Chapter I

Chapter I: Macrofinancial Risks

Global growth has been resilient, supported by fiscal measures, front-loaded trade, and strong AI-related investment, but downside risks persist due to high public debt, elevated asset valuations, and rising financial vulnerabilities. The Indian economy continues to grow strongly supported by robust domestic demand, easing inflation, and prudent macroeconomic policies. Though the economy and the financial system remain stable, external uncertainties and global market volatility could pose near-term vulnerabilities. Strong buffers, nonetheless, enhance the economy's ability to withstand adverse shocks.

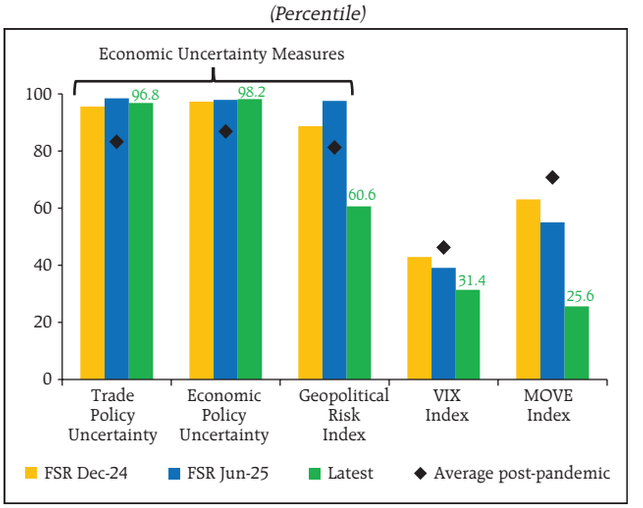
Introduction

1.1 The global economy and the financial system have proven more resilient than anticipated since the June 2025 Financial Stability Report (FSR), despite elevated policy uncertainty, persistent geopolitical tensions, and growing trade fragmentation. Global financial markets remain upbeat, with equity markets in particular scaling new peaks driven by optimism about artificial intelligence (AI) and strong corporate earnings.

1.2 The apparent resilience and risk-on sentiment, however, mask key vulnerabilities that have global financial stability implications. They include, but are not limited to, the risk of a sharp market correction amid stretched valuations, high and rising public debt, the expanding role of non-bank financial intermediaries and their deepening interconnectedness with banks, risks in the private credit market, and the rapid growth of stablecoins (see Special Feature on *'Financial Stability Implications of Stablecoins'*). The disconnect between uncertainty and volatility also remains wide (Chart 1.1). Overall, global financial stability risks stay elevated even as the world economy is exhibiting both resilience and fragility.

Chart 1.1: Disconnect between Uncertainty and Financial Market Volatility

(Percentile)



Notes: (1) Trade policy uncertainty is the index constructed by Caldara, Iacoviello, Molligo, Prestipino and Raffo (November 2019) counting the frequency of joint occurrences of trade policy and uncertainty terms across newspaper articles (such as 'tariff', 'import barrier', 'uncertain', *etc.*)

(2) Economic policy uncertainty is the index constructed by Baker, Bloom and Davis (March 2016) taking GDP-weighted average of national EPU indices for 20 countries, where each national EPU index reflects the relative frequency of own-country newspaper articles that contain a trio of terms pertaining to the economy, uncertainty and policy-related matters (such as 'uncertain', 'economic', 'regulation', *etc.*)

(3) Geopolitical risk is the index constructed by Caldara and Iacoviello (April 2022) using automated text-search results from newspaper articles (using words relevant to their definition of geopolitical risk, such as 'crisis', 'terrorism', 'war', *etc.)*

(4) The CBOE Volatility Index (VIX Index) is an index that measures United States (US) equity market volatility, derived from the prices of S&P 500 index options with expirations within the next 30 days.

(5) The Merrill Lynch Option Volatility Estimate for interest rates (MOVE Index) is a yield curve weighted index of the normalised implied volatility on one-month US Treasury options of several different tenors. (6) Percentiles are based on monthly values from 1997. Post-pandemic average is the average percentile since 2022. VIX and MOVE indices data till December 10, 2025.

Sources: Policyuncertainty.com; and Bloomberg.

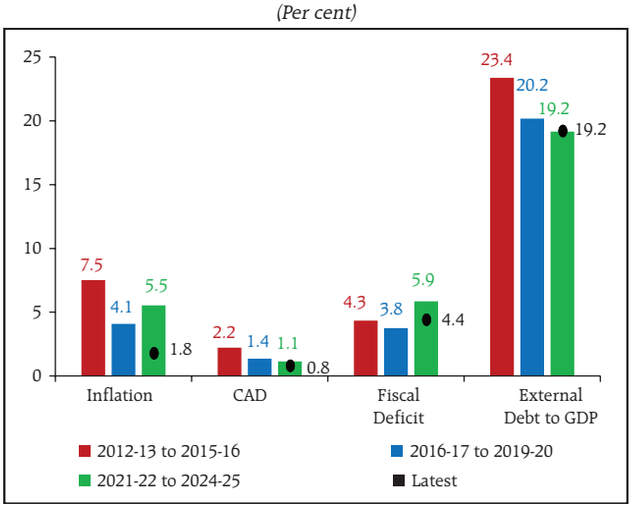
1.3 Against the backdrop of incessant global headwinds, the Indian economy is growing at a robust pace, driven by strong domestic demand. Alongside, a sharp moderation in inflation, commitment to fiscal consolidation and prudent macroeconomic policies are strengthening the resilience of the economy (Chart 1.2). The domestic financial system also remains resilient, bolstered by healthy balance sheets of bank and non-bank lenders, easy financial conditions and low volatility in financial markets (Chart 1.3).

1.4 There are, however, a few near-term risks to the Indian economy despite sound macroeconomic fundamentals and robust growth-inflation dynamics. Prominent among them are external uncertainties, further escalation in geopolitical and trade tensions and widening geoeconomic fragmentation. They could lead to higher volatility in exchange rate, weaker trade, lower corporate earnings and muted foreign direct investments. From a financial stability perspective, a sudden and sharp correction in the United States (US) equity market could cause a correction in domestic equities, affect investor confidence and wealth, trigger foreign portfolio outflows and tighten domestic financial conditions.

1.5 Importantly, the economy and the financial system have adequate buffers in terms of strong domestic growth drivers, sizeable foreign exchange reserves, and sufficient capital and liquidity buffers in the financial and corporate sectors to withstand adverse shocks. Moreover, the aggregate stress level in the Indian financial system, as indicated by the financial system stress indicator (FSSI), remains relatively low (Chart 1.4).

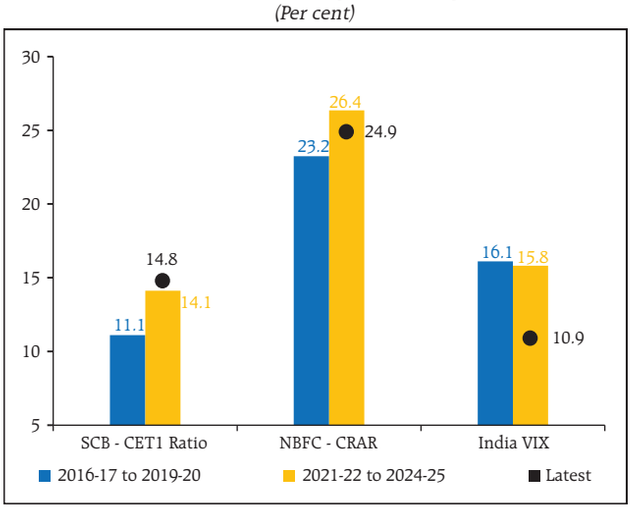
1.6 Against this backdrop, this chapter is structured into five sections. Section I.1 discusses evolving international and domestic macroeconomic developments and their implications for the near-term economic outlook. Section I.2 analyses key trends and financial conditions across equity, bond and foreign exchange markets, while Section I.3 provides an assessment of corporate and household

Chart 1.2: India - Sound Macroeconomic Fundamentals
(Per cent)



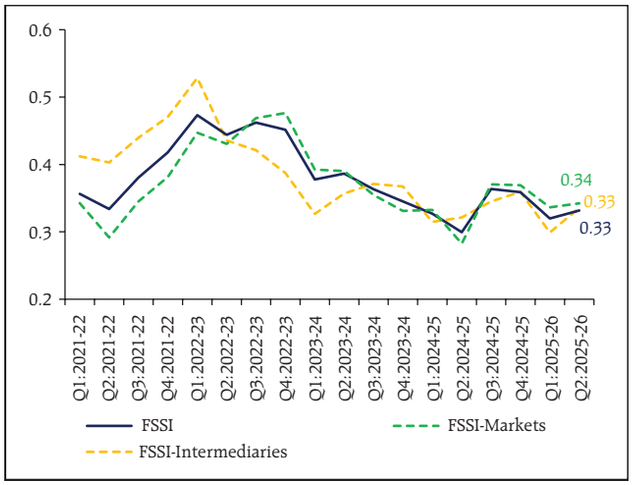
Note: Latest value for inflation is the monthly average between April and November 2025; CAD is for H1:2025-26; External debt to GDP ratio as of September 2025; and fiscal deficit based on budget estimates for 2025-26.
Sources: National Statistics Office (NSO); Union Budget Documents; and RBI.

Chart 1.3: India - Healthy Financial System
(Per cent)



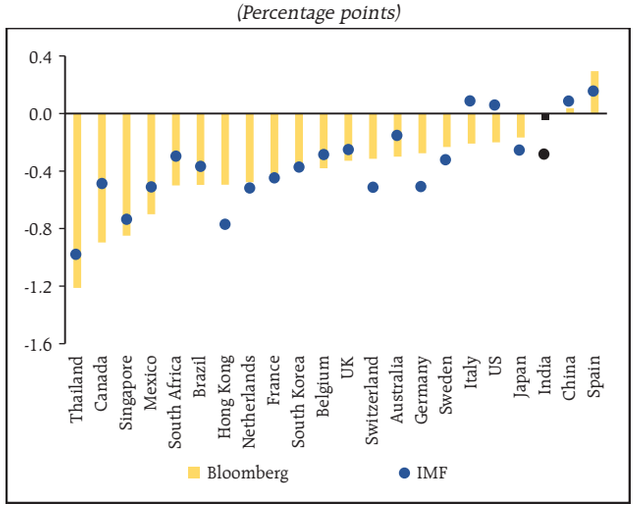
Notes: (1) The pandemic year 2020-21 is excluded.
(2) Upper layer and middle layer NBFCs are considered.
(3) Latest value for India VIX as on December 10, 2025. The other two indicators as at end-September 2025.
Sources: RBI supervisory returns; and Bloomberg.

Chart 1.4: Indian Financial System Stress Remains Low
(Index)



Note: Detailed methodology is provided in Annex 1.
Sources: DBIE; Bloomberg; RBI supervisory returns; and staff estimates.

Chart 1.5: 2026 Growth Forecast Revised Downwards
(Percentage points)



Notes: (1) IMF - Difference between IMF WEO GDP growth forecast for 2026 in October 2024 and in October 2025.
(2) Forecasts derived from the median of private sector economist surveys conducted by Bloomberg - difference between the GDP growth forecast for 2026 in October 2024 and October 2025.
Sources: IMF WEO Oct-24 and Oct-25; and Bloomberg.

sector vulnerabilities. Sections I.4 and I.5 examine the stability of the banking and non-bank financial sectors, respectively. The chapter also includes a special feature on stablecoins and its implications for financial stability.

I.1 Macroeconomic Outlook

I.1.1 Global Outlook

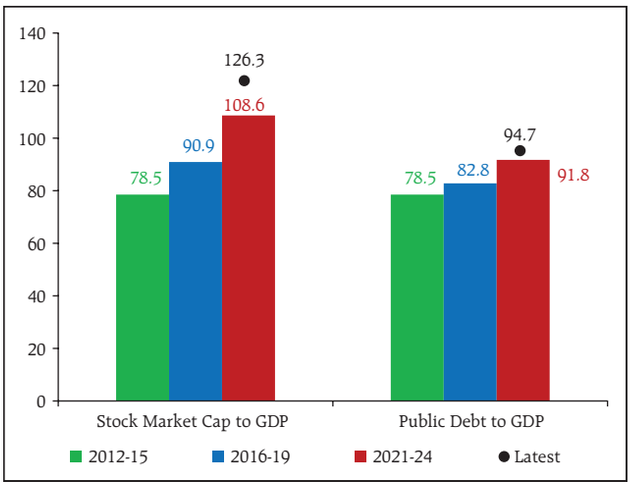
1.7 Global growth has surprisingly held up better than expected amid the US government's decision to impose tariffs on most of its trading partners and prolonged global economic and trade policy uncertainties. A combination of front-loading of trade, alacrity in finalising bilateral trade deals, some fiscal expansion, limited impact of tariffs on inflation, and huge AI-related investments has contributed to global growth resilience. Accordingly, the International Monetary Fund (IMF) revised its 2025 global growth projection upwards relative to its April 2025 forecast – from 2.8 per cent to 3.2 per cent.

1.8 Even as global growth has been steady, risks to the outlook in 2026 remain tilted to the downside (Chart 1.5). In the near-term, there are risks from further escalation in geopolitical tensions and trade barriers, prolonged policy uncertainty and AI not delivering its promise of a transformational economic impact. These risks, alongside fiscal vulnerabilities stemming from elevated levels of public debt and a disorderly market correction, could dampen consumption and investment, and lower global growth (Chart 1.6).

1.9 Fiscal strains in advanced economies (AEs) are likely to continue as borrowing needs remain well above the pre-pandemic levels, with no signs of a meaningful reversal. Rising interest expenses, growing healthcare costs from demographic shifts and higher defense spending have contributed to higher long-term borrowing costs. This is also reflected in the widening of swap spreads[1],

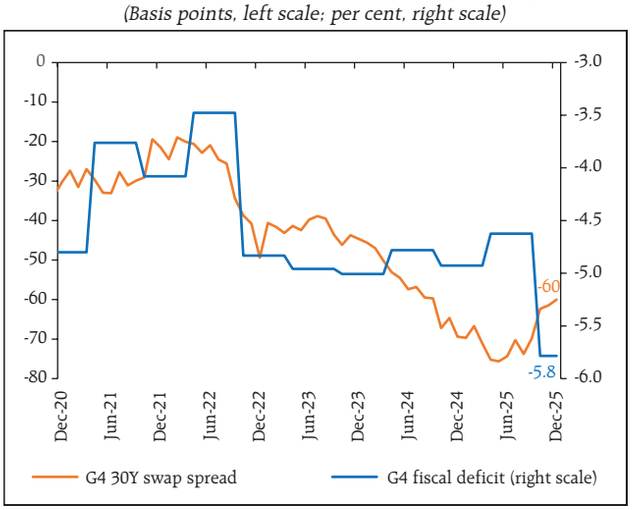
[1] Swap spreads measure the gap between swap rates and government bond yields of the same maturity. A negative spread indicates that government bond yields are trading higher than corresponding swap rates.

Chart 1.6: Rising Stock Market Capitalisation and Public Debt
(Per cent of GDP)



Notes: (1) The pandemic year 2020-21 is excluded.
(2) Latest value for stock market cap as on December 10, 2025. Public debt and GDP based on IMF projections for 2025.
Sources: IMF WEO October 2025; and Bloomberg.

Chart 1.7: Fiscal Strains Reflected in Widening Swap Spreads
(Basis points, left scale; per cent, right scale)

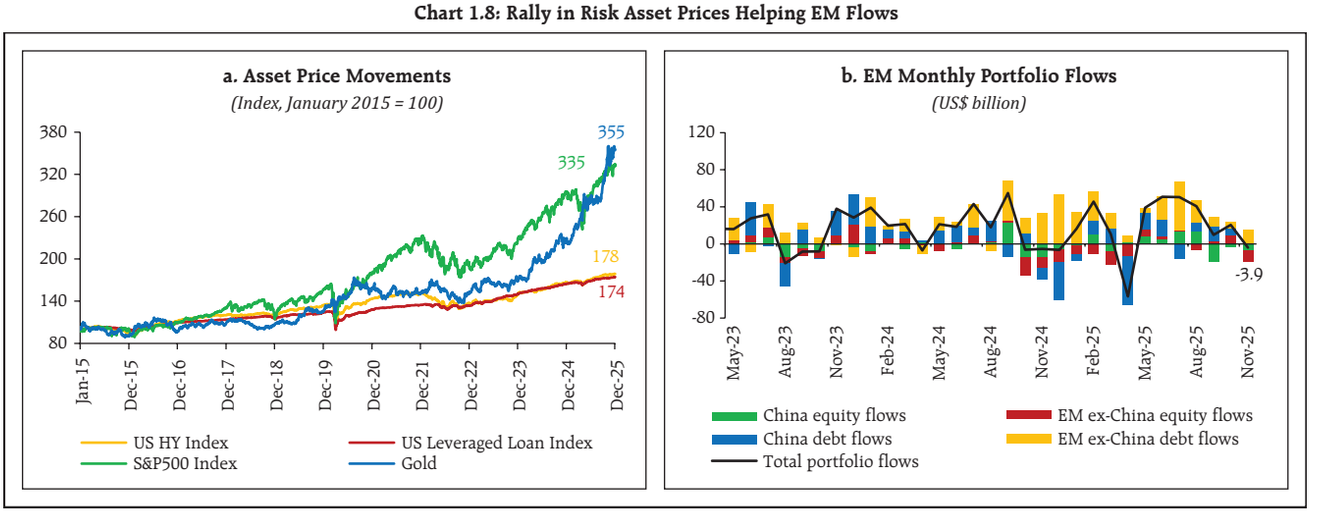


Notes: (1) G4 30Y swap spread calculated as GDP weighted average of US, UK, Euro Area and Japan.
(2) G4 fiscal deficit calculated as GDP weighted average of net lending/borrowing estimates over the next five years as per IMF World Economic Outlook.
Source: Bloomberg.

signalling a lack of appetite among investors for long-term sovereign exposure as well as a premium they require to invest (Chart 1.7). In the US, this is seen notwithstanding the increasing reliance on short-term issuances to finance the majority of incremental borrowing.

1.10 Increase in risk appetite alongside easy financial conditions and abundant liquidity is driving the prices of risk assets and gold, which is traditionally seen as a hedge against risk and uncertainty, to lofty levels (Chart 1.8 a). Emerging markets (EM) have also been a beneficiary of risk-

Chart 1.8: Rally in Risk Asset Prices Helping EM Flows



Sources: Bloomberg; and IIF.

on sentiment among investors, with both equity and debt flows remaining positive for most of the year (Chart 1.8 b). A sharp correction in asset prices, however, could be amplified by shifting asset correlations, leading to fire sales across market segments.

I.1.2 Domestic Outlook

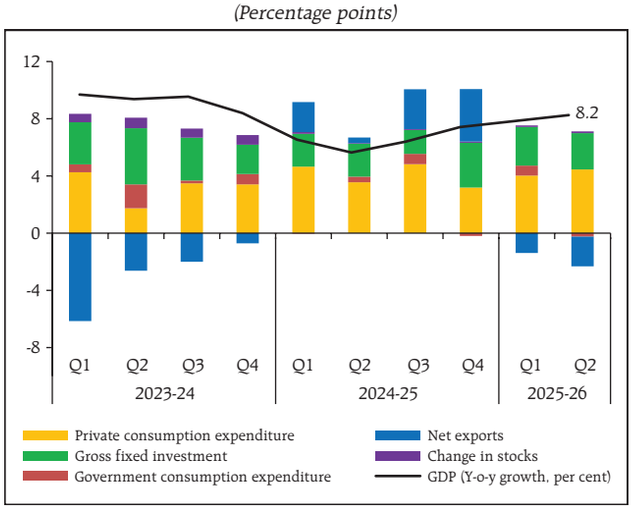
1.11 Domestic economic activity remained robust despite an unfavourable global backdrop. The real gross domestic product (GDP) growth surprised on the upside in both Q1:2025-26 and Q2:2025-26 at 7.8 per cent and 8.2 per cent, respectively, supported by strong private consumption and public investment (Chart 1.9).

1.12 Growth outlook remains positive, aided by low inflation, easy financial conditions, above normal monsoon, direct and indirect tax reforms, and the ongoing expansion of digital public infrastructure. This is also reflected in the upward revision of India's growth forecast by multilateral agencies such as the IMF, the Organisation for Economic Co-operation and Development (OECD) and the World Bank. The RBI has also revised its forecast for real GDP growth for 2025-26 upwards from 6.8 per cent to 7.3 per cent (Chart 1.10). Spillovers from geopolitical and trade tensions and a sell-off in global financial markets pose downside risks to the growth outlook.

1.13 India's fiscal dynamics remain healthy, supported by sustained improvement in the quality of spending with higher allocation for capital expenditure and commitment to fiscal consolidation. This was reflected in the S&P Global Ratings upgrade of India's sovereign rating from 'BBB-' to 'BBB' in August 2025. Moreover, India's debt remains sustainable because of the favourable interest rate-growth rate differential, the low level of foreign currency liabilities, the high average maturity of the debt portfolio, and very low level of floating-rate liabilities, together mitigating rollover and currency risks.

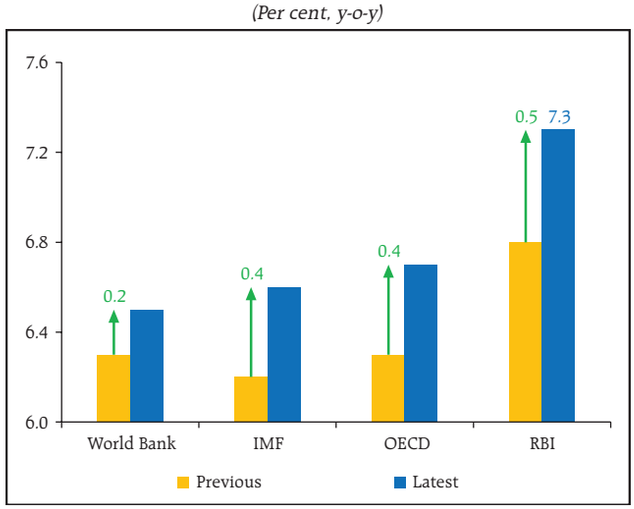
1.14 The weighted-average maturity (WAM) of outstanding debt and annual issuances of both central and state government debt have risen (Chart 1.11 a and b), and the yield curve has steepened

Chart 1.9: India – Contribution to Real GDP Growth
(Percentage points)



Source: National Statistics Office (NSO).

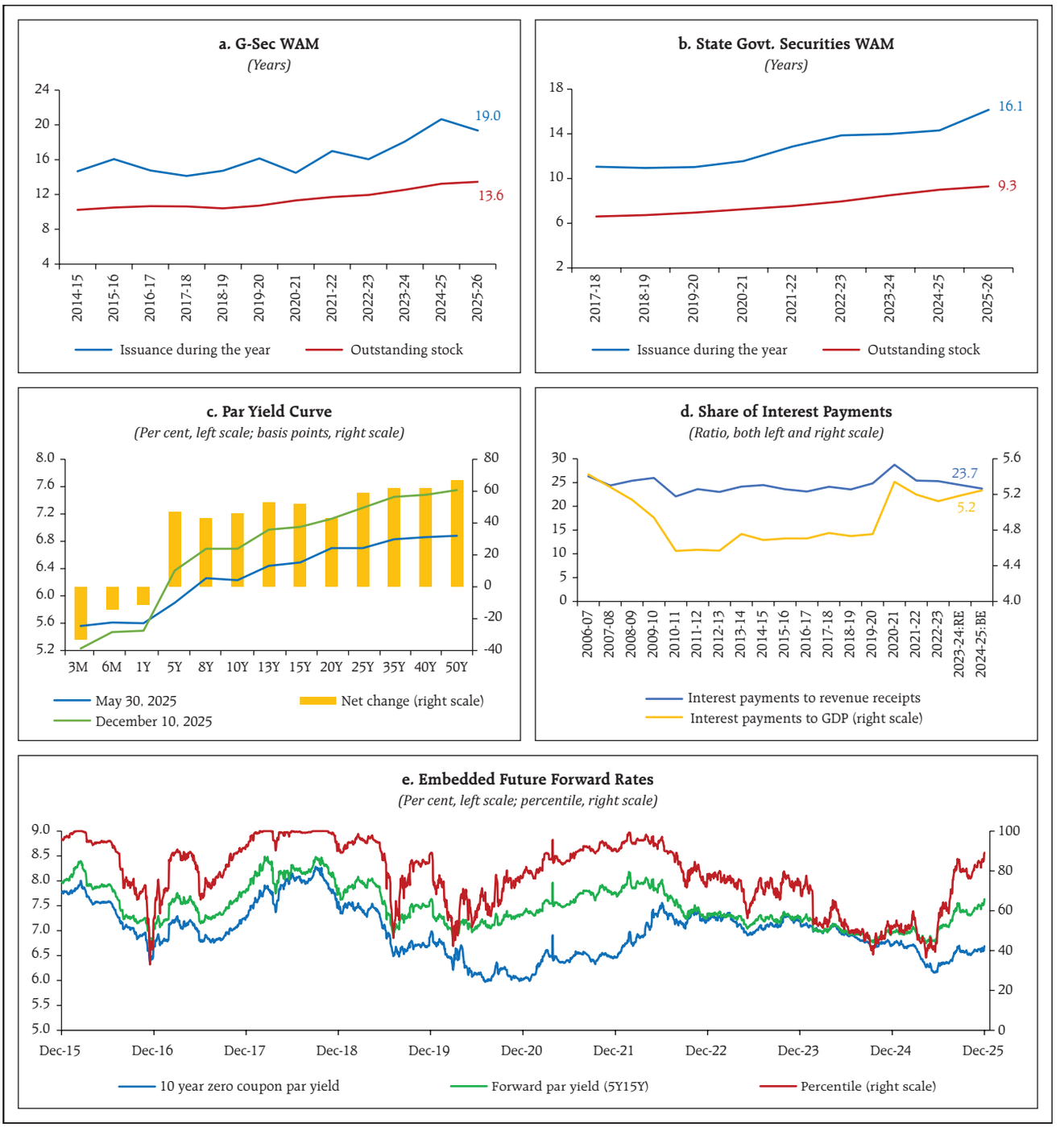
Chart 1.10: India – Real GDP Projections 2025-26 Revised Upwards
(Per cent, y-o-y)



Note: World Bank forecasts - Jun-25 and Oct-25; IMF forecasts - Apr-25 and Oct-25; OECD forecasts - Jun-25 and Sep-25; and RBI forecasts - Oct-25 and Dec-25.
Sources: World Bank Global Economic Prospects; IMF WEO; OECD Economic Outlook; and RBI Monetary Policy Statement.

(Chart 1.11 c). The share of interest payments has shown improvement (Chart 1.11 d). The steepness of the yield curve also illustrates that the embedded future forward rates are much higher (Chart 1.11 e).

Chart 1.11: Elongation of Weighted Average Maturity of Sovereign Bonds and Yield Curve Steepening



Notes: (1) In chart (a) and (b), data for 2025-26 updated till December 10, 2025.
(2) In chart (d), BE - budget estimates; RE - revised estimates.
(3) In chart (e), the forward par yield denotes the market pricing for a 10-year bond to be issued 5 years from now. The rates are derived from the zero-coupon yield curve built using the daily parameters published by CCIL. The percentile score is based on the number of days recorded from December 10, 2015 to December 10, 2025. The score shows the relative rank of the number of days when the current 10-year forward par yield is higher than the zero-coupon par yields seen during the said period.

Sources: CCIL; Budget Documents of Centre and States; RBI; and staff estimates.

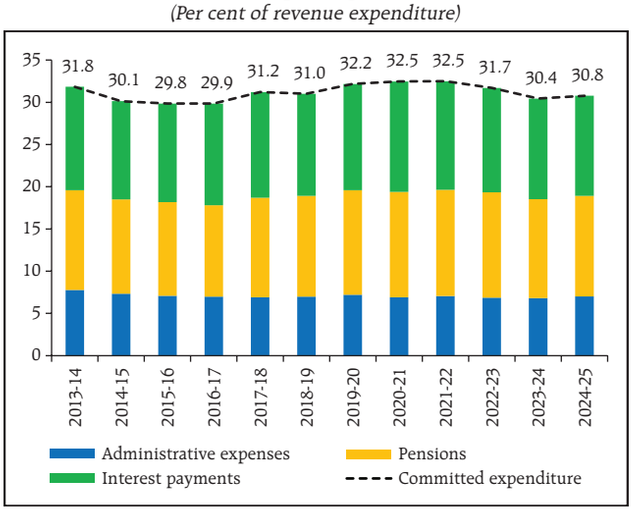
1.15 The supply of Central Government Securities (G-Sec) and State Government Securities (SGS) has risen considerably, with net issuance of G-Sec and SGS in the current fiscal year outpacing last year.[2] However, the demand for long-term sovereign debt among the largest investors, *viz.*, scheduled commercial banks, insurance companies and pension funds has declined. Even as banks accumulate more SGS and scale back on G-Sec, insurance and pension funds have shown a shift towards equity exposure (Table 1.1 and 1.2).

1.16 The overall debt-to-GDP ratio remains at around 82 per cent. This is largely due to elevated state government debt. Moreover, committed expenditure of states at around one-third of revenue expenditure remains high, which is likely to keep their market borrowing elevated along with the yield on their debt (Chart 1.12).

1.17 External sector stability has been a key pillar of India's overall macroeconomic stability. Despite a sequence of formidable external headwinds, the external sector has remained resilient. Although the current account deficit (CAD) has widened from 0.3 per cent of GDP in Q1:2025-26 to 1.3 per cent in Q2:2025-26, it remains eminently manageable with buoyant service exports and inward remittances expected to offset widening merchandise trade balance (Chart 1.13).

Chart 1.12: Higher Share of Committed Expenditure in States' Spending

(Per cent of revenue expenditure)



Note: BE – budget estimates.
Source: RBI.

Table 1.1: AUM of Pension Funds

₹ crore

	Mar-24	Mar-25	Sep-25
G-Sec	4,68,105	5,74,712	5,86,772
SGS	1,55,595	2,00,743	2,11,285
Equity	2,21,856	2,75,309	3,59,444
Corporate Bond	2,90,880	3,44,107	3,70,834
Others	37,100	49,883	52,214
Total	11,73,536	14,44,753	15,80,549
G-Sec *(per cent)*	39.9	39.8	37.1
SGS *(per cent)*	13.3	13.9	13.4
G-Sec + SGS *(HQLA, per cent)*	**53.1**	**53.7**	**50.5**
Equity *(per cent)*	18.9	19.1	22.7
Corporate Bond *(per cent)*	24.8	23.8	23.5

Note: The values mentioned above are at Market Value.
Source: PFRDA.

Table 1.2: AUM of Insurance Companies

₹ crore

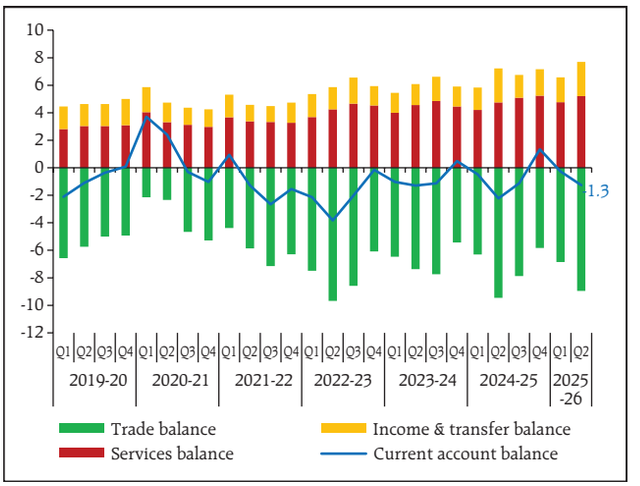
	Mar-24	Mar-25
G-Sec	27,24,749	29,39,658
SGS	14,45,597	15,07,310
Equity + Mutual Funds	14,25,947	16,62,359
Corporate Bond	10,04,470	11,61,967
Others	1,57,197	1,72,222
Total	67,57,960	74,43,516
G-Sec *(per cent)*	40.3	39.5
SGS *(per cent)*	21.4	20.2
G-Sec + SGS *(HQLA, per cent)*	**61.7**	**59.7**
Equity + Mutual Funds *(per cent)*	21.1	22.3
Corporate Bond *(per cent)*	14.9	15.6

Note: The values mentioned above are at Book Value except for the funds in respect of Unit Linked Life Insurance Products, which are at Market Value.
Source: IRDAI.

[2] The supply of G-sec and SGS, both high-quality liquid assets, has increased from ₹13.56 lakh crore in 2021-22 to ₹17.93 lakh crore in 2024-25. Alongside, the share of SGS rose from 36 per cent of total HQLAs issued in 2021-22 to 42 per cent in 2024-25.

Chart 1.13: Manageable Current Account Balance

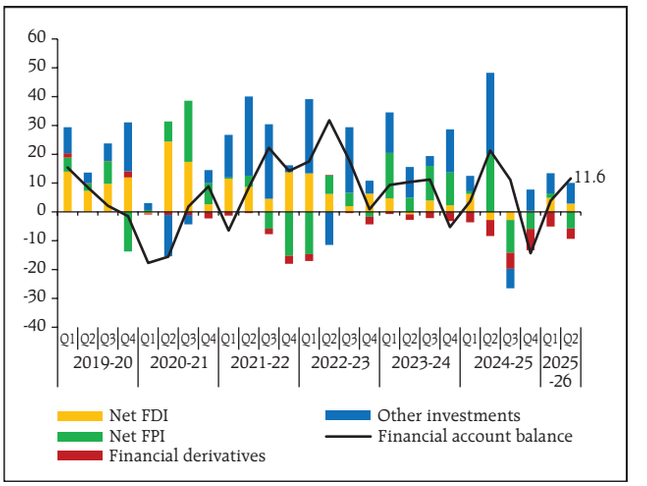
(Per cent of GDP)



Source: RBI.

Chart 1.15: Financial Account Turns Positive

(US$ billion)

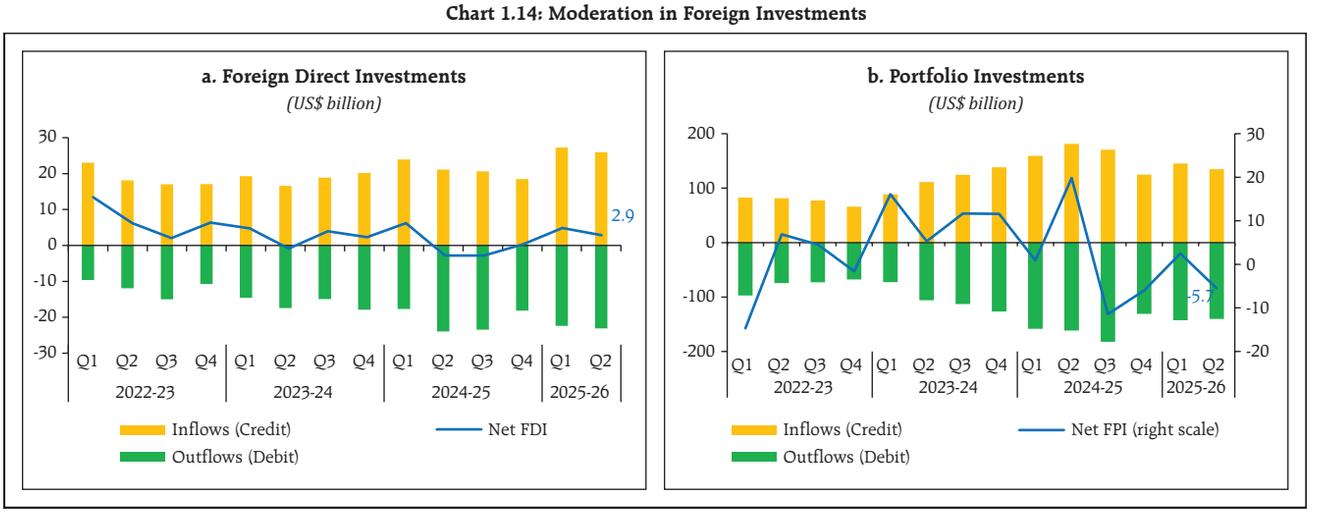


Source: RBI.

1.18 On the capital and financial accounts, net foreign direct investment (FDI) flows, after moderating in 2024-25 due to rising repatriation and outward FDI, have improved in H1:2025-26. Net portfolio investments have declined, driven by large equity outflows. India's inclusion in global bond indices attracted sizeable bond inflows, offsetting some of the overall impact (Chart 1.14 a and b). Steady external commercial borrowings (ECB) and non-resident deposits also contributed to capital inflows, though these flows have moderated compared to last year. Overall, the financial account balance turned positive in H1:2025-26 (Chart 1.15).

1.19 Notwithstanding the uncertainty surrounding the trade outlook, India's external vulnerability indicators remain robust and continue to show improvement. Foreign exchange reserves at US$ 693.3 billion, as on December 19, 2025, are sufficient to cover around 11 months of actual

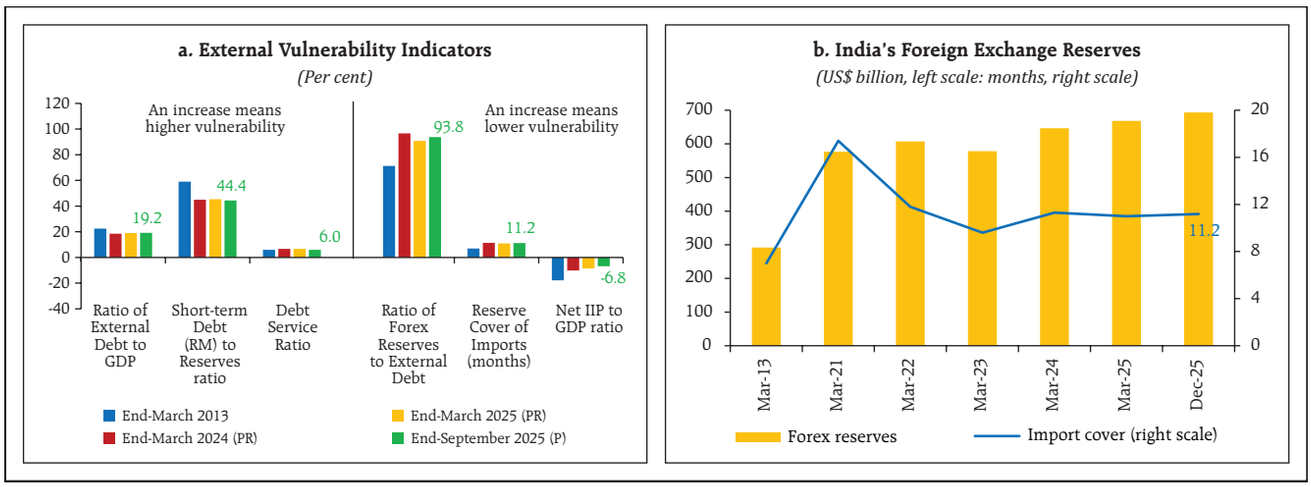
Chart 1.14: Moderation in Foreign Investments



Note: Data is based on BoP where credit is total inflows to India (including investment to India and sale of investment by India) and debit is total outflows from India (including sale of investment in India and investment by India).

Source: RBI.

Chart 1.16: Limited External Vulnerability and Adequate Reserves



Note: In chart (a), RM: Residual Maturity; R: Revised; P: Provisional; PR: Partially Revised. Reserve cover of imports is as on December 19, 2025.
Sources: RBI; and Ministry of Finance.

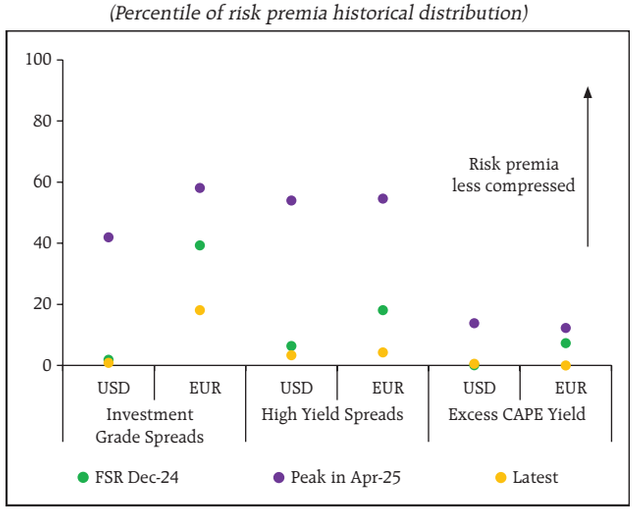
merchandise imports on a BoP basis; external debt stood at 19.2 per cent of GDP at end-September 2025; the share of short-term debt on residual maturity basis became more favourable at 44.4 per cent of foreign exchange reserves at end-September 2025; and net international investment position (IIP) also recorded improvement (Chart 1.16 a and b).

I.2 Financial Markets

I.2.1 Global Financial Markets

1.20 Since June 2025 FSR, despite persistent uncertainty around trade and economic policies and geopolitical tensions, risk-asset valuations have increased, volatility has declined, and credit spreads have compressed. Risk premia across a range of asset classes have tightened since the spike seen after the April 2025 tariff shock (Chart 1.17). Measures of equity valuations remain at the high end of the historical range, with stock prices of companies focused on AI particularly stretched and concentration within the stock index elevated

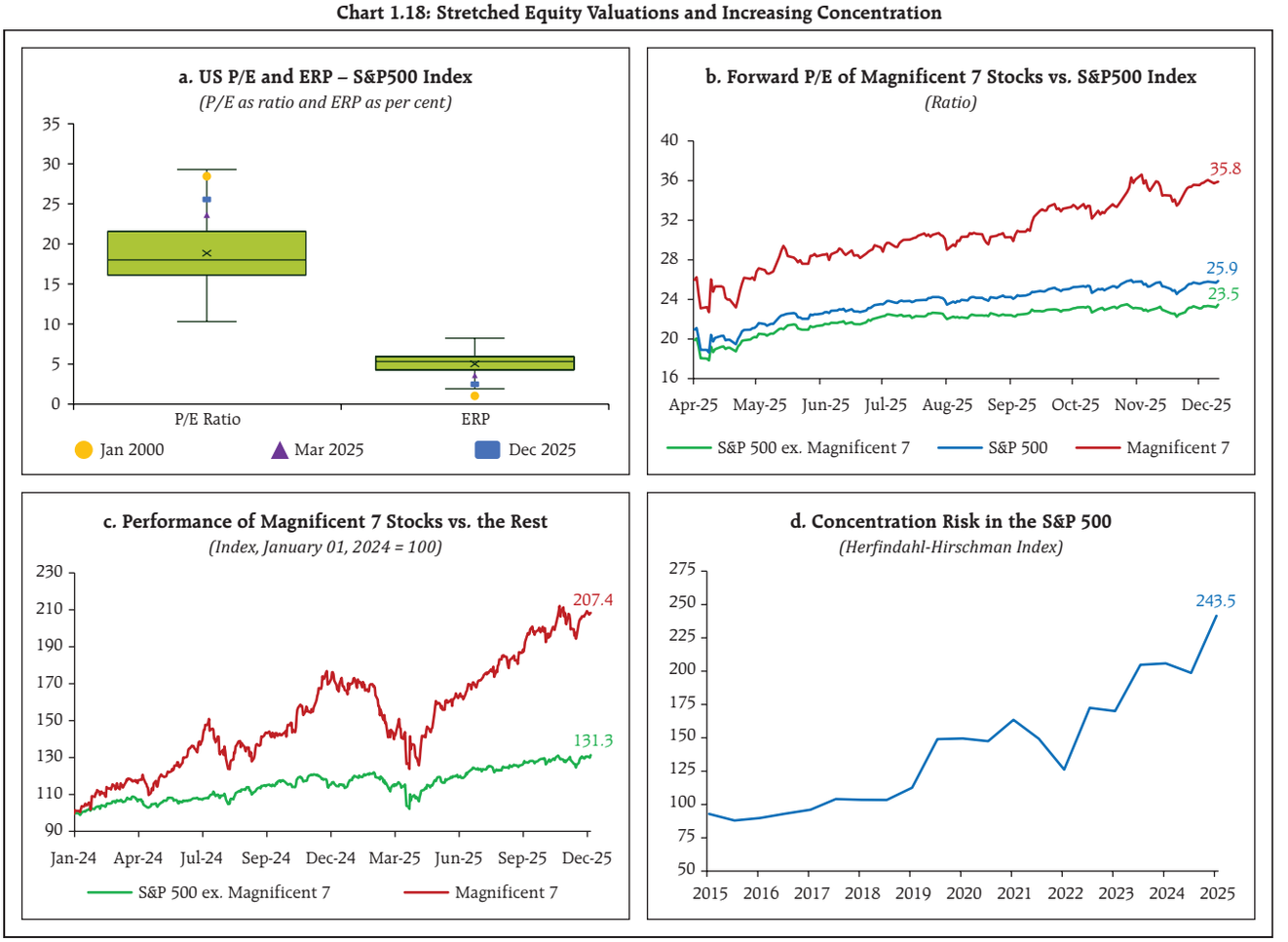
Chart 1.17: Valuations in a Range of Asset Classes at Historically Stretched Levels
(Percentile of risk premia historical distribution)



Notes: (1) Excess CAPE yield measures the additional real return expected from equities over risk-free asset. Percentile based on 3-day rolling average of daily data since 2002 for credit spreads (option-adjusted). For the excess cyclically adjusted price-to-earnings (CAPE) yield, the percentile based on 3-day rolling average of daily data since 2010 for the S&P 500 and STOXX Europe 600 indices.
(2) Latest value as of December 10, 2025.
Source: Bloomberg.

(Chart 1.18 a, b, c and d). Consequently, the likelihood of outsized price declines has risen, and markets remain especially vulnerable if expectations about AI's impact fade away.

Chart 1.18: Stretched Equity Valuations and Increasing Concentration



Notes: (1) In chart (a), the forward price-to-earnings (P/E) ratio is the ratio of equity prices to expected 12-month earnings and the equity risk premium (ERP) is the additional return that investors require for holding stocks relative to risk-free bonds. The chart shows the distribution of monthly P/E and ERP data of US S&P 500 Index for last 25 years, with each box denoting the interquartile range of a variable, with cross marks and lines inside the boxes being the average and median value, respectively. The whiskers represent the data's spread from the interquartile range to the lowest and highest values that are not considered outliers.

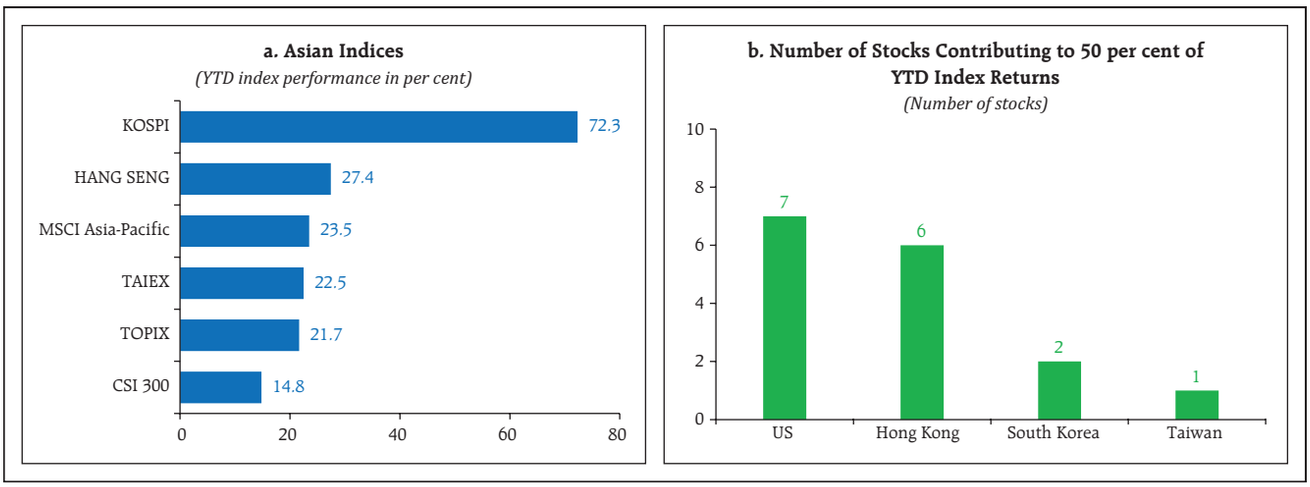
(2) In chart (b) and (c), the Magnificent 7 stocks are Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla.

Sources: Bloomberg; and RBI staff estimates.

1.21 The optimism around AI is also evident in Asian indices with big technology stocks driving most of the gains (Chart 1.19 a). A small number of stocks that are expected to benefit from AI now account for almost half of the returns in Hong Kong, South Korea and Taiwan, similar to the US (Chart 1.19 b). Thus, a major correction in US equities could become a global systemic risk, dragging down these markets with implications for equities in the region.

1.22 Another area of concern is the huge capital spending requirement to drive AI-related investments and their financing. So far, major firms have relied on their sizeable free cash flows to fund investments. However, with the spending on AI infrastructure estimated at trillions of dollars, debt financing has risen, and it is expected to increase substantially in the coming years (Chart 1.20 a). Moreover, there are complex circular financing structures between these firms that are also driving the credit boom in the AI sector. There are signs that the market is already making distinctions among firms, with those with relatively weaker financial positions seeing their spread over equivalent treasuries and credit default swap (CDS) spread

Chart 1.19: Asian Stocks' Performance Mirroring US Stocks

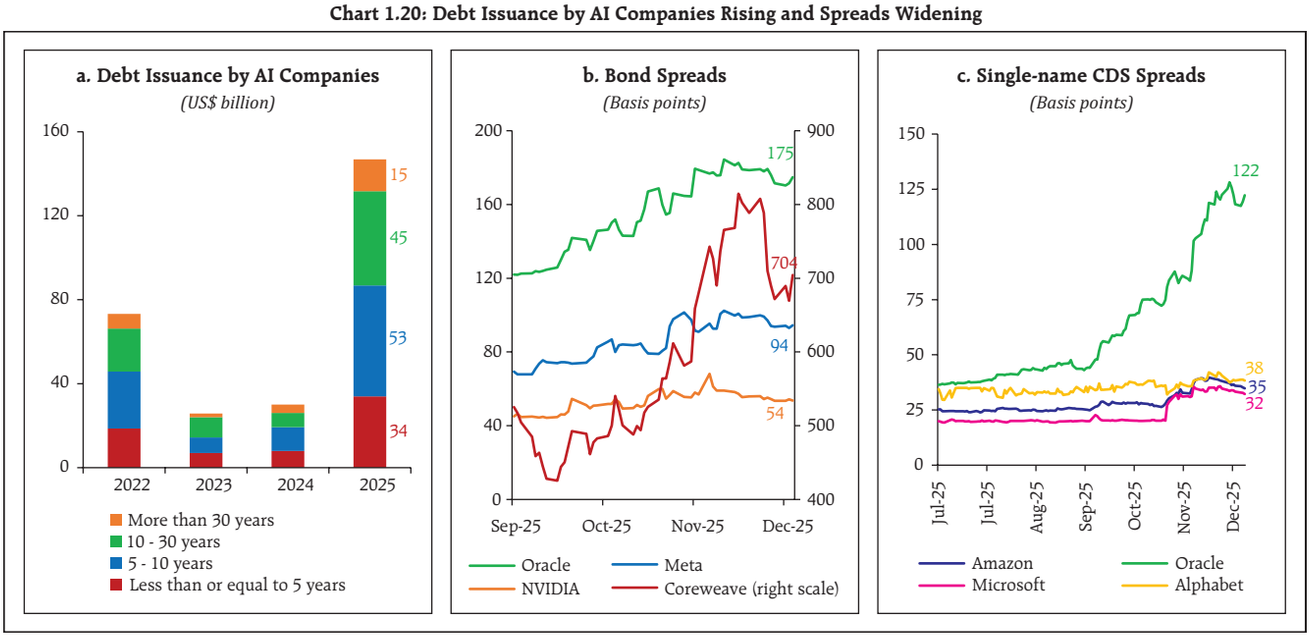


Notes: (1) In chart (a), data as of December 10, 2025.
(2) In chart (b), for each country, the representative equity index is being considered: US – S&P 500, Korea – KOSPI, Hong Kong – Hang Seng, Taiwan – TAIEX. The chart represents the number of stocks contributing at least ~50 per cent of the returns in the respective indices this year, which is estimated by multiplying each stock's weight at the beginning of the year by its year-to-date return.
Source: Bloomberg.

widening (Chart 1.20 b and c). Financial stability risks could materially increase if there is a deeper correction in AI-driven asset prices.

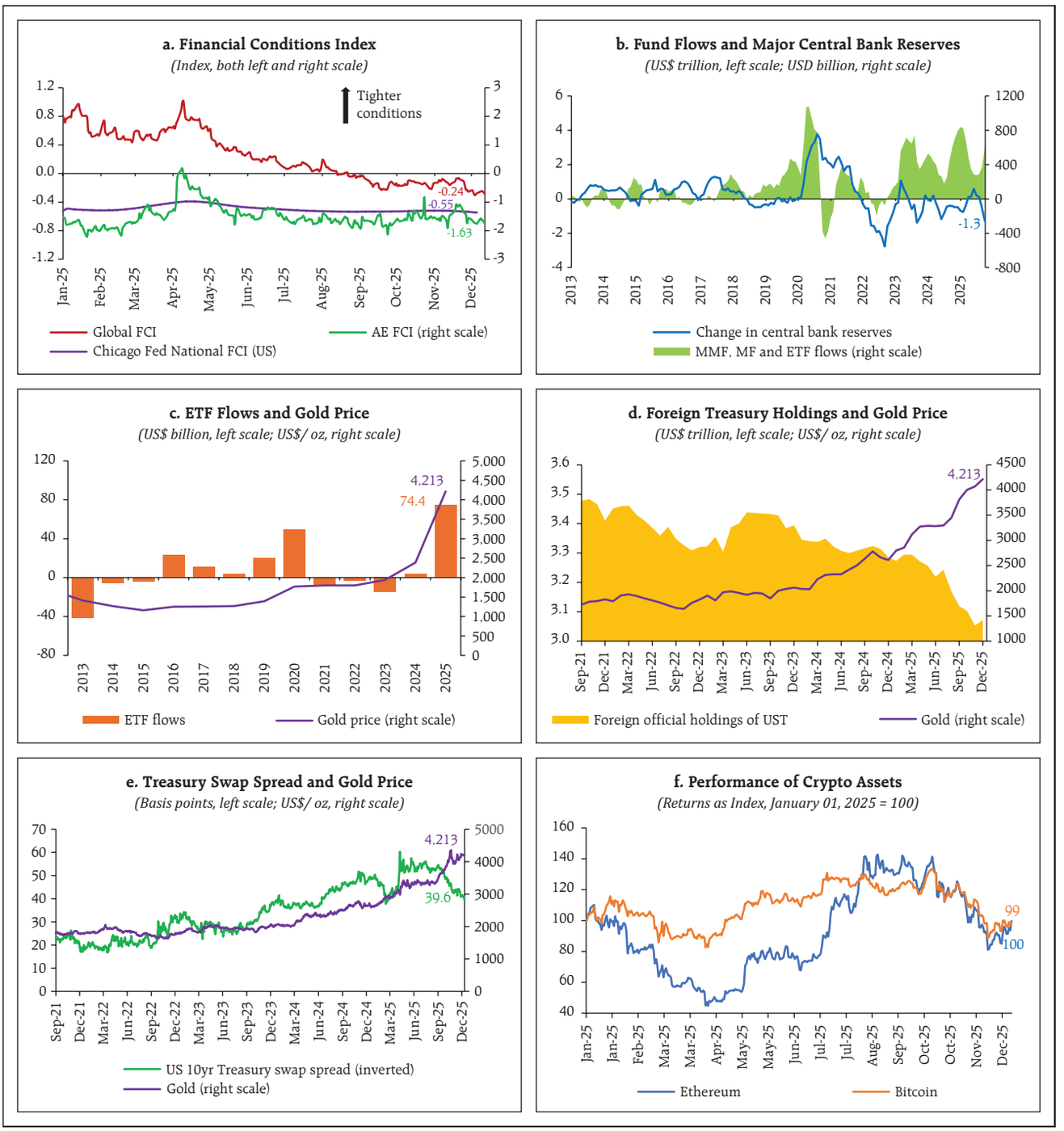
1.23 The rally in equities, compression in credit spreads, low volatility and decline in short-term rates have contributed to generally easing financial conditions (Chart 1.21 a). Alongside, ample liquidity, despite quantitative tightening by central banks, has continued to drive flows into mutual funds and exchange-traded funds (ETFs) supporting a range of asset classes (Chart 1.21 b). Gold prices have surged, driven by robust investor flows into the

Chart 1.20: Debt Issuance by AI Companies Rising and Spreads Widening



Notes: (1) In Chart 1.20a, the set of AI companies include Alphabet, Advanced Micro Devices, Amazon, Apple, Broadcom, Meta, Microsoft, NVIDIA, Oracle, Palantir, Tesla, and X.AI.
(2) In chart (b), bond spreads are estimated as spread over equivalent maturity treasury bond.
Source: Bloomberg.

Chart 1.21: Financial Conditions, Fund Flows and Asset Price Movements



Notes: (1) In chart (b), central banks reserves refer to data for US Federal Reserve, European Central Bank, Bank of England and Bank of Japan; MMF: Money Market Funds, MF: Mutual Funds, ETF: Exchange Traded Funds; US Fed data refers to reserve balances of depository institutions kept with Federal Reserve; Data for ECB refers to the excess liquidity defined as deposits at the ECB deposit facility net of funds availed in marginal standing facility; Data for Japan refers to the current deposits on Bank of Japan's balance sheet; Data for BoE refers to reserve balances on its balance sheet; Data for MMF, MF and ETF is from Investment Company Institute; Data is on 6-months rolling basis.

(2) In chart (c), data updated till end-September 2025.

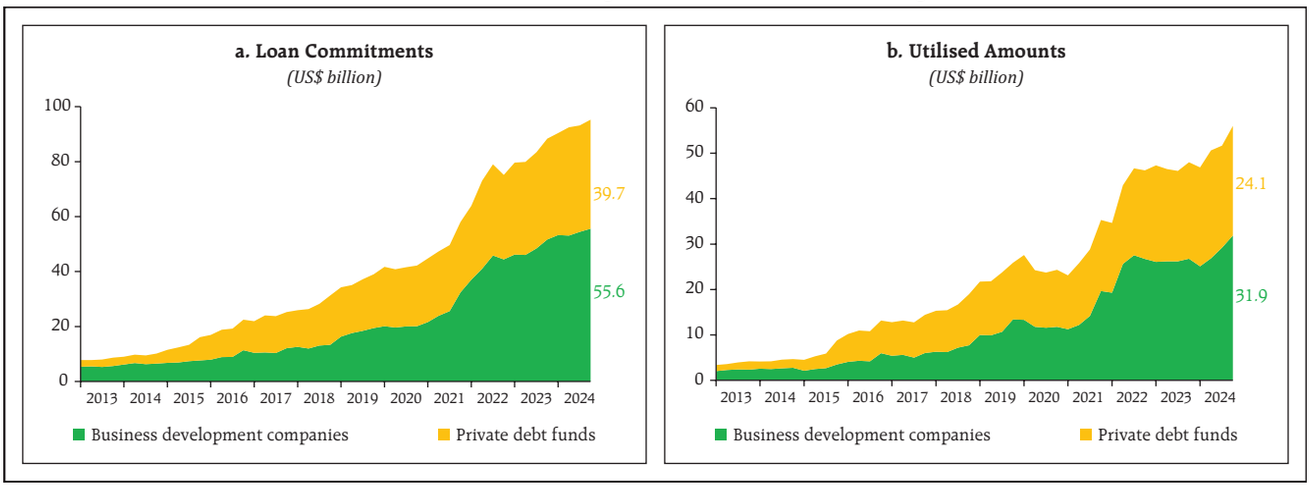
Sources: Goldman Sachs; World Gold Council; and Bloomberg.

ETFs, central bank diversification of their foreign exchange reserves and mounting fiscal concerns (Chart 1.21 c, d and e). In a sign of build-up in risk aversion, prices of crypto assets have fallen sharply from their record highs seen in the early part of the year (Chart 1.21 f).

1.24 Another potential source of vulnerability is the growth of private credit[3]. From a simple intermediation chain - where investors put money into a private credit fund or business development company (BDC) that then lends to businesses – the system has evolved in recent years into more complex chains that now include more leveraged institutions like banks and insurers.[4] Since they are private in nature and unregulated, there is considerable opacity regarding the size and riskiness of the private credit industry. Moreover, bank lending to private credit vehicles has increased significantly (Chart 1.22 a and b).[5] Thus, the interconnectedness between private credit and the broader financial system is increasing and the channels through which stress in private credit could transmit to the rest of the financial system are growing.

1.25 The growing footprint of hedge funds in the US treasury market, the largest and most liquid financial market in the world, along with their trading strategies, poses financial stability risks (see June 2025 FSR). Their holdings of treasury bills, notes, and bonds rose from 4.6 per cent of total treasuries in early 2021 to 10.3 per cent in the first quarter of this year, surpassing their pre-pandemic peak of 9.4 per cent.[6] Moreover, their leverage

Chart 1.22: Bank Lending to Private Credit Vehicles Growing



Source: Federal Reserve Y-14Q, Schedule H.1.

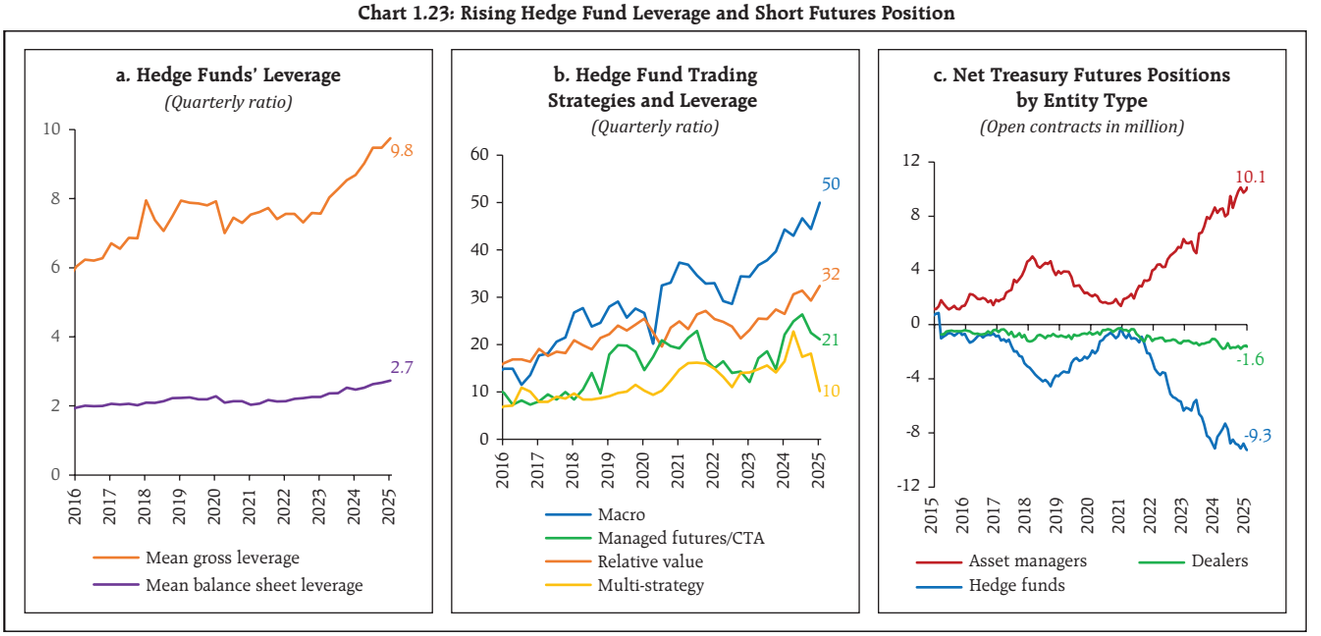
[3] Private credit generally refers to a loan that is negotiated directly between a borrower and a small group of nonbank lenders (source: Federal Reserve Bank of New York).

[4] Cook, Lisa D (2025), "A Policymaker's View of Financial Stability", Board of Governors of the Federal Reserve System, November 20.

[5] Berrospide, Jose, Cai, Fang, Lewis-Hayre, Siddhartha, and Zikes, Filip (2025), "Bank Lending to Private Credit: Size, Characteristics, and Financial Stability Implications," FEDS Notes, May 3, https://www.federalreserve.gov/econres/notes/feds-notes/bank-lending-to-private-credit-size-characteristics-and-financial-stability-implications-20250523.html

[6] Cook, Lisa D (2025), "A Policymaker's View of Financial Stability", Board of Governors of the Federal Reserve System, November 20.

Chart 1.23: Rising Hedge Fund Leverage and Short Futures Position



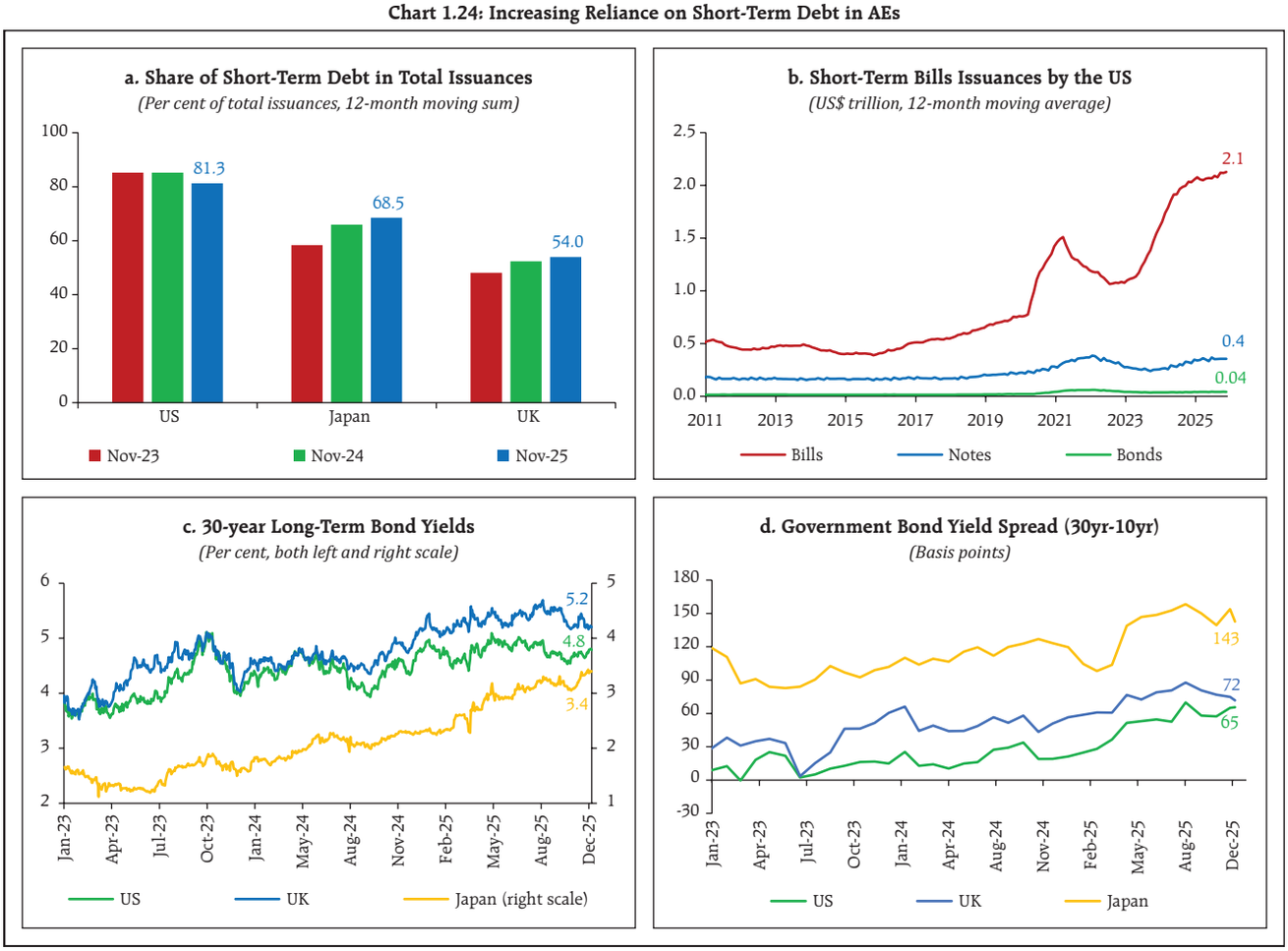
Note: In chart (a), gross leverage is the ratio of gross notional exposure to net asset value (NAV) and Balance sheet leverage is the ratio of gross asset value to NAV. Means are weighted by NAV.
Sources: Bloomberg; and US Securities and Exchange Commission.

remains elevated and continues to grow.[7] During past episodes of stress, hedge funds have abruptly unwound large leveraged positions in relative value trading strategies that they undertook to arbitrage between cash and derivatives markets using repo funding (Chart 1.23 a, b and c). These leveraged trades continue to remain a source of vulnerability.

1.26 Stretched public finances could impart volatility in core bond markets as some of the major AEs are increasingly relying on short-term debt to meet their funding requirements (Chart 1.24 a). In the US, although short-term debt makes up only about 20 per cent of total government debt, it represents roughly 80 per cent of all Treasury issuances (Chart 1.24 b). Simultaneously, long-term yields and spreads are trending higher (Chart 1.24 c and d). This will increase rollover risk by forcing countries to frequently refinance their short-term debt, and it may also pressure central banks to keep interest rates low, potentially undermining monetary policy independence.

[7] Board of Governors of the Federal Reserve System (2025), "Financial Stability Report", November.

Chart 1.24: Increasing Reliance on Short-Term Debt in AEs



Sources: Bloomberg; and RBI staff estimates.

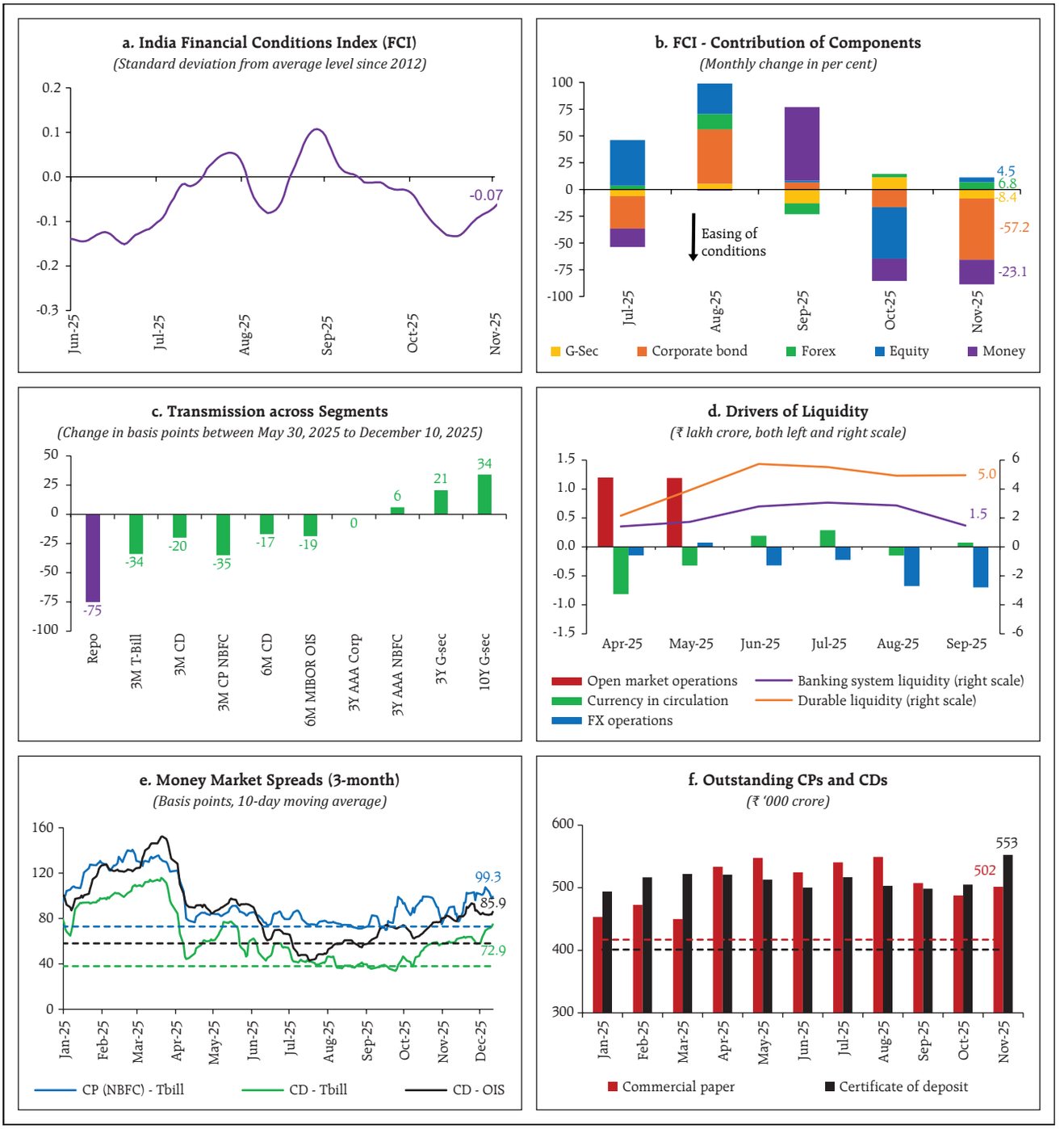
I.2.2 Domestic Financial Markets

1.27 Domestic financial conditions have remained easy since the June 2025 FSR, supported by gains in equity prices and compression in credit spreads (Chart 1.25 a and b). Robust monetary policy transmission, especially in short-term markets, and surplus banking system liquidity have also helped ease financial conditions (Chart 1.25 c and d). Consequently, money market spreads have retreated from the highs seen in Q1:2025-26 (Chart 1.25 e), and issuance of commercial papers (CPs) and certificates of deposit (CDs) has risen (Chart 1.25 f).[8]

1.28 The sovereign yield curve steepened, driven by monetary easing and declining inflation expectations. Short-term rates continued to decline, tracking rate cuts by the RBI and easy liquidity conditions, whereas long-term yields remained under pressure due to persistent supply. Consequently, term spreads rose and remained

[8] Net issuance of treasury bills by the government has been negative this year. This has enabled private sector to raise more resources from the short-term money market through CP and CD issuances.

Chart 1.25: Domestic Financial Conditions Eased



Notes: (1) In chart (a), the financial conditions index is constructed using twenty financial market indicators at daily frequency. A standardised index is used to present the results. The financial conditions index, when at zero, corresponds to a financial system operating at the historical average level of all the financial indicators included in the index. For further details, please refer to article "Financial Conditions Index for India: A High-Frequency Approach", RBI Monthly Bulletin (June 2025).

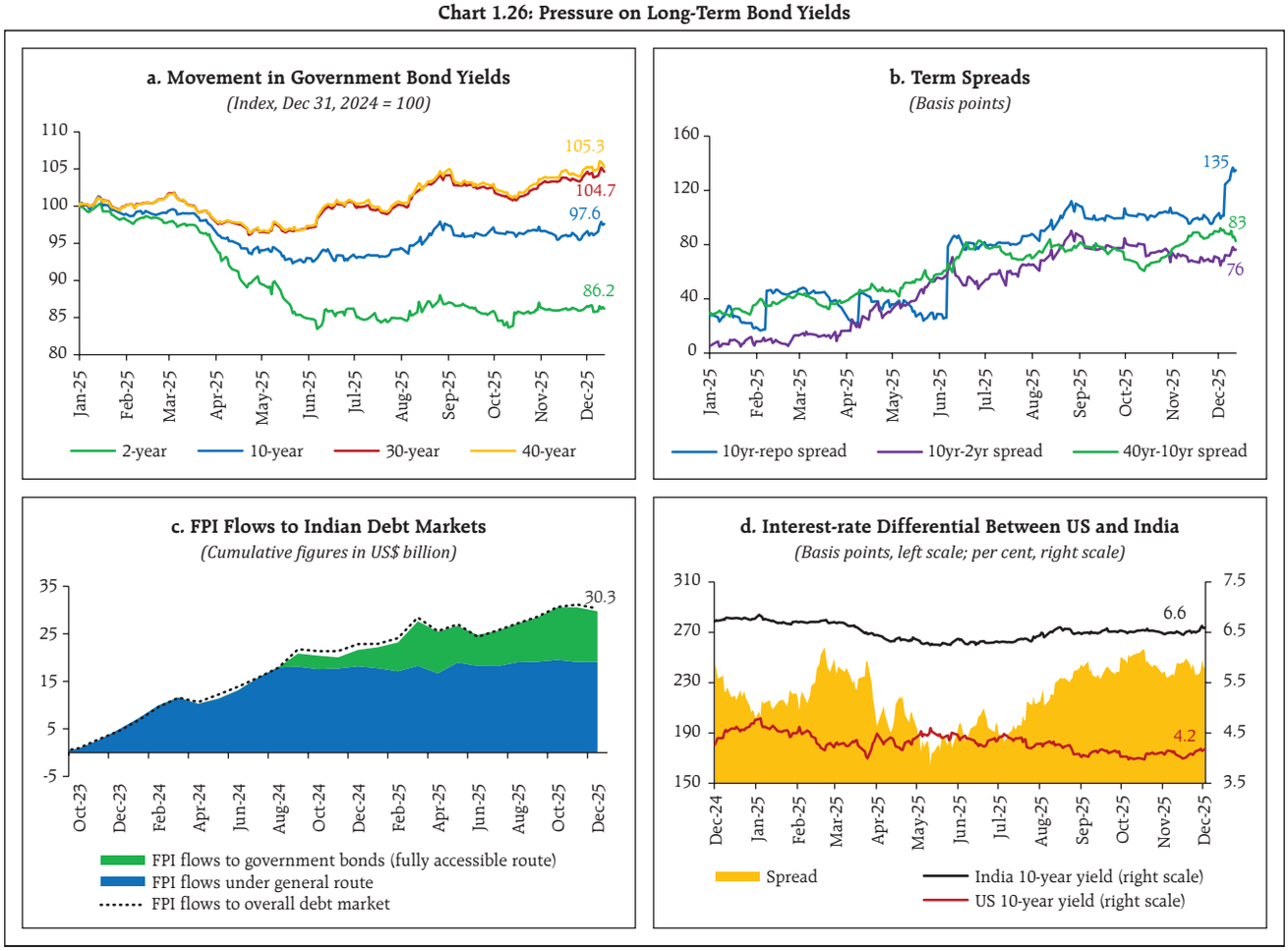
(2) In chart (d), positive figure on right scale denotes surplus liquidity.

(3) In chart (e), dotted lines indicate the average spread from 2018.

(4) In chart (f), dotted lines indicate the average outstanding of the last three years.

Sources: Bloomberg; DBIE; FBIL; LSEG Workspace; RBI; and staff estimates.

Chart 1.26: Pressure on Long-Term Bond Yields



Sources: Bloomberg; and CCIL.

elevated (Chart 1.26 a and b). Meanwhile, FPI flows to Indian government bonds, which saw a sharp rise following bond index inclusion last year, remained robust partly aided by the widening interest-rate differential between the US and India yields (Chart 1.26 c and d).[9]

1.29 The Indian rupee (INR) depreciated against the US dollar (USD), reflecting falling terms of trade due to the impact of tariffs and slowdown in capital flows (Chart 1.27 a and b). With the effective US tariff rate on India being the highest compared to its trading partners, the INR depreciated despite the broad weakening of the USD against other major and Asian currencies. The exchange market pressure index[10] indicates the rising depreciation pressure on the INR (Chart 1.27 c). Importantly, the exchange

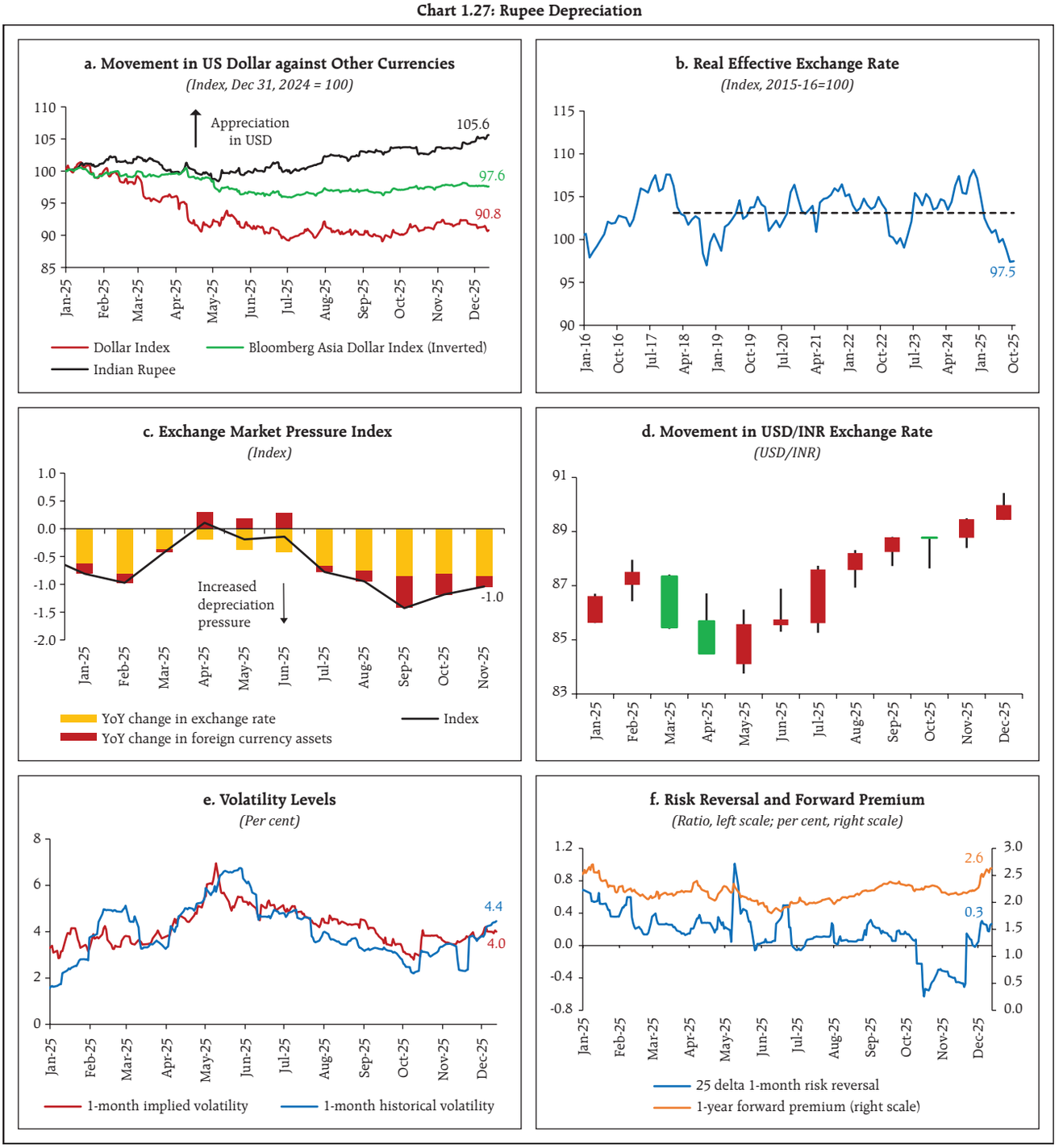
[9] J.P. Morgan announced on September 21, 2023, that it would include Indian government bonds in its Government Bond Index-Emerging Markets (GBI-EM), with the phased inclusion beginning on June 28, 2024. Subsequently, other index providers also announced inclusion. FPI inflows under General and FAR route stand at $8.2 bn for 2025 (till December 10, 2025), as against $16.7 bn in 2024.

[10] Exchange market pressure index (EMP) is used to measure external pressures on the currency and is constructed as a weighted average of exchange rate movements and changes in forex reserves.

$$EMP_t = \frac{1}{\sigma \Delta e_t} \Delta e_t + \frac{1}{\sigma \Delta r_t} \Delta r_t$$

where Δe_t is the y-o-y percentage change in exchange rate relative to the US dollar at time t, and Δr_t is the y-o-y percentage change of foreign exchange reserves at time t as a fraction of the monetary base (M3) at time t-1. $\sigma \Delta e_t$ and $\sigma \Delta r_t$ are the historical standard deviations of the two variables respectively. For more details, see Appendix 3.1 of IMF World Economic Outlook (October 2007, page no. 129-130). Since foreign exchange reserves capture valuation gains, the change in foreign currency assets is taken to provide a more accurate estimate of currency intervention.

Chart 1.27: Rupee Depreciation



Notes: (1) In chart (a), the dollar index measures the performance of the US Dollar against a weighted basket of six major currencies. The Bloomberg Asia Dollar Index replicates the performance of the 9 most liquid Asian currencies, such as the Chinese Renminbi, Korean Won, Singapore Dollar, and Indian Rupee, with weightings determined by trade flows and liquidity. Values above 100 denote appreciation of US Dollar against the respective currency basket.

(2) In chart (b), the trade weighted REER Index is based on 40-currency basket.

(3) In chart (c), the exchange market pressure index uses standardised changes in exchange rates and foreign currency assets to measure net pressure on exchange rate.

(4) In chart (d), black vertical lines show the price range for the month. Green bars denote appreciation in Rupee over the month. Data till December 10, 2025.

(5) In chart (e), the implied volatility is measured using the Black-Scholes model and is widely used as forward-looking metric that indicates the market's expectation of future price swings. Historical volatility is measured by annualising the variance of periodic logarithmic returns over the selected period.

(6) In chart (f), the risk reversal is calculated as the implied volatility for the call option minus the implied volatility for put option on the base currency with the same delta. A positive risk reversal indicates that the implied volatility and thus demand/price of call options is greater than that of put options and suggests a bearish outlook on the Indian rupee.

Sources: Bloomberg; DBIE; and RBI staff estimates.

rate has displayed wider trading range, which in turn has imparted higher volatility (Chart 1.27 d and e). Currency derivatives markets also point to the likelihood of increased volatility going forward as trade tensions continue to weigh on market sentiments. Risk reversal has moved to positive territory, signalling bearish near-term outlook on the Indian Rupee. (Chart 1.27 f).

1.30 Resource mobilisation through capital markets remained steady and grew by 3.3 per cent in H1:2025-26 compared to H1:2024-25 (Table 1.3), with almost two-thirds raised through debt and slightly above one-fourth through equity. The initial public offering (IPO) segment in the Indian equity market, which is vital not only for capital formation but also for bridging the demand-supply gap, remained one of the most active IPO destinations globally. Within this segment, the share of Offer for Sale (OFS), which accounted for 61.3 per cent of the IPO resource mobilisation in H1:2024-25, declined to 56.9 per cent in 2025-26 till November 2025, although on an absolute basis OFS has been steadily increasing (Chart 1.28 a and b).

Table 1.3: Resource Mobilisation through the Indian Securities Market

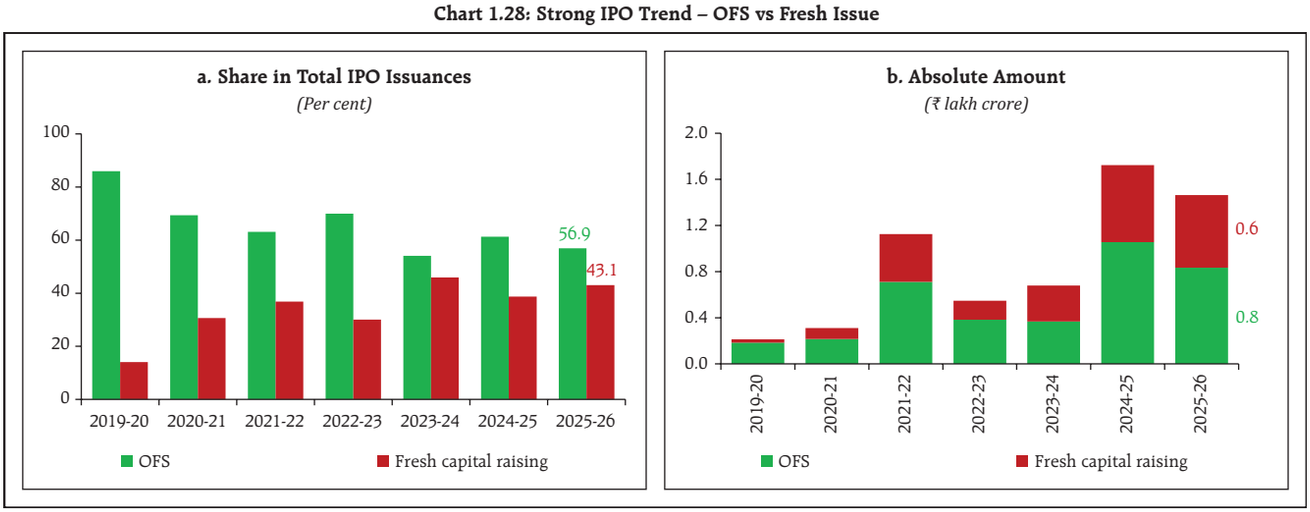
(₹ lakh crore)

Category	2023-24	2024-25	H1:2025-26
Equity-Public	0.8	2.1	0.9
Equity-Private	1.1	2.2	1.2
Debt-Public	0.19	0.08	0.05
Debt-Private on listed basis	8.4	9.9	4.7
REITs	0.06	0.05	0.06
InvITs	0.3	0.3	0.01
AIFs	0.9	1.1	0.7
Total Resource Mobilisation	**11.8**	**15.7**	**7.5**

Note: H1:2025-26 is from April 2025 to September 2025.
Source: SEBI.

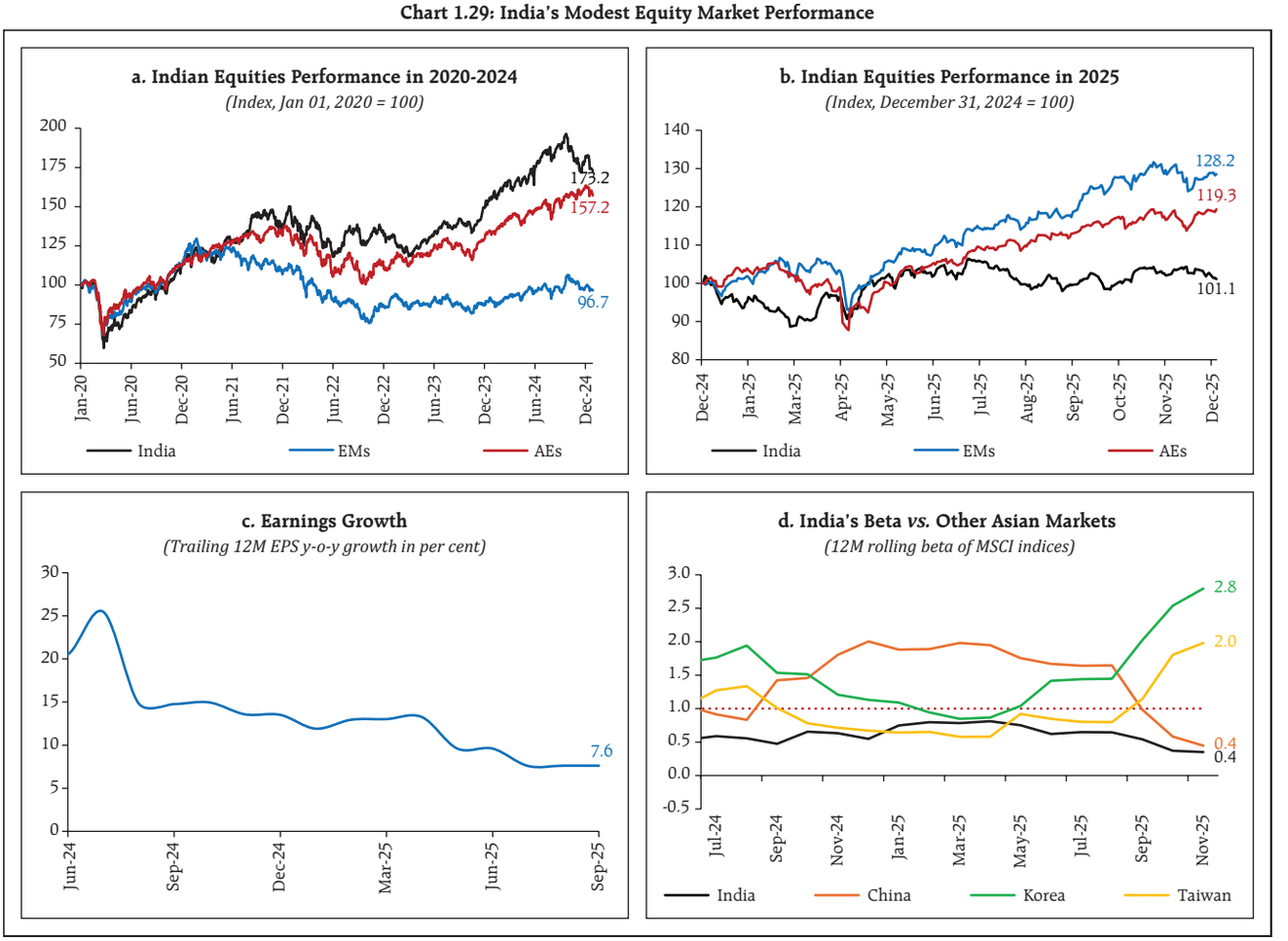
1.31 Indian equity market performance has been modest compared to its emerging market peers this year, following a five-year period of outperformance since 2020 (Chart 1.29 a and b). Tepid corporate earnings growth amid relatively slow nominal GDP growth, higher valuations, sustained FPI outflows, adverse tariff outcomes, and depreciation in INR have weighed on equities' modest performance

Chart 1.28: Strong IPO Trend – OFS vs Fresh Issue



Note: 2025-26 data till November 2025.
Source: SEBI.

Chart 1.29: India's Modest Equity Market Performance



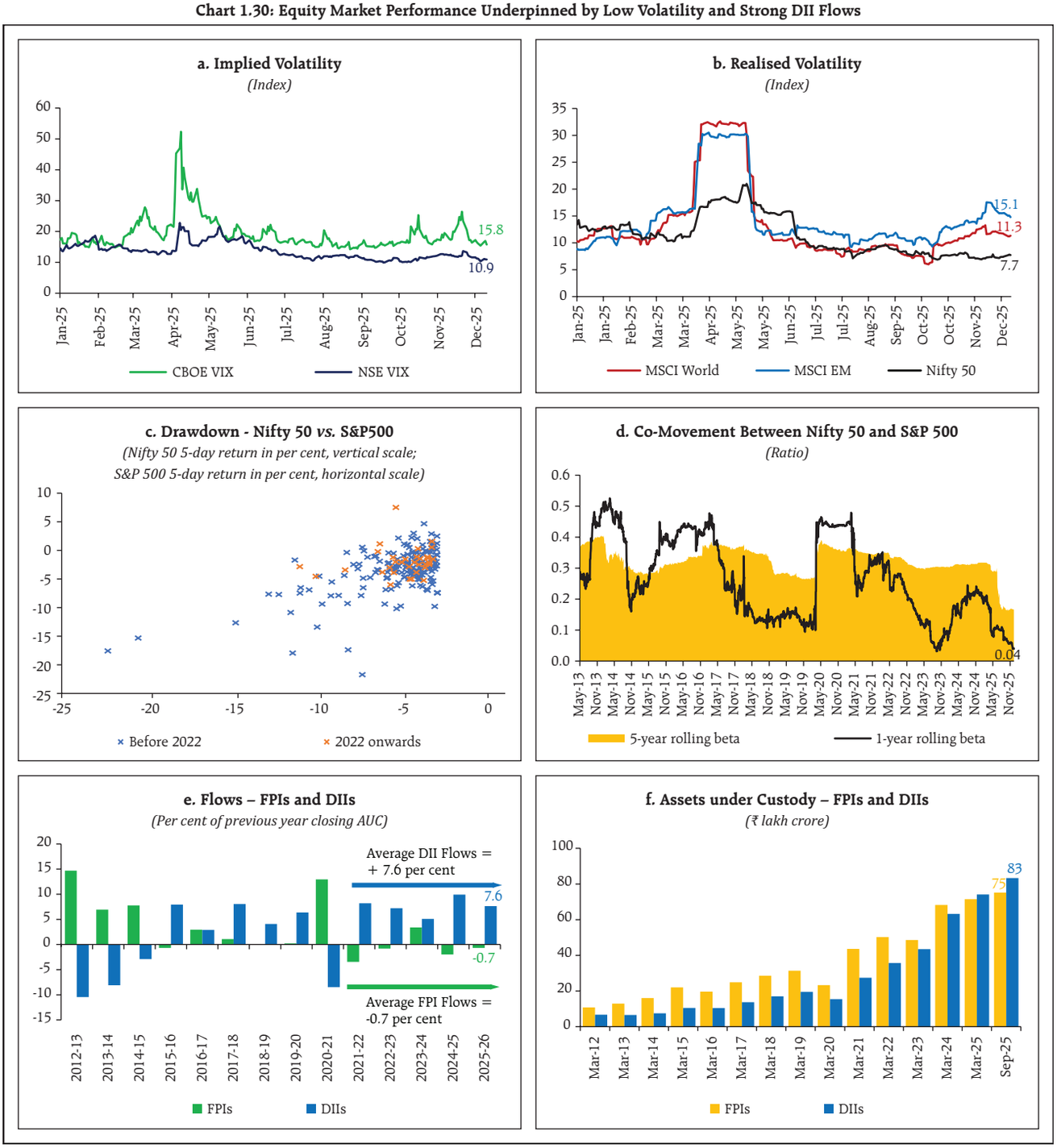
Notes: (1) In chart (a) and (b), equity performance based on dollar returns. MSCI India, MSCI EM and MSCI World have been taken as representative indices for India, EMs and AEs. Data as of December 10, 2025.
(2) In chart (d), the dotted line denotes beta of the benchmark index (MSCI-EM).
Sources: Bloomberg; and RBI staff estimates

(Chart 1.29 c). India's relative performance has also been dragged down by limited AI-driven trades and a lower beta[11] compared with other Asian markets (Chart 1.29 d).

1.32 Notwithstanding the relative underperformance of Indian equities, steady foreign investor outflows, and persistent global economic uncertainty, the Indian equity market has displayed remarkable resilience. Volatility remained subdued compared to other markets (Chart 1.30 a and b). Moreover, the impact of sharp corrections in the US markets, which have historically been outsized on Indian markets, has remained muted with recent data indicating reduced co-movement and declining beta of the Indian market with the US (Chart 1.30 c and d). The stability of the Indian equity market has been underpinned by strong demand from domestic institutional investors (DIIs). Their ownership of Indian stocks has not only surpassed that of foreign investors but also continues to grow (Chart 1.30 e and f). During the calendar year (till December 10, 2025), ₹7.4 lakh crore inflows from DIIs sharply outpaced ₹1.6 lakh crore outflows from foreign portfolio investors.

[11] Beta measures the covariability of Indian markets' returns with the returns of other markets.

Chart 1.30: Equity Market Performance Underpinned by Low Volatility and Strong DII Flows

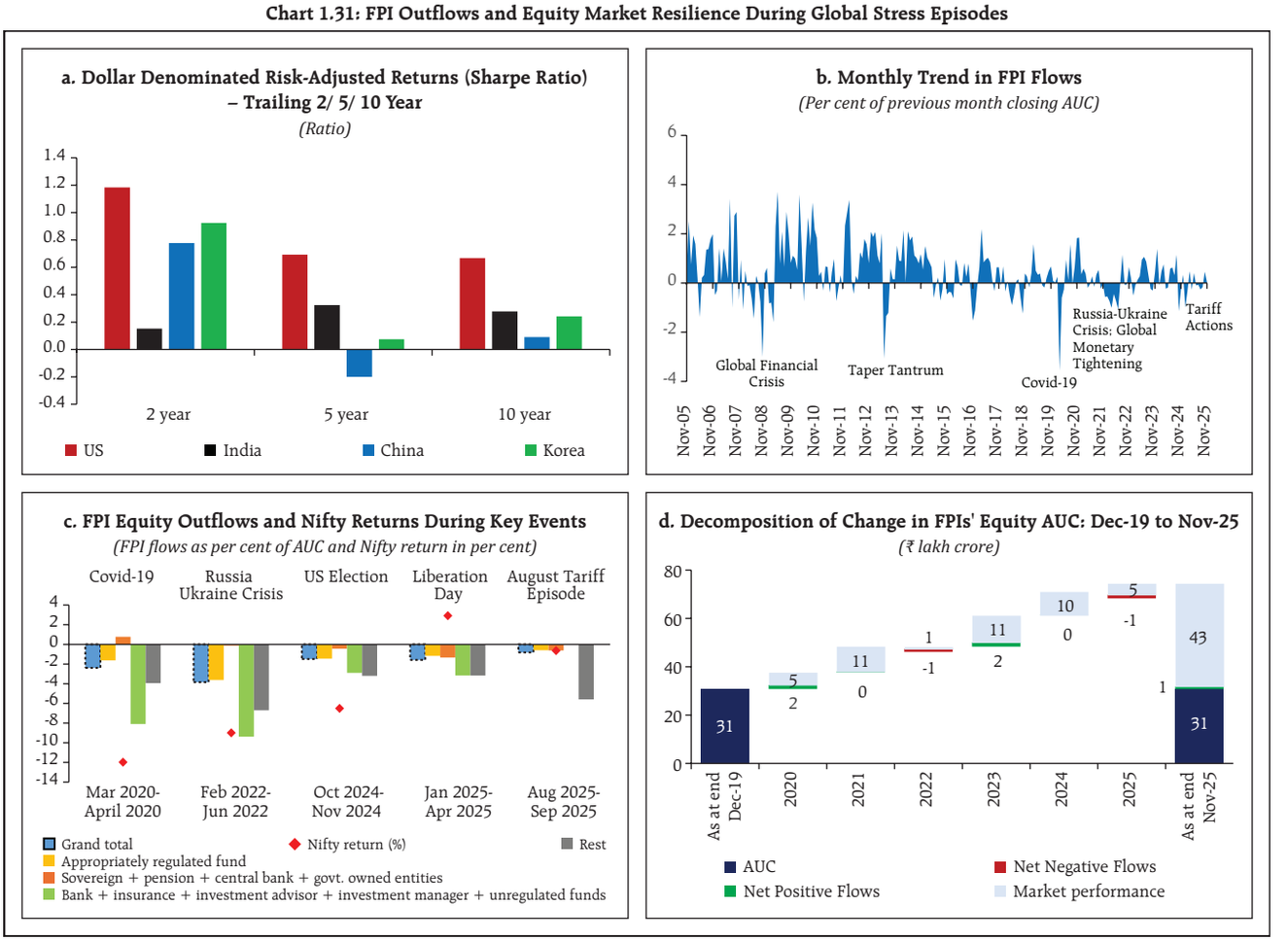


Note: (1) In chart (c), drawdown episodes with US 5-day rolling return decline of more than 3 per cent are considered.
(2) In chart (e), DII flows have increased at an average of ~7.6 per cent per year while FPI flows have reduced at an average of ~0.7 per cent per year between 2021-22 and 2025-26. Data updated till December 10, 2025.

Sources: BSE; NSDL; and SEBI.

1.33 FPIs remained net sellers of Indian equities cumulatively for the fifth year in a row as India has been a relative underperformer *vis-à-vis* EM peers in terms of risk-adjusted dollar returns during the last two years. However, India has performed better over a longer-term horizon (Chart 1.31 a). Nonetheless, their influence on domestic equity movements has been diminishing, and even during risk events—such as the recent tariff shock—capital outflows have been lower compared to past stress episodes. (Chart 1.31 b). Analysis of historical risk-off events indicates that the resilience of the Indian equity market improved despite foreign investor selling pressures during identified episodes. Within the FPI categories, banks, investment advisors and unregulated funds have shown relatively higher

Chart 1.31: FPI Outflows and Equity Market Resilience During Global Stress Episodes



Notes: (1) In chart (b), FPI Flows as a percentage of assets under custody (AUC) is estimated as total FPI flows (equity and debt combined) during the month as a percentage of FPI AUC (equity and debt combined) as of the end of the previous month. Over the period between January 2012 and November 2025, equities accounted for an average of about 90 per cent of total FPI assets (equity and debt combined).

(2) In chart (c), the grand total represents all FPIs; all categories of FPI owners have been put into four buckets – appropriately regulated funds (~55 per cent of total FPI AUC), sovereign + pension fund + central bank + government owned entities (~25 per cent of total FPI AUC), banks, insurance, investment advisors, investment managers, unregulated funds (~15 per cent of total FPI AUC), and rest of the categories (~5 per cent of total FPI AUC); Nifty returns are estimated on end-of-month basis.

(3) In chart (d), the change in the AUC of FPIs from Dec-19 to Nov-25 has been decomposed into market performance (valuation changes) and flows for each year.

(4) Constituent items may not add up to the total due to rounding off.

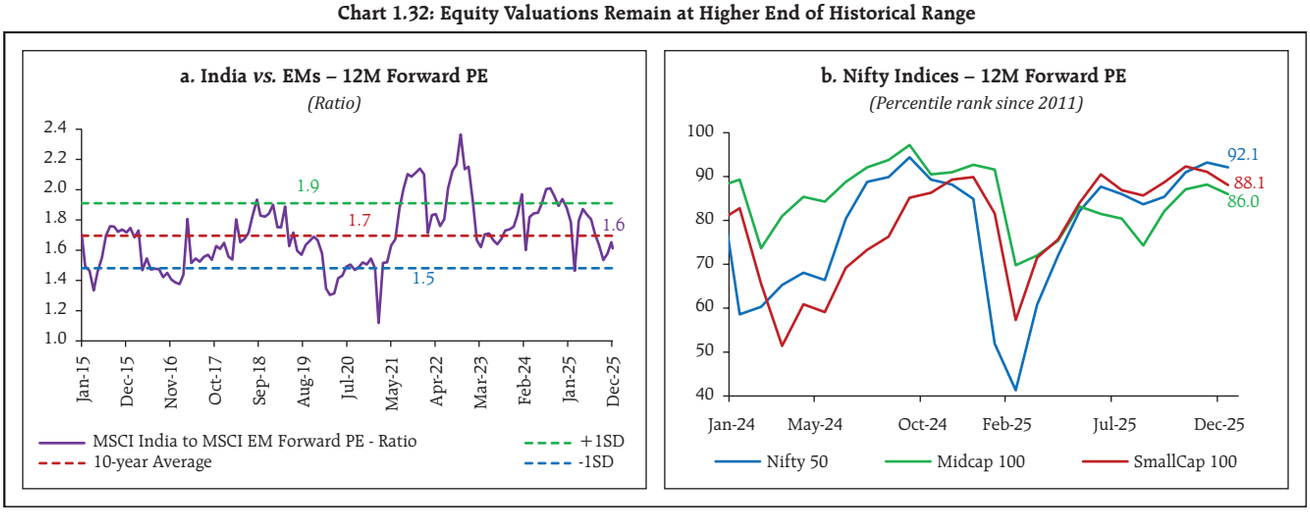
Sources: SEBI; NSDL; Bloomberg; and RBI staff estimates.

sensitivity to global risk sentiment, recording larger outflows as a share of their AUC during stress episodes (Chart 1.31 c). Importantly, the decomposition of FPIs' AUC shows that the changes in AUC have been primarily driven by valuation gains, which indicate that the recent outflows could be attributed to cyclical profit booking rather than structural shift in FPIs' outlook for Indian equities (Chart 1.31 d).

1.34 Indian equities have been trading at a premium relative to other emerging markets. Recent market corrections, however, have narrowed the valuation gap bringing it closer to the 10-year average of 70 per cent from 100 per cent in September 2024 (Chart 1.32 a). Nonetheless, valuations have returned to the high end of the historical range with markets recovering from the tariff shock and trading near their lifetime highs (Chart 1.32 b).

1.35 The implied equity risk premium (ERP)[12] demanded by investors, a key barometer of the price of risk in equity markets, has increased since September 2024 for all Nifty indices (Chart 1.33 a). Although, Nifty 50 cumulative returns since March 2022 have been primarily driven by earnings, returns of midcaps and smallcaps are driven more by compression of ERP[13] than by earnings growth (Chart

Chart 1.32: Equity Valuations Remain at Higher End of Historical Range

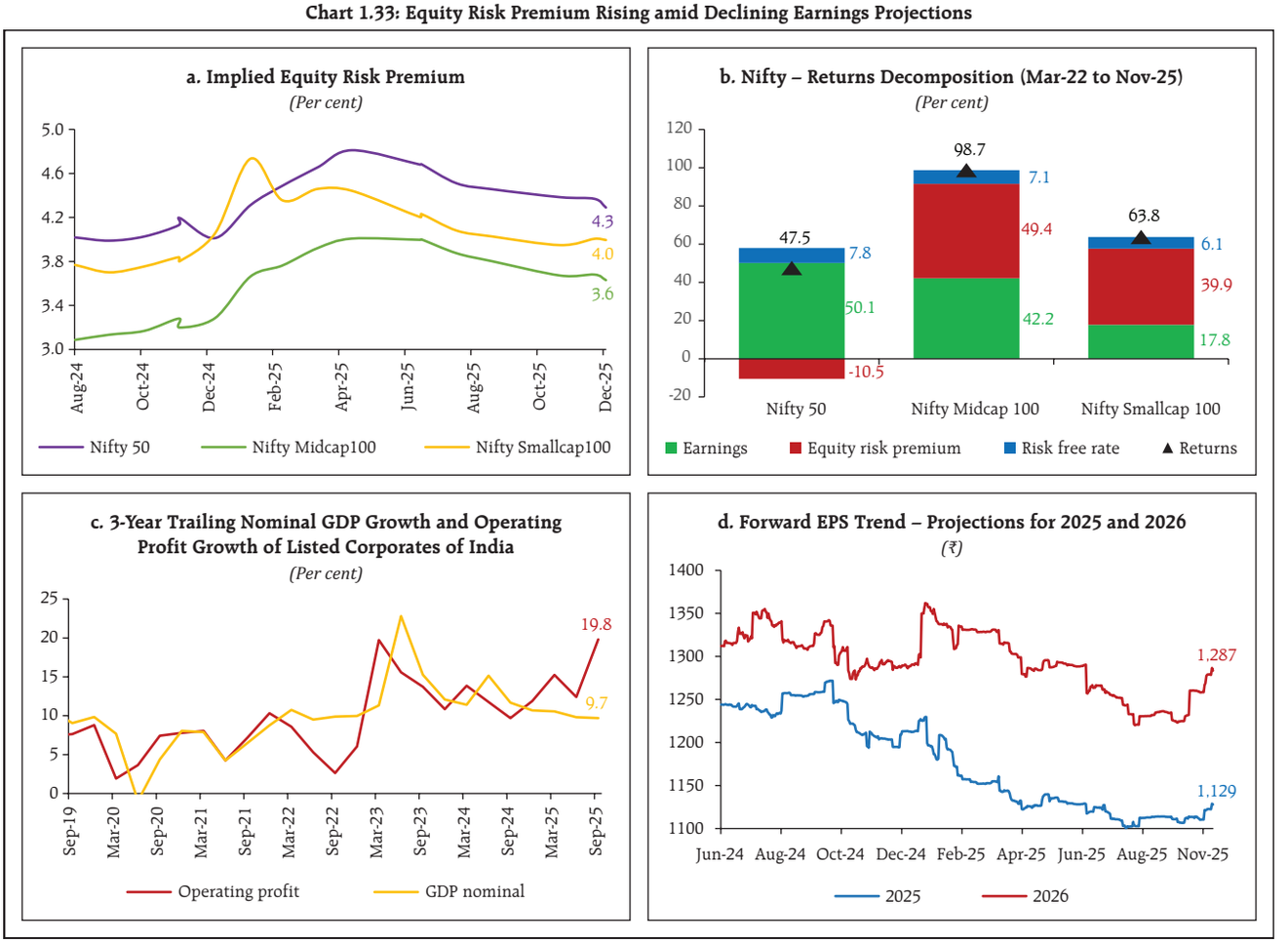


Note: Data as on December 10, 2025.
Sources: Bloomberg; and RBI staff estimates.

[12] The implied equity risk premium (ERP) is a forward-looking measure of the extra return investors expect from stocks over a risk-free rate, like government bonds. Instead of using historical returns, it is derived from current stock prices, estimated future cash flows (like earnings or dividends) and growth rate assumptions. The calculation for the implied ERP works backward from current market prices to determine the discount rate that justifies those prices. If investors' risk appetite increases, they demand less premium over risk-free rate, thereby decreasing the cost of equity and increasing the present value of equity.

[13] A lower implied ERP can suggest that stocks are becoming less attractive relative to bonds, or that investor confidence is high, driving stock prices up and compressing the premium.

Chart 1.33: Equity Risk Premium Rising amid Declining Earnings Projections



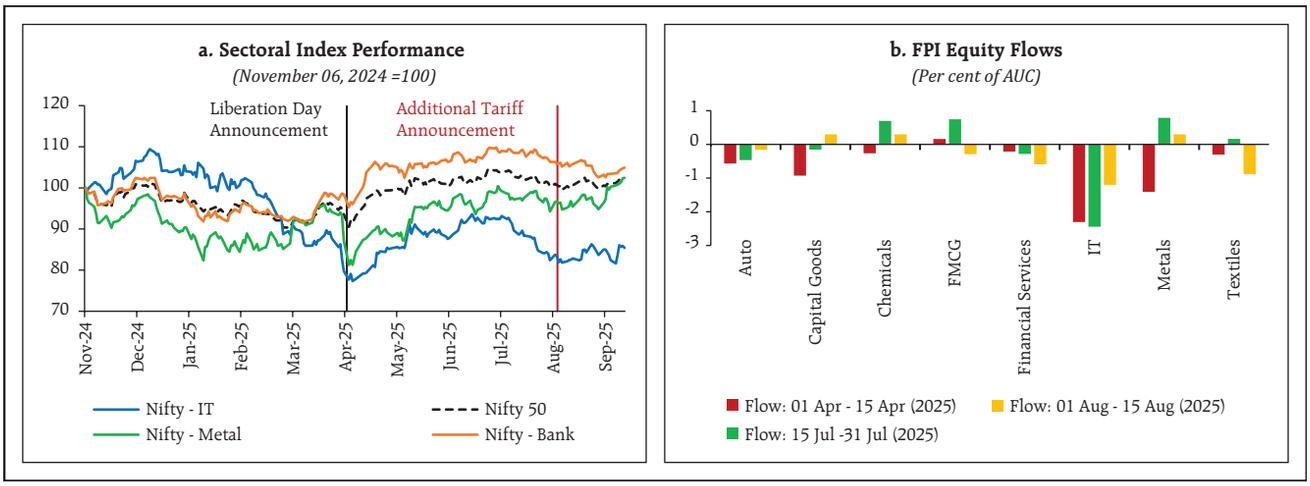
Notes: (1) In chart (b), data updated till December 10, 2025.
(2) In chart (d), lines show the time series of the projected yearly EPS of the Nifty 50 index for 2025 and 2026.
Sources: Bloomberg; and RBI staff estimates.

1.33 b). Moreover, risk to earnings growth remains in an environment of relatively slow nominal GDP growth, with forward earnings per share (EPS) consensus estimates for Nifty 50 for 2025 and 2026 showing a decline (Chart 1.33 c and d).

1.36 An assessment of the impact of the recent U.S. tariffs on domestic equity market showed heterogenous responses in equity sectoral indices, both during the April and August 2025 episodes (Chart 1.34 a and b), even as broad market indices remained resilient.

1.37 Furthermore, an event-study analysis revealed that while aggregate Bank Nifty Index exhibited limited volatility around the liberation day announcement, there was substantial variation among individual bank stocks with those having higher exposure to trade-sensitive corporates recording larger negative returns (Chart 1.35). The dispersion of returns across other banks was narrower, highlighting that market reactions were not systemic, but concentrated among few trade-exposed banks.

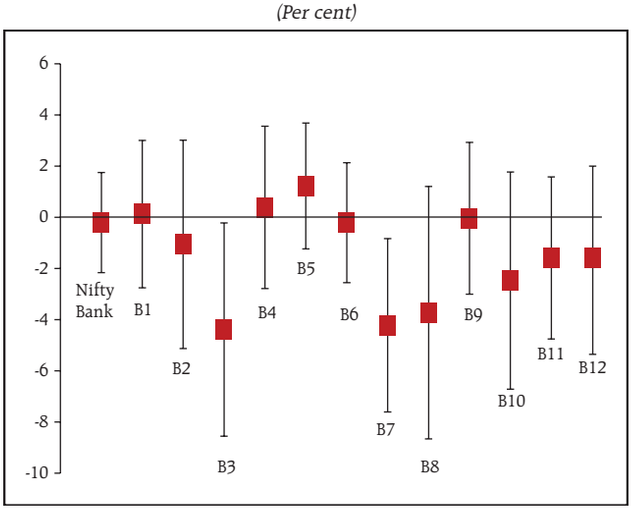
Chart 1.34: Impact of US Tariffs - Sectoral Indices Performance



Notes: (1) In chart (a), November 06, 2024 is taken as the base date corresponding to the announcement of the US election results. FPI sectoral flows are disclosed on a fortnightly basis.
(2) In chart (b), the FPI equity flows is shown as a per cent of AUC at the beginning of the fortnight.
Sources: Bloomberg; CDSL; NSDL; and RBI staff estimates.

1.38 Corporate debt market continued to witness growth, with net outstanding of bonds (listed and unlisted) increasing to ₹57.5 lakh crore as at end-November 2025. However, secondary market turnover remained low (Chart 1.36 a). AAA-rated companies continued to dominate the issuance even as issuance by firms rated below AA has increased (Chart 1.36 b). Listed private placements remained the preferred route for resource mobilisation led by NBFCs (Chart 1.36 c). More than 90 per cent of the bonds issued were fixed coupon bonds, with floating rate instruments largely linked to money market, government securities and equity-linked benchmarks (Chart 1.36 d). NBFCs and non-financial corporates remained the prime mobilisers of funds, whereas insurance companies and mutual funds remained the major providers in the listed corporate bond market category. Unlisted corporate bonds are mainly held by non-financial corporates and newer investment vehicles such as alternative investment funds (Chart 1.36 e and f).

Chart 1.35: Bank Stock Performance Around Liberation Day Announcement
(Per cent)



Note: The chart presents the estimated β_0 coefficients from the regression specification: $\ln(R_t) = \alpha + \sum_{[s=-5]}^{(s=4)} \beta_s D_{s,t} + \varepsilon_t$. Where $\ln(R_t)$ is the log daily returns of Bank Nifty (or specific bank stocks). $D_{s,t}$ =1 if day t is s days relative to the tariff announcement (ranging from 5 days before to 4 days after), and 0 otherwise. β_s captures the average return impact 's' days from the event, ε_t, is the error term. The dotted vertical lines represent the 95 per cent confidence intervals around the point estimates. B_i represents individual bank stocks.
Sources: Bloomberg; and RBI staff estimates.

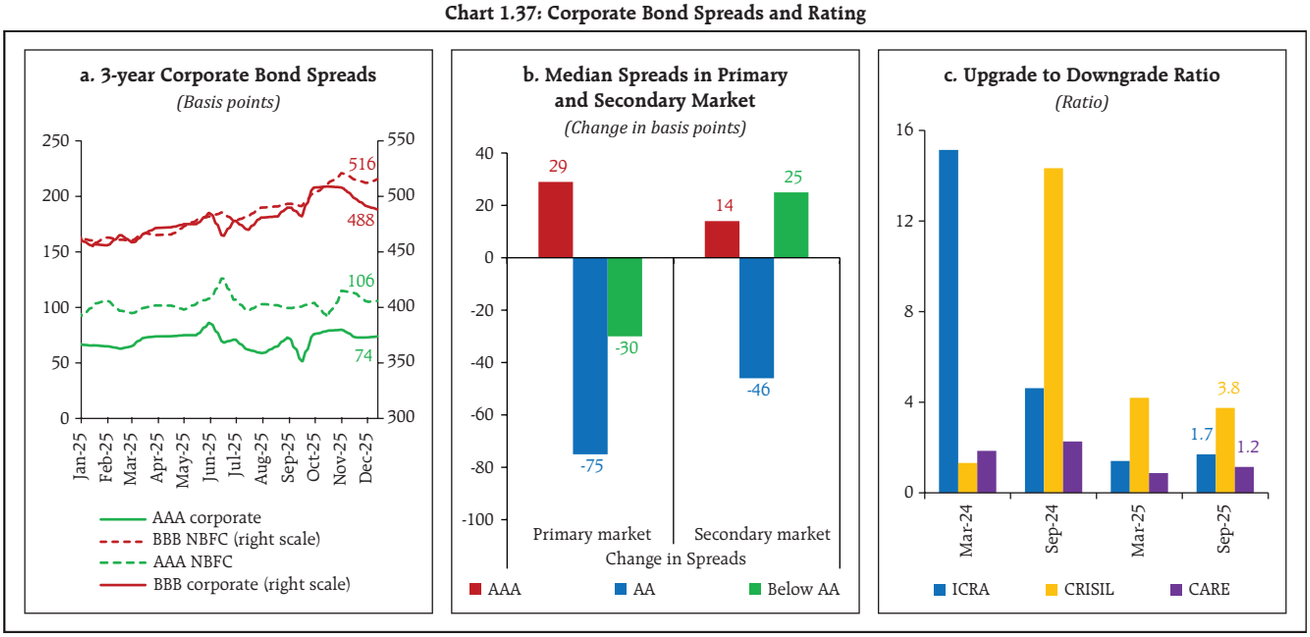
1.39 Corporate bond spreads have remained stable, with AAA-rated bonds trading 80 to 100 basis points above similar-maturity government securities. Median spreads for AA and lower-rated

Chart 1.36: Corporate Bond Market Trends

Notes: (1) In chart (a), average monthly turnover is a percentage of total outstanding. Data for 2025-26 till November 2025.
(2) In chart (b), below AA category includes bonds for which the rating is not available. Data updated till December 10, 2025.
(3) In chart (c), only major categories are shown. Data pertains to April-November 2025.
(4) In chart (d), data updated till December 10, 2025.
(5) In chart (e) and (f), data as of end-November 2025. NBFC: Non-Banking Finance Company; PSU: Public Sector Undertaking; HFC: Housing Finance Company; FPI: Foreign Portfolio Investor; AIF: Alternative Investment Fund.

Sources: SEBI; Prime database; NSDL; CDSL; and RBI staff estimates.

Chart 1.37: Corporate Bond Spreads and Rating



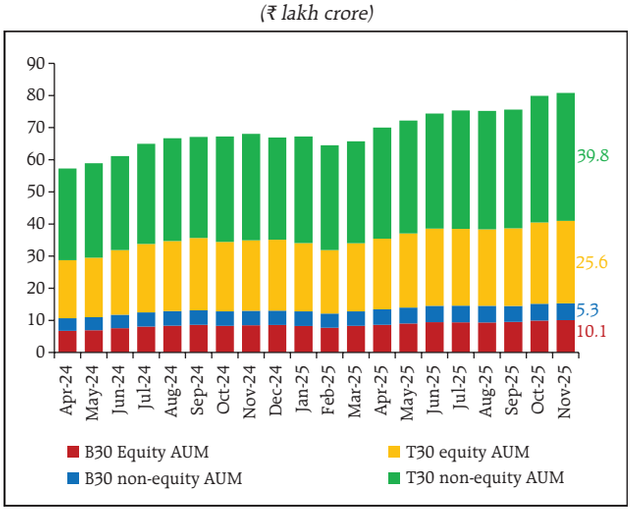
Notes: (1) In chart (b), the net change in median yields from June 2025 to November 2025.
(2) In chart (c), data for the respective half-year.
Sources: SEBI; NSDL; CDSL; and RBI staff estimates.

borrowers in the primary market fell as a sign of improving risk appetite among investors (Chart 1.37 a and b). The upgrade-to-downgrade ratio, known as the credit ratio, also indicates an improving credit environment (Chart 1.37 c).

1.40 The assets under management (AUM) of the domestic mutual fund industry increased to ₹80.8 lakh crore, recording a 18.7 per cent growth (y-o-y) as at end-November 2025 (Chart 1.38). Out of the total AUM, ₹35.7 lakh crore were in equity schemes and ₹45.1 lakh crore in non-equity schemes.[14]

1.41 Robust inflows through systematic investment plans (SIPs) continued as H1:2025-26 recording a net contribution of ₹1.0 lakh crore, up by

Chart 1.38: AUM of the Domestic Mutual Fund Industry Growing
(₹ lakh crore)

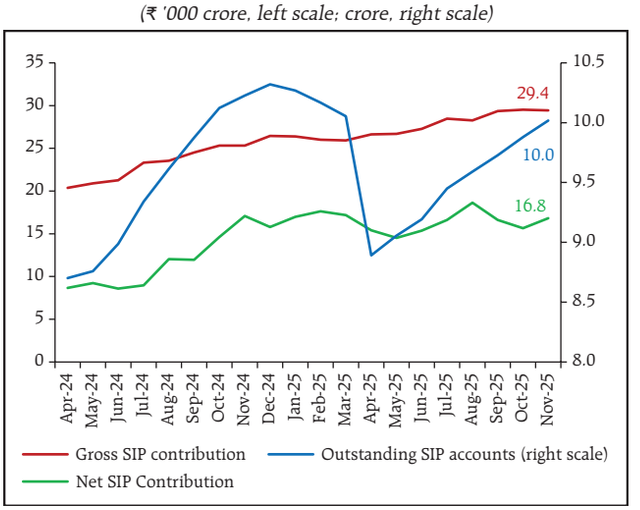


Note: T30 refers to the top 30 geographical locations in India and B30 refers to the locations beyond the top 30 cities.
Source: SEBI.

[14] Equity schemes include all growth/equity-oriented schemes, while non-equity schemes include hybrid schemes, income/debt-oriented schemes, solution-oriented schemes and other schemes.

Chart 1.39: Resilient SIP Flows

(₹ '000 crore, left scale; crore, right scale)



Note: Pursuant to a SEBI directive, AMCs are now considering failed SIPs as discontinued from the month of January 2025. The April 2025 data includes past legacy data on account of failed SIPs.

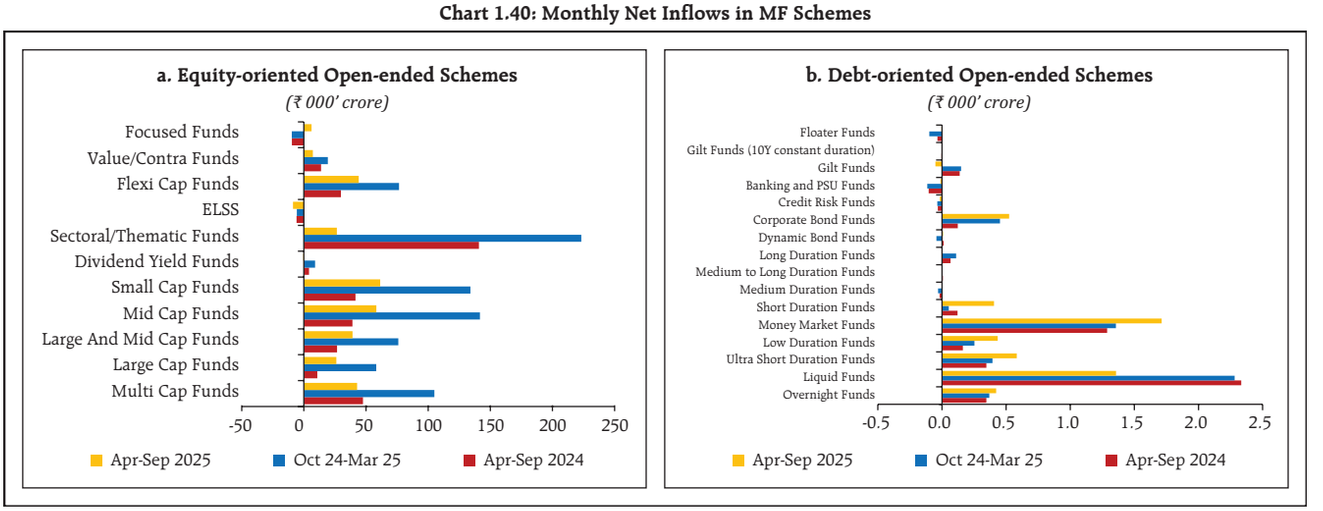
Source: SEBI.

63.4 per cent (y-o-y) and the number of outstanding SIP accounts, which sharply fell in April 2025, is also growing (Chart 1.39). The SIP AUM both as a share of the AUM of equity-oriented schemes and as a share of the total AUM of the domestic mutual fund industry has been increasing and currently stands at 54.4 per cent and 20.4 per cent as at end-November 2025, respectively, underlining the steady demand for equities exposure among retail investors.

1.42 Overall, however, equity-oriented schemes have seen a slowdown in net inflows in H1:2025-26 - down 10.6 per cent compared to H1:2024-25. Amongst the schemes, the highest inflows were in small-cap funds, mid-cap funds and flexi-cap funds, while thematic funds saw moderating inflows *vis-à-vis* the previous period (Chart 1.40 a). Cumulative net inflows into open-ended debt schemes rose 12.9 per cent during the same period, with money market and liquid funds recording the highest inflows (Chart 1.40 b).

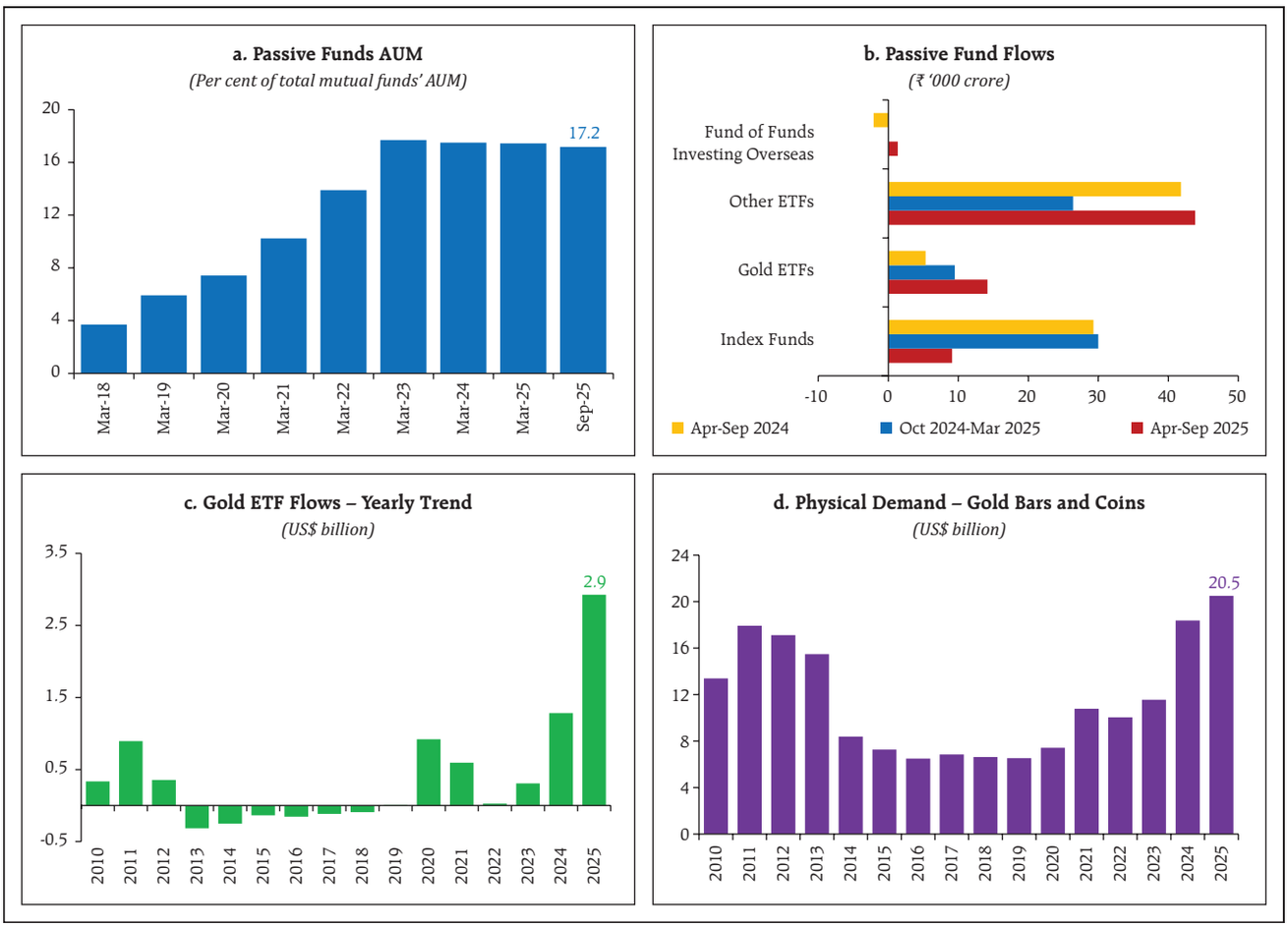
1.43 Flows to passive funds also slowed down by 7.9 per cent in H1:2025-26 compared to H1:2024-25, even though their AUM remained steady at 17 per cent of the total MF AUM (Chart 1.41 a). Inflows into ETFs and index funds were flat or declined, except for Gold ETFs, which surged 128 per cent year-on-year to a record US$ 2.9 billion in 2025 (Chart 1.41 b and c). Rising gold prices also increased demand for physical gold, which reached US$ 20 billion in value terms this year (Chart 1.41 d).

Chart 1.40: Monthly Net Inflows in MF Schemes



Source: SEBI.

Chart 1.41: Domestic Passive Fund Flows



Sources: AMFI; and World Gold Council.

I.3 Corporate and Household Sector

I.3.1 Corporate Sector

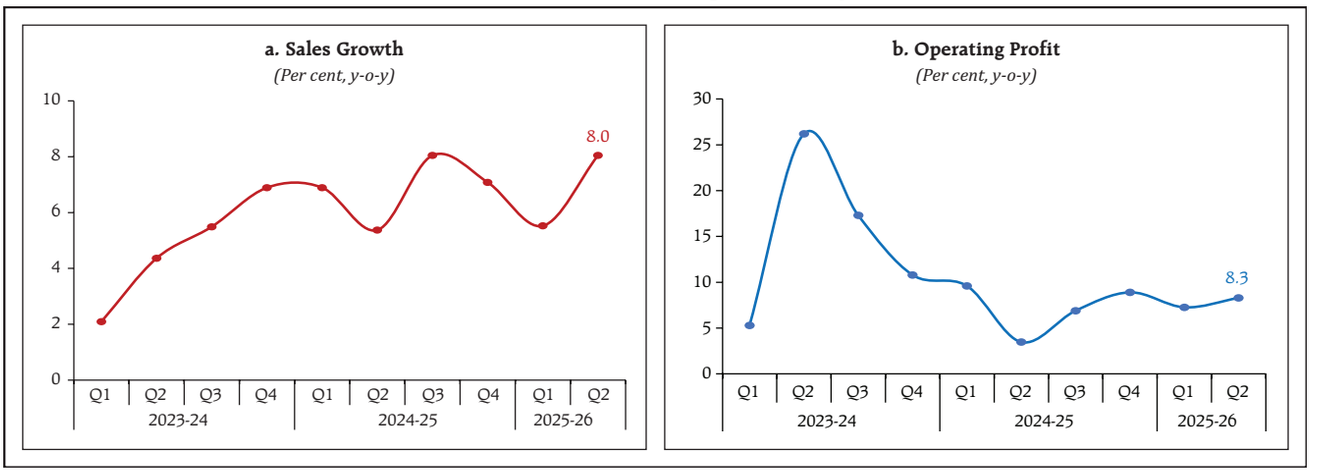
1.44 Private non-financial corporate sector remained healthy, supported by steady profitability and sales as well as stable firm-level risk metrics amid trade related disruption. Sales growth of listed non-government non-financial companies (NGNF) improved to 8.0 per cent (y-o-y) during Q2:2025-26 from 5.5 per cent growth in the previous quarter (Chart 1.42 a), led by improvement in sales growth across all the major sectors.[15] Operating profit rose by 8.3 per cent (y-o-y) during Q2:2025-26 (Chart 1.42 b) but remained flat sequentially from Q1:2025-26.

1.45 At the aggregate level, debt serviceability, as measured by the interest coverage ratio (ICR)[16], and the proportion of vulnerable firms – those with ICR<=1 – and debt held by those firms

[15] Based on quarterly results of 3,118 listed non-government non-financial companies for Q2:2025-26.

[16] ICR (*i.e.*, ratio of earnings before interest and tax to interest expenses) is a measure of debt servicing capacity of a company. The minimum value for ICR is 1 for a company to be viable.

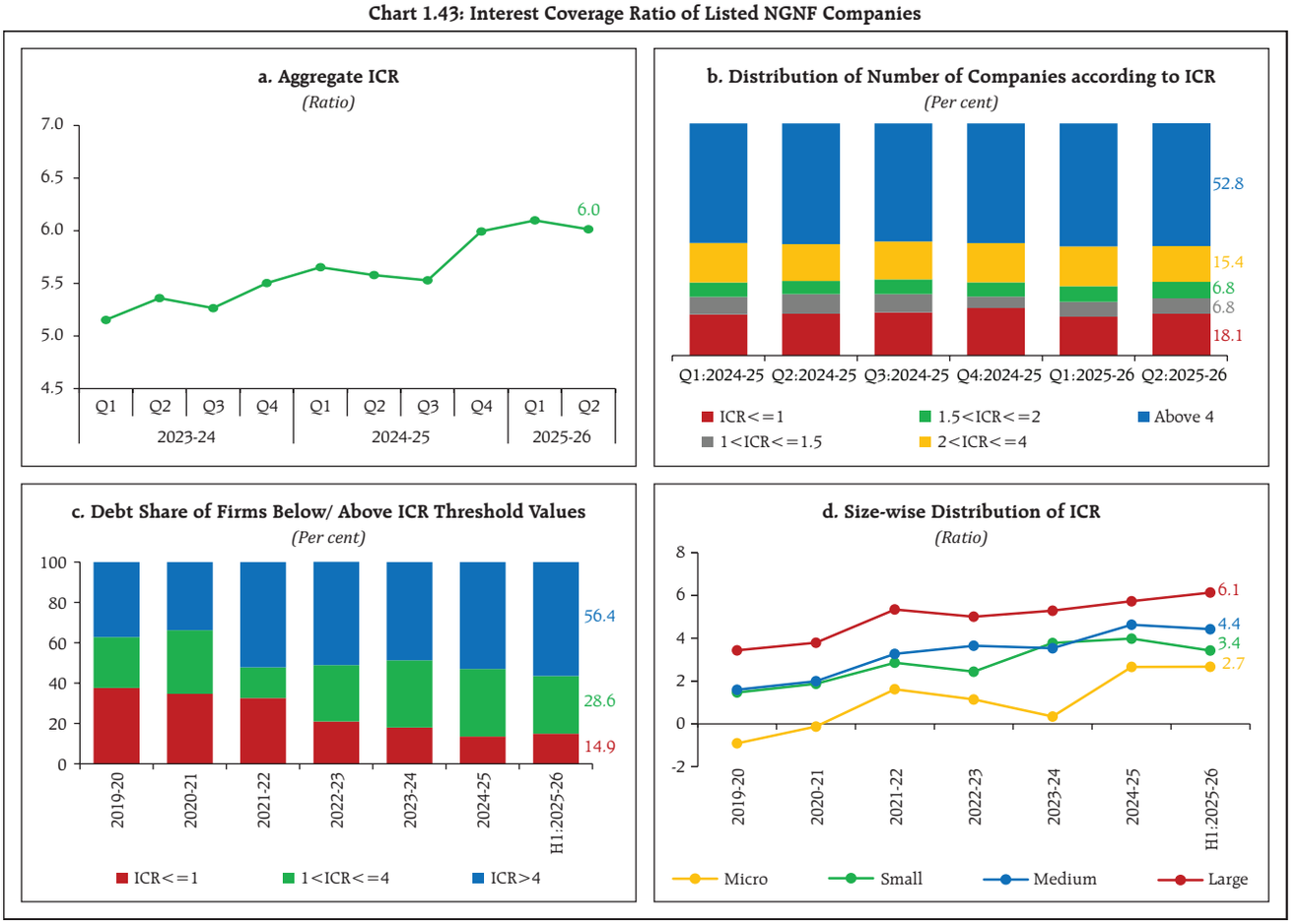
Chart 1.42: Listed Private Non-Financial Companies – Steady Sales and Profits



Note: The number of companies varies across quarters. For Q2:2025-26, results are based on 3,118 listed private non-financial companies.
Sources: Capitaline database; and RBI staff estimates.

broadly remained stable (Chart 1.43 a, b and c). At a disaggregated level, the ICR has moderated marginally across different enterprises, except for large firms (Chart 1.43 d).

Chart 1.43: Interest Coverage Ratio of Listed NGNF Companies



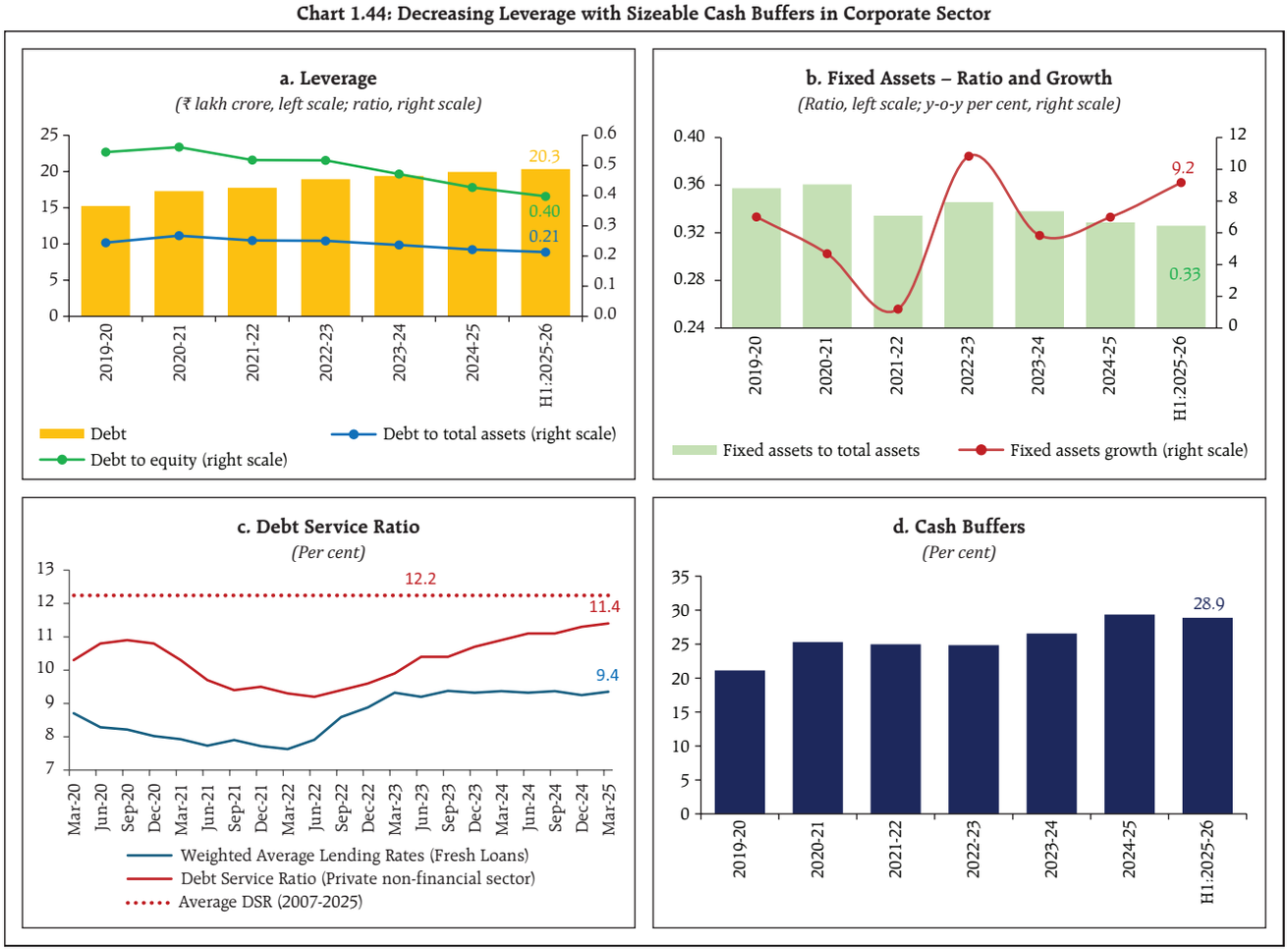
Notes: (1) The number of companies varies across periods. In chart (a) and (b), results are based on 2,725 listed NGNF companies for Q2:2025-26 that have non-zero interest expenses.
(2) In chart (c), debt is calculated as total liabilities less total equity. Results are based on 2,536 listed NGNF companies who have non-zero interest expenses for H1:2025-26.
(3) Chart (d) is based on data of 2,828 listed NGNF companies for H1:2025-26. The superset of companies for each period has been divided into four quartiles by size (total assets) – Micro (Quartile 1), Small (between Quartile 1 and Quartile 2), Medium (between Quartile 2 and Quartile 3) and Large Companies (above Quartile 3).
Sources: Capitaline database; and RBI staff estimates.

1.46 The balance sheet analysis of listed NGNF companies indicated that the gradual decline of leverage in terms of both debt-to-total assets and debt-to-equity has continued (Chart 1.44 a).[17] Fixed assets remained flat as a ratio of total assets although on an absolute basis they grew by 9.2 per cent (y-o-y) during H1:2025-26 as compared to 7 per cent in 2024-25 (Chart 1.44 b). The debt service ratio of non-financial sector remained below its historical average even as the weighted average lending rate has increased by 172 bps between March 2022 and March 2025. Moreover, corporate cash buffers remained substantial (Chart 1.44 c and d).

I.3.2 Household Sector

1.47 Household debt stood at 41.3 per cent of GDP as at end-March 2025, marking a sustained increase compared to its 5-year average of 38.3 per cent. However, relative to most of the peer EMEs, India's household debt remained lower (Chart 1.45 a and b).

Chart 1.44: Decreasing Leverage with Sizeable Cash Buffers in Corporate Sector

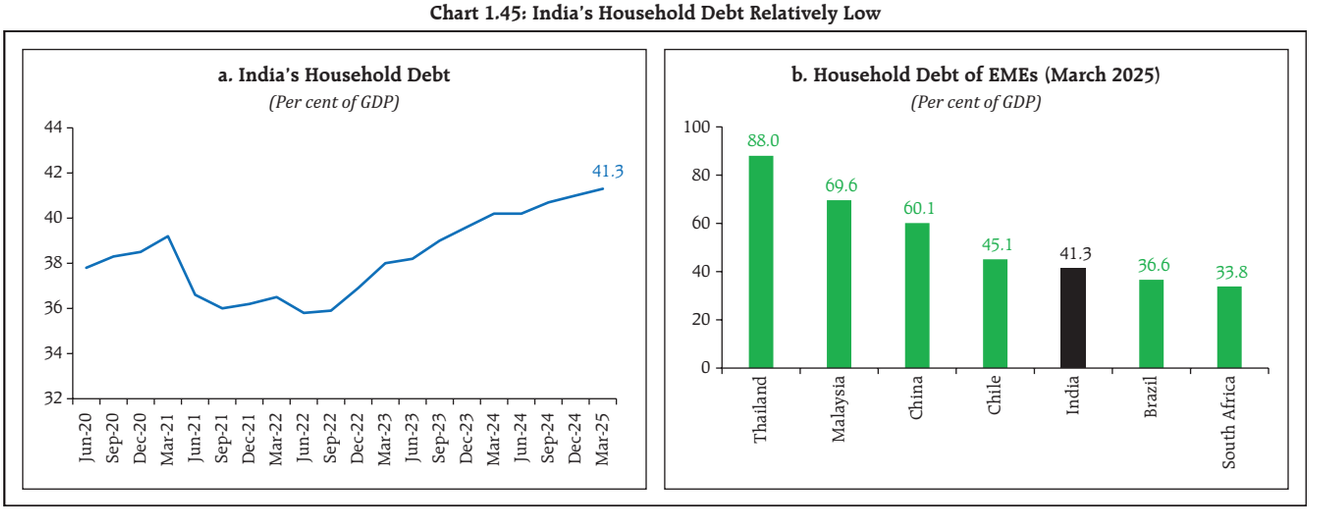


Notes: (1) In chart (a), leverage is defined as debt/equity and debt/total assets, wherein debt = sum of 'long-term borrowings' and 'short-term borrowings' and equity = sum of 'share capital' and 'reserves and surplus'.
(2) In chart (a), (b) and (d), annual data is based on 3,498 common listed NGNF companies, while half-yearly analysis is based on 3,449 listed NGNF companies.
(3) In chart (c), the BIS database on 'debt service ratio' reflects the share of income used to service debt for the total private non-financial sector.
(4) In chart (d), cash buffer is defined as cash/total liabilities*100, wherein cash = sum of 'cash and cash equivalents', 'short term loans and advances' and 'current investments'; and total liabilities = sum of 'total long-term borrowings' and 'total current liabilities' less 'short-term provisions'.

Sources: Capitaline; BIS; and RBI staff estimates.

[17] Half-yearly balance sheet analysis is based on abridged balance sheet of 3,449 listed non-government non-financial companies.

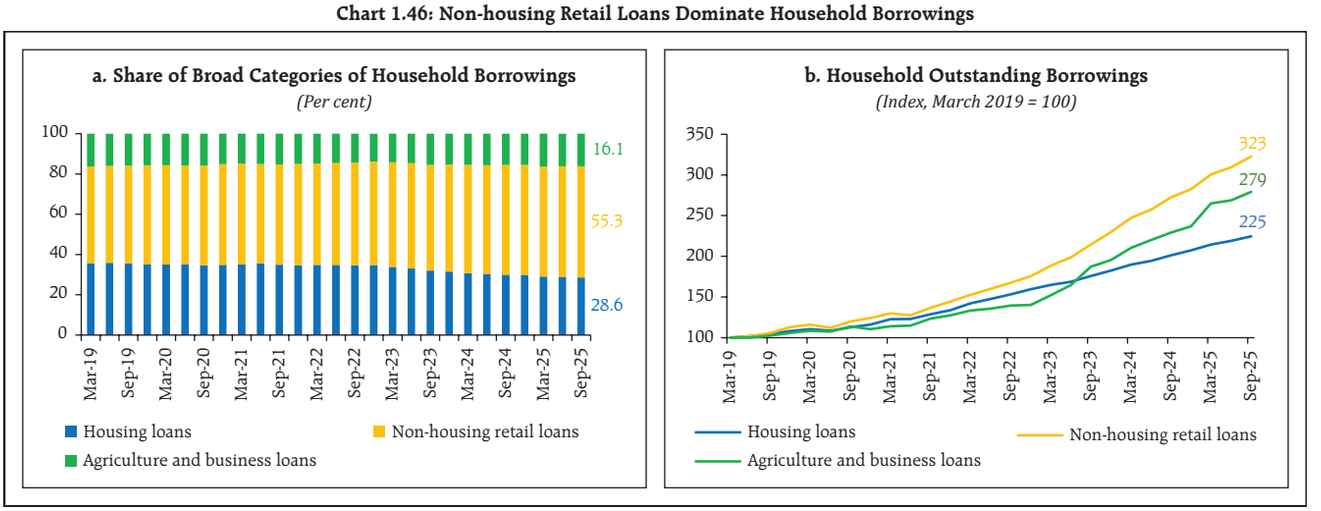
Chart 1.45: India's Household Debt Relatively Low



Note: Data for India is sourced from the RBI, while data for other countries is sourced from the BIS.
Sources: RBI; and BIS database.

1.48 Among broad categories of household borrowings[18], non-housing retail loans extended mostly for consumption purposes continue to be the dominant segment, accounting for 55.3 per cent of total household borrowing from financial institutions as of September 2025 (Chart 1.46 a). Their share has risen over the years, with growth consistently surpassing that of housing loans, and agriculture and business loans (Chart 1.46 b). From a risk perspective, the share of better-rated customers, *viz.*, prime and above, has increased both in terms of the outstanding amount and number of borrowers, indicating that the overall resilience of the household sector remains sound (Chart 1.47 a and b).

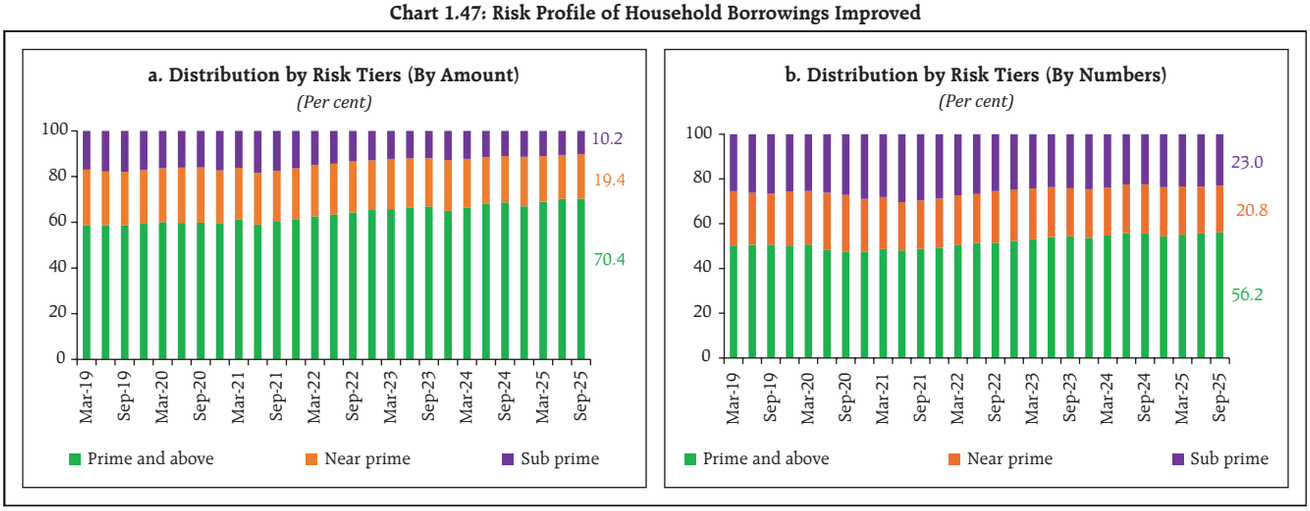
Chart 1.46: Non-housing Retail Loans Dominate Household Borrowings



Source: TransUnion CIBIL.

[18] In this analysis, consumer segment loans are used as a proxy for the total household debt. Consumer segment loans refer to credit that is extended to individuals in their personal capacity, utilised for either personal or business purposes, and is recorded in the consumer repository of credit bureau(s).

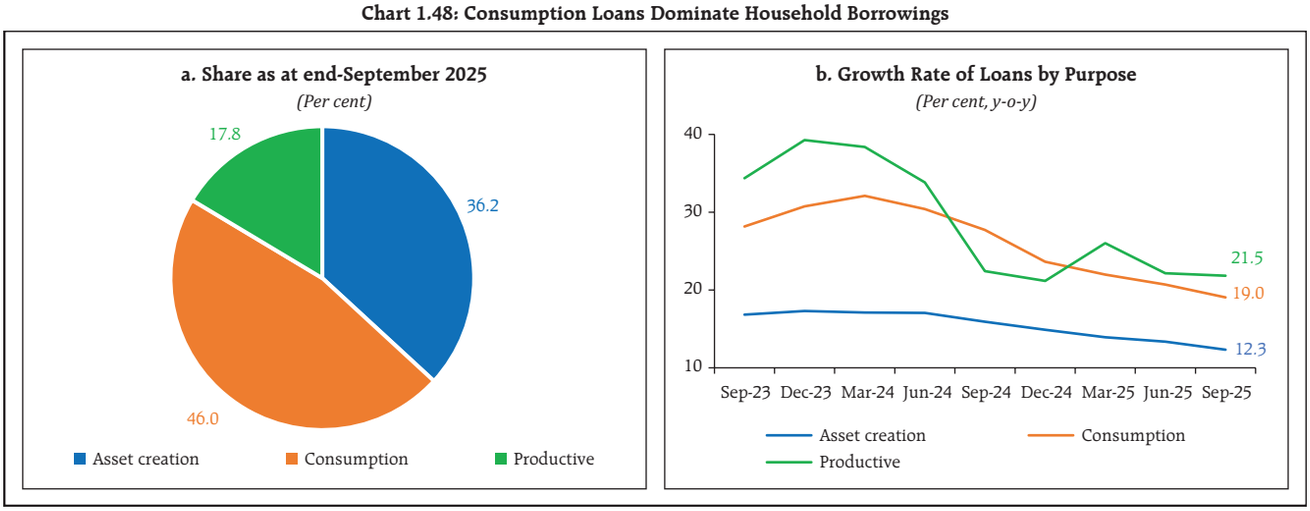
Chart 1.47: Risk Profile of Household Borrowings Improved



Note: The segregation of risk tiers based on CIBIL scores is as follows – Super Prime:791-900; Prime Plus: 771-790, Prime: 731-770; Near Prime: 681-730; and Sub-Prime: 300-680.
Source: Transunion CIBIL.

1.49 The decomposition of household borrowings shows a dominant share of loans taken for consumption purposes[19] followed by asset creation[20] and productive purposes[21] (Chart 1.48 a). The growth rate of these loans has moderated (Chart 1.48 b). Risk profile of borrowers availing loans for consumption and productive purposes has shown improvement, with the share of prime and above borrowers in outstanding loans showing an increasing trend (Chart 1.49 a and b).

Chart 1.48: Consumption Loans Dominate Household Borrowings



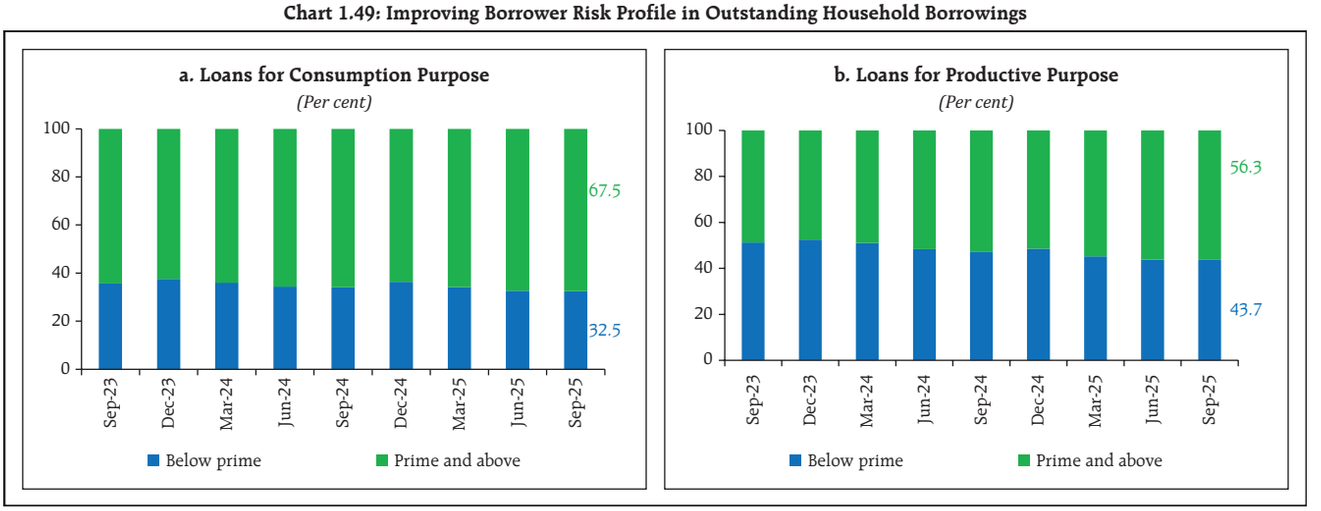
Sources: Transunion CIBIL; and RBI staff estimates.

[19] Includes personal loans, credit cards, consumer durable loans, other personal loans, *etc.*

[20] Includes housing loans, vehicle loans and two-wheeler loans.

[21] Includes agriculture loan - individual, business loan - individual and education loans.

Chart 1.49: Improving Borrower Risk Profile in Outstanding Household Borrowings



Sources: Transunion CIBIL; and RBI staff estimates.

1.50 Personal loans formed 22.3 per cent of consumption purpose loans as at end-September 2025. The risk-tier migration matrix for personal loans shows that a higher percentage of borrowers retained their risk tier categories in the September 2024-2025 period than in the September 2023-2024 period. Near prime and prime borrowers saw higher upgrades while prime plus and super prime borrowers witnessed a higher share of downgrades, but a large part of these borrowers remained in the prime and above category (Table 1.4).

1.51 Net household financial savings improved to 7.6 per cent of GDP in Q4:2024-25 on account of rise in financial assets and stabilisation of liabilities,

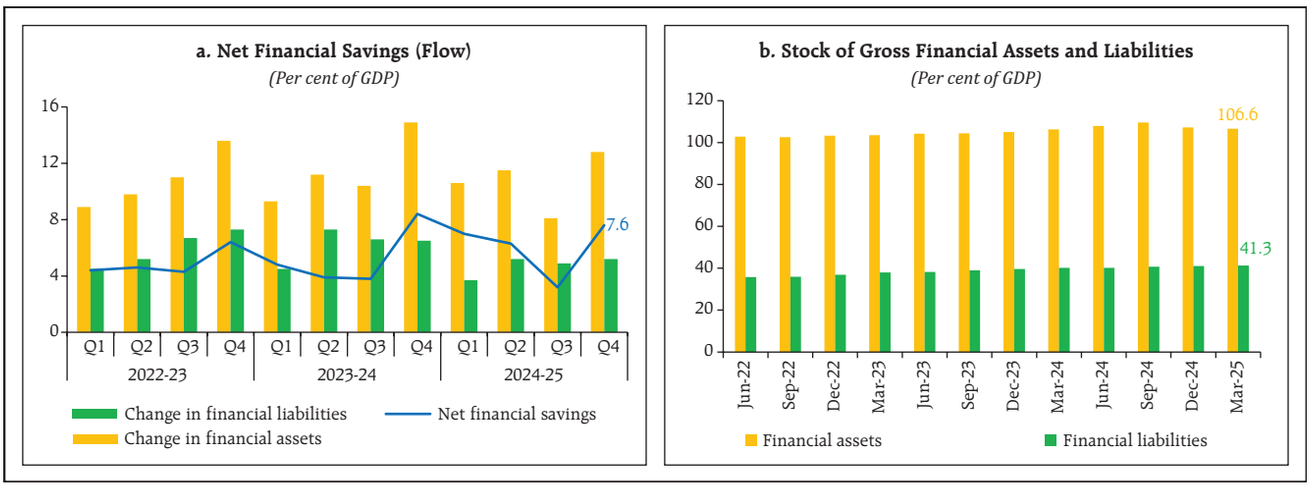
Table 1.4: Personal Loans - Score Migration for Risk Categories

(Per cent)

		Subprime	Near prime	Prime	Prime plus	Super prime	Score tier downgrade	Score tier upgrade
Live Borrowers - Score Movement (Sep 2023 to Sep 2024)								
		Risk Tier (Sep 2024)						
Risk Tier (Sep 2023)	**Subprime**	**75.9**	15.5	6.8	1.6	0.2		**24.1**
	Near prime	20.7	**31.7**	35.0	11.9	0.7	**20.7**	**47.6**
	Prime	9.5	15.2	**43.6**	30.0	1.8	**24.6**	**31.8**
	Prime plus	4.2	8.5	25.4	**54.8**	7.1	**38.1**	**7.1**
	Super prime	2.5	7.3	19.3	26.9	**44.1**	**55.9**	
Live Borrowers - Score Movement (Sep 2024 to Sep 2025) *(Per cent)*								
		Risk Tier (Sep 2025)						
Risk Tier (Sep 2024)	**Subprime**	**79.2**	13.7	5.5	1.4	0.3		**20.8**
	Near prime	22.4	**31.9**	33.6	11.3	0.8	**22.4**	**45.8**
	Prime	9.5	15.5	**45.0**	28.7	1.3	**25.0**	**30.0**
	Prime plus	4.3	8.7	24.4	**57.3**	5.3	**37.4**	**5.3**
	Super prime	2.1	6.9	18.3	27.2	**45.4**	**54.6**	

Sources: Transunion CIBIL; and RBI staff estimates.

Chart 1.50: Household Financial Assets and Liabilities



Source: RBI.

while stock of gross financial assets remained steady above 100 per cent of GDP (Chart 1.50 a and b). As per the latest data, growth in the financial wealth of households moderated, reflecting a correction in equity and investment funds (Chart 1.51 a and b). In terms of asset allocation, deposits and insurance

Chart 1.51: Household Financial Wealth *(Contd.)*

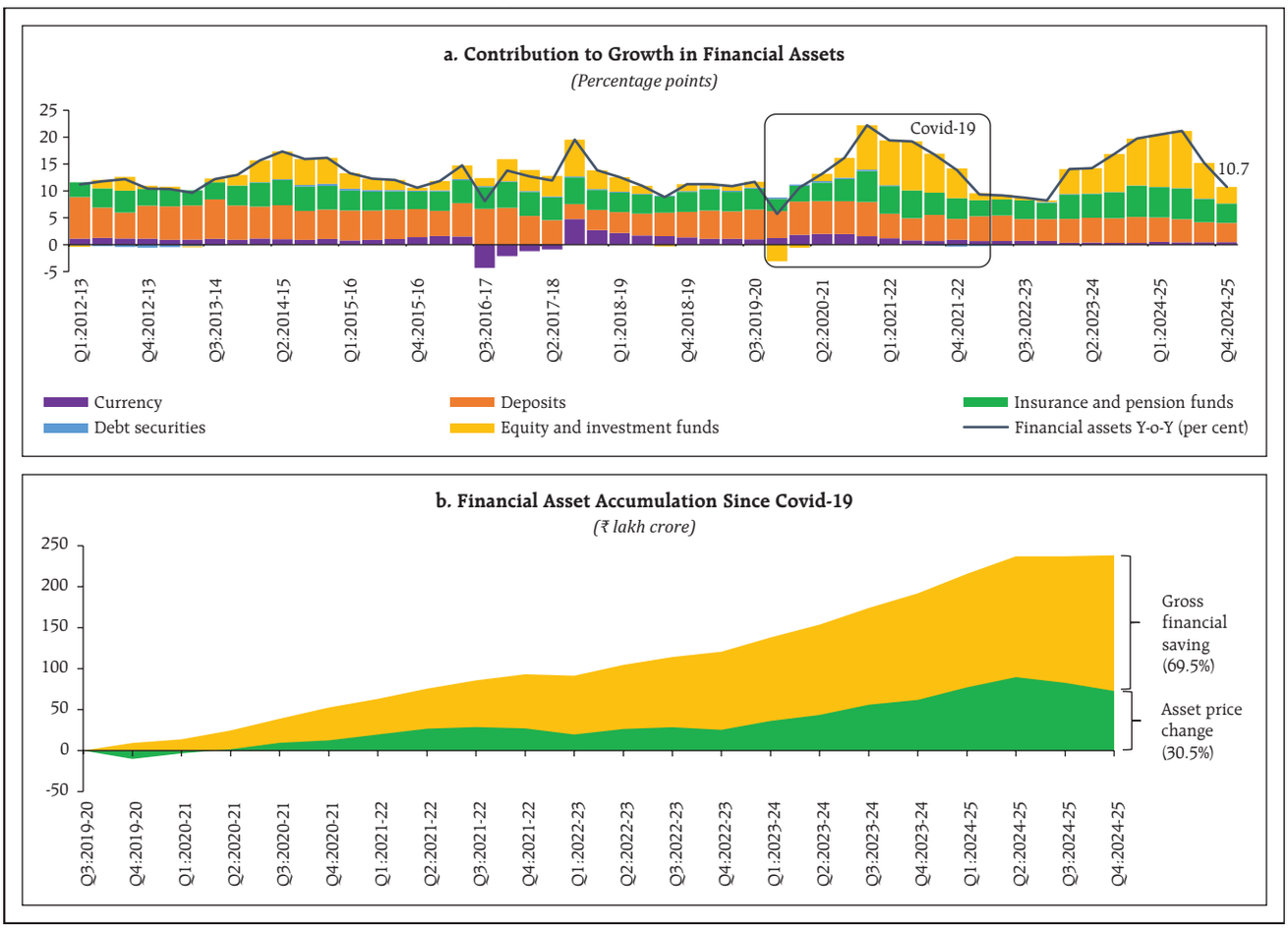
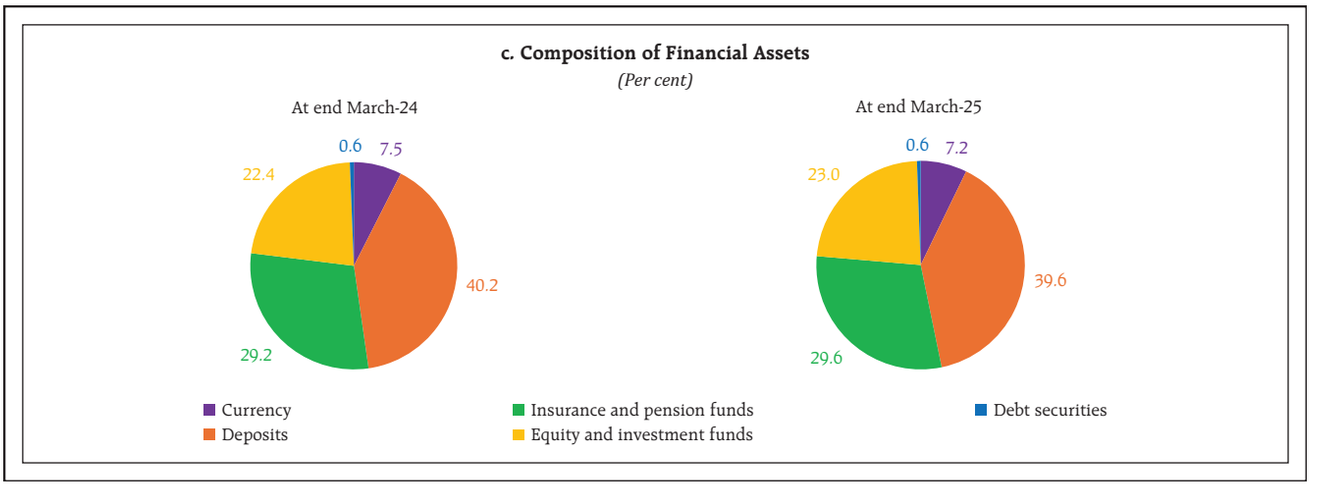


Chart 1.51: Household Financial Wealth *(Concld.)*



Sources: RBI; and staff estimates.

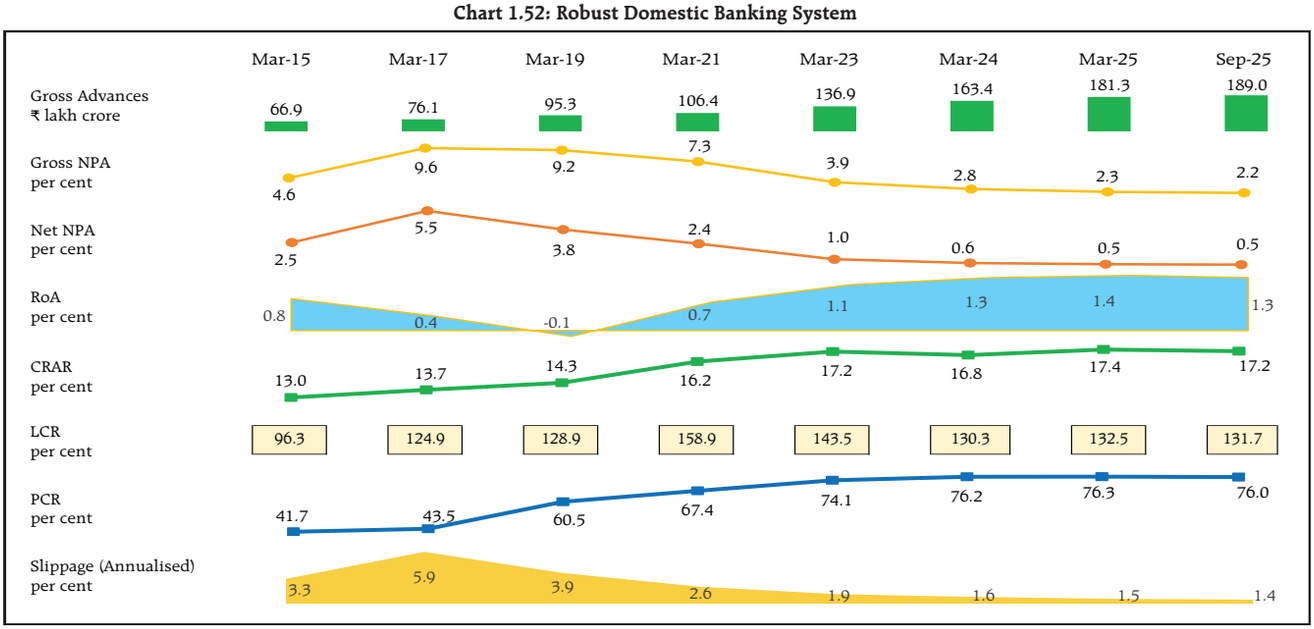
and pension funds accounted for nearly 69.2 per cent of household financial wealth as at end-March 2025 even as the share of equities and investment funds has increased marginally (Chart 1.51 c). As per the latest survey conducted by the SEBI, despite growing awareness about securities market products, overall household penetration remained at 9.5 per cent (out of the 337.2 million total households), mainly arising from urban centres. Within the securities market, however, equity remains the dominant asset class for households. Therefore, diversification of household savings to asset classes other than equity and bank deposits, has the potential to aid financialisation of savings and long-term capital formation.

I.4 Banking System

1.52 The resilience of the banking system[22] is paramount in preserving financial stability. The Indian banking system, led by scheduled commercial banks (SCBs), remains healthy with strong capital, liquidity and profitability positions. Alongside, declining non-performing loan ratios and steady slippage are improving overall asset quality (Chart 1.52). Robust common equity tier 1 (CET1) capital, lower loan losses and credit costs, and healthy return-on-equity reinforce banking system's strong performance (Chart 1.53 a, b and c).

[22] The analyses done in this section are based on domestic operations of SCBs (including SFBs), unless otherwise stated.

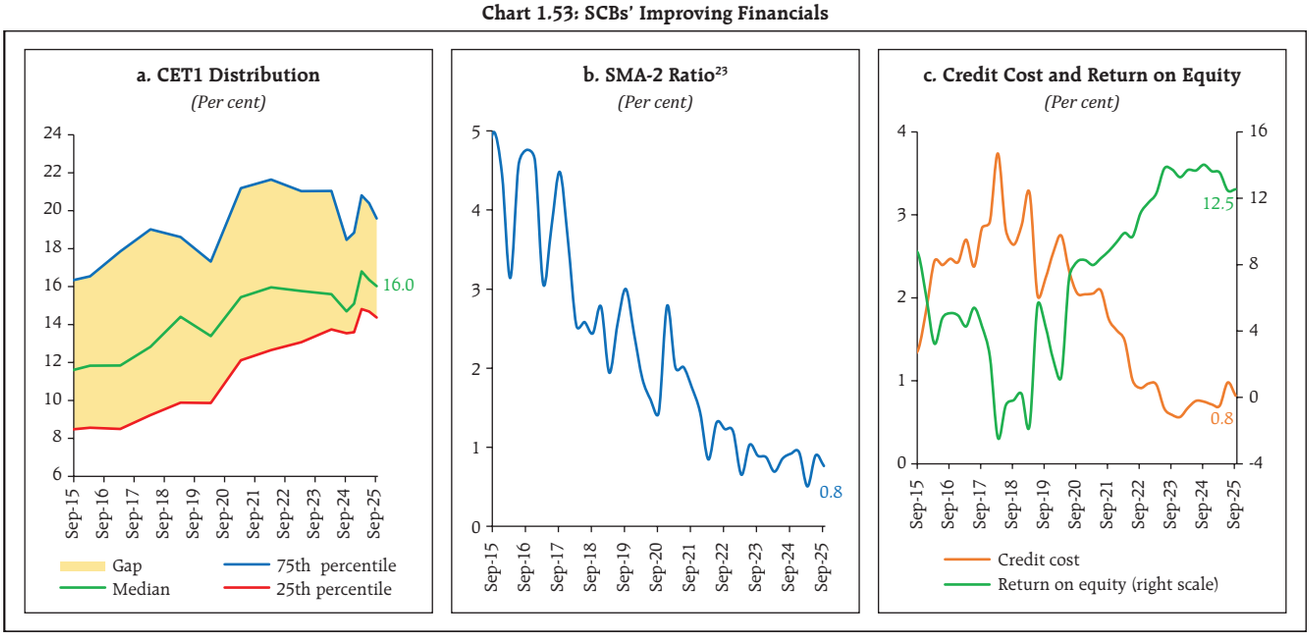
Chart 1.52: Robust Domestic Banking System



Notes: (1) Domestic operations of SCBs, including SFBs (except for CRAR, whose minimum regulatory requirement is higher for SFBs).
(2) Data as of December 10, 2025.
Source: RBI supervisory returns.

1.53 Year-on-year change in bank funding composition shows that over the past year, equity capital has seen a strong increase even as the primary source of funding, *viz.*, deposits from

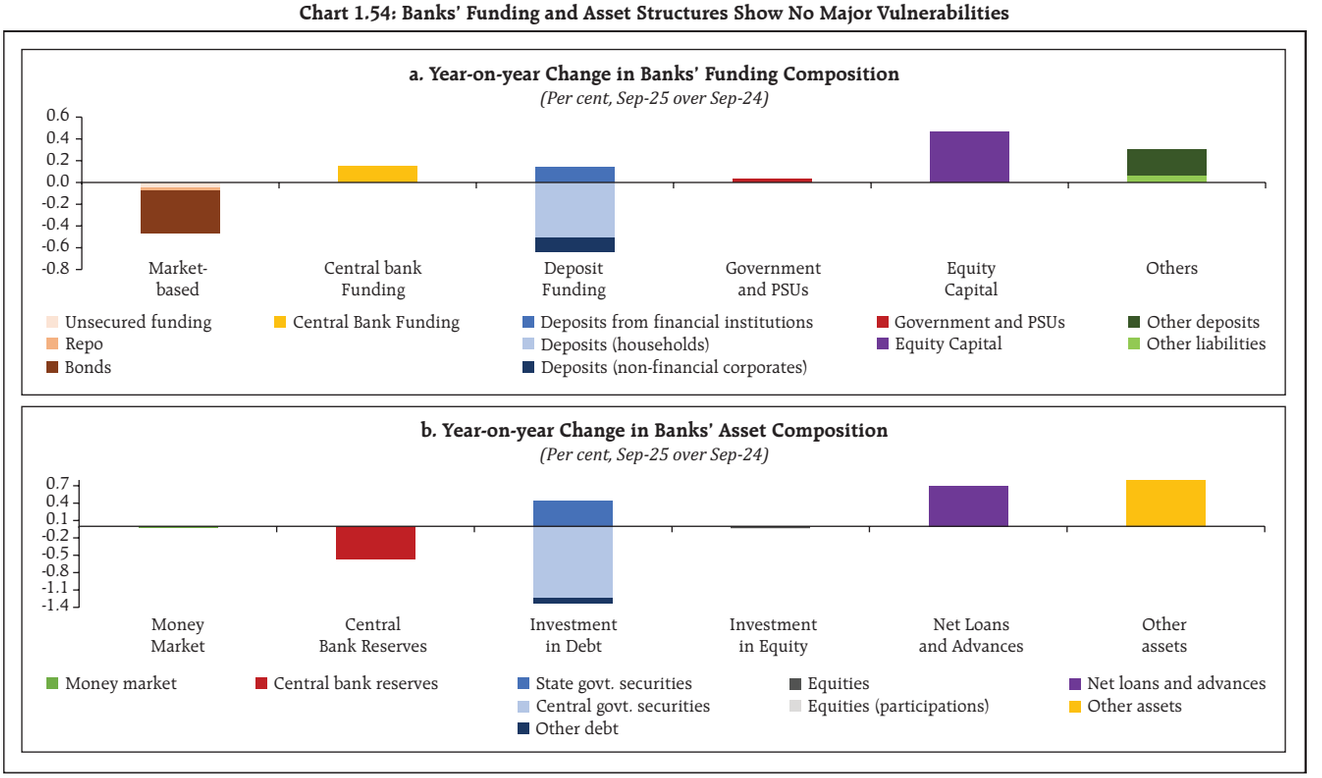
Chart 1.53: SCBs' Improving Financials



Note: In chart (c), Credit Cost = Annualised (Risk provisions + write-offs) / Average gross loans and advances.
Sources: RBI supervisory returns; and staff estimates.

[23] Special mention account (SMA) is defined as:
a) For loans with revolving facilities (*e.g.* cash credit/ overdraft): if the outstanding balance remains continuously more than the sanctioned limit or drawing power, whichever is lower, for a period of 31-60 days - SMA-1; 61-90 days - SMA-2.
b) For loans other than revolving facilities: if principal or interest payment or any other amount wholly or partly overdue remains outstanding up to 30 days - SMA-0; 31-60 days - SMA-1; 61-90 days - SMA-2.

Chart 1.54: Banks' Funding and Asset Structures Show No Major Vulnerabilities



Sources: RBI supervisory returns; and staff estimates.

households decreased (Chart 1.54 a).[24] A similar change in asset composition shows an increase in net loans and advances, investments in state government securities and other assets (Chart 1.54 b).[25] Consequently, the credit-to-deposit (CD) ratio has increased from 78.0 per cent in September 2024 to 78.9 per cent in September 2025. Importantly, the increase in the CD ratio is driven by the substitution of funding from deposits with an increase in equity capital.

1.54 The recent pickup in bank credit growth alongside a recovery in credit impulse[26] reflects a more supportive credit environment for economic activity (Chart 1.55 a). Furthermore, the growth in bank lending to NBFCs and unsecured retail, in which risk weights were increased in November 2023, is showing signs of revival (Chart 1.55 b). Credit to large corporates, however, remains subdued. Alongside, the yield curve has steepened and the spread between state government securities and G-sec yields have risen. This is driving demand away from loans (except MSMEs), especially in respect of PVBs, as these investments are offering better returns on a risk-adjusted basis (Chart 1.55 c, d and e).[27]

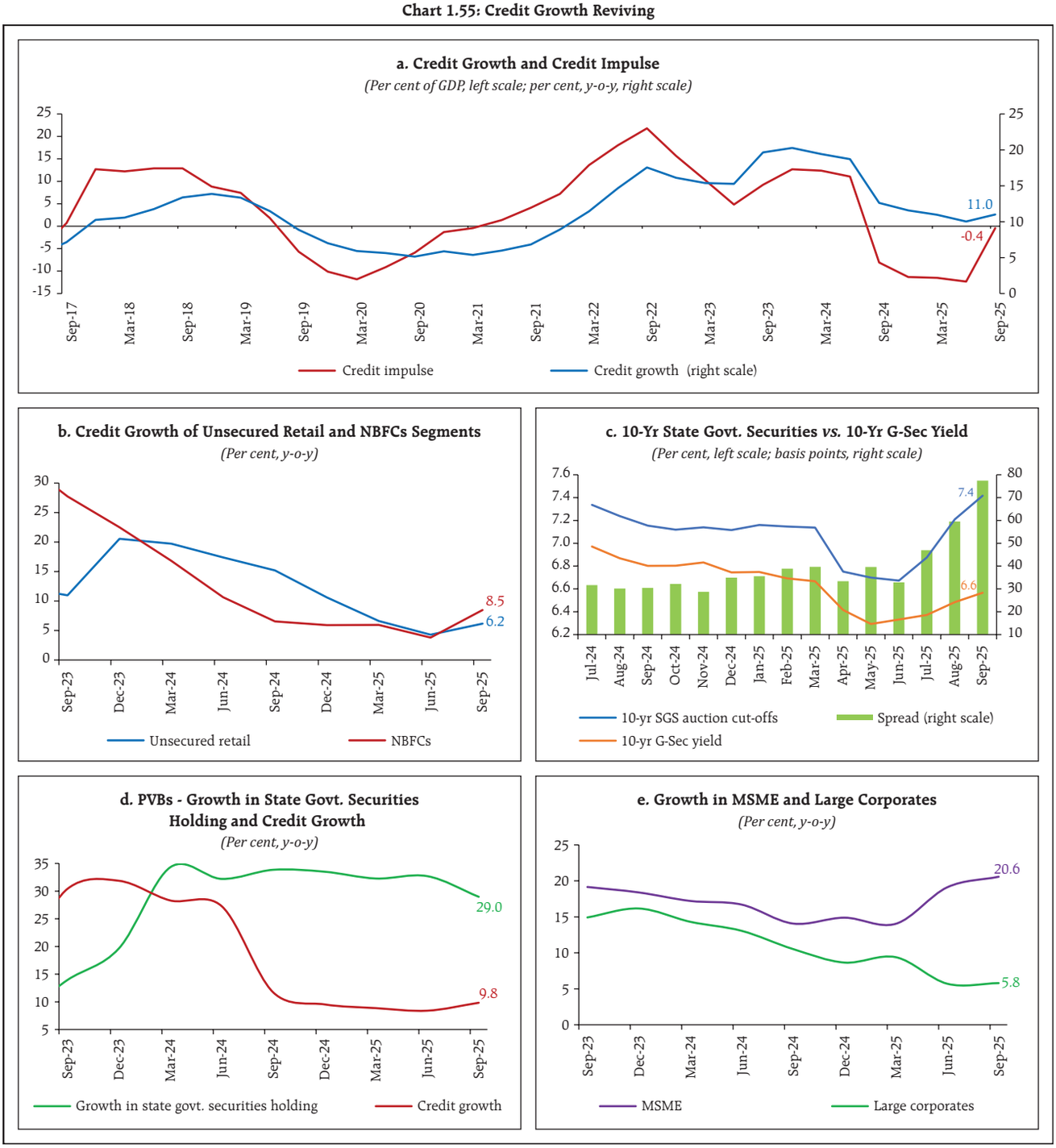
[24] Household deposits formed 47.2 per cent of total liabilities as at end-September 2025, down from 47.7 per cent in September 2024. The other major sources of funding are deposits from non-financial corporates (12.6 per cent), equity capital (10.6 per cent) and deposits from government and public sector undertakings (10.0 per cent).

[25] Net loans and advances form 60.9 per cent of total assets. Other major assets include central government securities (14.3 per cent), state government securities (7.3 per cent), other assets (9.3 per cent) and central bank reserves (3.7 per cent).

[26] Credit impulse is the change in new credit issued as a percentage of GDP. Essentially, it captures the change in growth rate of credit between time t and (t-1) and (t-1) and (t-2), as a percentage of four-period rolling average of quarterly GDP at time (t-1).

[27] Compared to investments in state government securities, banks have to incorporate costs associated with expected credit loss, capital requirements and priority sector lending when they lend to corporates.

Chart 1.55: Credit Growth Reviving

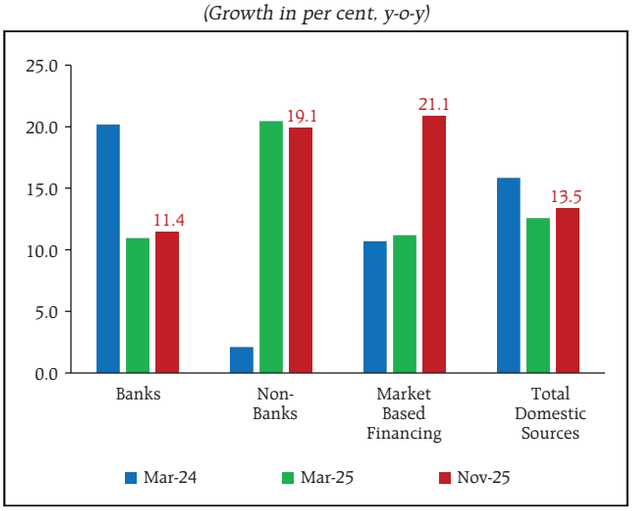


Sources: Bloomberg; CCIL; RBI supervisory returns; and staff estimates.

1.55 However, there is significant diversification among sources of credit to the commercial sector with lending from non-banks and market-based financing growing steadily. Thus, credit from these sources have not only substituted bank credit, but also ensured steady flow of funds to the commercial sector (Chart 1.56).

Chart 1.56: Outstanding Credit to Commercial Sector from Domestic Sources

(Growth in per cent, y-o-y)



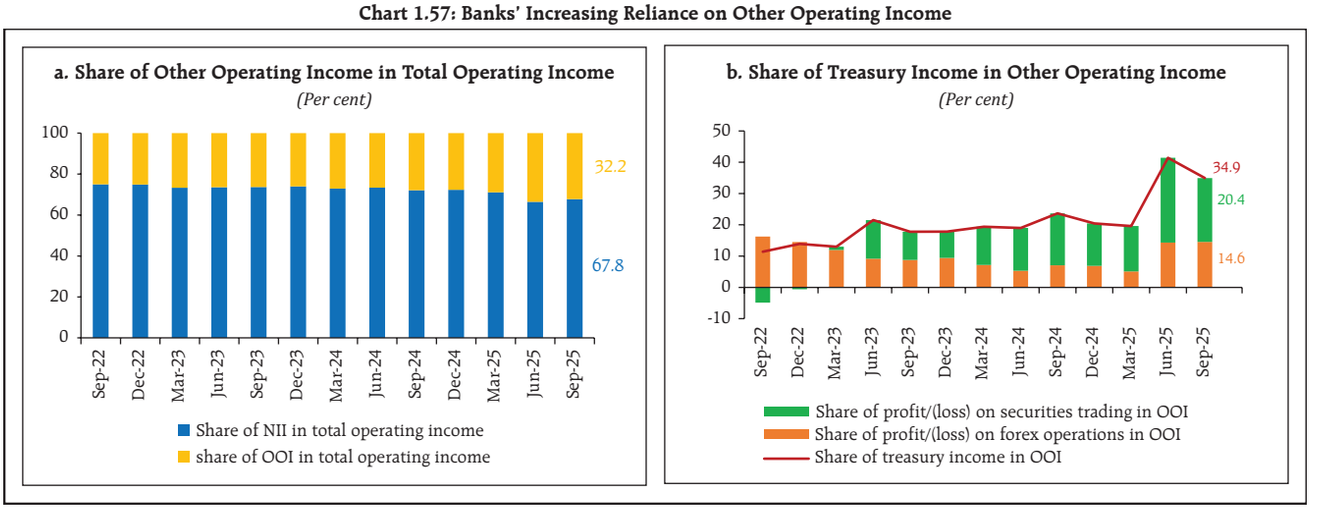
Note: Non-banks include NBFCs, HFCs and AIFIs. Market-based financing refers to corporate bond and commercial paper issuances by non-financial entities.
Sources: RBI; and staff estimates.

1.56 The share of other operating income (OOI) has increased over the years in the bank's overall earnings, with income generated out of treasury operations emerging as a key source of other operating income, especially in the last two quarters (Chart 1.57 a and b). The current steepening of the yield curve and relatively higher exchange rate volatility, if sustained, could impact treasury income. Thus, even as earnings-at-risk associated with net interest income (NII) have not changed significantly since the last FSR (see section on *Interest Rate Risk* in Chapter 2), the overall impact on banks' earnings could be higher in the future.

1.57 Unsecured retail lending, a key driver of bank loan growth during the post-pandemic period, declined sharply after the RBI increased risk weights on certain consumer segment loans in November 2023. Even as asset quality in aggregate remains stable - GNPA ratio at 1.8 per cent *vis-à-vis* 1.1 per cent for retail advances - slippages in unsecured retail loans constituted 53.1 per cent of the total retail loan slippages of SCBs. Among bank groups, the share of PVBs in fresh slippages of unsecured loans was higher, and their write-offs continue to remain elevated (Chart 1.58 a, b, c and d).

1.58 Bank credit to the Micro, Small and Medium Enterprises (MSME) rose sharply, aided partly by a change in classification criteria[28], registering a

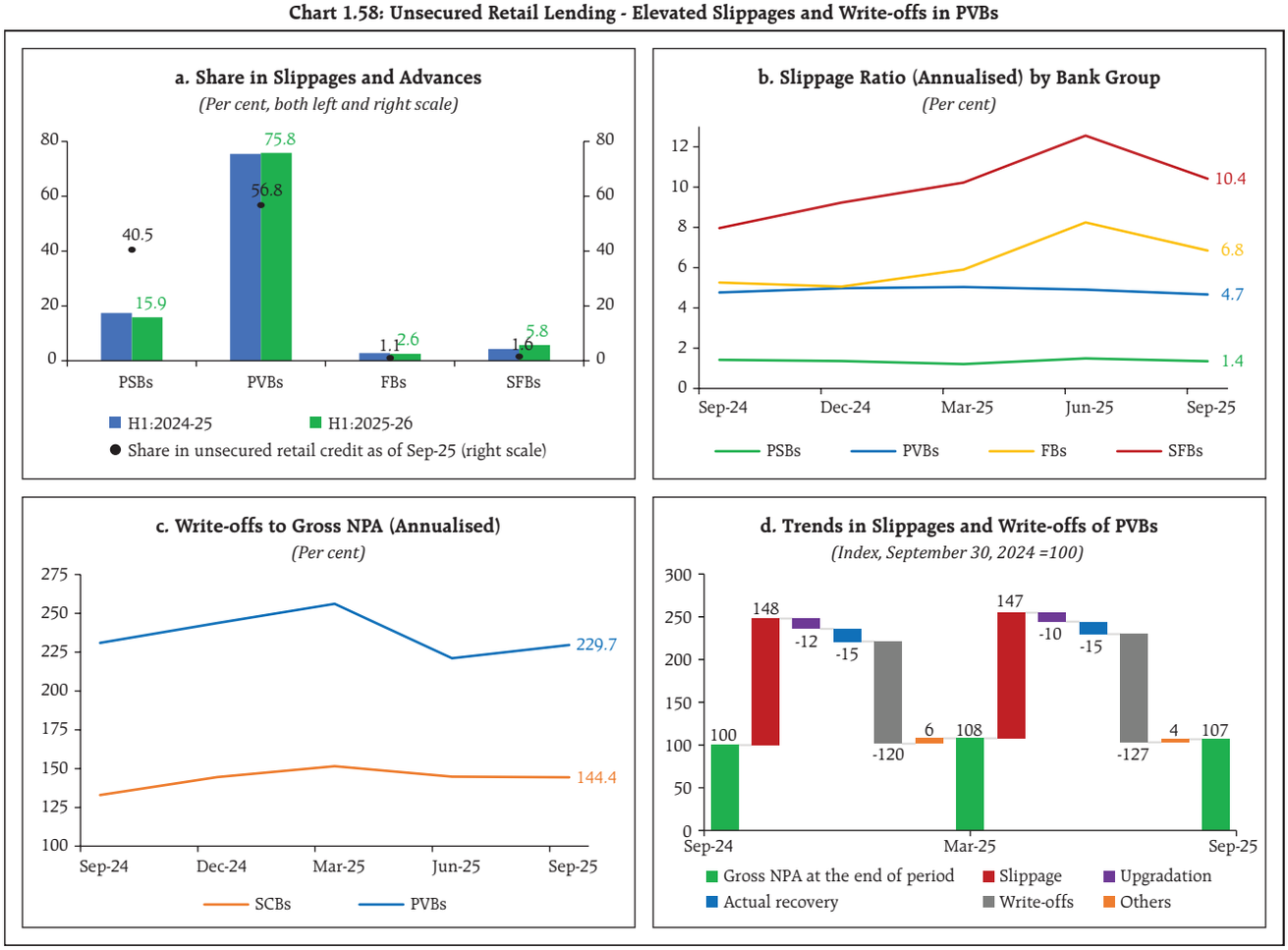
Chart 1.57: Banks' Increasing Reliance on Other Operating Income



Sources: RBI supervisory returns; and staff estimates.

[28] In terms of Gazette Notification S.O. 1364 (E) dated March 21, 2025, an enterprise shall be classified as a micro, small or medium enterprise on the basis of the following criteria *viz.*, (i) a micro enterprise, where the investment in plant and machinery or equipment does not exceed ₹2.5 crore and turnover does not exceed ₹10 crore; (ii)a small enterprise, where the investment in plant and machinery or equipment does not exceed ₹25 crore and turnover does not exceed ₹100 crore; and (iii) a medium enterprise, where the investment in plant and machinery or equipment does not exceed ₹125 crore and turnover does not exceed ₹500 crore.

Chart 1.58: Unsecured Retail Lending - Elevated Slippages and Write-offs in PVBs



Sources: RBI supervisory returns; and staff estimates.

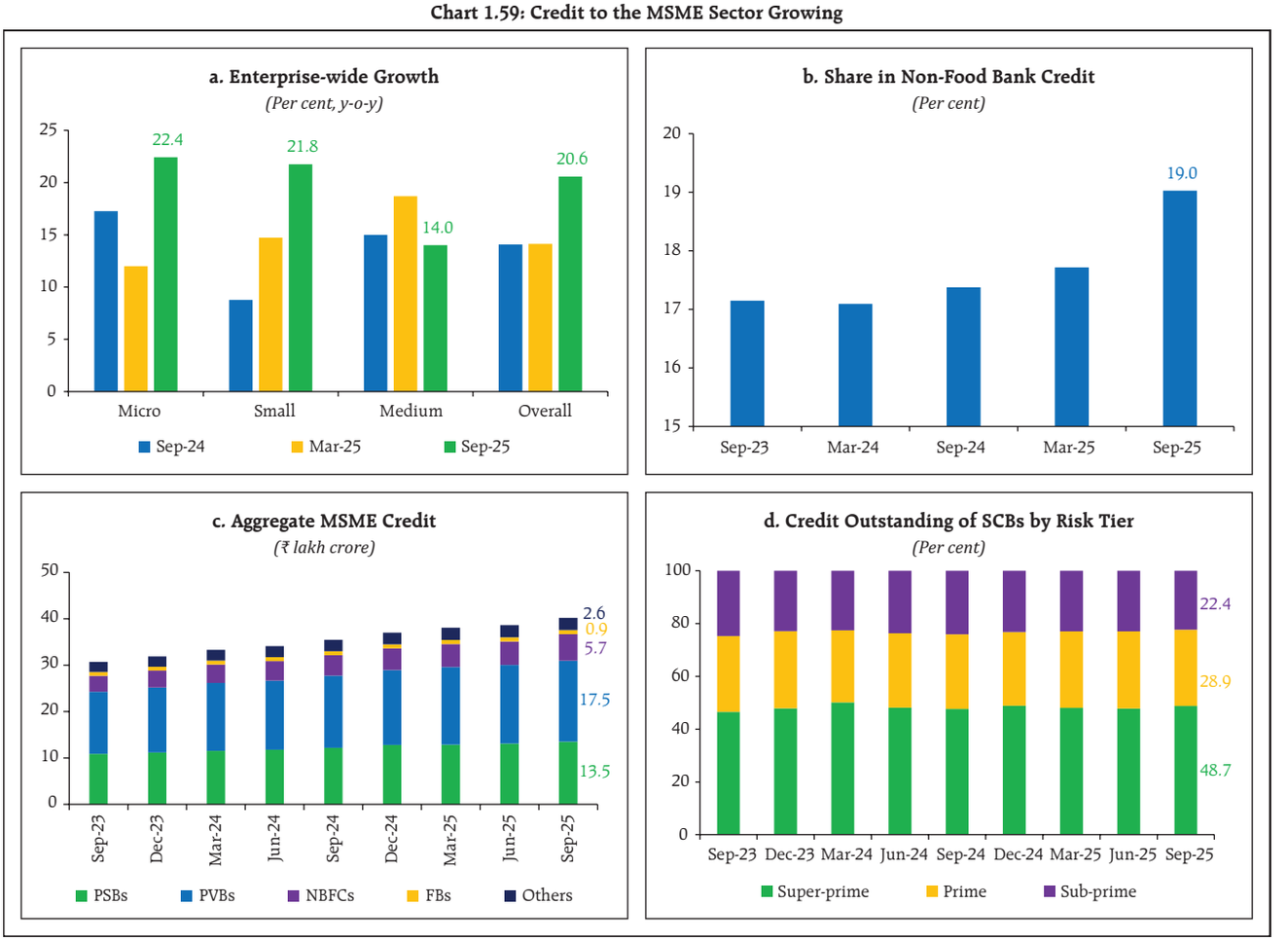
growth of 20.6 per cent (y-o-y) in September 2025 and taking the share of MSME credit to 19 per cent in total non-food bank credit.[29] Importantly, advances to the super prime borrower category remained dominant, contributing almost 49 per cent of total MSME advances (Chart 1.59 a, b, c and d). Moreover, their asset quality remained sound with the aggregate gross NPA ratio showing further improvement - it fell from 5.2 per cent in September 2023 to 3.3 per cent in September 2025. The improvement is seen across sectors, even though the default rate for micro enterprises remained a tad elevated (Chart 1.60 a and b).

1.59 Analysis of sectors[30] that were potentially exposed to higher US tariffs showed that the share of banks' lending to these sectors remained

[29] Based on constant sample definition using TransUnion CIBIL data, aggregate lending to the MSME industry grew at 13.4 per cent (y-o-y) in September 2025. Micro, Small and Medium segments grew at 9.0 per cent (y-o-y), 15.8 per cent (y-o-y) and 13.5 per cent (y-o-y), respectively.

[30] US tariff exposed sectors considered for analysis include Gems and Jewelry, Textiles, Rubber, Plastics and their products, Marine products, Leather and Leather products, Electronic Goods, Drugs and Pharmaceuticals.

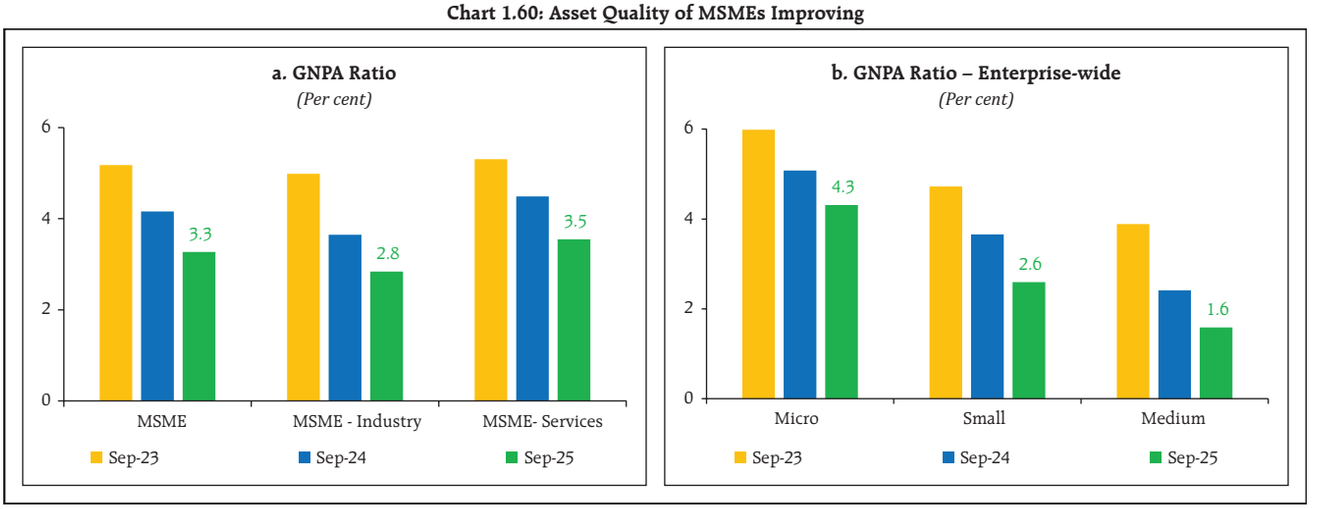
Chart 1.59: Credit to the MSME Sector Growing



Note: CIBIL MSME Ranks by Risk Tier are: Super-Prime: CMR 1-3, Prime: CMR 4-6, Sub-Prime: CMR 7-10.
Sources: RBI supervisory returns; TransUnion CIBIL; and staff estimates.

steady at 12.6 per cent as at end-September 2025 - with advances to the textiles sector forming the largest share (Chart 1.61 a and b).[31] In terms of asset quality, while the SMA ratio in these sectors

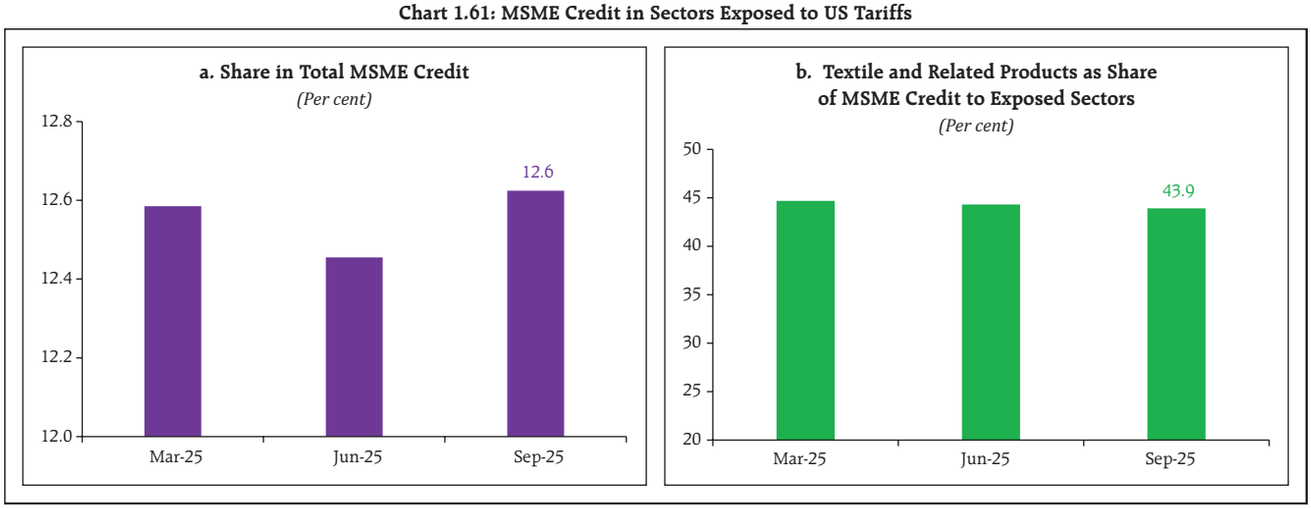
Chart 1.60: Asset Quality of MSMEs Improving



Sources: RBI supervisory returns; and staff estimates.

[31] Based on survey of seven banks (PSBs and PVBs) with a total share of 61 per cent of gross MSME credit.

Chart 1.61: MSME Credit in Sectors Exposed to US Tariffs



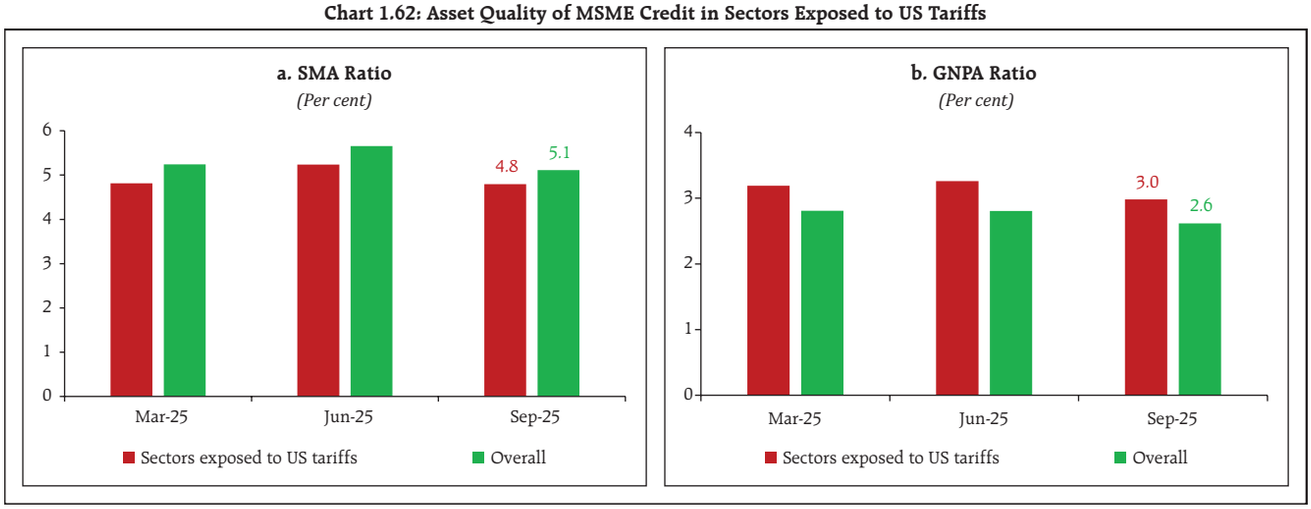
Note: In chart (b), textiles and related products include cotton yarn/ fabs/ madeups, handloom products, etc.
Sources: Survey of select banks; and RBI staff estimates.

remained broadly stable, the GNPA ratio remained higher (Chart 1.62 a and b). Overall, these sectors are showing resilience despite the unfavourable external environment.

1.60 Small Finance Banks' (SFBs) footprint has been growing in the Indian banking system with their share in total banking sector credit and deposits gradually increasing from 1.3 per cent and 0.9 per cent in September 2022 to 1.6 per cent and 1.4 per cent in September 2025, respectively. Their credit and deposit growth were higher than the banking sector average at 17.2 per cent and 19.3 per cent (y-o-y) in September 2025, respectively. However, profitability remained under pressure even as loan losses, funding costs and slippages remain elevated (Chart 1.63 a, b, c and d).

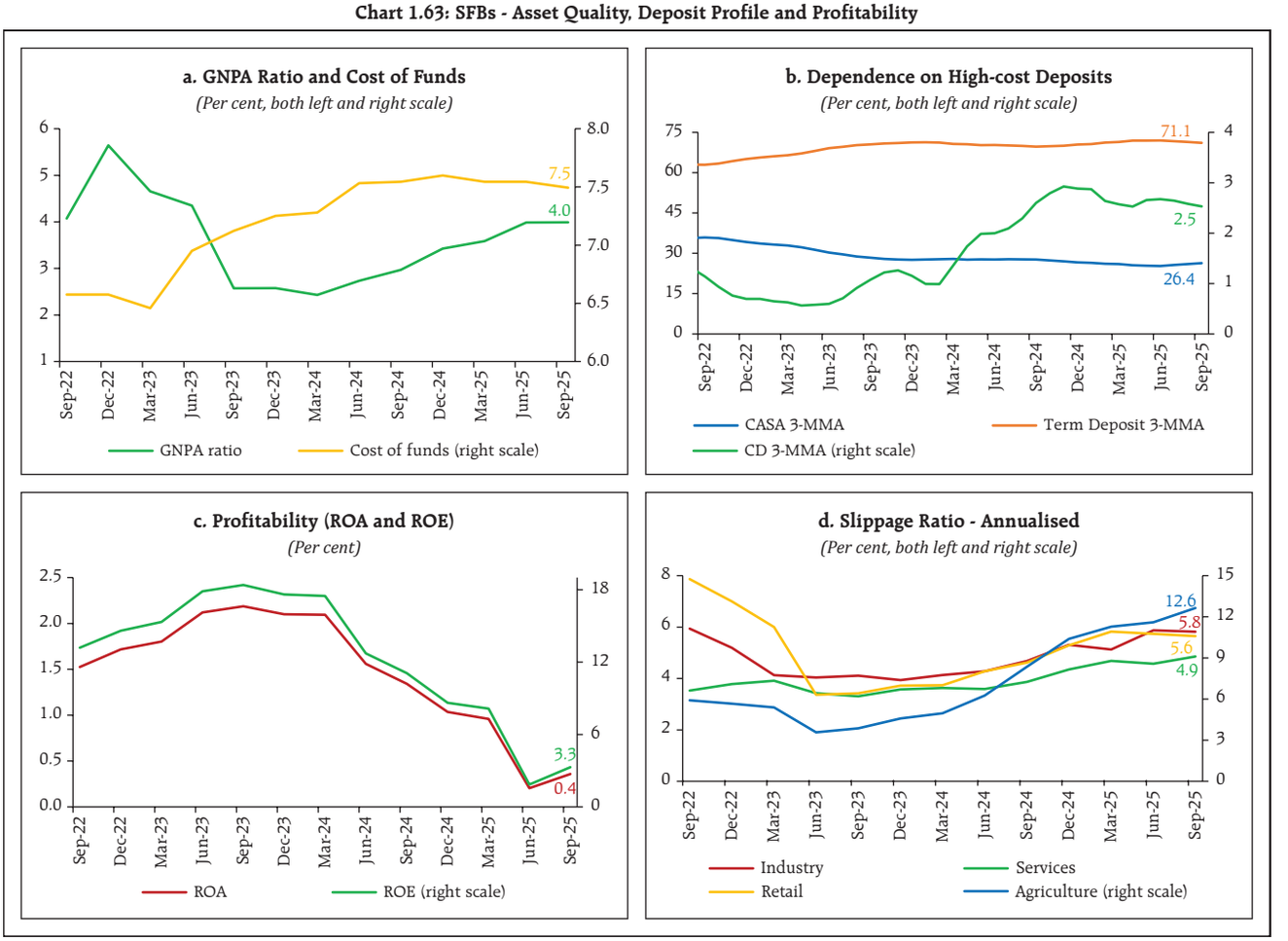
1.61 Credit to the microfinance sector declined for the sixth consecutive quarter with a 9.3 per cent

Chart 1.62: Asset Quality of MSME Credit in Sectors Exposed to US Tariffs



Sources: Survey of select banks; and RBI staff estimates.

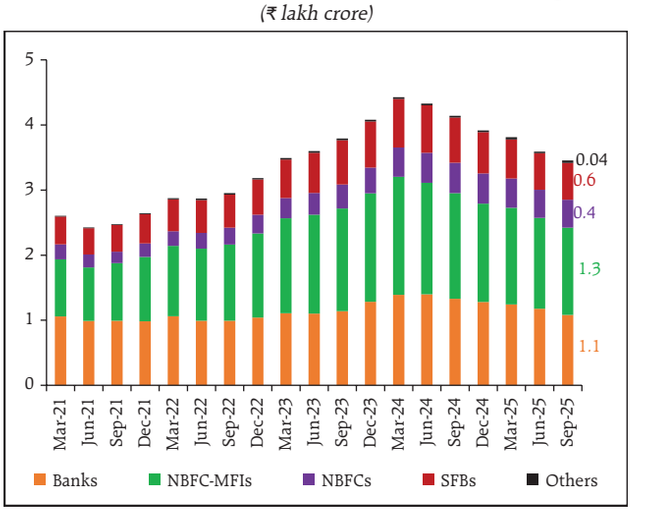
Chart 1.63: SFBs - Asset Quality, Deposit Profile and Profitability



Note: In chart (b), 3-MMA = 3-month moving average.
Sources: RBI supervisory returns; and staff estimates.

fall in H1:2025-26 (Chart 1.64) with the total active borrowers in the sector decreasing by 78 lakh. Bank credit[32] to the sector, which forms 47.7 per cent of total credit outstanding to the sector, contracted by 10.6 per cent during the same period. Asset quality is showing signs of improvement with the ratio of stressed assets declining in three successive quarters (Chart 1.65 a). Borrower indebtedness, measured by the share of borrowers availing loans from three or more lenders, rose marginally in September 2025 after declining consistently over the last two years

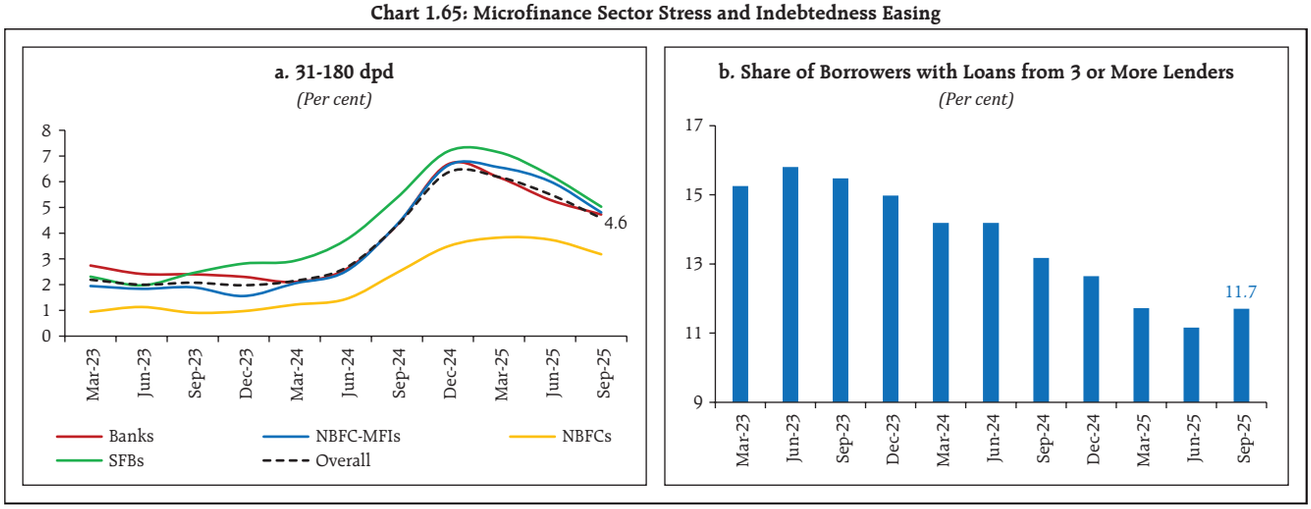
Chart 1.64: Credit to the Microfinance Sector Declining
(₹ lakh crore)



Note: Lender category as reported by financial institutions to the credit information company.
Source: CRIF High Mark.

[32] Including SFBs.

Chart 1.65: Microfinance Sector Stress and Indebtedness Easing



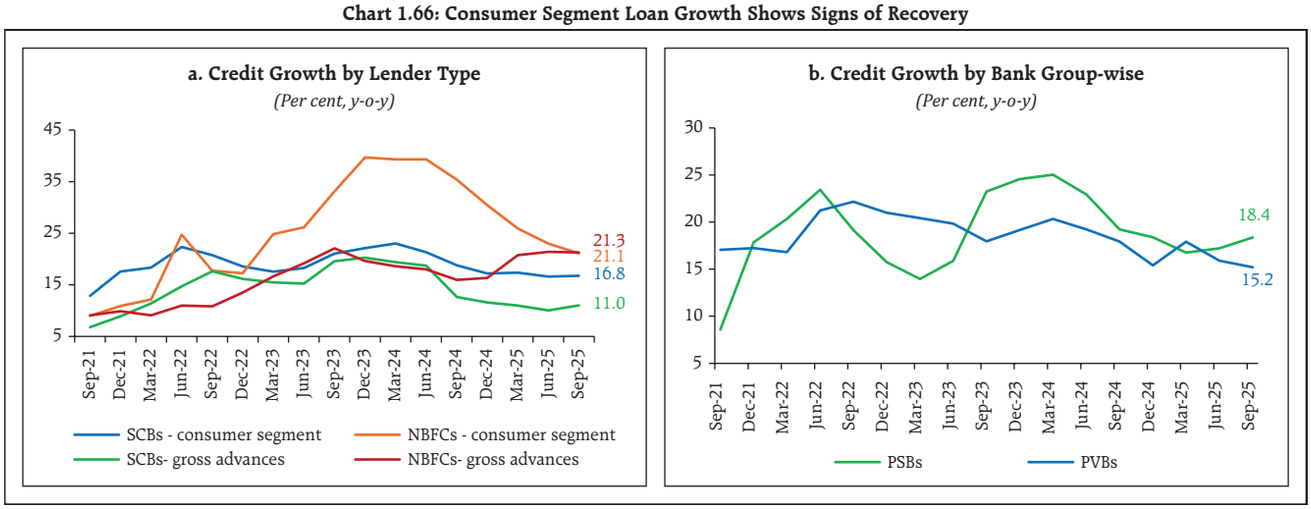
Source: CRIF High Mark.

(Chart 1.65 b). Though there has been consolidation in the microfinance sector, some stress persists and requires close monitoring.

1.62 Consumer segment loans remain a key driver of loan demand for both banks and non-bank finance companies (NBFCs). After registering sharp growth post-pandemic, loans to consumer segment declined following countercyclical regulatory measures by the RBI to arrest the rapid growth in this segment. There are signs of stabilisation in the segment (Chart 1.66 a and b). Enquiry volumes have picked up in the month of September 2025, reflecting a rebound in demand post-GST rate cuts, even as the slowdown in the growth of credit active consumers appears to have bottomed out (Chart 1.67 a and b).

1.63 Among different product types, gold loans saw sharp growth across SCBs and NBFCs.[33] Similarly, unsecured business loans also grew quickly led by SCBs (Chart 1.68 a, b, c and d). The share of outstanding loans held by below prime borrowers in the NBFCs' gold loan portfolio reduced but remained

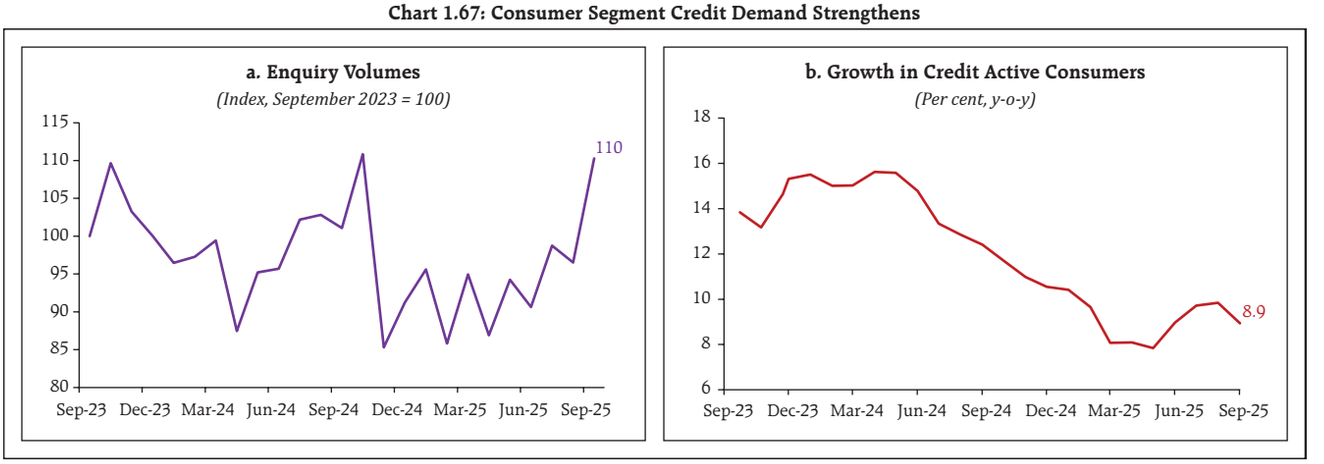
Chart 1.66: Consumer Segment Loan Growth Shows Signs of Recovery



Sources: TransUnion CIBIL; and RBI supervisory returns.

[33] Gold loans form 5.8 per cent of total advances of SCBs and NBFCs.

Chart 1.67: Consumer Segment Credit Demand Strengthens



Source: TransUnion CIBIL.

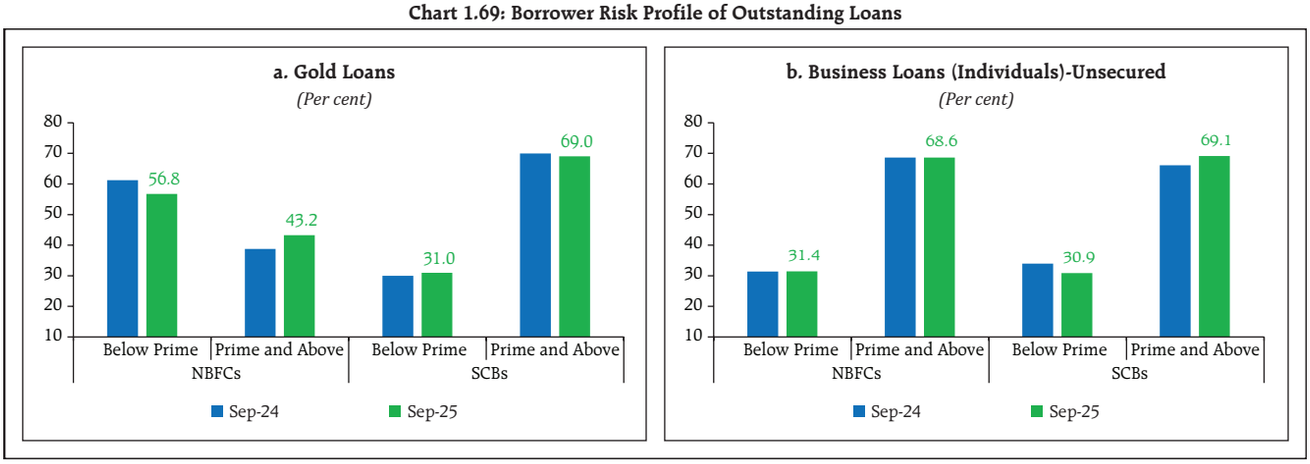
sizeable (Chart 1.69 a). In both banks and NBFCs, the outstanding loans held by higher quality borrowers dominated the unsecured business loans category (Chart 1.69 b).

1.64 The asset quality of the consumer segment loans remained sound across lender and product types with declining levels of non-performing loans (Chart 1.70 a and b). Slippages from SMA-2

Chart 1.68: Consumer Segment Credit Growth

Note: LAP stands for loan against property; BL stands for business loans.
Source: TransUnion CIBIL.

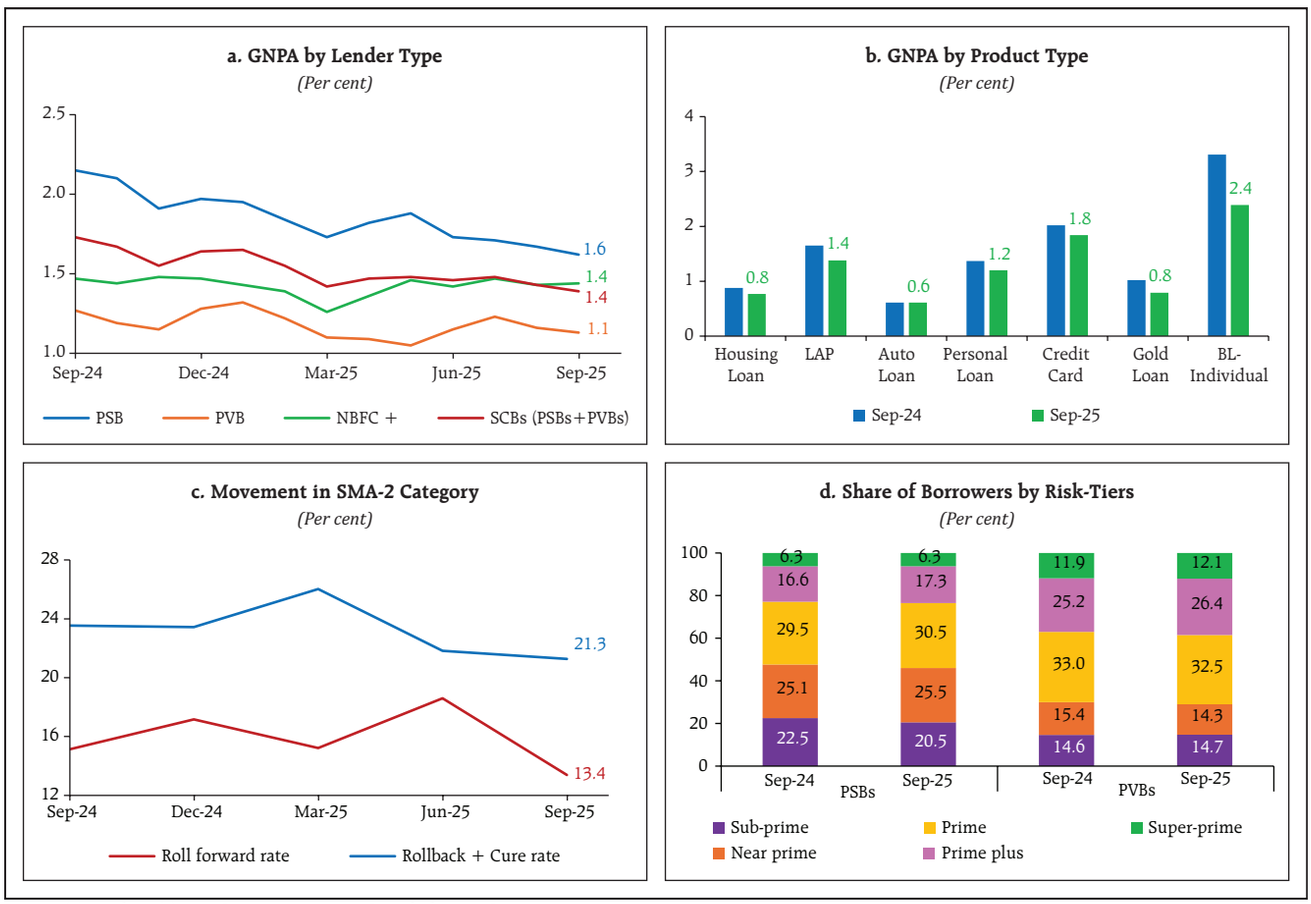
Chart 1.69: Borrower Risk Profile of Outstanding Loans



Source: TransUnion CIBIL.

accounts also decreased. However, upgradations which saw a jump in Q4:2024-25, are trending lower (Chart 1.70 c). Overall, the high share of better-quality borrowers – prime and above categories – augur well for consumer loan performance (Chart 1.70 d).

Chart 1.70: Asset Quality of Consumer Segment Loans Improving



Notes: (1) In chart (a), NBFC+ represents NBFCs including HFCs.
(2) In chart (b), LAP stands for loans against property and BL stands for business loans.
(3) In chart (c), the roll forward rate is the percentage change (by amount) from the SMA-2 category (61-90 dpd) in the current month, which moved to the NPA category (90+dpd) in the next month (aggregated quarterly). Rollback + cure rate is the percentage change (in amount) in the SMA-2 category in the current month, which rolled back to SMA-1/ SMA-0/ 0 dpd in the next month (aggregated quarterly).

Source: TransUnion CIBIL.

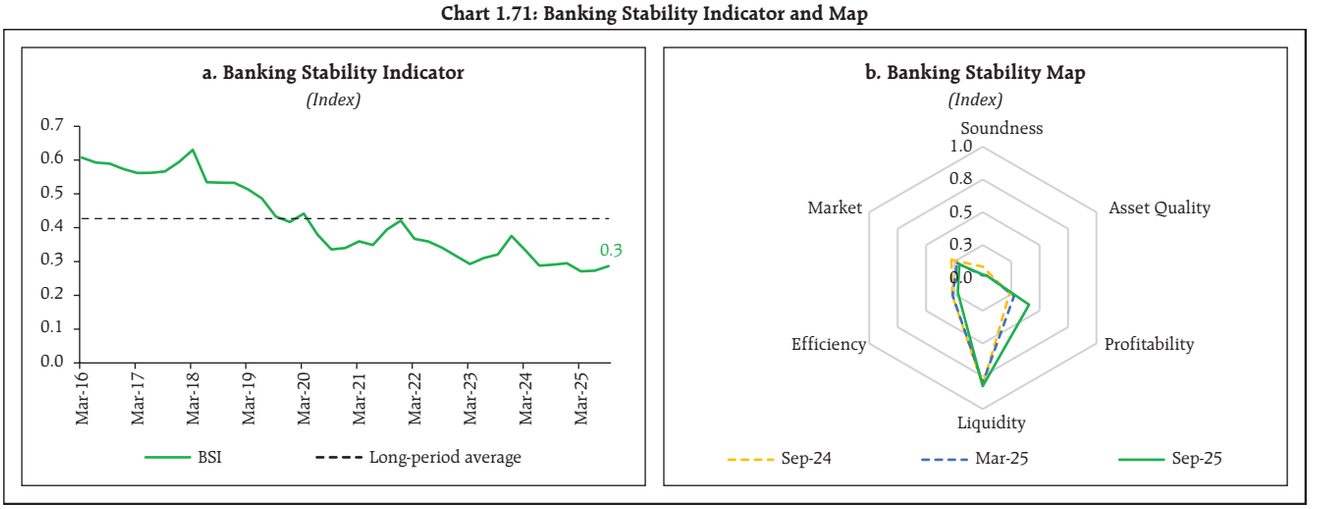
1.65 The resilience of the banking system remained strong, as reflected in the Banking Stability Indicator (BSI)[34], an aggregate indicator of the banking system's robustness, which remained well below the long-term average.[35] Improved soundness and asset quality, along with easing market risk, have partly offset the weakening in liquidity and profitability indicators (Chart 1.71 a and b).

1.66 The growth in non-bank financial intermediaries (NBFIs)[36] and their increasing interlinkages with the banking system is a key concern globally. In India too, banks asset exposures to NBFIs are rising. PSBs predominantly hold funded exposures, whereas PVBs have nearly half of their total exposure in non-funded facilities[37], which may be invoked by NBFIs during periods of liquidity stress (Chart 1.72 a and b).

I.5 NBFC Sector

1.67 The NBFC sector[38] remained broadly resilient, supported by strong capital buffers, robust net interest margin, healthy profitability and low

Chart 1.71: Banking Stability Indicator and Map



Notes: (1) In chart (a), average of the last 40 quarters considered.
(2) In chart (b), away from the centre indicates an increase in risk.
Sources: RBI supervisory returns; and staff estimates.

[34] See Annex 1 for detailed methodology and variables used.

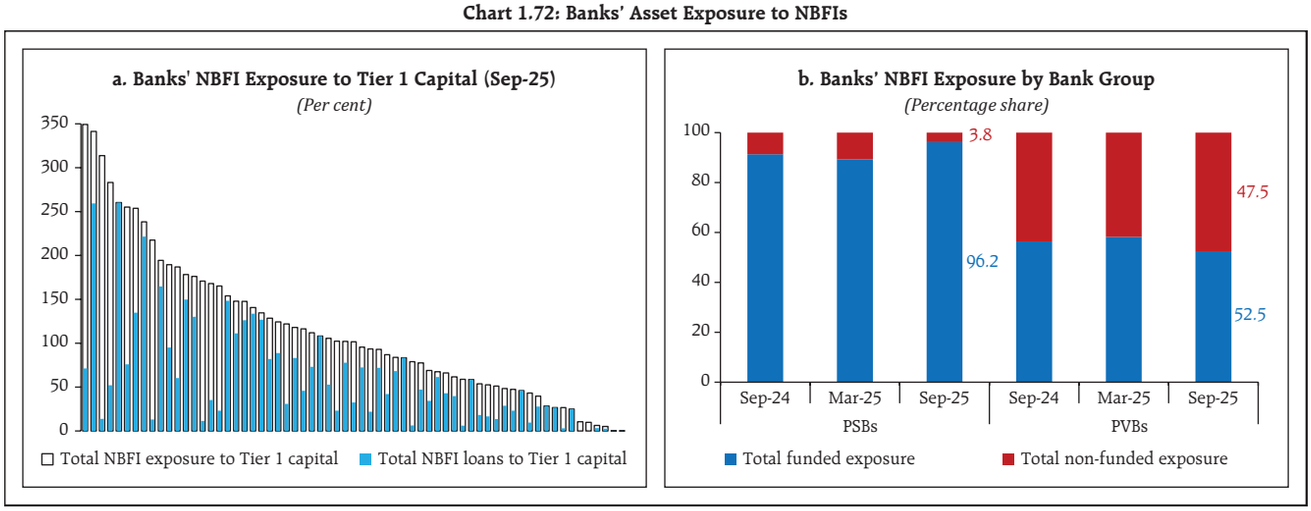
[35] Lower values indicate improvement in BSI.

[36] NBFIs constitute NBFCs (including MFIs and HFCs), (2) mutual funds, (3) insurance and pension funds, (4) DFIs and (5) other financial intermediation activities.

[37] Non-funded facilities are essentially off-balance sheet and include Letters of Credit, Guarantees, Acceptances and endorsements, Underwriting and standby commitments, Undrawn binding commitments to extend credits over 1 year, Sale and repurchase agreements/asset sales with recourse, Contracts (Forex Forwards Contracts, Forward rate agreements) and Derivatives (Futures, Options, Swaps, CDS).

[38] The analyses done in this section are based on NBFCs in upper and middle layers but excludes housing finance companies (HFCs), core investment companies (CICs) and standalone primary dealers (SPDs), but includes NBFCs presently under resolution; The analyses is based on provisional data available as of December 10, 2025.

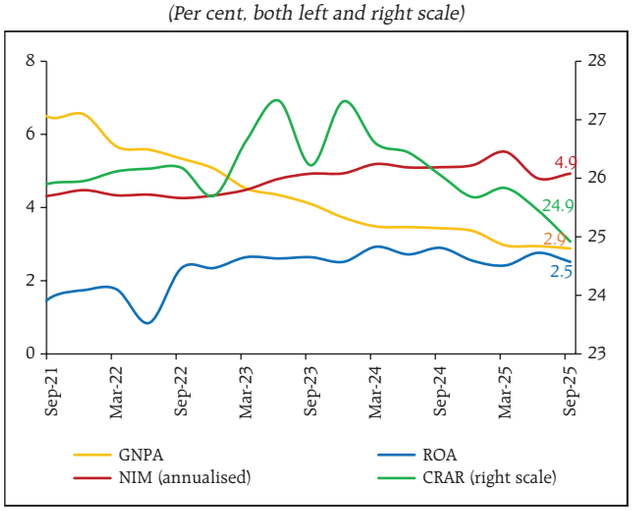
Chart 1.72: Banks' Asset Exposure to NBFIs



Note: (1) In chart (a), banks' exposure to NBFI includes total credit exposure (funded + non-funded) and total investment exposure. Each bar in the chart represents a bank.
(2) In chart (b), total funded exposure includes total investment.
Sources: RBI supervisory returns; and staff estimates.

asset impairments (Chart 1.73). Credit growth steadied, supported by improved funding conditions - bank lending to NBFCs increased - and lending to retail borrowers rose. Alongside, their credit costs continued to trend downward (Chart 1.74 a, b, c and d).

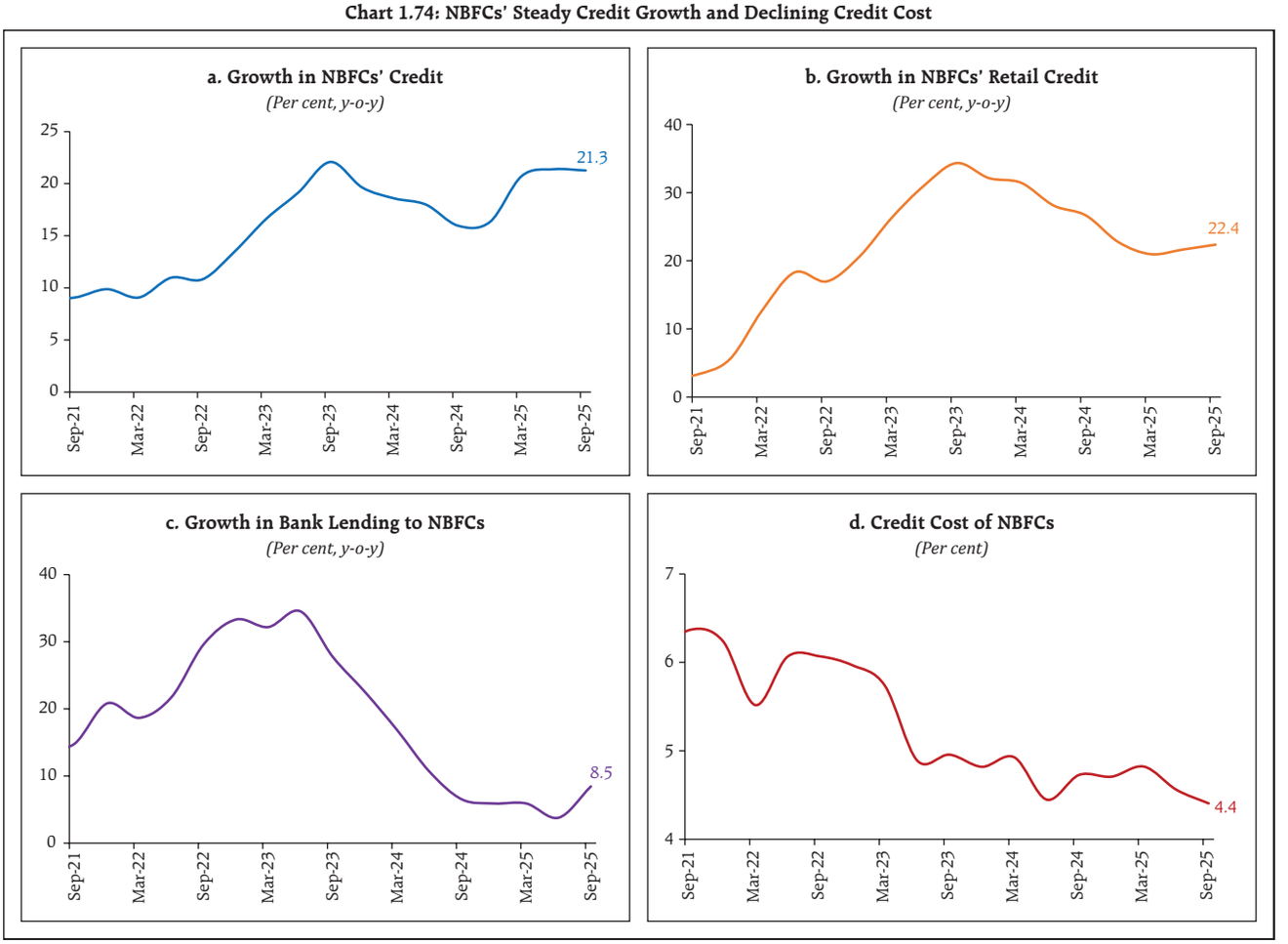
Chart 1.73: NBFC Sector Remains Robust
(Per cent, both left and right scale)



Sources: RBI supervisory returns; and staff estimates.

1.68 NBFCs continued to diversify their funding profile, as reflected in the moderation in borrowings from banks, even as they remained the dominant source of funding (Chart 1.75 a). Easing money market rates and an increase in foreign currency borrowings have helped NBFCs steady the rise in the cost of funds. However, growing reliance on external funding has increased the NBFC sector's susceptibility to exchange rate volatility, which could

Chart 1.74: NBFCs' Steady Credit Growth and Declining Credit Cost



Note: Credit Cost = (Provision for Standard Assets and Non-Performing Assets + Annualised Write-offs)/Average gross advances.
Sources: RBI supervisory returns; and staff estimates.

partly erode the benefits of lower funding costs in periods of stress (Chart 1.75 b and c). Notably, close to 86 per cent of the foreign currency borrowings are hedged.

Chart 1.75: NBFCs' Borrowing and Funding Profile *(Contd.)*

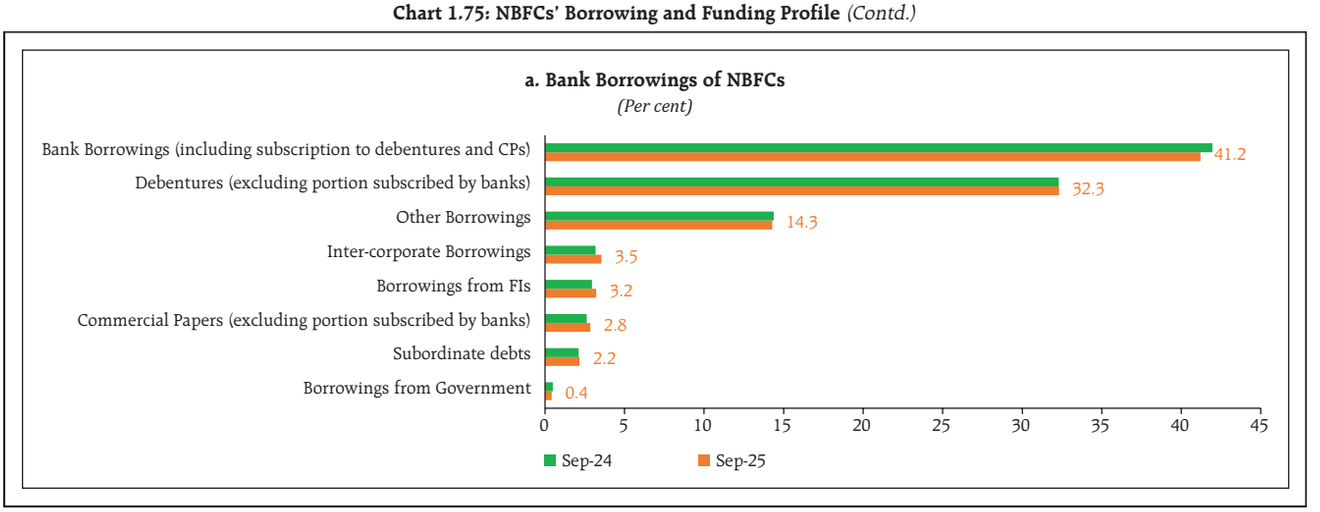
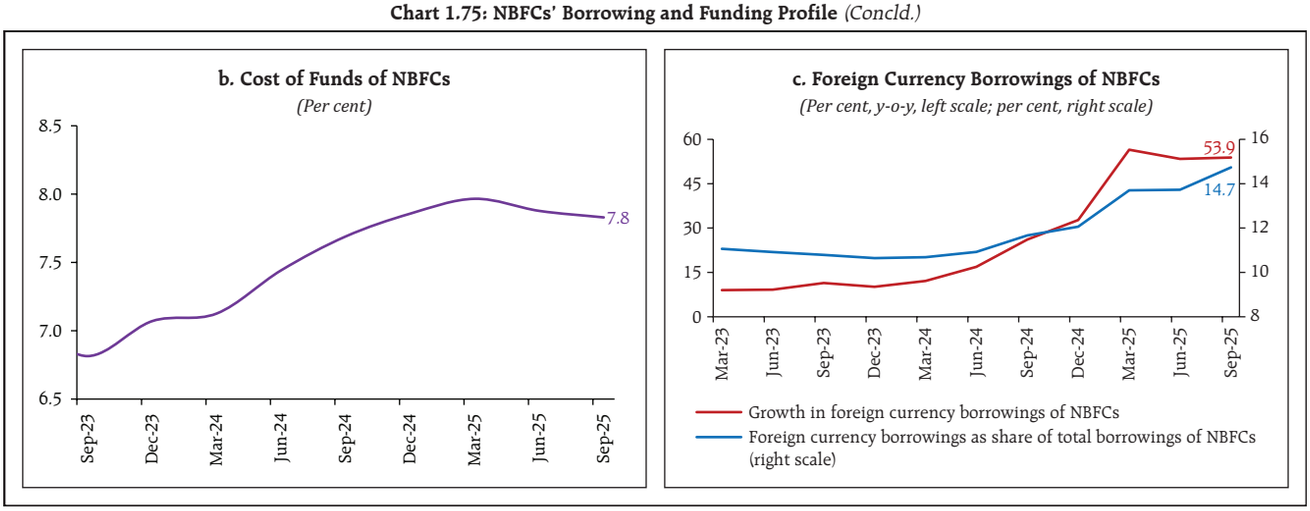


Chart 1.75: NBFCs' Borrowing and Funding Profile *(Concld.)*

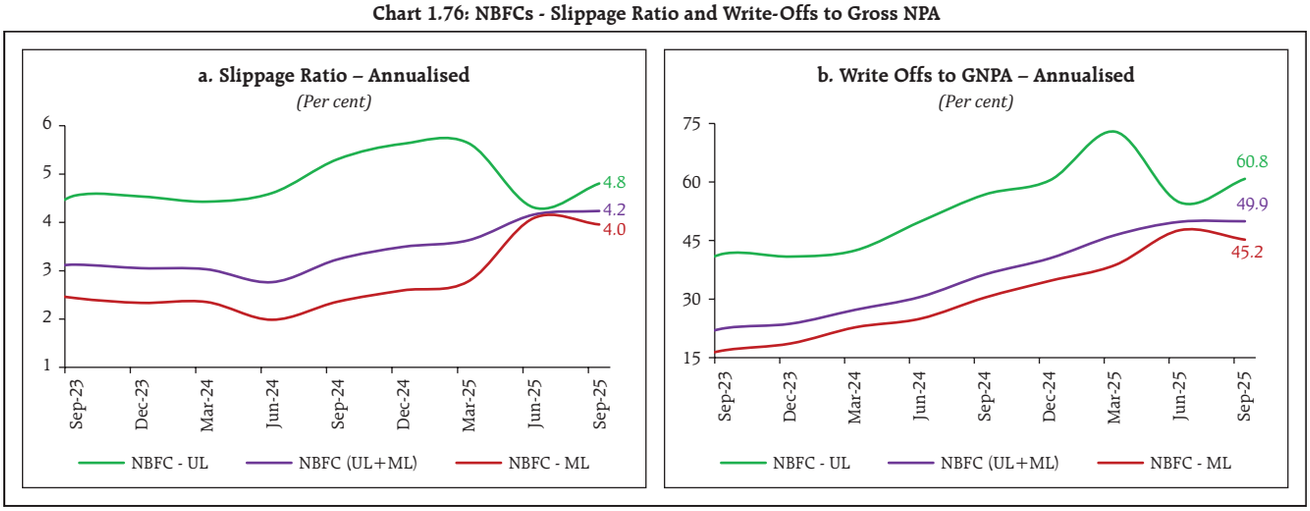


Notes: (1) In chart (b), Cost of funds = Annualised Interest Expense and Other Financing Cost/ (Average Total Borrowings + Average Public Deposits)
(2) In chart (c), foreign currency borrowings include borrowings through bonds and debentures.
Sources: RBI supervisory returns; and staff estimates.

1.69 Even as the GNPA ratio in NBFCs has declined, fresh accretions to NPAs are trending higher. Moreover, write-offs are also growing, indicating some build-up of stress in their loan portfolio (Chart 1.76 a and b).

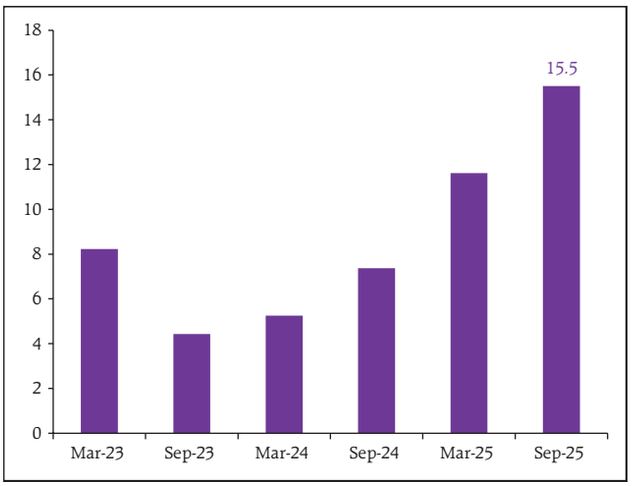
1.70 Combined credit from NBFCs and NBFC-MFIs to the microfinance sector, which comprises 51.2 per cent of total credit outstanding to the sector, contracted by 8.5 per cent in H1:2025-26. In terms of asset quality, the ratio of stressed assets (31-180 dpd) has been declining for three successive quarters. The credit cost of NBFC-MFIs, however, rose sharply from 4.4 per cent in September 2023 to 15.5 per cent in September 2025, due to higher risk provisions and write-offs (Chart 1.77).

Chart 1.76: NBFCs - Slippage Ratio and Write-Offs to Gross NPA



Sources: RBI supervisory returns; and staff estimates.

Chart 1.77: NBFC-MFIs' Credit Cost Rising
(Per cent)

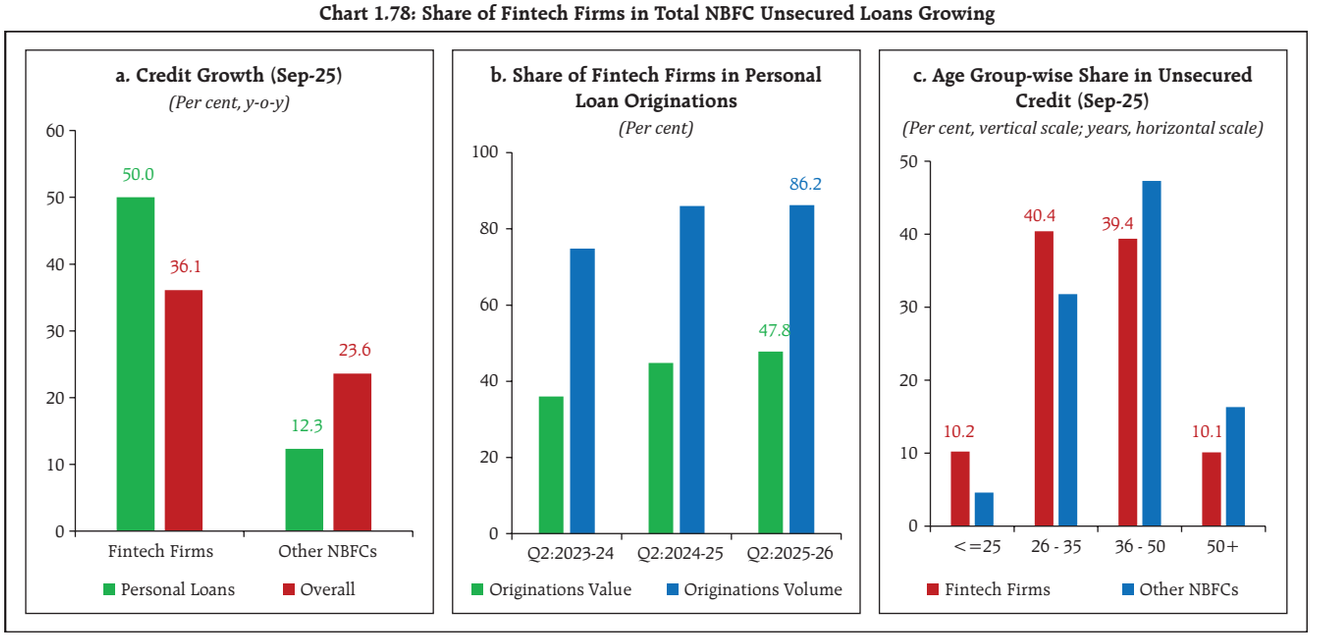


Notes: (1) Based on a common sample of middle-layer NBFC-MFIs.
(2) Credit Cost = (Provision for Standard Assets and Non-Performing Assets + Annualised Write-offs)/Average gross advances.
Sources: RBI supervisory returns; and staff estimates.

1.71 Fintech firms[39] have been increasing their footprint in retail lending which now forms 8.9 per cent of total NBFC consumer segment loans, up from 7.3 per cent in September 2023. Between September 2024 and September 2025, they registered a robust growth of 36.1 per cent, largely driven by personal loans that formed more than half of their outstanding loan portfolio and are rising both in terms of value and volume (Chart 1.78 a and b). Unsecured loans[40] form more than 70 per cent of their total loan book, and more than half of them were extended to borrowers under 35 years of age (Chart 1.78 c).

1.72 In terms of asset quality, the impairment[41] of personal loans in the fintech firms' portfolio has declined over the last one year even as credit has expanded rapidly (Chart 1.79 a). Compared to other NBFCs, however, the impairment in the small ticket loans (up to ₹50,000) were relatively higher (Chart 1.79 b). Furthermore, the impairment among borrowers who have availed unsecured loans from five or more lenders was also elevated (Chart 1.79 c).

Chart 1.78: Share of Fintech Firms in Total NBFC Unsecured Loans Growing



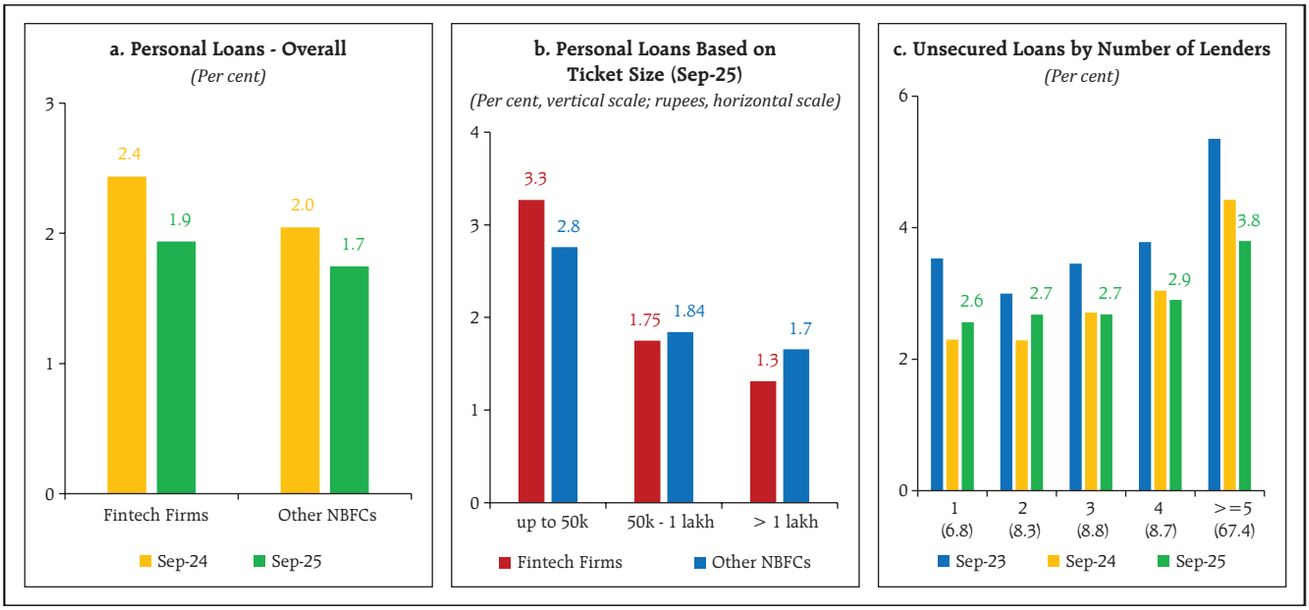
Sources: CRIF High Mark; and RBI staff estimates.

[39] Fintech firms, as classified by CRIF High Mark, are NBFCs which have digital lending as their core strategic focus. 'Other NBFCs' are NBFCs other than fintech firms.

[40] Unsecured loans comprise of personal loans and unsecured business loans.

[41] Measured as 91-180 days past due (dpd) portfolio to total balance outstanding.

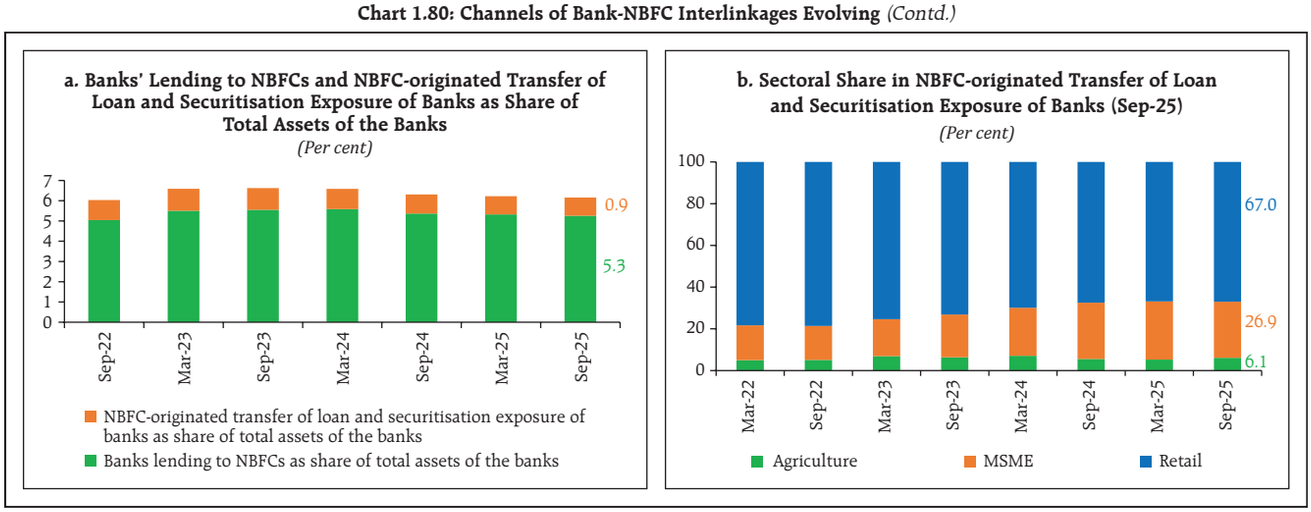
Chart 1.79: Impairment in Unsecured Loans Declining



Note: In chart (c), the borrower level worst DPD is considered. Numbers in parentheses represent the share of amount outstanding as at end-September 2025. Unsecured loans comprise of personal loans and unsecured business loans.
Sources: CRIF High Mark; and RBI staff estimates.

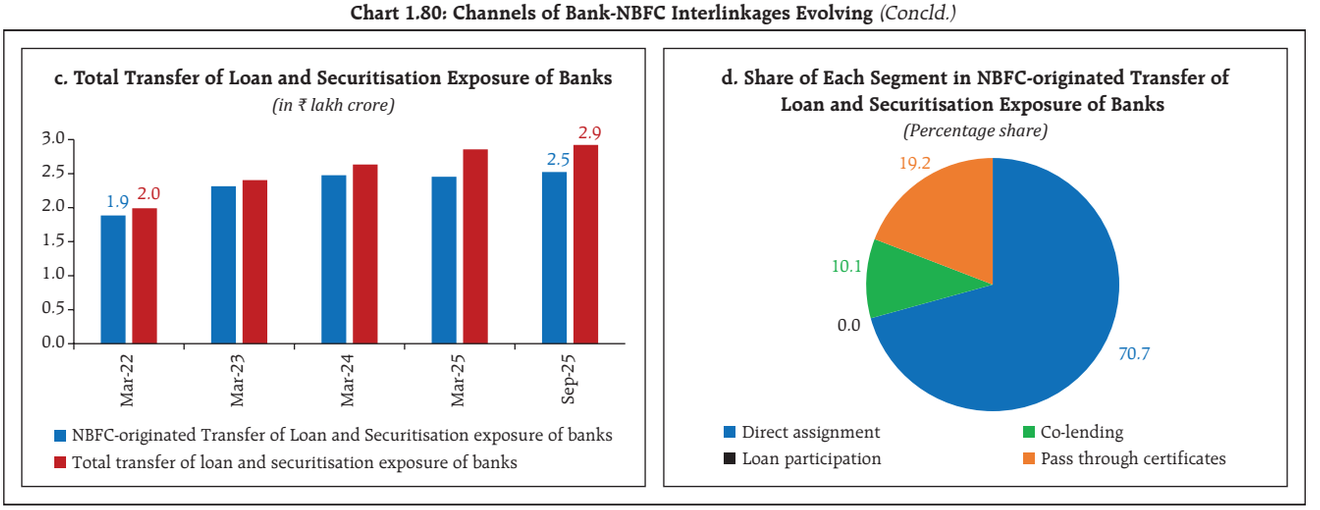
1.73 In recent years, however, bank–NBFC interlinkages have evolved beyond the traditional lending-borrowing channel (Chart 1.80 a). As NBFCs increasingly sell or securitise their retail and MSME loan portfolios (Chart 1.80 b), banks are not only extending credit to NBFCs but also acquiring NBFC-originated assets through transfer of loan and securitisation, including direct assignment, pass-through certificates, and co-lending arrangements (Chart 1.80 c and d).[42]

Chart 1.80: Channels of Bank-NBFC Interlinkages Evolving *(Contd.)*



[42] Based on survey of fifteen public and private sector banks, which form 73 per cent of total assets in the banking sector as at end-March 2025, around 86 per cent of total transfer of loan and securitisation exposures are NBFC-originated.

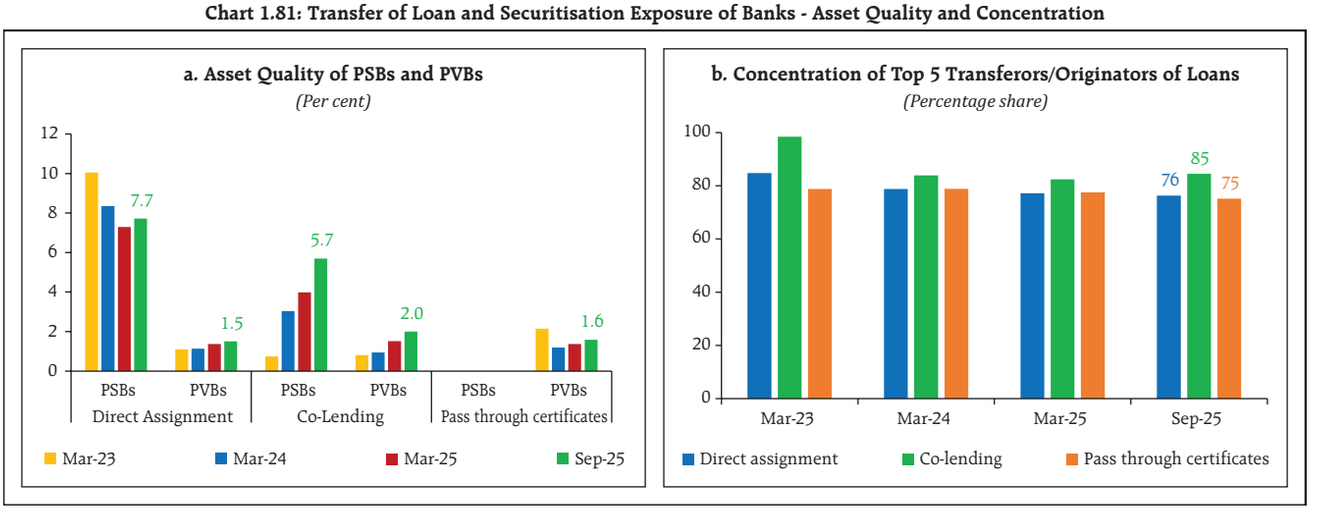
Chart 1.80: Channels of Bank-NBFC Interlinkages Evolving *(Concld.)*



Notes: (1) NBFCs include NBFCs, HFCs and MFIs.
(2) Banks include PSBs and PVBs.
Sources: Survey of select banks; RBI supervisory returns; and staff estimates.

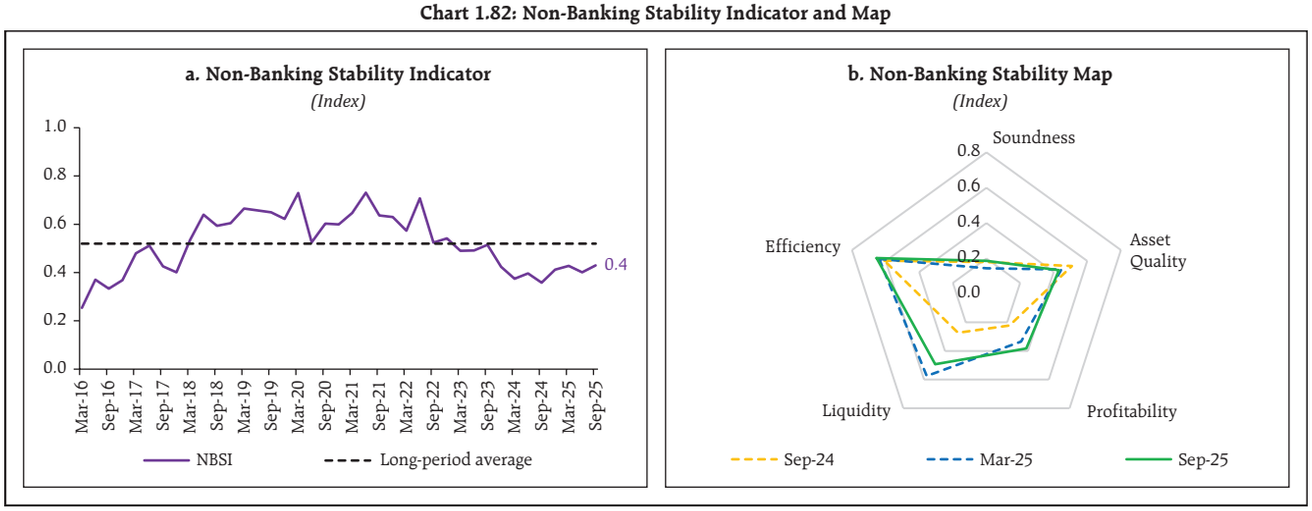
1.74 Banks are increasingly acquiring these assets to scale their retail portfolios, earn higher yields, and meet priority-sector targets. While the credit performance of acquired pools by PSBs has been weaker than their own originations, with direct assignment and co-lending pools showing higher loan losses, PVBs acquired pools that performed better (Chart 1.81 a). Moreover, banks are acquiring around 80 per cent of these assets through a limited number of NBFCs, which could create correlated risk and amplification of stress (Chart 1.81 b).

Chart 1.81: Transfer of Loan and Securitisation Exposure of Banks - Asset Quality and Concentration



Notes: (1) For Asset Quality, GNPA Ratio is considered for Direct Assignment and Co-Lending and Percentage of loans overdue more than 90 days in the underlying pools is considered for Pass-through certificates.
(2) Pass-through certificates asset quality data is not available for PSBs.
Sources: Survey of select banks; and RBI staff estimates.

Chart 1.82: Non-Banking Stability Indicator and Map



Notes: (1) In chart (a), lower values indicate improvement. Long-period average is average of NBSI since March 2016.
(2) In chart (b), away from the centre indicates increase in risk.
Sources: RBI supervisory returns; and staff estimates.

1.75 The overall risk in the NBFC sector, as reflected in the non-banking stability indicator (NBSI)[43] rose in September 2025 compared to its eight-year low in September 2024. The NBSI, however, remained below the long-term average and steady *vis-à-vis* the March 2025 position, aided by improvement in asset quality and liquidity (Chart 1.82 a and b).

[43] See Annex 1 for detailed methodology and variables used.

Special Feature

Financial Stability Implications of Stablecoins

Introduction

Stablecoins have emerged as a key component of the crypto asset ecosystem, and their prominence has risen following legal and regulatory clarity in select jurisdictions. By aiming to maintain a stable value, stablecoins claim to function as a reliable payment instrument and a safe store of value, unlike their unbacked counterparts like Bitcoin, as well as offer faster and cheaper payments. While they are currently mostly used in the crypto asset network, their wider application could pose significant risks, including risk to the '*singleness* of money', threat to monetary sovereignty, run and liquidity vulnerabilities, and potential credit disintermediation. This special feature examines the rapid evolution of stablecoins, their use cases, potential benefits and risks, and regulatory approach across jurisdictions.

Stablecoins are crypto assets issued by private entities denominated in currencies, such as the US dollar (USD) or Euro, which aims to maintain a stable value by pegging to a specific asset or basket of assets in those currencies.[1] They emerged to address the high volatility in unbacked crypto assets while serving as a medium of exchange within the crypto asset ecosystem. By providing a stable reference asset, they facilitate trading, borrowing, and lending of crypto assets and enable storage and transfer of value.

Over the past two years, the number of active stablecoins surged from around 60 in mid-2024 to over 170 by mid-2025.[2] Alongside, the market capitalisation rose from approximately US$ 120 billion to US$ 300 billion in the last two years (Chart 1 a). The stablecoin market, however, remains highly concentrated in terms of peg currency with almost 99 per cent of market capitalisation denominated in USD.[3] Moreover, two issuers, *viz.*, Tether (USDT) and Circle (USDC), account for around 85 per cent of the total market capitalisation. Despite their recent surge, the volatility remains high, especially for algorithmic stablecoins (Chart 1 b).

Purported Benefits and Use Cases

Stablecoins, with their combination of programmability, faster settlements, low-cost transactions and round the clock operability, have drawn attention as a possible means of improving the efficiency of financial transactions. Currently, by far the most dominant use case of stablecoins is in crypto trades – mainly to purchase crypto assets and provide liquidity in that market. Stablecoins currently account for over 80 per cent of trading volume on major centralised crypto exchanges.[4]

A frequently cited use case is cross-border payments, which is increasing (Chart 2). Conventional cross-border payments often involve multiple intermediaries, high transaction costs, and

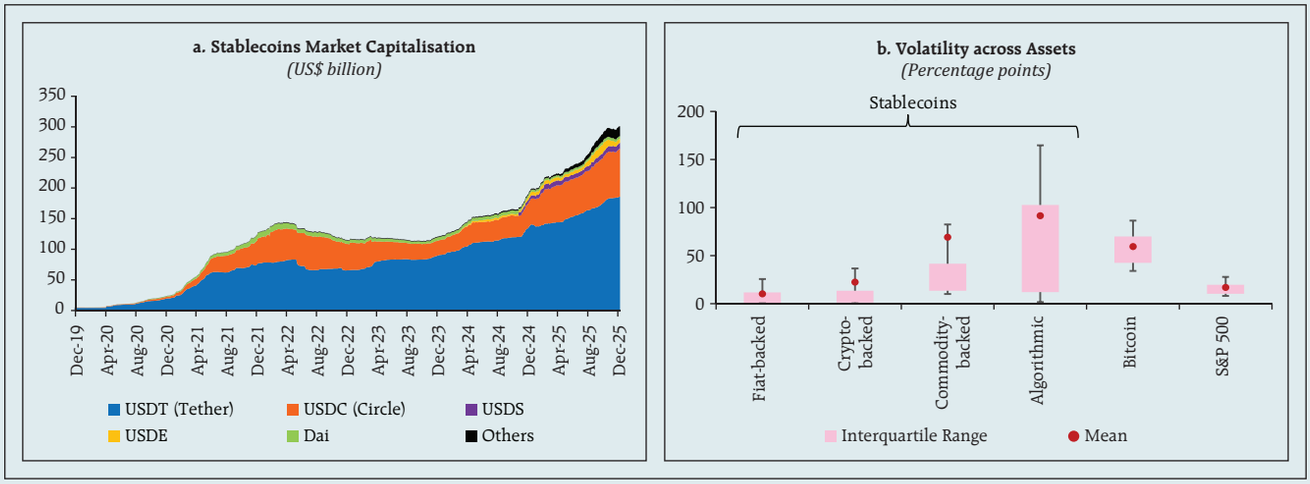
[1] Assets that back stablecoins range from financial assets to commodities and other crypto assets. Accordingly, there are different types of stablecoins. Fiat-backed stablecoins are backed by financial assets in the currency in which they are denominated. Commodity-backed and crypto-backed stablecoins are backed by commodities and other crypto assets. Another type of stablecoin, *viz.*, algorithmic stablecoin do not have asset backing and aims to maintain their stable value through trading in the market.

[2] Bank for International Settlements (2025), "Stablecoin growth – policy challenges and approaches", BIS Bulletin no 108, July.

[3] *Ibid.*

[4] Waller, Christopher J. (2025), "Reflections on a Maturing Stablecoin Market", Board of Governors of the Federal Reserve System, February.

Chart 1: Stablecoin Market Capitalisation and Volatility



Notes: (1) In chart (a), stablecoins with market capitalisation more than US$ 1 billion as on December 10, 2025 are considered. Others include PayPal USD, USD1, Tether Gold, Falcon USD, PAX Gold, BFUSD, Ripple USD and Global Dollar.

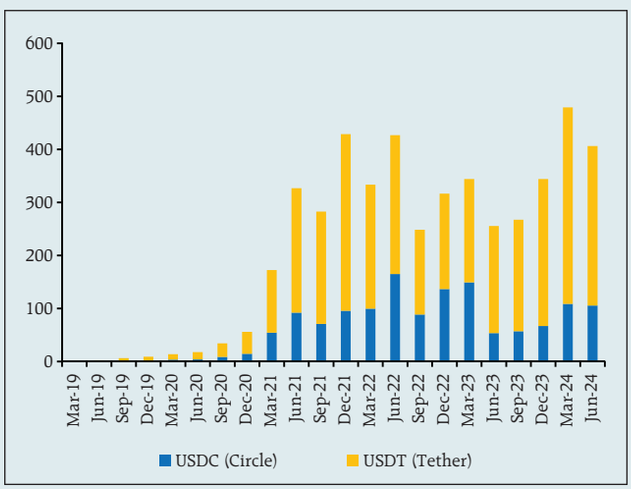
(2) In chart (b), volatility is defined as the annualised standard deviation of daily returns computed on 21-trading day moving windows. The whisker represents 10th-90th percentile range.

Sources: CoinGecko; and BIS.

multi-day settlement times. Stablecoins, by contrast, claim faster transfers of value on blockchain networks with lower costs, offering benefits for remittances.[5] Thus, stablecoins can enable faster and cheaper cross-border payment by bypassing the inefficiencies of traditional correspondent banking networks.[6]

Chart 2: Stablecoin Cross-Border Flows

(US$ billion)



Source: BIS.

With tokenisation of securities and real-world assets expected to expand rapidly, from US$ 600 million in 2025 to US$ 18.9 trillion in 2033[7], stablecoins claim to have the potential to become a key medium for on-chain clearing and settlement in an even larger digital ecosystem. They can be an appealing alternative for the users in countries with high inflation, tight capital controls and restricted access to dollar accounts.[8] Interestingly, their cross-border transaction volumes generally increase after episodes of high inflation and exchange rate fluctuations in sending and receiving economies (Chart 3).

Many of the claimed benefits suggest potential efficiency gains and wider applications - ranging from cross-border payments to future roles in tokenised asset ecosystems. However, they remain largely untested and unrealised at scale. The FSB

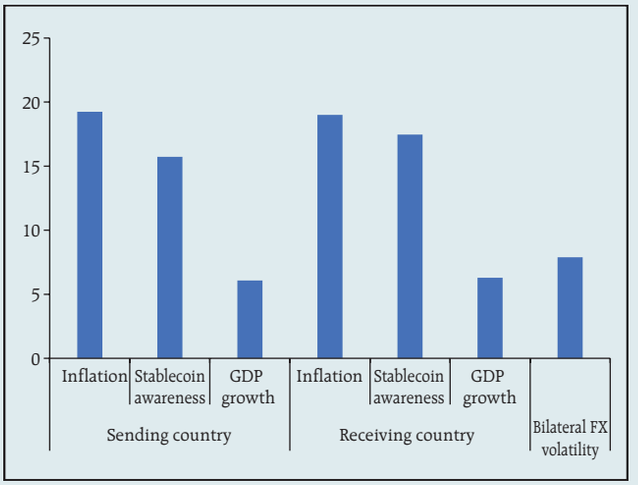
[5] Bank for International Settlements (2025), "Annual Economic Report 2025", June.

[6] Rey, Helene (2025), "Stablecoins, Tokens, and Global Dominance", IMF Finance and Development Magazine, September.

[7] Ripple and Boston Consulting Group (2025), "Approaching the Tokenization Tipping Point", April.

[8] Bank for International Settlements (2025), "Annual Economic Report 2025", June.

Chart 3: Stablecoin Cross-Border Flows - Country-Level Drivers
(Per cent)



Note: Estimated increase in bilateral cross-border tether flows for sending and receiving countries that experience high inflation (i.e., top quartile of a large sample of countries from 2017 to 2024), GDP growth, stablecoin awareness or bilateral exchange rate (FX) volatility.
Source: BIS.

in its review of real use cases of stablecoins also found that many of the anticipated benefits are yet to materialise.[9] Moreover, the claim that stablecoins can serve as settlement assets in a tokenised environment overlooks a key vulnerability, *i.e.*, stablecoins are tradable instruments whose prices can deviate from par.[10] Therefore, it remains unclear whether stablecoins would deliver lasting competitive advantages. Features often claimed as advantages, such as programmability, atomic settlement, and interoperability, stem from the underlying technologies (DLT, blockchain, tokenisation), and may not be unique to stablecoins. Unlike stablecoins, tokenised central bank reserves offer a stable and trusted settlement asset for wholesale transactions.[11]

Financial Stability Risks

Stablecoins can create important financial stability risks because of their inherent vulnerabilities. Trust in money is the foundation for maintaining financial stability. As stablecoins position as an alternative form of money, it is vital to recognise that they fall short of the foundational requirements expected from a sound monetary system – *singleness*, *elasticity* and *integrity*.[12,13] Stablecoins could undermine '*singleness* of money', which is the principle that all forms of money are freely interchangeable at par, *i.e.*, they trade at the same price and accepted everywhere. Since private stablecoins will involve multiple issuers of different credit worthiness with no central bank or government backing, their prices can deviate from par. Empirical evidence shows that stablecoins often fails to maintain their stable value and deviate from their peg both intraday and at the end of the day.[14] The recent downgrade of USDT (Tether), the largest stablecoin, to 'weak' category by the rating agency S&P Global Ratings due to increased exposure to high-risk assets in its reserves and continued gaps in disclosure underscore the challenges faced by stablecoins to maintain its stable value.[15] In the short history of stablecoins, there have been multiple episodes, such as the May 2022 collapse of TerraUSD and the March 2023 U.S. banking turmoil, wherein they saw significant price volatility (Chart 4). Such deviations from par convertibility could weaken stablecoins' role as reliable settlement

[9] Financial Stability Board (2024), "Cross-border Regulatory and Supervisory Issues of Global Stablecoin Arrangements in EMDEs", July 23.

[10] Bank for International Settlements (2025), "Annual Economic Report", June.

[11] *Ibid.*

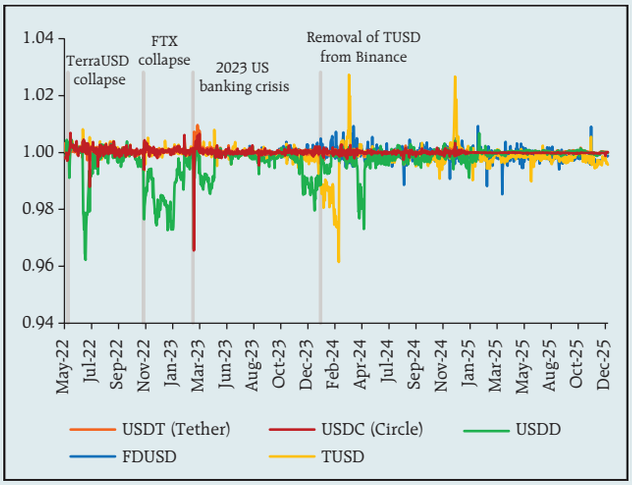
[12] *Ibid.*

[13] Elasticity refers to the ability to provide money flexibly to meet the need for large-value payments in the economy, so that obligations are discharged in a timely way without gridlock. Integrity refers to the ability of monetary system to prevent widespread abuse from fraud, financial crime and other illicit activities.

[14] Kosse, Anneke, Glowka, Marc, Mattei, Ilaria and Rice, Tara (2023), "Will the real stablecoin please stand up?", November.

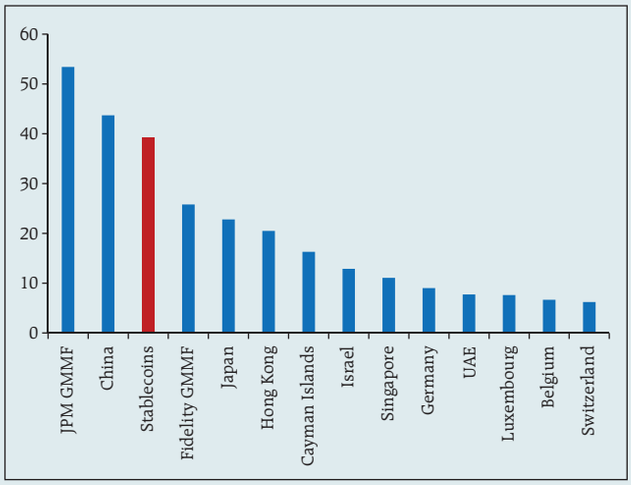
[15] S&P Global Ratings (2025), "Stablecoin Stability Assessment: Tether (USDT)", November 26.

Chart 4: Peg Stability of Stablecoins during Stress Episodes
Stablecoin Price vs. USD Peg (US$ 1.00)



Source: CoinGecko.

Chart 5: Stablecoin Issuers among Top Buyers of US T-bills in 2024
(US$ billion)



Note: GMMF stands for government money market fund.
Source: BIS.

assets, fragment the payment system, and ultimately heighten financial stability risks.

Stablecoins could experience destabilising runs if holders lose confidence in their ability to redeem at par. The perception of on-demand redemption creates funding risks from liquidity and asset maturity mismatches. These vulnerabilities can amplify shocks and spill over into other market segments and the traditional financial system by creating interconnections.[16] These risks are exacerbated by the demand for reserve assets, such as US treasuries from stablecoin issuers, which are also the mainstay for traditional financial institutions for funding and market liquidity (Chart 5). Thus, a run on stablecoins could trigger a fire-sale of their reserve assets. Moreover, these vulnerabilities are likely to persist since stablecoins are expected to grow rapidly, there is high concentration - two issuers account for roughly 90 per cent of USD-denominated stablecoins in circulation – and there are interchangeability issues across stablecoins.[17,18] Hence, instability in stablecoins could become a source of systemic risk.

Rapid growth of stablecoins could adversely affect credit intermediation and deposit flight. Although most jurisdictions prohibit stablecoin issuers from offering yield, third-parties or affiliates such as crypto asset service providers (CASPs) remain free of such restrictions, including in the US. These intermediaries may offer returns through lending, margin funding or other yield-generating mechanisms. The yield-bearing products based on stablecoins could compete with bank deposits and result in more expensive funding for banks, limit the credit available to the real economy and make deposit flows more volatile during periods of stress.[19] They could also pose funding risks to banks as at the aggregate level retail deposits will convert into wholesale deposits, which are less stable.[20]

[16] Pablo D. Azar and *et al.* (2024), "The Financial Stability Implications of Digital Assets", Federal Reserve Bank of New York, Economic Policy Review, November.
[17] European Central Bank (2025), "Financial Stability Review", November.
[18] Unlike bank deposits that are accepted by everyone even though they maintain different banking relationships, stablecoins are not currently freely interchangeable among holders.
[19] Ocampo, Denise Garcia (2025), "Stablecoin-related yields: some regulatory approaches", FSI Briefs No 27, October.
[20] This could happen directly if stablecoin issuers maintain some of their reserves in bank deposits or indirectly through deposits from entities from which reserve assets are bought.

Other Macrofinancial Risks

The rapid growth in foreign currency pegged stablecoins can lead to currency substitution and challenge a country's monetary sovereignty.[21] Easy access to dollar-denominated stablecoins can lead to 'digital dollarisation', a scenario where digital form of dollar-denominated or dollar-pegged currencies substitute local currency. Moreover, unlike traditional forms of dollarisation, the stablecoins have the potential to displace local currencies more rapidly through digital channels and network effects.[22]

Widespread adoption of foreign currency-denominated stablecoins can cause erosion of monetary control and weaken the transmission channels of domestic monetary policy.[23] Moreover, since the effectiveness of monetary policy is dependent on central bank's ability to influence interest rates and money supply, emergence of stablecoins and their impact on bank deposits and reserve assets could pose challenges for monetary policy implementation.

Stablecoins can circumvent controls on capital movement and complicate macroeconomic management for the central bank. This is especially important for emerging economies like India where capital flow management frameworks (CFM) play a key role in preserving external sector stability. Stablecoins, like other crypto assets, can be used to bypass the current system for transferring foreign exchange in and out of the country, impeding the effectiveness of CFMs, which aims to maintain macroeconomic stability, safeguard foreign exchange reserves, and manage the risks associated with sudden and volatile capital flows.

Purported benefits of stablecoins such as pseudonymity, low-transaction costs and cross-border usage also create risks to financial integrity. Evidently, since 2022, stablecoins have replaced bitcoin as the primary vehicle for illicit crypto flows.[24] Without adequate regulation, stablecoins—like other crypto assets—can be exploited for serious crimes, including money laundering, terrorism financing, and the financing of weapons proliferation.[25] In fact, their relative stability could make them more attractive for illicit activities. These risks intensify for emerging economies due to capacity constraints, including limited resources for oversight, enforcement, and cross-border coordination. Furthermore, lack of robust regulatory frameworks, advanced blockchain analytics, and tax enforcement mechanisms to track crypto flows create additional challenges.

Policy Approach

One of the drivers of stablecoin growth could be the emergence of legal/regulatory frameworks across major jurisdictions between 2023 and 2025, including the US, European Union, Singapore, Hong Kong and Japan. Emerging regulatory approaches have several common themes such as requiring issuers to be legal entities, maintaining full backing with high-quality liquid assets, providing statutory redemption rights to holders, mandating that reserves be separated and shielded from the issuer's creditors, and banning issuers from paying interest on stablecoins.[26]

[21] International Monetary Fund (2025), "Global Financial Stability Report: Shifting Ground beneath the Calm", October.

[22] International Monetary Fund (2025), "Understanding Stablecoins", December.

[23] Rey, Helene (2025), "Stablecoins, Tokens, and Global Dominance", September.

[24] Chainalysis (2025), "The Road to Crypto Regulation. Part 2: Stablecoins at the Crossroads of Financial Services and Crypto", August.

[25] International Monetary Fund (2025), "Understanding Stablecoins", December.

[26] *Ibid.*

However, there are significant divergence in policy approach across jurisdictions, including eligible issuers, approach towards foreign-currency stablecoins and differentiated treatment of systemically important issuers.[27] The Guiding and Establishing National Innovation for U.S (GENIUS Act) in the US and Markets in Crypto-Assets Regulation (MiCAR) in Europe has given a regulatory framework for issuing dollar and euro-backed stablecoins, including reserve requirements, audits, AML controls, and supervision. Similarly, the Hong Kong Stablecoins Bill, passed in May 2025, establishes a licensing regime for fiat-referenced stablecoins. While countries are in various phases of developing regulatory frameworks for stablecoins, some countries like China, Egypt, Nepal, *etc.*, have imposed a ban on crypto assets, including stablecoins. Such divergences in regulatory frameworks across jurisdictions leaves scope for regulatory arbitrage. Moreover, there has been limited progress in the effective implementation of Financial Stability Board's global regulatory framework for crypto asset activities among its members. In its thematic review, the Financial Stability Board has highlighted inconsistencies in cross-border regulatory cooperation which could pose risks to financial stability. The macrofinancial risks posed by stablecoins may be larger for EMDEs given weaker institutional frameworks, larger share of unbanked population, lower financial literacy and additional incentive to bypass capital flow restrictions. Accordingly, EMDEs may need to consider additional targeted measures to mitigate specific risks.[28]

Conclusion

Stablecoins have gained attention in recent years, and their issuance has grown rapidly. Their size, however, remain low relative to wider crypto asset market capitalisation. Currently, risks from stablecoins to macrofinancial stability outweigh their purported benefits. In their short history, stablecoins have proven to be volatile and vulnerable to confidence shocks and structural fragilities. Wider adoption of stablecoins can introduce new channels of financial stability risks, particularly during periods of market stress. To mitigate risks posed by their rapid growth, it is vital that jurisdictions carefully assess the attendant risks and determine policy responses appropriate to its financial system.

The Reserve Bank of India (RBI) has highlighted that widespread adoption of stablecoins could pose significant risks to India's monetary sovereignty and financial stability. The RBI maintains a cautious stance on crypto assets, including stablecoins, prioritising sovereign digital infrastructure to safeguard monetary sovereignty amid global shifts and preserve financial stability. Central bank money is what preserves the *singleness* of money and the *integrity* of the financial system. It must remain the ultimate settlement asset, and it should remain the anchor for trust in money. Central bank digital currencies (CBDCs) can achieve the benefits that stablecoins claim to offer, *i.e.*, efficiency, programmability, and instant settlement, but with the credibility and safety of central bank money. The RBI, therefore, strongly advocates that countries should prioritise central bank digital currencies (CBDCs) over privately issued stablecoins to maintain trust in money, preserve financial stability and design next generation payments infrastructure that is faster, cheaper and secure.

[27] International Monetary Fund (2025), "Understanding Stablecoins", December.

[28] Financial Stability Board (2023), "IMF-FSB Synthesis Paper: Policies for Crypto-Assets", September.