

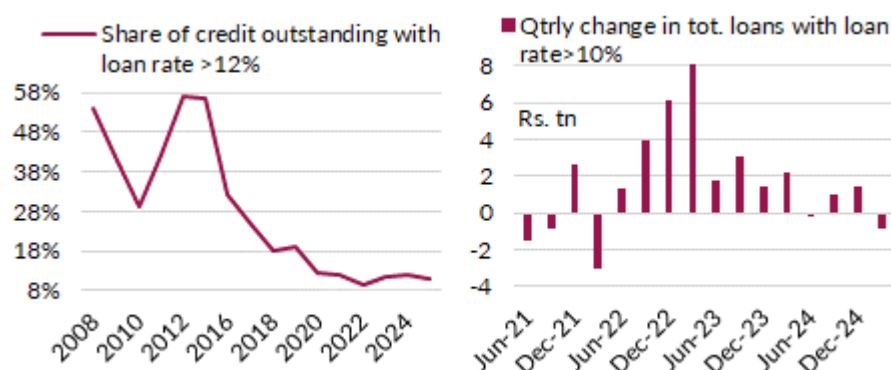
## Does Monetary Policy affect credit growth? If so, how?

How fast can credit growth pick up, and by how much? With wholesale funding costs down 175bps, cuts to savings deposit rates and term deposits repricing lower over the next 12 months, loan rates on new loans are falling. More potent, in our view, is the credit channel: FY25's loan slowdown was supply-driven, as banks pulled back on high-rate lending despite steady demand. Axis Capital banking team expects growth to rebound to 13% YoY by Mar-2026. We believe the first signs may become visible by Nov/Dec. Momentum could carry growth to the mid-teens: regulatory easing (CRR and risk weight cuts) are likely to amplify the recovery, in our view, and bank capital buffers are strong.

June 27, 2025

Monetary Policy Transmission

### Exhibit 1 - Low share of high-rate loans → supply is the bottleneck



Source: RBI, Axis Bank Research

With the RBI/MPC decisively easing monetary conditions, the debate shifts to the pace and quantum of credit revival. Of the four channels of monetary transmission – rates, credit, asset prices and exchange rates, we believe the first two are the most potent in India.

### Rates channel: a sharp fall in marginal cost of funds underway, but frictions exist

Rates on new loans (WALR in Fig 2) and policy rates (WACR) move together, but the gap between them is volatile (Fig 3), reflecting transmission lags, risk appetite, and structural shifts in the banking system. With a ~175bps fall in marginal cost of wholesale funds since Mar-2025 (repo rate cuts, fall in 12M CD-OIS spreads: Fig 6), banks have begun cutting rates on new loans. With ~60% of funding from term deposits (TDs), of which 75% are of > 1 year duration, the fall in overall marginal cost of funds may take a year. This is more challenging for PSU banks, whose historically low WALR-WACR spread provides less room to cut (Fig 5).

### Credit channel: Likely to be more potent, as FY25 slowdown was supply-driven

For faster loan growth, more important than lower loan rates is the credit channel: monetary easing helps credit availability via impact on borrowers' creditworthiness as well as lenders' risk appetite (Bernanke, 1995). The 4.3pp slowdown in YoY loan growth FY24 to FY25 (ex-HDFC merger), which has worsened in 1Q26, has been across segments (Fig 8). Evidence that it was supply-led: India's low debt-to-GDP, rising gold loans, and the high share of 12%+ loans pre-Covid (Fig 9). Loan demand is thus unlikely to be the bottleneck. A large part of the loan growth slowdown in FY25 came from banks curtailing loans at >10% rates (Fig 10, 11).

### Cuts to CRR and risk weights are likely to intensify the eventual recovery

Even as lower rates boost incremental demand, and decisive signals from the RBI reopen the credit channel, lower risk weights and reserve ratios are likely to amplify the credit cycle (link). Once loan growth picks up, momentum can take growth to mid-teens YoY. Factors that dampened the credit recovery during the 2014-16 cuts (Fig 12) are absent, and banks now have stronger capital buffers. PSU banks' tactics (like over-priced bulk deposits, Fig 16-17) have slowed transmission thus far, but may only be delaying the inevitable.

Neelkanth Mishra

Neelkanth.Mishra@axisbank.com

Prateek Ancha

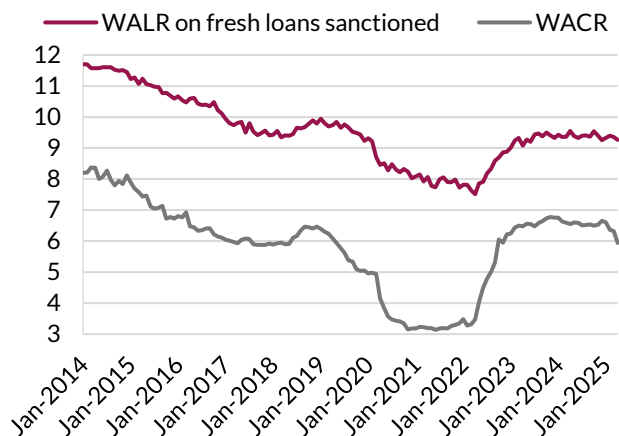
Prateek.Ancha@axisbank.com

Tanay Dalal

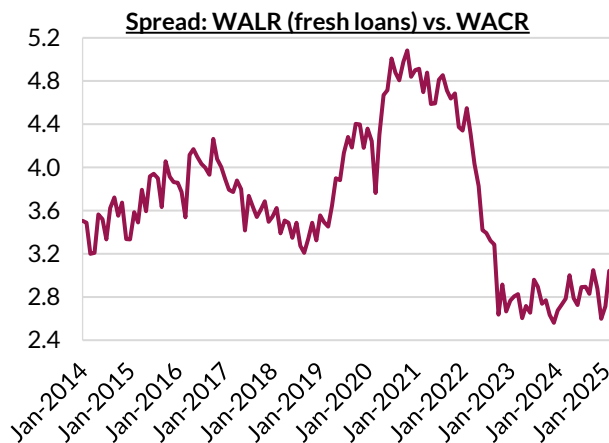
Tanay.Dalal@axisbank.com

Pulkit Kapoor

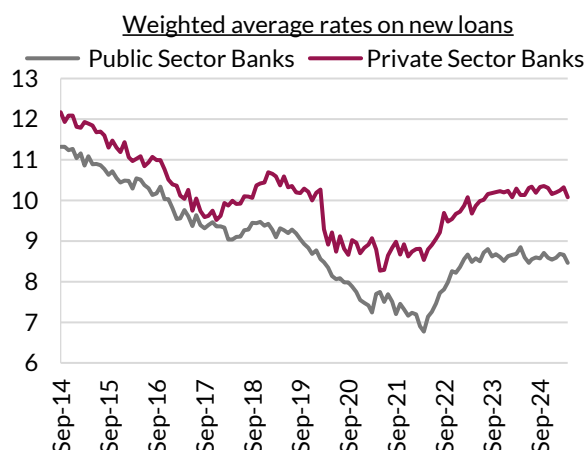
Pulkit1.Kapoor@axisbank.com

**Exhibit 2 - Policy rates and lending rates move together..**


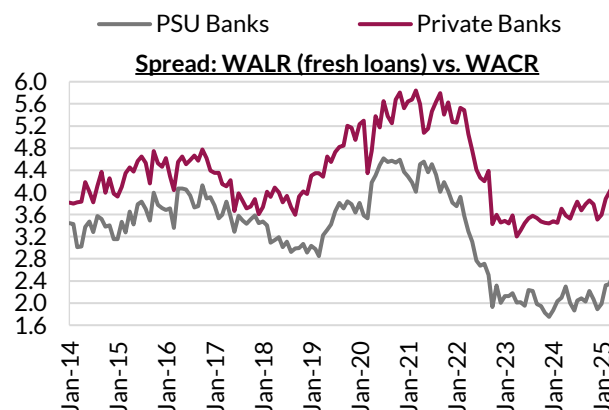
Source: RBI, Axis Bank Research

**Exhibit 3 - ... but the gap between them is not constant**


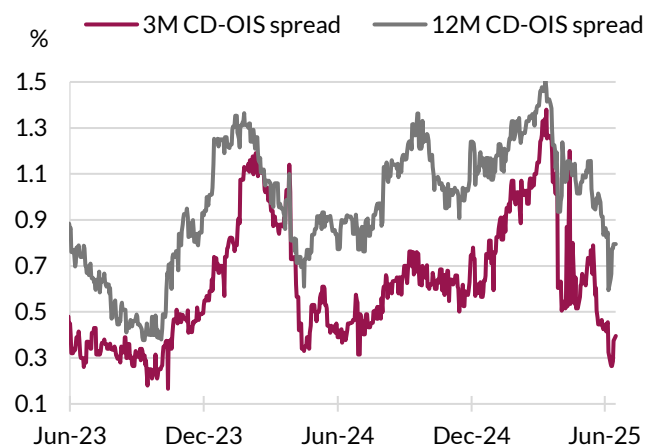
Source: RBI, Axis Bank Research

**Exhibit 4 - The gap in loan rates between private and PSU banks has doubled vs. pre-Covid average**


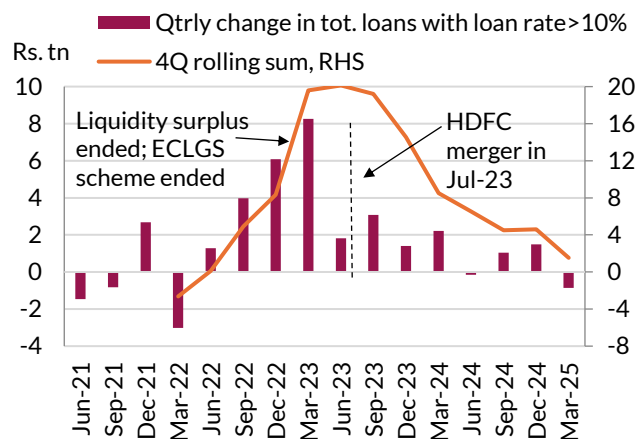
Source: RBI, Axis Bank Research

**Exhibit 5 - The already low spread for PSU banks reduces scope for meaningful further rate cuts**


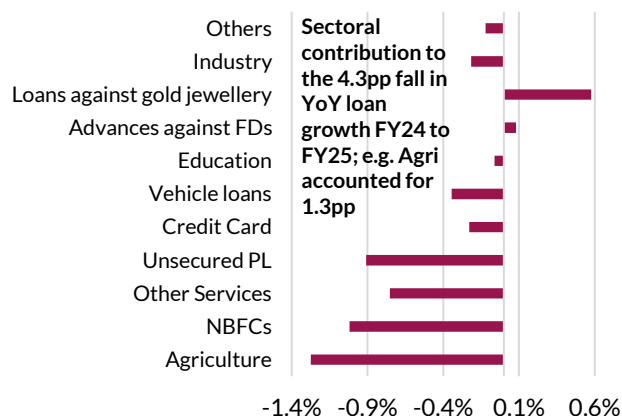
Source: RBI, Axis Bank Research

**Exhibit 6 - The cost of liquidity has eased meaningfully**


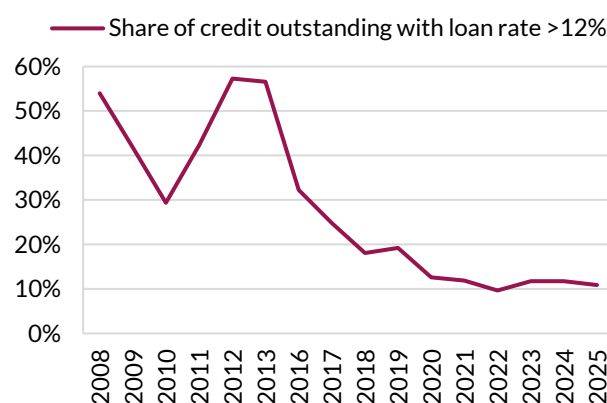
Source: RBI, Axis Bank Research

**Exhibit 7 - High-rate loans peaked when ECLGS ended; as these loans mature, banks have held back**


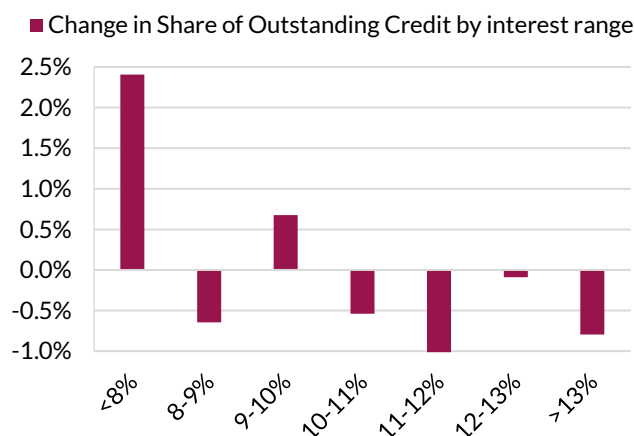
Source: RBI, Axis Bank Research

**Exhibit 8 - Loan growth slowed across segments; unsecured personal loans/CCs were only 1.1pp of the 4.3pp slowdown**


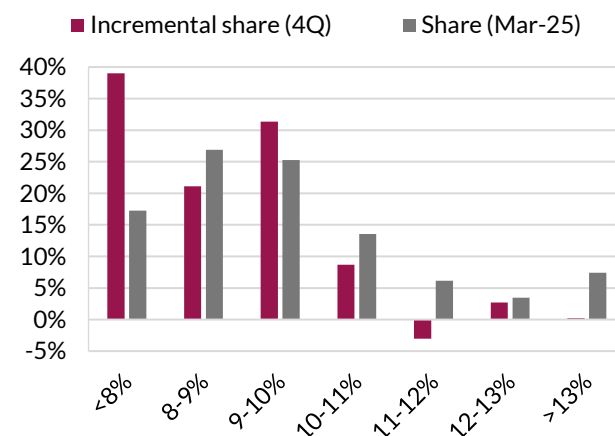
Source: RBI, Axis Bank Research

**Exhibit 9 - Share of loans in the banking system with interest rates greater than 12% is at historic lows**


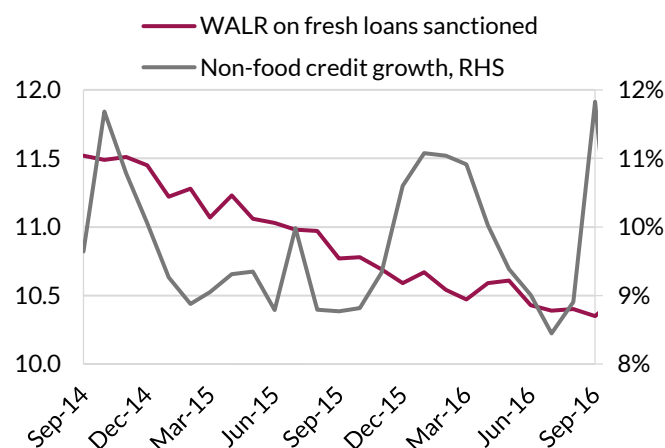
Source: RBI, Axis Bank Research

**Exhibit 10 - Banks sharply curtailed 'risky' lending in FY25**


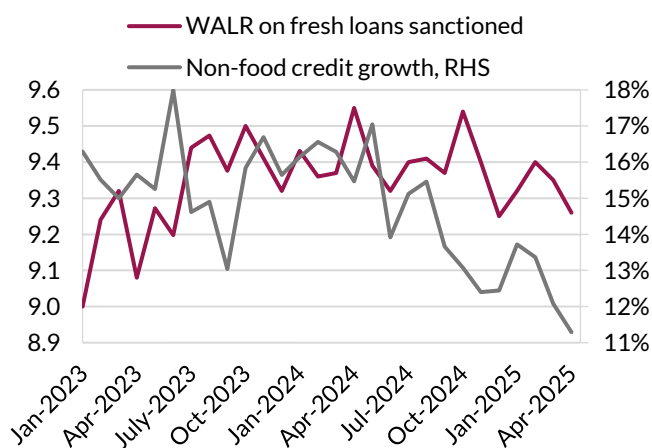
Source: RBI, Axis Bank Research

**Exhibit 11 - Reversal of this the most important**


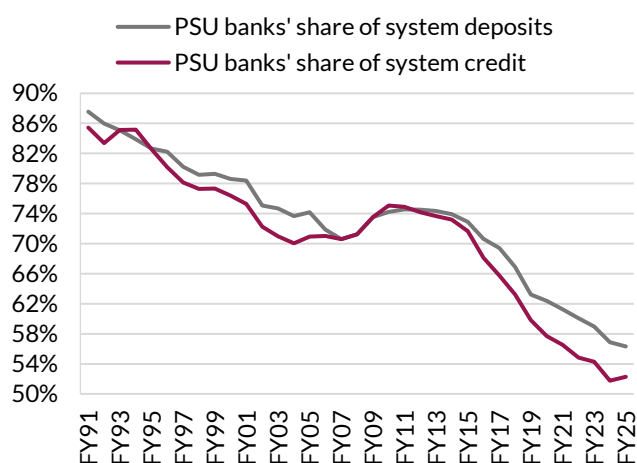
Source: RBI, Axis Bank Research

**Exhibit 12 - Falling rates did not boost demand 2014-16**


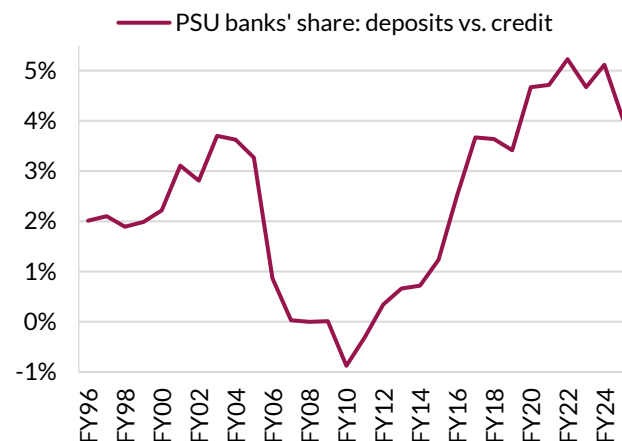
Source: RBI, Axis Bank Research

**Exhibit 13 - Even recent slowdown despite stable WALR**


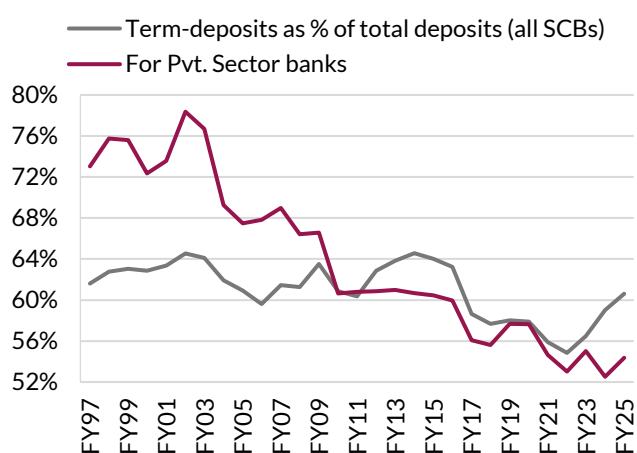
Source: RBI, Axis Bank Research

**Exhibit 14 - PSU banks share of deposits & credit still falling**


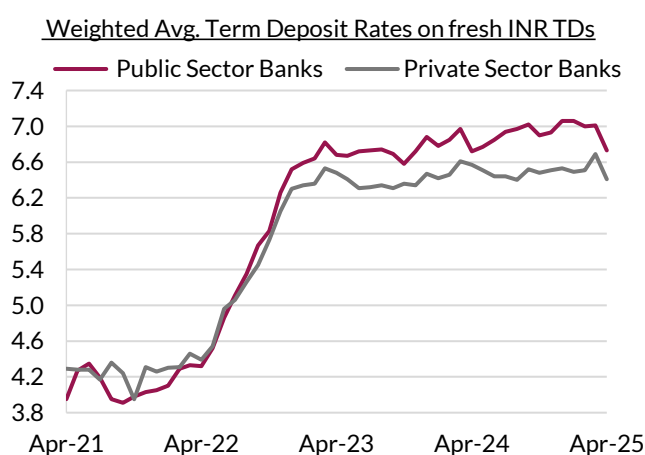
Source: RBI, Axis Bank Research

**Exhibit 15 - Their share of deposits 4pp above share of credit**


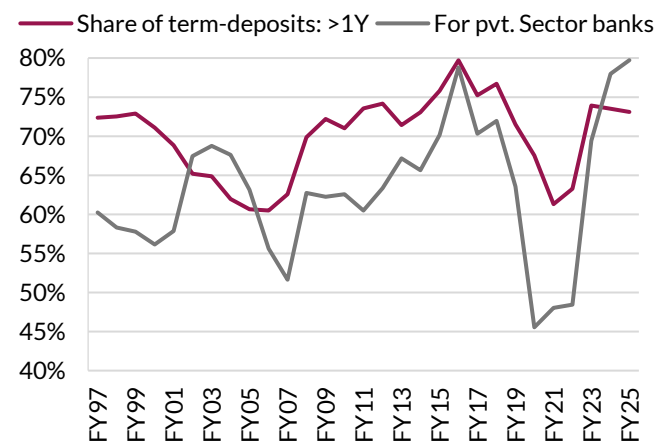
Source: RBI, Axis Bank Research

**Exhibit 16 - Private banks cutting TD reliance, but not PSUs...**


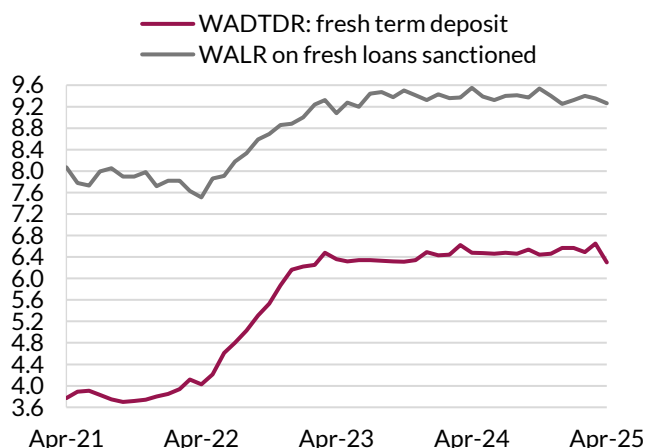
Source: RBI, Axis Bank Research

**Exhibit 17 - ... PSUs now pay 0.5pp more than private banks**


Source: RBI, Axis Bank Research

**Exhibit 18 - Higher PSU TD rates not due to longer duration**


Source: RBI, Axis Bank Research

**Exhibit 19 - System WALR can fall as WADTDR will fall too**


Source: RBI, Axis Bank Research

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