

RBI's 25-bps Hike to 5.50% and Calibrated Tightening: Implications for Banks and NBFCs



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Overview

The Monetary Policy Committee unanimously raised the repo rate to 5.50% and shifted from neutral to calibrated tightening. August CPI inflation rose to 4.82%, core inflation edged higher, the economy grew 7.8% in the first quarter, and higher crude prices added to imported-inflation risk. The US Fed also hiked by 25 bps in September. The Fed commentary thereafter, along with rate tightening by other central banks, has reinforced expectations of higher global policy rates. The 25-basis-point hike itself is unlikely to unsettle lenders and was broadly in line with our expectations. The stance change matters more than the hike. Moving from neutral to calibrated tightening effectively rules out rate cuts in this cycle. For banks and NBFCs, that means higher funding costs, followed by normalised lending spreads and, if the pressure persists, weaker credit quality.

Loans Reprice First, So Banks Get Near-Term Margin Support

Banks enter this cycle from a position of strength, with comfortable asset quality (NNPA Ratio at 0.4% in Q1FY27 compared to 0.5% in Q1FY26), healthy capital buffers (CRAR of 17.9% in Q1FY27), a robust liquidity cushion with LCR of 126.7% as of end June 2026, and Net Interest Margin at 3.22% for Q1FY27 vs 3.26% in Q1FY26—and strong credit growth. As of September 15, outstanding credit and deposits increased by 18.1% and 17.3% on a y-o-y basis, respectively. The credit-deposit gap has narrowed to 81 basis points (bps) in the fortnight ended September 15, 2026, from over 89 bps in the corresponding period last year.

The near-term margin impact is likely to be limited. Much of bank lending is tied to external benchmarks (68.2% as of June 2026), so loan rates adjust quickly. Deposit costs move more slowly, helped by older deposits that are yet to mature. FCNR(B) inflows of \$132.9 bn have also strengthened the deposit base and eased pressure on the incremental credit-deposit ratio. FCNR(B) inflows help liquidity but cannot replace a strong domestic deposit franchise. As the RBI absorbs surplus liquidity, money-market rates and marginal funding costs will track the policy rate more closely. Within a few quarters, support for benign deposit pricing is likely to fade. Additionally, higher policy rates usually lift bond yields, creating mark-to-market pressure for banks with long-duration holdings. Impact will differ by bank. Those with large AFS/HFT books and longer duration will see the larger MTM losses. Over time, asset quality matters more. Personal-loan (loan to individuals) growth reached 16.9% year-on-year in August, and the segment now accounts for roughly one-third of bank credit. Asset-quality stress will first appear among highly leveraged borrowers with thin income buffers. First-order impact is manageable; the risk builds if rates stay high. Loans reprice faster than deposits, offering early support. If rates stay high, however, deposit costs will catch up, treasury losses will become more visible and leveraged retail borrowers may show stress.

For NBFCs, The Funding Mix Matters More Than the Headline Rate

NBFCs rely on a mix of bank loans, market borrowings, commercial paper and other wholesale funding. Many of their products, such as vehicle finance, microfinance, gold loans and small-ticket consumer credit, are either fixed-rate or reprice slowly. The mismatch is simple: funding costs can rise quickly, while loan repricing depends on the product and competition. The sector does have buffers. Capital levels are comfortable (Total CRAR was 25.5% while Tier I CRAR was 23.66% in June 2026) and asset quality has improved considerably (NNPA ratio improved from 1% in Q1FY26 to 0.84% in Q1FY27). NIM has increased from 4.99% in Q1FY26 to 5.39% in Q1FY27. This gives larger, better-rated NBFCs some additional headroom to absorb an initial rise in funding costs. Smaller lenders

with concentrated borrowing sources or limited pricing power may struggle more. Pressure will be greatest on NBFCs that rely heavily on wholesale funding, have shorter liability maturities or operate in highly competitive segments. Even a modest rise in funding costs can quickly erode their spreads.

Bank competition adds to the challenge. RBI data for August 2026 showed non-food bank credit growing 18.8% year-on-year, while lending by NBFCs grew 15.8% in August. NBFCs must either pass on the full cost increase and risk slower growth or absorb part of it and accept lower profits.

Three things to keep an eye on

- **Liquidity:** It will determine how quickly the hike moves through the system. Faster absorption of surplus liquidity could force banks to offer higher deposit rates and raise wholesale borrowing costs for NBFCs. A slower adjustment would give margins more room.
- **Inflation:** The next inflation readings will show whether price pressures are easing or becoming more persistent.
- **Pricing power:** Passing on higher funding costs will depend on competition, borrower sensitivity to rate changes and the loan mix.

A single 25-basis-point hike is unlikely to become a balance-sheet shock for banks or larger NBFCs as they have strong capital and asset-quality buffers. However, if higher rates persist, funding costs will rise. Lenders with durable deposit or funding franchises, disciplined pricing and borrowers who can absorb higher rates are best placed, irrespective of size.

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