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SOCIO-ECONOMIC VOICES



"Fed Hike, Weak Rupee Can Soon Mean Higher Home Loan EMIs"

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"Cash Flow, Not Collateral, Should Drive MSME Credit"

Intro: *The numbers look strong. Credit is racing ahead, deposits are catching up and festive demand is around the corner.* But banking strategy and economics expert **Rittika Das Saha** reads the same data and sees something different. Speaking to senior journalist **Mahima Sharma**, behind the headline growth, she points to a cushion that may not last, a link between banks and NBFCs that deserves a harder look and a deadline in 2027 that every lender should already be preparing for. In this exclusive **Indiastat** interview, the banking strategist explains what could quietly strain the system and what it means for the household paying an EMI. Our **Socio-economic Voice** of the week.

MS: With the festive season and the second half of the fiscal year underway, which structural strengths or emerging pressure points in the banking sector (such as deposit mobilisation, margins or asset quality) should policymakers watch most closely? What practical steps can strengthen resilience early?

RD Saha: The banking sector remains resilient, but policy makers should closely watch margins and emerging credit risks. The recent repo rate hike may raise borrowing costs for external benchmark-linked borrowers at contractual reset dates. While lending yields may improve, credit demand could soften, partly cushioned by festive spending.

- Rising deposit costs are likely to sustain pressure on net interest margins (NIMs) in the coming quarters.
- Export-oriented businesses and agricultural borrowers exposed to El Niño- related weather risks also warrant attention.
- Gold loans, which grew 83.2% YoY in August 2026, merit closer scrutiny given the influence of rising gold prices on collateral valuations and the need for robust fraud controls. Banks must also track early signs of borrower stress. This is particularly in Special Mention Accounts (SMAs), ahead of the Expected Credit Loss (ECL) framework's implementation on April 1, 2027.

The priority should be to translate early warning signals into timely, borrower specific action. Banks can use parallel ECL assessments to anticipate potential provisioning pressures and identify vulnerable portfolios ahead of implementation. For export-oriented MSMEs and agricultural borrowers, indicators such as order book cancellations, export realisations, crop conditions and repayment patterns can help distinguish temporary liquidity stress from deeper credit deterioration. In gold lending, independent collateral checks can help identify purity discrepancies and potential fraud. Such measures would strengthen resilience through earlier intervention and better informed credit decisions, rather than adding layers of routine monitoring.

MS: Bank credit was up about 18.6 per cent year on year in mid-August. Deposits were growing near 12 per cent in mid-June. How worrying is this gap for bank stability?

RD Saha: I would view the credit-deposit (CD) gap as a funding vulnerability rather than an immediate threat to banking stability. As of September 30, 2026, bank credit grew 19.4% YoY against deposit growth of 17.8%, narrowing the gap to around 1.6 percentage points. However, this narrowing has been supported by exceptional FCNR(B) mobilisation and should not be mistaken for a structural improvement in domestic deposit mobilisation.

The underlying funding challenge persists. Elevated inflation can erode the real returns on deposits, while expectations of further rate hikes may encourage households to favor shorter tenures or defer locking in rates. Banks also face competition from NBFCs offering attractive deposit rates, intensifying the challenge of securing stable funding at a reasonable cost. Meanwhile, the RBI's withdrawal of surplus system liquidity, alongside tighter daily CRR maintenance, may reduce banks' flexibility in managing short-term liquidity needs. If these conditions persist, banks could become more reliant on market borrowings or compete more aggressively for domestic deposits, pushing up marginal funding costs.

To address these pressures, banks must strengthen domestic deposit mobilisation and align credit expansion with sustainable funding capacity. The system-wide credit-deposit (CD) ratio also warrants close attention, as aggregate figures may mask tighter funding conditions at individual banks. Ultimately, the resilience of the banking system will depend not only on deposit growth, but also on stability, cost and composition of its funding base.

MS: Basic account access is now widespread. What would be the most effective next step to move people from simply holding accounts to actively using savings, insurance, pension and credit products, especially in smaller towns and rural areas?

RD Saha: The Pradhan Mantri Jan Dhan Yojana (PMJDY) has made significant progress in expanding financial inclusion. Between September 2024 and September 2026, the number of beneficiaries increased from 53.61 crore to 59.49 crore, while deposits rose from ₹2.32 lakh crore to ₹3.20 lakh crore, registering a two-year CAGR of around 17.5%. However, the next challenge is to translate access into sustained financial participation. Mint reported that 15.42 crore Jan Dhan accounts were inoperative as of September 2026, accounting for nearly one in every four accounts. This underscores the persistent gap between account ownership and active usage.

The priority should be to understand the reasons for inactivity and link accounts to regular DBT receipts, digital payments, recurring savings, micro-insurance, pensions and suitable credit products. In smaller towns and rural areas, banking correspondents can play a crucial role through assisted transactions, doorstep services and local language financial awareness. Account reactivation should be supported by appropriate KYC and fraud-prevention checks, while products must be tailored to customers' cash flows and financial needs. The effectiveness of financial inclusion should therefore be assessed not merely by the number of accounts opened, but by their regular usage and the extent to which they enhance customers' financial security and access to formal financial services.

MS: Which sectors do you expect to drive credit demand over the coming months (last two quarters of the financial year)? And what can lenders and regulators do to ensure that MSMEs and small borrowers get their fair share of this growth?

RD Saha: Over the next two quarters, infrastructure and manufacturing are likely to remain key drivers of credit demand, with services providing additional momentum. RBI data show that industrial credit grew 18.2% YoY in August 2026, while services credit expanded by 24.3%. The key transmission channel is the crowding-in of private

investment: public capital expenditure on transport, energy and logistics can improve project viability and generate demand for private capacity expansion. Early signs of a revival in private capex suggest that this could translate into higher demand for project finance, industrial credit and funding for contractors, suppliers and ancillary businesses across supply chains.

MSMEs remain constrained not only by access to credit but also by the equity capital needed to expand capacity, adopt technology and access larger markets. The Government's ₹10,000 crore SME Growth Fund, approved in October 2026, seeks to bridge this gap by providing equity support to eligible enterprises with strong growth prospects.

Banks must complement this initiative by aligning lending with firms' investment requirements and providing term finance, working capital and supply chain credit. Greater use of GST records, transaction histories and cash-flow-based assessments can help viable firms secure credit even when conventional collateral is limited. Regulators, in turn, should strengthen credit information infrastructure and monitor whether credit growth is reaching smaller enterprises, particularly those integrated into infrastructure and manufacturing supply chains. The objective should be to ensure that viable MSMEs have access to financing suited to their scale and growth ambitions, enabling them to expand capacity, improve productivity and participate more fully in the investment cycle.

MS: How can the system sustain healthy credit growth while guarding against over-leverage in segments like unsecured retail loans and what early-warning practices would you recommend to lenders?

RD Saha: The risk lies in the quality of unsecured lending, not merely in headline credit growth. As of March 2026, gross NPAs in unsecured retail loans stood at 1.7%, compared with 0.7% in secured retail loans. In personal loans below ₹50,000, fintech lenders held 56.8% of the market, with delinquencies at 6.4%, compared with 5.7% for NBFCs and 4.1% for banks. Unsecured loans constituted 70.5% of fintech loan books, highlighting the need for careful assessment of borrowers' repayment capacity.

Lenders should assess borrowers' aggregate indebtedness across institutions, particularly where fresh borrowing may be used to service existing debt. Early-warning systems (EWS) should combine borrowers' aggregate outstanding obligations relative to verified income with repeated borrowing across lenders, vintage-wise default trends and collection efficiency. This can help identify emerging over-leverage before it translates into material credit losses.

At the ecosystem level, incremental credit should be channeled towards diversified, scalable and productive lending, rather than concentrated disproportionately in high yielding retail products. MSMEs offer scope for sustainable growth as expanding enterprises require working capital, term finance, trade finance and transaction banking. This would diversify credit growth beyond unsecured retail while supporting productive economic activity.

MS: RBI has raised the repo rate to 5.50 per cent after 125 basis points of cuts in 2025, while August inflation is 4.82 per cent. What does this thin real rate mean for household savers and will more hikes push up inflation in the coming months?

RD Saha: The current interest rate environment presents a challenge for household savers, particularly if inflation remains elevated. The repo rate has risen to 5.50% following 125 basis points of cuts in 2025. With CPI inflation increasing from 4.82% in August to 5.54% in September 2026, the simple ex-post real policy rate is marginally negative. However, the appropriate assessment of the real policy rate also depends on the inflation outlook. WPI

inflation rose to 11.39% in September, signaling significant upstream cost pressures and the risk of further pass-through to retail prices.

Further rate hikes, if required to contain persistent inflation, would be intended to moderate price pressures. Their effectiveness would depend on the persistence and source of inflation: monetary tightening can moderate demand and anchor expectations, but supply side pressures from food and energy prices may take longer to ease.

For households, the impact is asymmetric: EMIs on external benchmark-linked loans can rise at contractual reset dates, while returns on existing fixed deposits remain unchanged until maturity and rates on fresh deposits adjust with a lag. These pressures come against a backdrop of declining purchasing power, with reported data indicating a 5.7% decline in real wages over the three months ending July 2026. Household financial savings have also declined to 6.2% of GDP in FY26, while household debt has reached 49.1% of GDP. If incomes fail to keep pace with living costs and borrowing expenses, household repayment stress and delinquencies could increase. For savers, the key concern is whether returns on financial assets adequately compensate for inflation; for policymakers, it is to restore price stability without placing undue strain on household balance sheets.

MS: The US Fed raised rates by 25 basis points in September, its first hike in three years. The rupee has traded above 94 per dollar. How will this reach an Indian household's loan rate?

RD Saha: The US Federal Reserve's 25 bps rate hike in September may appear distant from an Indian household's borrowing costs, but global financial markets are closely interconnected. Higher US yields make dollar assets more attractive, encouraging capital to move away from emerging markets and putting pressure on their currencies. India has faced these pressures amid sustained foreign portfolio outflows, with the rupee depreciating around 6-7% this year.

A weaker rupee raises the domestic cost of imported crude oil and other inputs, adding to inflationary pressures. Persistent capital outflows can also complicate currency management, while a widening current account deficit can amplify external vulnerabilities. These developments may constrain the RBI's policy choices if currency depreciation feeds into domestic inflation.

However, a US rate hike does not automatically translate into higher Indian lending rates. The impact depends on domestic inflation, the RBI's policy response and banks' lending benchmarks. If domestic rates rise, borrowers with repo-linked floating-rate home loans may face higher EMIs or longer repayment tenures at contractual reset dates. The transmission is indirect, but global financial conditions can affect household borrowing costs.

MS: The RBI's decision to absorb the ~3.5% hedging cost allowed commercial banks to aggressively price 3-to-5-year USD FCNR(B) deposits as high as 7.1%. Given that total collections crossed $132.9 billion by the August 31 deadline, how has this massive influx of foreign currency liquidity reshaped the bank's domestic liability strategy? Specifically, did this ease the ongoing pressure to hike domestic retail term deposit and loan rates or did the operational focus required to capture this NRI window temporarily cannibalise regular domestic resource mobilisation?

RD Saha: The FCNR(B) mobilisation strengthened banks' liability positions and appears to have eased near-term pressure to compete aggressively for domestic deposits. Aggregate deposit growth accelerated from 12.2% YoY at end May to 17.8% at end August 2026. Fresh rupee term deposit rates also moderated to 5.67% in August from 5.85% in July, indicating some easing in marginal funding costs.

However, these developments do not establish that domestic deposit mobilisation was cannibalised by the operational focus on FCNR(B) deposits. The inflows should therefore be treated as a complementary funding source, with treasury management accounting for residual currency exposure on accrued interest and the eventual maturity of these liabilities.

MS: While the RBI's Special Swap Window completely protected banks' principal against exchange-rate volatility, the operational guidelines clarify that the swap window covered only the deposit principal, not the accrued interest. With banks now sitting on a portion of these multi-billion-dollar inflows, how will they structure credit deployment to match these 6% to 7.1% yields?

RD Saha: Banks should deploy the FCNR(B) resources selectively, ensuring that incremental lending generates risk-adjusted returns commensurate with the all-in cost of funds, credit risk, operating costs and capital requirements. The opportunity lies in using the additional funding capacity to meet viable credit demand while maintaining pricing discipline and aligning loan tenors and repricing profiles with the underlying liabilities.

Banks should adopt a segmented approach to credit deployment, prioritising borrowers and sectors with sound repayment capacity and attractive risk-adjusted returns. While elevated corporate bond yields may influence the relative attractiveness of bank borrowing, the recent 25 bps repo rate hike could also raise borrowing costs and moderate credit demand.

The key consideration is whether FCNR(B) inflows can improve returns on assets (RoA) through profitable balance-sheet expansion. Banks should compare the effective cost of this funding with alternative sources and deploy the funds where they offer genuine commercial advantage, rather than pursuing lending growth for its own sake.

About Rittika Das Saha

Rittika Das Saha is a banking professional with a varied and vast experience in applied economic analysis, financial markets and banking strategy. She currently serves as a Manager in the Strategy and Economic Intelligence Desk at Bank of India, where she analyses macroeconomic developments, monetary policy, financial market trends and regulatory changes to assess their implications for the banking sector and the Bank's business strategy. She has also contributed to public policy initiatives within ministerial departments of the Government of India and collaborated with international research institutions on economic and development focused assignments. She holds a Master's degree in Economics from Loyola College.

About the Interviewer

Mahima Sharma is an Independent Journalist based in Delhi NCR. She has been in the field of TV, Print & Online Journalism since 2005 and previously an additional three years in allied media. In her span of work she has been associated with CNN-News18, ANI - Asian News International (A collaboration with Reuters), Voice of India, Hindustan Times and various other top media brands of their times. In recent times, she has diversified her work as a Digital Media Marketing Consultant & Content Strategist as well. Starting March 2021, she is also a pan-India Entrepreneurship Education Mentor at Women Will - An Entrepreneurship Program by Google in Collaboration with SHEROES. Mahima can be reached at media@indiastat.com

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