

Monetary Policy Transmission in India: Evidence from the Housing Credit Channel

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INTRODUCTION

India’s financial system is bank-dominated, so changes in the RBI repo rate reach households primarily through bank lending rates. Housing credit is a particularly useful margin because mortgages are long-term, collateralized, and sensitive to borrowing costs. States also differ substantially in financial development, so the same national policy-rate change may not affect borrowers uniformly.

RESEARCH QUESTION:

Where is monetary-policy transmission most visible in India’s credit market and did the 2016 flexible-inflation-targeting reform broaden its reach?

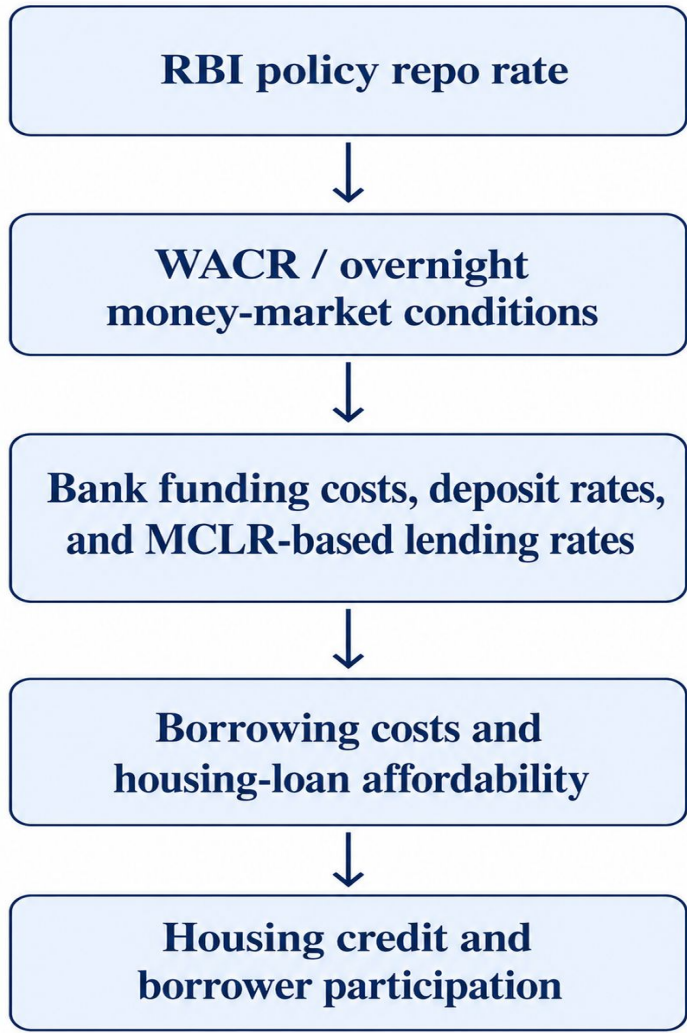
RESEARCH DESIGN

- State-level panel: 28 states + 8 union territories, 2012-2024
- Outcomes: total bank credit, housing credit, and total borrower accounts
- Bank-level panel: 91 scheduled commercial banks, monthly data, for MCLR lending-rate pass-through
- Sources: Reserve Bank of India Database on Indian Economy and related RBI publications
- Estimation: OLS with state or bank fixed effects, macroeconomic controls, and robust standard errors.
- Heterogeneity: states above versus below the median credit-to-GSDP ratio; pre-versus post-2016

EMPIRICAL APPROACH

$$Y_{s,t} = \alpha + \beta MP_t + \gamma \log(GSDP_{s,t}) + \delta \log(CPI_t) + \mu_s + \varepsilon_{s,t}$$

β is the approximate percentage change in the outcome associated with a 1-percentage-point change in the repo rate.



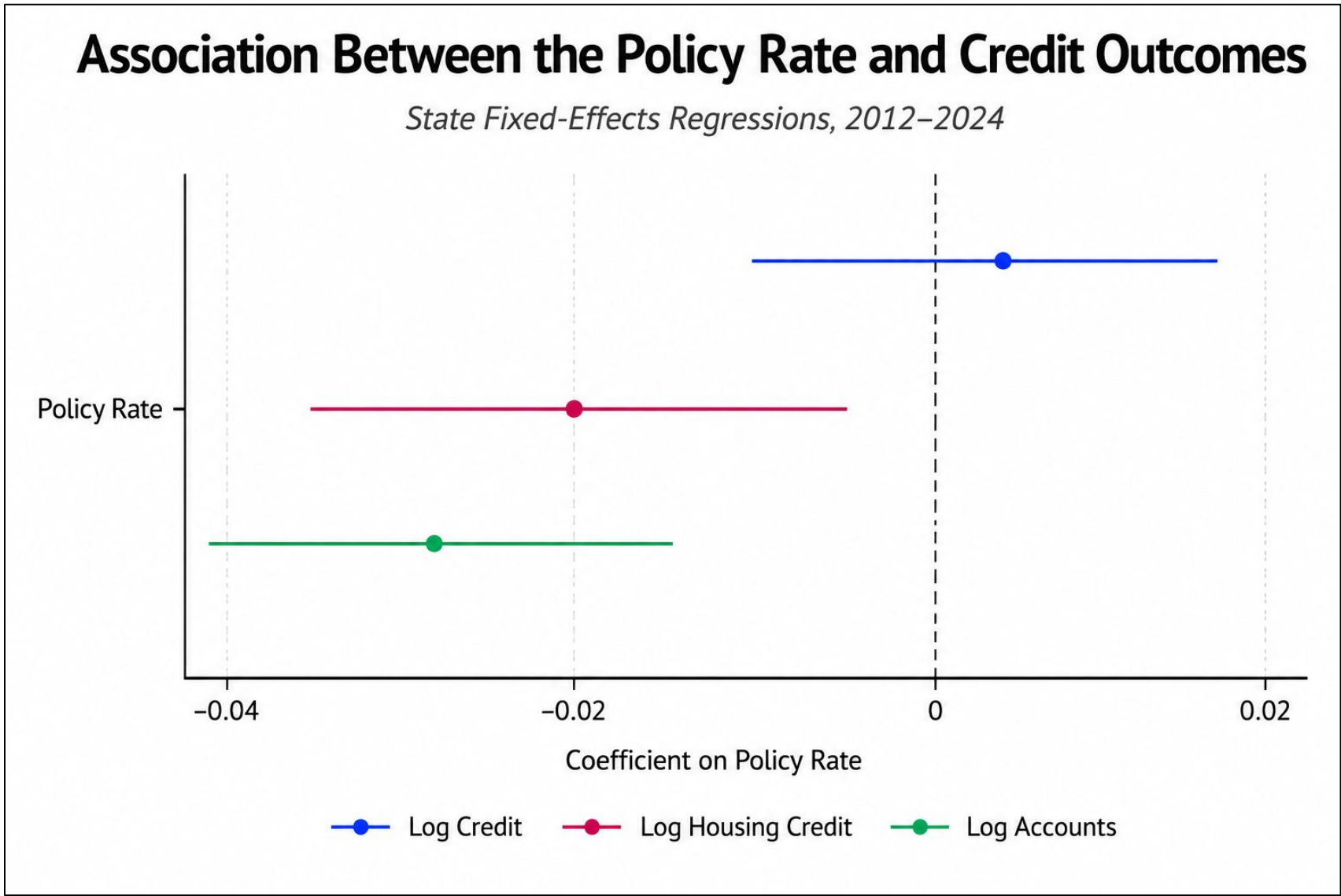
LIMITATIONS

- Estimates are conditional associations, not fully causal effects; the national repo rate is not instrumented.
- The 2016 split jointly captures flexible inflation targeting and the MCLR lending-rate reform, so their separate effects cannot be identified.
- Annual state-level data may miss shorter-run timing and adjustment dynamics in credit responses.
- State-level aggregates cannot identify borrower- or bank-specific mechanisms.

CONCLUSIONS AND POLICY IMPLICATIONS

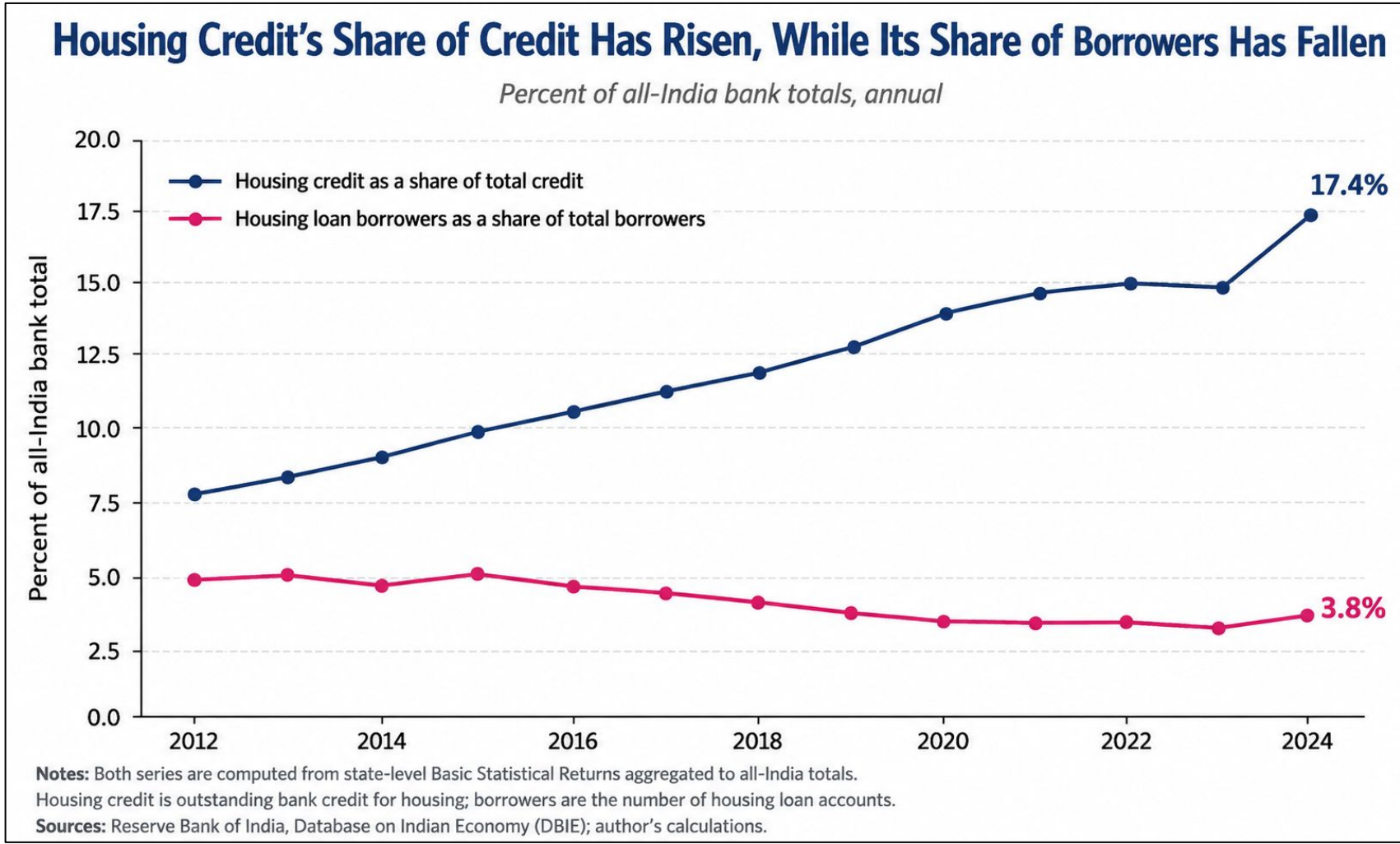
Monetary tightening does not affect all borrowers equally. Housing credit and borrower participation respond significantly to policy-rate changes, with **with significant housing-credit effects only in less financially developed states**. Policy implication: Aggregate credit is an incomplete measure of monetary transmission. The RBI and financial policymakers should track housing credit, borrower participation, and state-level financial depth alongside aggregate lending to **identify where tightening may have disproportionate effects**.

MAIN FINDINGS



Monetary policy affects credit composition, not aggregate volume.

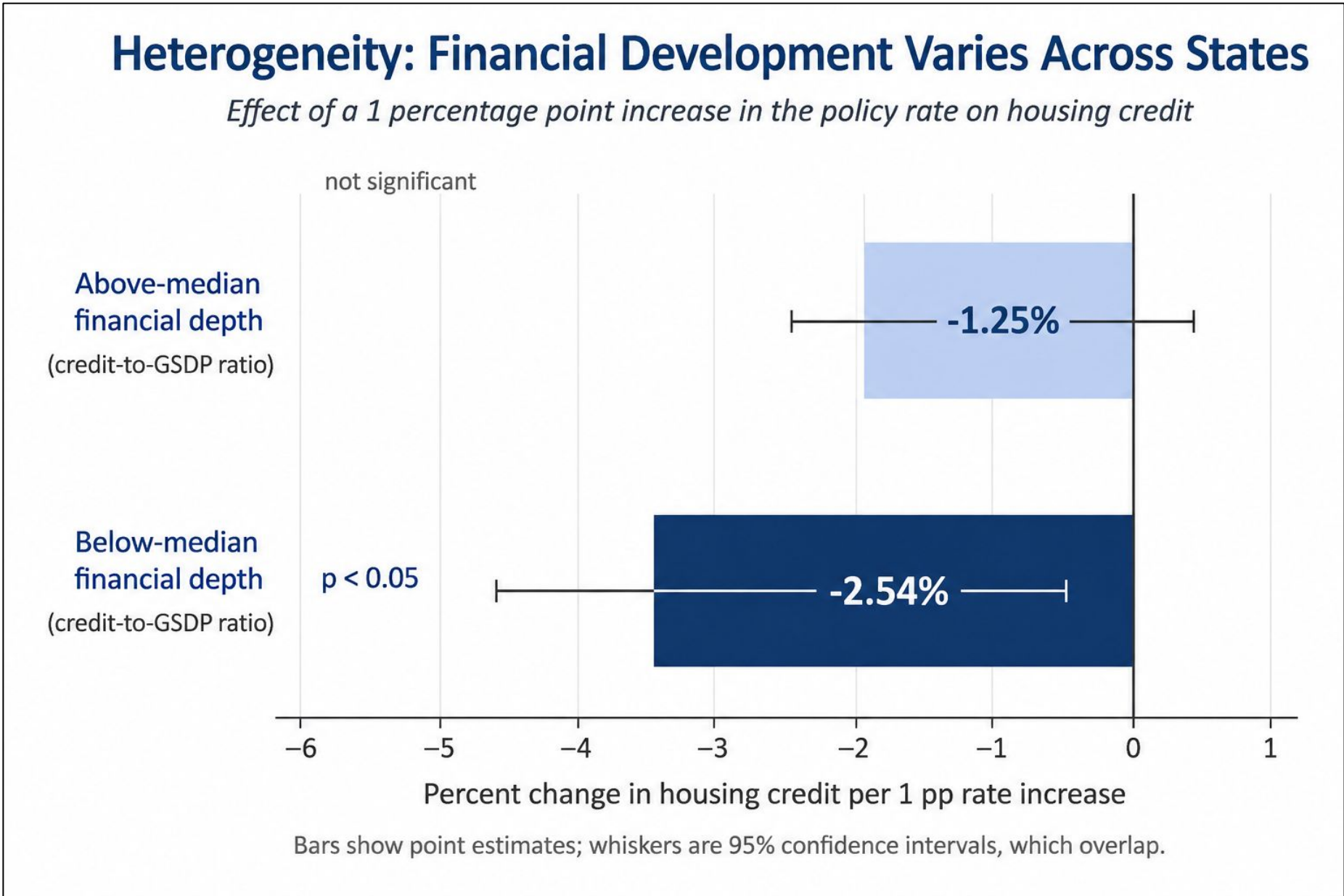
With macro controls and state fixed effects, a 1%-point increase in the repo rate is associated with housing credit reducing by 1.93% and borrower accounts by 2.76%, while aggregate credit does not respond significantly. Housing credit is therefore the most consistently sensitive credit margin, while aggregate credit masks important compositional responses.



Descriptive trends: housing credit’s share of total credit rose while its share of borrower accounts declined.

Pass-through to lending rates is strong: 0.646

At the bank level, a 1%-point increase in the policy rate is associated with a **0.646%-point increase** in MCLR-based lending rates. This pricing response provides a mechanism linking monetary tightening to weaker housing credit and lower borrower participation.



Housing credit responds significantly only in less financially developed states

A 1-percentage-point increase in the policy rate is associated with a 2.54% decline in housing credit in below-median credit-to-GSDP states. The estimate for above-median states is smaller (1.25%) and not statistically significant.

The 2016 reform broadened transmission

Housing credit responds negatively both before and after the adoption of flexible inflation targeting. After 2016, however, total credit and borrower accounts also become statistically responsive. The evidence is consistent with the 2016 framework broadening the reach of transmission rather than initiating the housing-credit channel.

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