



Macroeconomic Themes: Article Summary

Credit-Deposit Divergence: A Balance-Sheet Decomposition

Highlights:

- ✓ *Faster credit growth has resulted in a higher Credit-Deposit Ratio for the banking system.*
- ✓ *The modern monetary system is designed in a way that every credit creates an equivalent deposit and reduces the need for banks to mobilize liabilities (such as deposits) prior to credit creation.*
- ✓ *Therefore, deposits per se may not be a binding constraint for credit creation.*

RBI Bulletin for September 2026 carries an article titled “Credit-Deposit Divergence: A Balance Sheet Decomposition” co-authored by Saurabh Ghosh, Prabhat Kumar, Madhuresh Kumar and Monica from RBI’s Department of Economic Policy and Research (DEPR). The article argues that in a modern i.e. digital monetary system, every credit extended by scheduled commercial banks (SCBs) creates an equivalent deposit, and a bank does not necessarily need to mobilize liabilities such as deposits before credit creation, and the Credit-Deposit (CD) ratio is not by itself an entirely appropriate metric to gauge funding vulnerability of a banking system that is experiencing high credit growth.

The CD ratio is a metric that is closely observed by the banking system to assess the funding sustainability of the system. Along with the incremental Credit- Deposit (I-CD) ratio, it is used to assess the pace of credit growth in context of deposit growth. As the CD ratio crossed a significant level of 80 per cent for the first time in 2022-23 and stood at a peak level of 82.2 per cent during March 2026, implications of a high CD ratio have been debated with increasing intensity. A high CD ratio raises questions on how incremental credit is being supported by the financial system.

The two phases of increasing CD ratio: India has experienced two clearly identifiable rising CD ratio phases as evident from the slope of the CD ratio phases from September 2002 to September 2008, when the CD ratio rose from 50.8 per cent to 73.3 per cent; and from September 2021 to March 2026, when it rose from 68.6 per cent to 82.2 per cent. The ratio was hovering around 82 per cent during March-August 2026. Economies in high-growth phases often experience credit outpacing deposits growth, as observed in China, and Australia. Conversely, Japan's three decade-long experience of structurally depressed loan demand and corporate deleveraging left its banks, particularly regional ones, with excess deposits.



Against this backdrop, this article uses balance sheet analysis to examine the financing dynamics of credit growth. It traces how the balance-sheet structure of banks adjusts to changes in credit and deposit growth across different underlying economic conditions and corresponding rise and fall in CD ratios.

The underlying concern of a high CD ratio: While every credit creates a matching deposit simultaneously, the concern regarding a high CD ratio is that if credit keeps growing faster than deposits, banks may eventually run out of resources to meet reserve requirements or regulatory capital requirement including provisions (ex-post) and may be forced either to slow credit growth or have to rely on more expensive and less stable sources of funds. To examine whether this concern is valid, the article takes a deep dive into the process of credit and deposit creation/attrition in an economy and develops a simplified representation of bank financing through money creation (FMC).

The difference in traditional and modern analysis of banking: In the traditional intermediation of loanable funds for banking, balance sheet expansion arises first from liabilities side, through deposit mobilization, which then enables credit expansion. In the more recent version of the credit creation theory of banking, balance sheet expansion or liquidity expansion arises from the asset side - either through credit or investment with deposits as its matching entry, on the liability side. In this system, deposit creation becomes endogenous to asset side movement of bank balance sheet. Therefore, in the FMC model, households' saving is a consequence, rather than a cause of bank lending.

Analyzing the changes in the CD ratio: The rise or fall in CD ratio is determined by dominance of deposit creation channel. When credit channel is dominant, deposits are largely created through the act of lending, and the CD ratio may rise. When the external or investment channels dominate, deposits expand independently of credit, and the CD ratio falls. Money (M3) is created by both banks and the central bank and is increasingly being influenced by the developments in non-bank financial intermediaries (NBFIs).

The ratio $CD = L/D$ (L =Loan & Advances, D =Deposits) is not independently determined but it is the outcome of changes in all balance sheet items happening simultaneously.

A rise in the CD ratio can reflect:

1. Every loan increases deposits by the same amount: credit to deposit ratio increases as deposit base is higher than credit (numerator effect).
2. Asset side rebalancing: credit could increase CD ratio with the reduction in investment, even with the same deposit base.



3. Non-deposit sources (borrowings, capital) are growing as a substitute to deposit; or any combination of these.

Key Findings from the Banks' Accounts Decomposition Analysis:

Increasing CD Ratio Phase (Sep 2002-Sep 2008; and Sep 2021-Mar 2026)

- Credit-led deposit creation dominated both rising CD-ratio episodes.
- On the liability side of the SCBs balance sheet, the share of non-deposit sources increased in the current phase i.e. Sep-2021-Mar 2026. The accretion to banks' capital in recent years is associated with increase in their profitability.
- Borrowings also increased during the current rising CD ratio phase; however, the borrowings costs declined for the banks during FY2024-25 as compared with FY2023-24. While annual data for FY2025-26 is not yet published, with repo rate cuts in 2025, borrowing costs are expected to decline further.
- In both phases of high CD ratio, banks rebalanced their asset portfolios away from investments to loans and advances.

Declining CD Ratio Phase (Dec 2008-Sep 2009; and Mar 2019-Sep 2021)

- During the two declining phases, the increase in banks' investments generally accompanied the deposit growth. In the pandemic phase, of every ₹100 of deposits mobilized, ₹39.8 were invested by the banks. This number was even higher in the post GFC period, when banks invested ₹52.9. This reflects the pattern wherein banks pare down investments when credit growth is strong and rebuild them when it slows.

Is high CD Ratio a Constraint? While the CD ratio attracts considerable attention, the ratio by itself does not represent the underlying funding situation. During high CD ratio phase, profitability considerations and/or prudential regulations may restrain credit creation at the margin.

In recent years, Indian savers have shifted from traditional fixed deposits to financial market products offered by NBFIs like mutual funds, the latter tend to park these inflows as high-velocity deposits (i.e., deposits with high run-off factor). The trend is reflected both in the rising demand deposit to time deposit ratio and the share of Certificates of Deposit in total deposits, which though rising, remain low relative to their historic highs



In theory, this shift could raise asset-liability mismatch concerns and have higher liquidity risk implications. However, Indian banks are currently maintaining an LCR of around 125 per cent and Certificates of Deposit-to-Deposit ratio at only around 2.5 per cent. Further, the health of the banking sector has improved markedly during the recent rising CD ratio phase with gross NPAs at historic lows, Capital-to Risk Weighted Assets Ratio (CRAR) remaining well above regulatory thresholds, and profitability ratios [return on asset (RoA) and return on equity (RoE)] strengthening considerably. All these suggest that the recent rise in CD ratio coincides with a sound banking system, where prudential targets are adequately satisfied.

Conclusion: In the modern (digital) monetary system, banks do not need to mobilize liabilities (such as deposits) first for credit creation, and therefore deposits may not be a limiting factor. In this framework, CD ratio may change due to several factors. Hence the CD ratio, by itself, may not be an appropriate metric to gauge funding vulnerability of a banking system that is experiencing high credit growth. Rather, a holistic review of the overall dynamics of credit and deposit creations/attritions and the interplay among various balance-sheet components in response to these dynamics should be undertaken. Indeed, the current phase of rising CD ratio coincides with a growing economy along with a profitable and sound banking system, where prudential targets are adequately satisfied. Therefore, high CD ratio per se does not signal constraints in credit creation or funding vulnerability for the banking system.

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