RBI report: Gap in credit, deposit growth shrinking but challenges remain

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The gap between credit and deposit growth in banks, which has been a major concern for the Reserve Bank of India (RBI) over the past two years, is finally narrowing, according to the latest State of the Economy report released by the central bank on Friday.

As on September 6, the gap had shrunk to just over 200 basis points (bps), down from more than 700 bps at the start of 2024. Loan growth in banks had moderated to 13.3 per cent, while deposit growth had climbed to over 11 per cent.

"In the credit market, with deposit mobilisation becoming a challenge, banks continue to rely heavily on certificates of deposit to meet funding needs so that lagging deposit growth does not constrain credit," stated the report, which is part of the monthly RBI Bulletin.

It further observed that banks are offering higher interest rates on deposits, with more than two-thirds of term deposits now earning 7 per cent or more. "The gap between credit and deposit growth is, however, beginning to narrow," stated the report, which has been authored by RBI staffers but does not represent the banking regulator's views.

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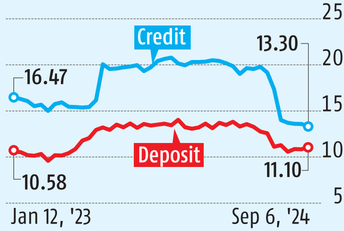
IT'S NARROWING

Y-o-Y growth (in %)



Source: Bloomberg/RBI
Compiled by BS Research Bureau

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- RBI BUYS $6.93 BN IN JULY
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RBI asks microfinance institutions to slow down loan growth

During the August review of the monetary policy, RBI Governor Shaktikanta Das cautioned banks against relying too heavily on short-term non-retail deposits and other liability instruments to meet the incremental credit demand.

The State of the Economy report also had a cautionary note for microfinance institutions, asking them to slow down loan growth amid building up of non-performing assets (NPAs). “Microfinance institutions are facing some asset quality issues, warranting slowing down the pace of loan growth,” it warned.

A separate caution was raised for the private credit market. Rough estimates, according to the report, suggest private credit assets under management at around $15 billion. Fintech lenders, which now hold over 52 per cent of the market share in personal loans, are increasingly turning to private credit for funding and sources diversification. "The resilience of private credit in a credit downturn, however, remains untested," the report further said.

On the inflation front, the State of the Economy report hailed the fact that headline retail inflation has remained below the RBI's 4 per cent target as a “positive development”. It also noted that the vegetable price shocks that drove food inflation in the first quarter of 2024-25 are starting to reverse, suggesting that the inflationary persistence “may be behind us”.

While an unfavourable base effect could influence the September inflation figure, the report highlighted that the outlook for international crude prices has turned benign and is likely to remain so.

"The prospects of headline inflation averaging 4.5 per cent in the second half of 2024-25, as set out in the August 2024 resolution of the monetary policy committee, have improved,” it said, while warning that food price volatility remains a contingent risk given recent trends.

With headline inflation easing, household consumption is expected to have picked up in the July-September quarter, buoyed by a revival in rural demand. “Yet another consumption booster is the ramping up of hiring by e-commerce majors ahead of the festival season, not just in the metros but in tier 2 and 3 cities, as well,” it said, and noted demand for fast-moving consumer goods (FMCG) is accelerating, as companies increasingly target older consumers with healthy lifestyle products in response to rising life expectancy.

On the Q1 GDP figures, the RBI staffers’ report pointed to strong domestic drivers, particularly private consumption and gross fixed investment. Net exports also provided sequential support to GDP growth. “The underperformance of agriculture was compensated for by a buoyant manufacturing sector and resilient services,” it added.