acceleration can be seen in other personal loans, advances against fixed deposits and advances against shares, bonds etc. At the same time, advances against gold jewellery have continued to grow at a robust pace of 83.2% in the same period.
- Housing credit has remained largely stable at 11.1% in Aug'26, largely due to a slowdown in housing sales in major metro cities and higher housing prices.
- Auto loans have seen acceleration due to continued demand for premium cars and EVs.
- On the other hand, education loans have witnessed a marginal slowdown.

Lending/Deposit rate:

Lending and deposit rates of SCBs have declined since Jan'25 (RBI started rate cuts), however, the transmission has not been complete and varies across banks. While RBI reduced policy repo rate by 25bps, the weighted average lending rates of SCBs on fresh rupee loans, declined by 64bps in the same period. For PVBs, the transmission was higher with WALR declining by 97bps, while for PSBs the WALR declined by only 55bps. This can be attributed to a higher share of EBLR loans for PVBs. In fact, share of EBLR loans for PVBs stood at 90.8% in Jun'26. For PSBs, while the share of EBLR loans in total loan portfolio has increased from 44.6% in Dec'24 to 53.6% in Jun'26, it still remains significantly lower than PVBS which makes transmission difficult. In terms of sectors, transmission to segments such as rupee export credit (149bps) and education (146bps) has been higher than the cumulative reduction in policy repo rates. At the same time, transmission has been near complete in sectors such as MSMEs (115bps) and vehicle (110bps). On the other hand, transmission to sectors such as trade (45bps), large corporate (60bps) and agriculture (60bps) has been much slower.

Table 2: Sectoral credit composition in Aug'26

Rate on Fresh loans/deposits	Jan-25	Mar-26	Apr-26	May-26	Jun-26	Jul-26	Aug-26
WALR							
--PSBs	8.59	7.84	7.87	7.93	8.03	7.98	7.99
--PVBs	10.20	9.12	9.19	9.12	9.12	9.09	9.19
--SCBs	9.33	8.40	8.50	8.51	8.53	8.52	8.61
WADTDR							
--PSBs	7.06	6.44	6.14	6.29	6.34	6.35	6.20
--PVBs	6.70	6.26	6.01	5.94	6.21	5.96	5.82
--SCBs	6.62	6.07	5.76	5.80	5.95	5.85	5.67

Source: RBI Bank of Baroda Research

While not complete, transmission to deposits rates has been higher than lending rates. For SCBs, the weighted average domestic term deposit rate (WADTDR) has declined by 95bps. Across bank groups, the transmission has been more or less equal with WADTDR for PSBs declining by 86bps, and PVBs by 88bps. Incidentally, since Jun'26 there has been a sharp decline in WADTDR of SCBs (28bps), largely contributed by PVBs (39bps). This can be attributed to lower pressure on banks to mobilize deposits due to a surge in FCNR (B) deposits, especially PVBs.

Expectations from the Monetary Policy

What has changed since the last policy?: A few notable developments have taken place since the last policy meeting by the RBI in Aug'26. On the global front, hostilities between US and Iran flared once again, pushing oil prices firmly above the US\$ 100/bbl mark. In fact, oil prices have increased by about 28% since 5 Aug 2026. Second, US Fed raised its policy rates by 25bps, after holding rates steady since Dec'25. India's bond yields have hardened significantly by 44bps since the last policy, reflecting both global as well as domestic factors. CPI inflation in India inched up to 4.8% in Sep'26.

Expectations from MPC: We expect the RBI to keep both the repo rate as well as the stance unchanged with a very cautious tone. Hence, the policy repo rate is expected at 5.25%, and the stance to be maintained at neutral.

Revision to growth and inflation forecasts: GDP forecast is expected to be revised higher, reflecting the stellar growth performance in Q1. Inflation forecast could be revised marginally higher, tracking current trends in prices of key commodities.

Rationale for this decision:

1. **Domestic growth scenario:** GDP growth in Q1 FY27 surpassed estimates. At 7.8% GDP growth was much higher than RBI's own estimate of 7%. Pickup in investment and consumption, supported the strong growth performance. In Q2 FY27, high frequency indicators point towards a continued resilience in the face of a volatile external environment. India's manufacturing and services PMI registered a sequential improvement in Sep'26 rising to 55.1 (52.8 in Aug'26) and 55.8 (54.1 in Aug'26) respectively. IIP growth too has been expanding at a faster pace of 7.7% in Jul-Aug'26 compared with 6.2% in Q1 FY27, led by an improvement in manufacturing output. Exports too have increased at a healthy pace, despite external headwinds. Other indicators such as auto sales, GST collections, port cargo traffic, vehicle registrations, diesel consumption, state-wise stamp duty collections and state tax receipts have also shown traction. This suggests that the GSP growth trajectory is likely to overshoot RBI's estimates. We expect GDP growth in the range of 7-7.2% in FY27. This gives RBI room to keep rates steady at the present juncture.
2. **Inflation:** Domestic inflation has been on an upward trajectory after falling to 0% in Oct'25. In Q1 FY27, inflation averaged 3.9% which was below RBI's estimates. Headline inflation increased further in Jul-Aug'26 to an average rate of 4.6%. High-frequency price data suggests that inflation is likely to have inched up further in Sep'26, possibly overshooting RBI's estimate of 4.8% for Q2 FY27. However, headline inflation continues to trade within RBI's target range

of 2-6%. While inflationary pressures have intensified in recent days, the risks largely stem from the food basket, even as core inflation has remained broadly contained. Inflation expectations too have remained anchored. More importantly, the most recent inflation print of 4.8% is within RBI's expected trajectory and does not warrant any rate action. Hence, RBI could possibly look beyond the current policy and keep rates steady at this point and wait for a few more data points before deciding to hike rates in Q3 FY27.

3. **Festive season:** Another factor which the RBI must consider before raising rates is that a rate hike just before the onset of the festive season could affect demand prospects. Private consumption has registered a strong growth rate in Q1 FY27. Demand indicators since then too have been promising (GST collections, non-oil-non-gold imports, auto sales). A rate hike at this juncture, especially ahead of the peak spending period, could slow the momentum in demand and affect growth prospects.
4. **Transmission of rate hike:** Given that there has been a huge liquidity surplus in the system, transmission of a rate hike could become challenging. In Aug'26, liquidity surplus in the system averaged Rs. 3.7 lakh crores and further to Rs. 7.8 lakh crores in Sep'26. RBI has been managing the liquidity situation by conducting VRRR auctions as well as OMO sales operation. Even so, domestic liquidity continues to remain above 1% NDTL.
5. **Hardening bond yields:** India's bond yields have inched up significant since the last policy. Higher global oil prices, FPI outflows from the debt segment, higher global bond yields and possibility of a rate hike have kept bond yields elevated. Since RBI's last policy, the yield on India's 10Y benchmark security has inched up by 44bps and currently stands at 7.12%, a 29-month high. Similar trend has been observed in short-term rates, with yields on 91-day, 182-day and 364-day T-bill rate rising by 38bps, 44bps and 42bps respectively since the last policy. RBI's decision to keep policy rate steady would send a positive signal to the market and could help in softening bond yields.

To sum up: We expect RBI to keep policy rate steady at 5.25% in the coming policy given the current growth-inflation dynamics. Domestic growth has shown continued resilience. Inflation has been inching up but continues to remain within RBI's 4% (+/-2%) range. Rising global oil prices and weak monsoon and sowing activity are key risks to the outlook. RBI's projections suggest that inflation is expected to peak in Q3 FY27. At the current juncture, a rate hike could be avoided as RBI keeps a close watch on the evolving inflation trajectory. We expect the RBI is likely to hike rates only in Dec'26, with a cumulative 50-75bps rate hikes expected in this cycle.

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