Spreads Compression Amid Asymmetric Rate Transmission in December 2025

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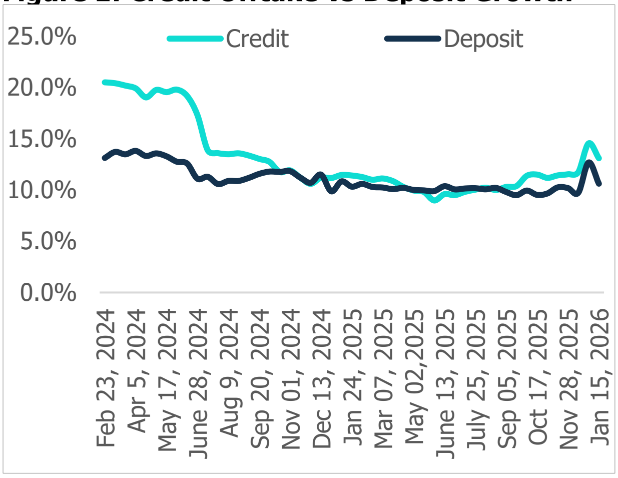
CareEdge RATINGS

Synopsis

- In December 2025, SCBs' fresh spread decreased marginally by seven bps year-on-year (y-o-y), to 2.61%, attributed to rate cut transmission, which led to faster repricing on the asset side than on the liability side. The high share of EBLR/MCLR-linked loans led to a quicker pass-through of repo rate cuts into fresh lending rates, compressing incremental yields. In contrast, deposit rates remained relatively sticky amid tighter liquidity and rising competition for deposits.
  - As of December 2025, lending and deposit rates on fresh loans for SCBs decreased by 97 and 90 basis points (bps) y-o-y to reach 8.28% and 5.67%, respectively.
- In December 2025, the spread between the outstanding (o/s) weighted average lending rate (WALR – Lending Rate) and the o/s weighted average domestic term deposit rate (WADTDR – Deposit Rate) for scheduled commercial banks (SCBs) contracted by 48 bps on a y-o-y basis, to 2.38%, reflecting differential transmission across assets and liabilities. Meanwhile, a shift in the credit mix toward better-rated corporates weighed on average lending yields. The faster pass-through on the asset side relative to liabilities has led to compression in o/s spreads.
  - The SCBs' lending rate on o/s rupee loans fell by 80 bps y-o-y to 9.06%, reflecting partial transmission of the cumulative policy rate cuts, driven by gradual repricing of the existing loan book. The pass-through to outstanding lending rates has remained incomplete due to repricing lags within the existing portfolio and banks' cautious approach. In an environment of elevated and sticky deposit costs, banks have selectively reduced lending rates on outstanding loans to contain pressure on spreads, resulting in partial transmission of policy rate cuts.
  - The deposit rate on o/s rupee term deposits declined by 32 bps y-o-y to 6.68%, driven by 18 and 34 bps reduction by private sector banks (PVBs) and public sector banks (PSBs) respectively, as banks are gradually repricing deposits to protect margins.
- In January 2026, the one-year median MCLR declined by 60 bps y-o-y to 8.40%. The moderation was primarily led by PVBs, whose one-year median MCLR fell by 80 bps to 9.20%. Meanwhile, PSBs fell 30 bps to 8.75%. Additionally, foreign banks (FBs) significantly reduced their MCLR by 92 bps y-o-y to 6.98%.

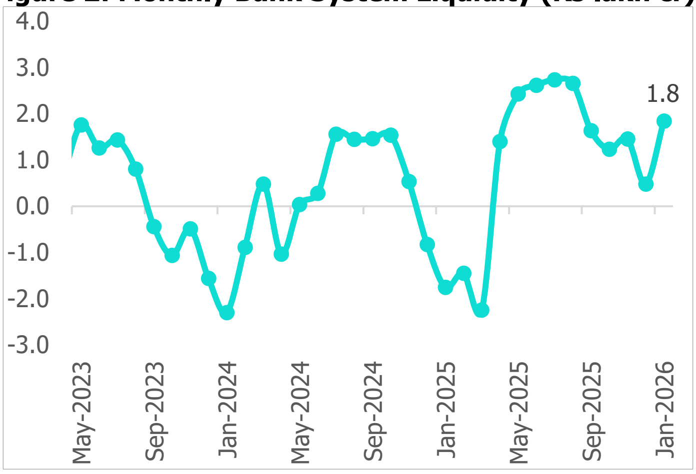
Credit Offtake Outpaces Deposit Growth; Systemic Liquidity Continues to Remain in Surplus

Figure 1: Credit Offtake vs Deposit Growth



Source: RBI, CareEdge Calculations. Under the Banking Laws (Amendment) Act, 2025, the definition of fortnight has been revised from alternate Fridays to the 15th and the last calendar day of a month, w.e.f. December 15, 2025.

Figure 2: Monthly Bank System Liquidity (Rs lakh cr)

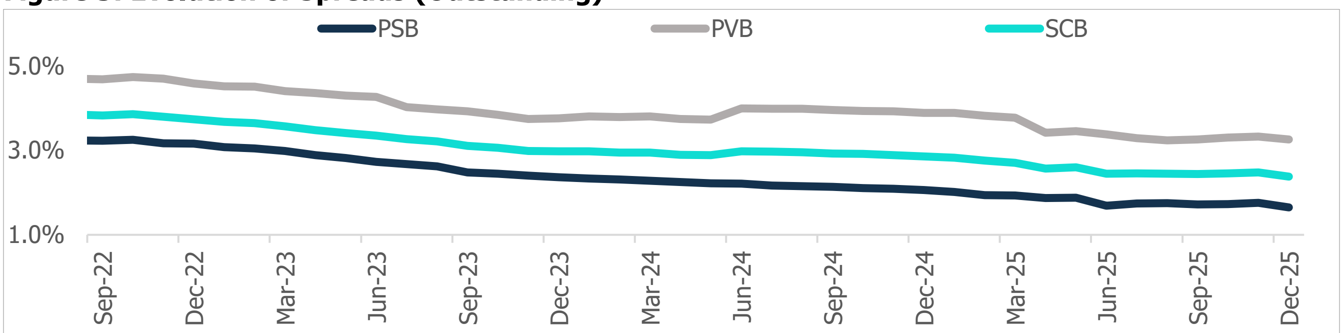


Source: RBI, CMIE

- Bank credit growth stood at Rs 201.3 lakh crore as of the fortnight ended January 15, 2026, and maintained strong momentum, registering a y-o-y growth of 13.1%, up from 11.5% a year earlier. Overall credit growth was supported by steady retail demand, led by auto loans, healthy MSME offtake, and increased lending to NBFCs, alongside a pickup in infrastructure and opportunistic corporate borrowings. As of January 15, 2026, aggregate bank deposits stood at Rs 245.0 lakh crore, recording a y-o-y growth of 10.6%, slightly lower than the 10.8% growth in the corresponding period last year. The moderation could be attributed to ongoing rate-cut transmission and a continued shift of household savings toward higher-yielding alternative instruments. In addition, the increase in short-term bond rates likely prompted a partial reallocation of bulk deposits toward market-linked instruments.
- The banking system liquidity remained comfortable at an average surplus of Rs 1.8 trillion by the end of January 2026. According to CareEdge Economics, the RBI has announced Rs 2 lakh crore in OMOs to support liquidity conditions. Previously announced CRR cuts and OMOs also have supported core liquidity; however, FX interventions, a drawdown in government cash balances, and an increase in currency in circulation partially offset these measures. In FY26 so far, the RBI has undertaken net OMO purchases worth Rs 4.2 lakh crore- the highest on record and well above the previous peak of Rs 3.1 lakh crore in FY21.

O/s Spread Witness Downtick in December 2025

Figure 3: Evolution of Spreads (Outstanding)



Source: RBI

As of December 2025, SCBs' outstanding spreads narrowed by 48 bps y-o-y to 2.38%, reflecting differential transmission across assets and liabilities. Lending rates adjusted more swiftly due to the high share of floating-rate and externally benchmarked loans. In contrast, deposit rates repriced only partially despite selective cuts, constrained by tight liquidity and intense competition for retail deposits. At the same time, a shift in the credit mix toward better-rated corporates weighed on average lending yields. The faster pass-through on the asset side relative to liabilities led to compression in outstanding spreads. Consequently, faster asset-side repricing, combined with structurally sticky deposit costs, led to a compression of outstanding spreads.

Outstanding Business: Deposit and Lending Rates Decrease on a y-o-y basis

Figure 4: Evolution of WALR O/s Lending Rate

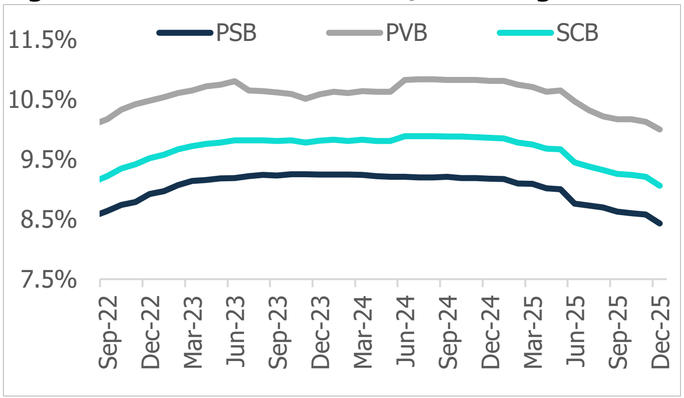
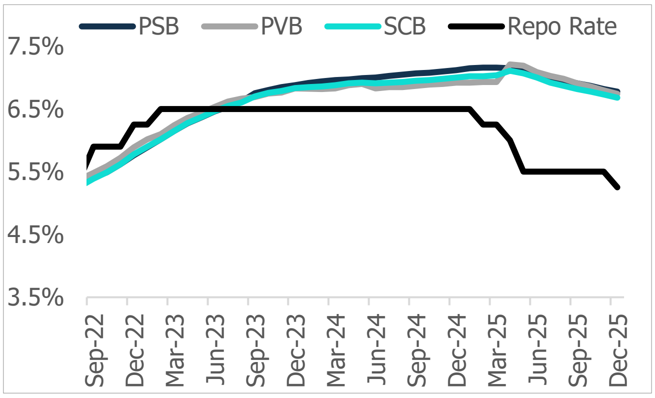


Figure 5: Evolution of WADTDR O/s Deposit Rate

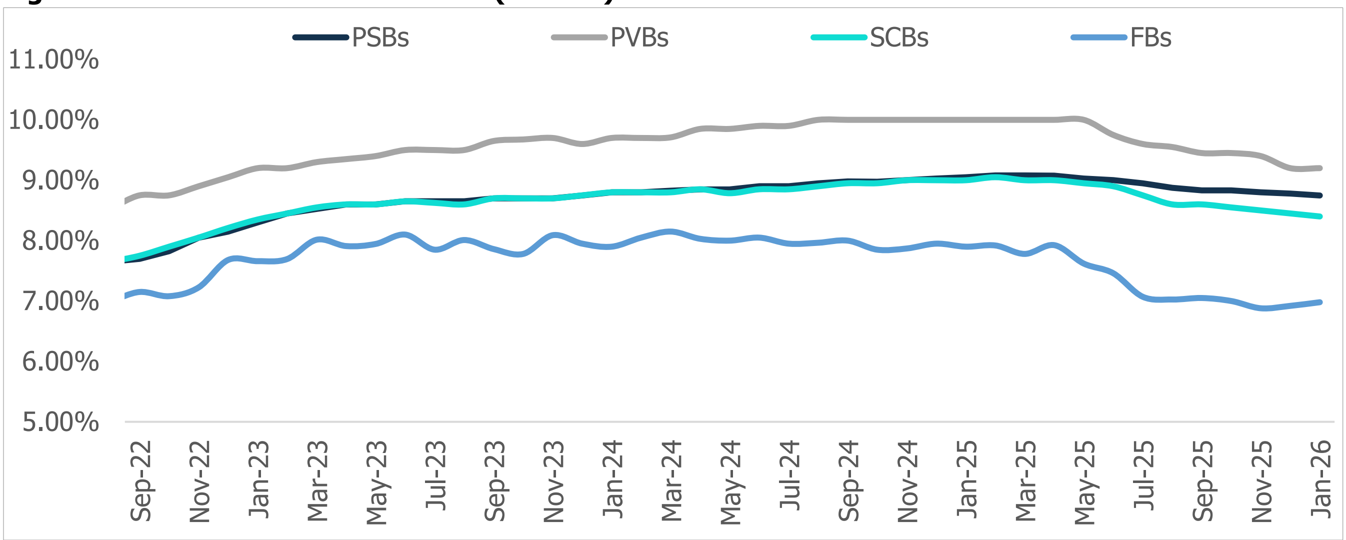


Source: RBI

- As of December 2025, SCBs' outstanding lending rate decreased by 80 bps y-o-y to 9.06%, with PSBs reducing by 75 bps to 8.43%, while PVBs reduced by 81 bps to 10.00%. Meanwhile, the outstanding deposit rates of SCBs decreased by 32 bps y-o-y to 6.68%, and PSBs, PVBs, and FBs declined by 34, 18 and 116 bps, reaching 6.78%, 6.74% and 5.06% respectively. This reflected partial transmission of the cumulative policy rate cuts, driven primarily by the gradual repricing of the existing loan book.

MCLR Rates Witness a Significant Downtick y-o-y

Figure 6: Movement in 1-Year MCLR (Median)



Source: RBI

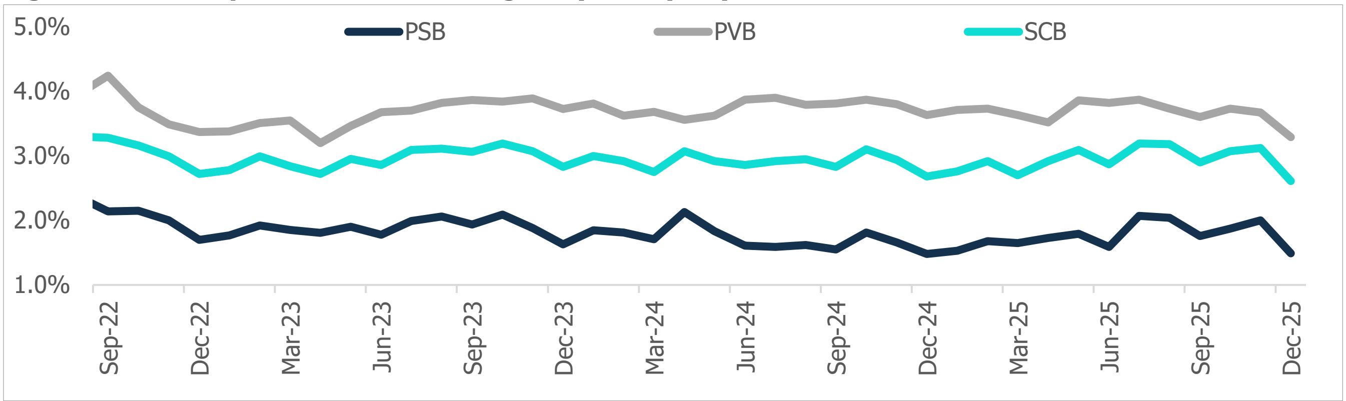
- On a y-o-y basis in December 2025, the one-year median MCLR decreased significantly by 60 bps to 8.40%. The decline was attributed to the cumulative 100 bps policy rate cut, which reduced banks' marginal cost of funds. Further, normalisation in systemic liquidity conditions and moderation in incremental deposit rates over the year helped ease funding pressures. A shift towards better-rated borrowers allowed banks to compress the tenor and spread components of the MCLR, resulting in a broad-based downward adjustment in benchmark lending rates. However, MCLR remains 20 bps above the pre-pandemic level of February 2020.

Figure 7: MCLR Rates (In %) Ease for PSBs; PVBs Continue to Extend Sharper Y-o-Y Slide

Banks	Jan-25	Feb-25	Mar-25	Apr-25	May-25	Jun-25	Jul-25	Aug-25	Sep-25	Oct-25	Nov-25	Dec-25	Jan-26	Y-o-Y
Public Sector Banks														
BoB	9.00	9.00	9.00	9.00	8.95	8.90	8.90	8.80	8.80	8.75	8.75	8.75	8.75	-0.25
BoI	9.05	9.05	9.05	9.05	9.05	9.05	9.00	8.90	8.85	8.85	8.85	8.85	8.75	-0.30
BoM	9.10	9.15	9.15	9.15	9.10	9.10	9.10	9.10	8.90	8.90	8.85	8.85	8.85	-0.25
Canara	9.10	9.10	9.10	9.10	9.00	8.80	8.75	8.75	8.75	8.75	8.70	8.70	8.70	-0.40
CBI	9.00	9.00	9.00	9.00	8.95	8.95	8.90	8.80	8.75	8.70	8.70	8.70	8.65	-0.35
Indian	9.05	9.10	9.10	9.10	9.10	9.05	9.00	9.00	8.85	8.85	8.85	8.80	8.75	-0.30
IOB	9.10	9.10	9.10	9.10	9.10	9.10	9.00	8.90	8.85	8.85	8.85	8.80	8.80	-0.30
PSB	9.20	9.20	9.20	9.20	9.20	9.15	9.10	9.05	9.00	8.95	8.95	8.85	8.85	-0.35
PNB	9.00	9.05	9.05	9.05	8.95	8.95	8.90	8.85	8.80	8.80	8.75	8.75	8.75	-0.25
SBI	9.00	9.00	9.00	9.00	9.00	9.00	8.80	8.75	8.75	8.75	8.75	8.70	8.70	-0.30
UCO	9.05	9.10	9.10	9.10	9.10	9.00	9.00	8.95	8.90	8.85	8.85	8.80	8.75	-0.30
UBI	9.00	9.00	9.00	9.00	8.95	8.90	8.75	8.60	8.60	8.60	8.60	8.60	8.60	-0.40
HDFC	9.40	9.40	9.40	9.30	9.15	9.05	8.75	8.70	8.65	8.55	8.50	8.45	8.40	-1.00
ICICI	9.10	9.10	9.10	8.85	8.75	8.50	8.40	8.35	8.35	8.35	8.35	8.35	8.35	-0.75
Axis	9.40	9.40	9.40	9.25	9.15	8.90	8.90	8.75	8.75	8.70	8.75	8.70	8.70	-0.70
IndusInd	10.55	10.55	10.45	10.40	10.35	10.30	10.20	10.15	10.15	10.10	10.10	10.05	10.00	-0.55
Kotak	9.55	9.55	9.55	9.35	9.20	8.90	8.75	8.60	8.55	8.45	8.40	8.40	8.40	-1.15
Yes	10.60	10.65	10.65	10.65	10.30	10.20	9.85	9.80	9.80	9.70	9.70	9.70	9.70	-0.90

Source: RBI

Figure 8: Fresh Spreads Contract Marginally on a y-o-y Basis



Source: RBI

- In December 2025, fresh spreads for SCBs decreased marginally by seven bps y-o-y, to 2.61%, attributed to rate cut transmission, which led to faster repricing on the asset side than on the liability side. The high share of EBLR/MCLR-linked loans led to a quicker pass-through of repo rate cuts into fresh lending rates, compressing incremental yields. In contrast, deposit rates remained relatively sticky amid tight systemic liquidity and rising competition for deposits. Meanwhile, PVBs declined faster than PSBs by 34 bps to 3.29%, attributable to competitive pressures.

Fresh Deposit and Lending Rates Witness a Significant Downtick y-o-y

Figure 9: Evolution of Lending Rate Fresh Loans

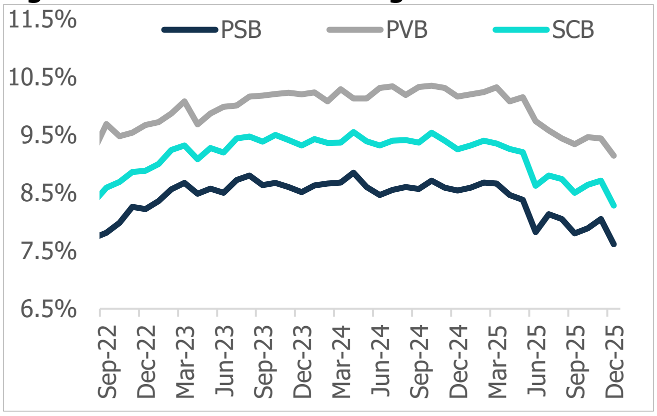
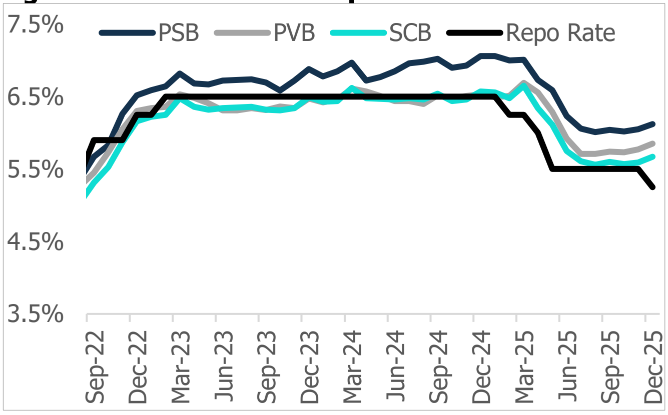


Figure 10: Evolution of Deposit Rate Fresh Loans



Source: RBI

- The lending rate on fresh loans for SCBs decreased by 97 bps y-o- y to reach 8.28%, while deposit rates on fresh loans decreased by 90 bps to get 5.67%, reflecting a near-complete pass-through of the cumulative 100 bps policy rate cut into the system. Meanwhile, rate transmission on fresh lending has mainly been front-loaded, aided by the high share of EBLR-linked loans. At the same time, deposit rates have also adjusted meaningfully, albeit with a marginal lag and a slightly lower pace, reflecting competitive pressures that are leading savers to shift to alternative avenues.

Conclusion

In December 2025, banking spreads compressed y-o-y amid asymmetric transmission of the cumulative policy rate cuts. Asset-side repricing was faster, supported by the high share of EBLR-linked loans (64.8% as of Sep-25), leading to a sharper decline in fresh lending rates relative to outstanding loans. In contrast, deposit rate transmission remained slower and uneven, constrained by longer-tenor fixed-rate deposits and intense competition for funding as credit growth outpaced deposit mobilisation. This divergence resulted in near-term pressure on spreads and incremental NIMs. Transmission varied across bank groups, with private banks leading in lending-side repricing and PSBs showing higher pass-through to fresh deposit rates. Going forward, the impact of the December rate cut is likely to play out more fully in January 2026, with margin outcomes hinging on the pace of deposit repricing, portfolio rebalancing toward higher-yield segments, operating leverage, and pricing discipline.

Contact

Sanjay Agarwal	Senior Director	Sanjay.agarwal@careedge.in	+91 - 22 - 6754 3582 / +91-81080 07676
Saurabh Bhalerao	Associate Director – BFSI Research	saurabh.bhalerao@careedge.in	+91 - 22 - 6754 3519 / +91-90049 52514
Sarthak Hirekhan	Analyst – BFSI Research	Sarthak.hirekhan@careedge.in	+91 - 22 - 6754 3630 / +91-89567 53551
Mradul Mishra	Media Relations	mradul.mishra@careedge.in	+91 - 22 - 6754 3596

CARE Ratings Limited
Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022
Phone : +91 - 22 - 6754 3456 l CIN: L67190MH1993PLC071691

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