



DEBT MARKET

How interest rates work

What an interest rate pays for, why there are so many, and how RBI's rate reaches a deposit, a loan and a bond

Market yields as on 1 September 2026; policy rate as on 7 October 2026

For training and education only. Not investment advice.

An interest rate is the price of using someone else's money for a period of time.

The borrower pays to spend now. The lender is paid for waiting and for the risk taken. There are many rates because there are many borrowers, periods and risks.

What a lender is paid for



Waiting

The lender gives up the use of the money for a period. Interest is the payment for that wait.



Rising prices

Money repaid later buys less if prices have risen. Lenders ask for a rate that covers the inflation they expect.



Risk of loss

A borrower may not repay in full or on time. The weaker the ability to repay, the higher the rate a lender asks.



Being locked in

Money tied up for long, or hard to get back early, usually earns more than money available on demand.

Each interest rate is a mix of these four payments. Change the borrower or the period and the mix shifts.

Nominal rate and real rate

THE SET-UP

A saver puts ₹1,00,000 in a one-year deposit at 7%.

Over the same year, prices rise 5%.

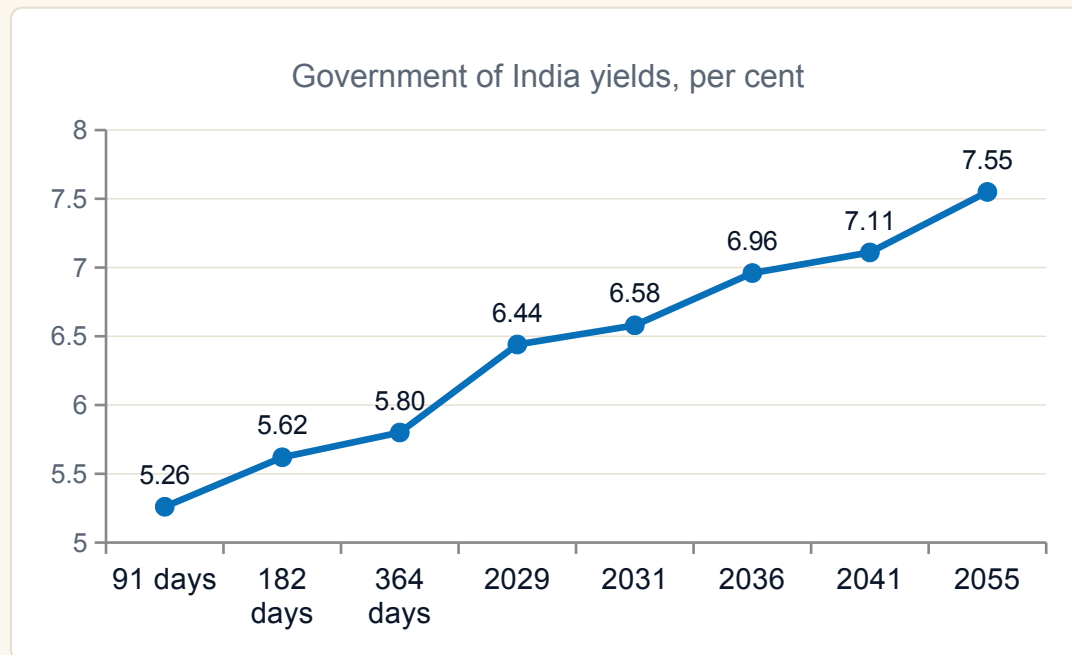
Both figures are assumed.

- 1 After one year the deposit is worth $₹1,00,000 \times 1.07 = ₹1,07,000$. The 7% is the nominal rate: the rate in rupees.
- 2 Goods that cost ₹1,00,000 a year ago now cost $₹1,00,000 \times 1.05 = ₹1,05,000$.
- 3 What the saver can buy has grown by $1,07,000 \div 1,05,000 = 1.0190$, that is 1.90%. This is the real rate.
- 4 The shortcut is nominal minus inflation: $7\% - 5\% = 2\%$. It is close, and it slightly overstates the exact answer.

Nominal 7%, inflation 5%, real 1.90%. The real rate is what the saver gains in buying power.

Illustration with assumed figures. Not a forecast and not an indication of any deposit rate. Tax is ignored.

Same borrower, longer period, higher rate



Read the chart

- One borrower throughout: the Government of India. Only the period changes.
- A 91-day Treasury bill yields 5.26%. A bond that matures in 2055 yields 7.55%.
- Lenders are paid more for a longer wait and for more years of uncertain inflation.
- This upward slope is the usual shape. It is not a rule.

Source: RBI Current Rates as on 1 Sep 2026. Treasury bills (91, 182, 364 days): cut-off yield at the auction of 27 Aug 2026. Bonds maturing 2029 to 2055: yields on 1 Sep 2026.

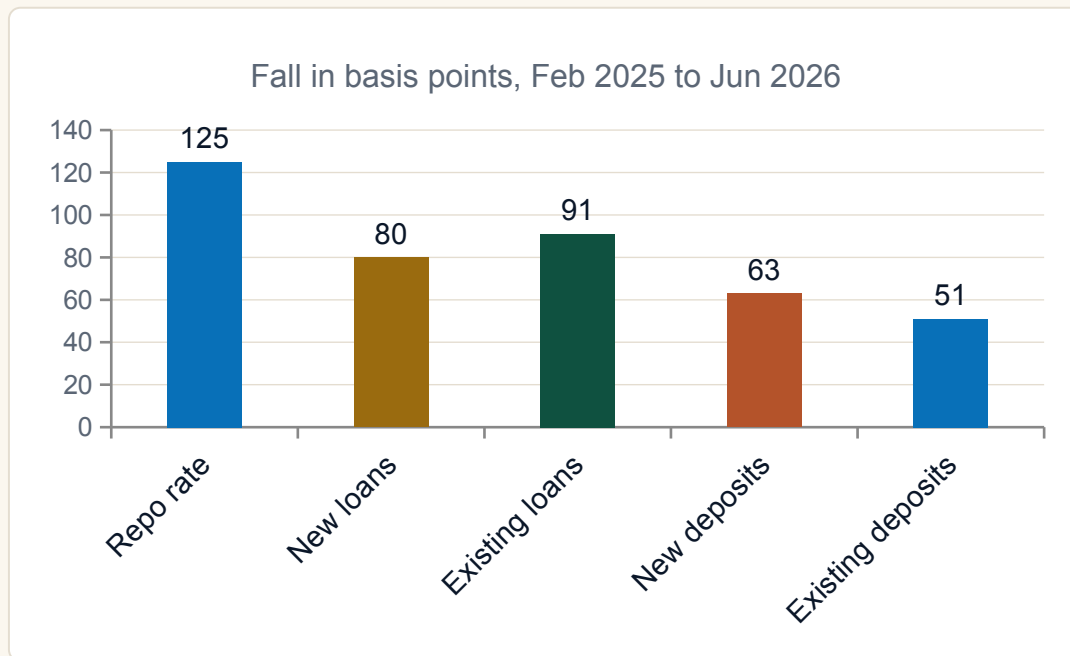
From the repo rate to your rate

RBI's policy repo rate is 5.50%. Each rate below follows it in its own way and at its own speed.

Rate	How the policy rate reaches it
Money market rates	Overnight and other short-term rates move almost at once. The deck 'RBI's toolkit' shows the corridor that holds them.
Deposit rates	Banks reset the rates they offer on new deposits. A fixed deposit already made keeps its contracted rate until it matures.
Loans on an external benchmark	Floating-rate retail loans and loans to micro, small and medium enterprises. Reset at least once in three months.
Loans on MCLR	Loans priced from 1 April 2016 on the bank's own cost of funds. Reset on the loan's reset date, at least once a year.
Bond yields	Short-term yields tend to move with the repo rate. Longer yields also weigh expected inflation and government borrowing.

Sources: RBI Monetary Policy Statement, 7 Oct 2026; RBI (Commercial Banks – Interest Rates on Advances) Directions, 28 Nov 2025; RBI MCLR release, 17 Dec 2015.

A 125 basis point cut: what arrived



Read the chart

- RBI cut the repo rate by 125 basis points between February and December 2025. 100 basis points is 1 percentage point.
- By June 2026 banks' average rate was down 80 basis points on new loans and 91 on existing loans.
- Average term deposit rates were down 63 basis points on new deposits and 51 on existing ones.

Source: RBI Governor's Statement, 5 Aug 2026, footnote on transmission. Scheduled commercial banks; weighted average rates on rupee loans and domestic term deposits.

Where rates stand

Four rates, four numbers: borrower, period and date all differ. Check the date before you quote them.

RBI POLICY REPO RATE

5.50%

Overnight money for banks. Raised from 5.25% on 7 October 2026.

364-DAY TREASURY BILL

5.80%

The Government borrowing for a year. Cut-off yield, auction of 27 August 2026.

BOND MATURING 2036

6.96%

The Government borrowing to 2036. Yield on 6.94% GS 2036, 1 September 2026.

NEW BANK LOANS, AVERAGE

8.61%

Banks' average rate on fresh rupee loans in August 2026.

Sources: RBI Monetary Policy Statement, 7 Oct 2026; RBI Current Rates as on 1 Sep 2026; RBI, Lending and Deposit Rates of Scheduled Commercial Banks, 30 Sep 2026.

Who feels a change in rates

When rates rise

- New deposits and new bonds pay more.
- Floating-rate borrowers pay more: the EMI rises or the loan runs longer.
- Bonds already issued fall in price. Debt fund NAVs carry that fall.
- New borrowing costs businesses more.

When rates fall

- New deposits and new bonds pay less.
- Floating-rate borrowers pay less: the EMI falls or the loan ends sooner.
- Bonds already issued rise in price. Debt fund NAVs carry that rise.
- New borrowing costs businesses less.

Fixed-rate deposits and loans keep their contracted rate. This slide describes effects; it is not advice.

If you learnt this from older material

What older decks say

- Banks price loans off their Base Rate or prime lending rate.
- A rate cut reaches a borrower when the bank chooses to change its own benchmark.
- The reverse repo rate is the floor for overnight rates.

What holds now

- MCLR replaced the Base Rate for new loans from 1 April 2016.
- New floating-rate retail loans follow an external benchmark, since 1 October 2019.
- The floor is the Standing Deposit Facility rate, since April 2022.

At end-June 2026, 68.2% of banks' floating-rate rupee loans were on an external benchmark.

Sources: RBI press release of 17 Dec 2015 (MCLR); RBI circular of 4 Sep 2019 and Directions of 28 Nov 2025; RBI, Lending and Deposit Rates of SCBs, 30 Sep 2026.

Four things people get wrong



'RBI sets the rate on my loan.'

RBI sets the repo rate. The bank sets the loan rate: a benchmark plus a spread that the bank decides.



'A 7% deposit grows my money by 7%.'

In rupees, yes. In buying power the gain is the real rate. With prices rising 5%, that is 1.90% before tax.



'Repo is cut, so my deposit pays less.'

A fixed deposit already made keeps its rate until maturity. New deposits and renewals get the new rates.



'Longer loans always carry higher rates.'

Usually, not always. When lenders expect rates to fall, long-term rates can sit level with or below short-term rates.

Check yourself

Q1

A deposit pays 8% a year and prices rise 6% over the year. What is the real rate, by the shortcut and exactly?

Q2

A home loan is linked to the repo rate. RBI raised the repo rate on 7 October 2026. How soon must the loan rate reflect it?

Q3

As shown by RBI on 1 September 2026, a 91-day Treasury bill yielded 5.26% and a bond maturing in 2036 yielded 6.96%. Give two reasons for the gap.

Sources and disclaimer

SOURCES FOR THE FIGURES IN THIS DECK

- Repo rate 5.50%, raised from 5.25%: RBI Monetary Policy Statement, Press Release 2026-2027/1264, 7 Oct 2026.
- Treasury bill and government bond yields: RBI Current Rates as on 1 Sep 2026, page archived 2 Sep 2026 (Treasury bills at the 27 Aug 2026 auction cut-off).
- Average loan and deposit rates, August 2026; external benchmark and MCLR shares, end-June 2026: RBI Press Release 2026-2027/1224, 30 Sep 2026.
- Fall in lending and deposit rates, February 2025 to June 2026: RBI Governor's Statement, 5 Aug 2026.
- External benchmark, reset at least once in three months: RBI Interest Rates on Advances Directions, 28 Nov 2025 (first set 4 Sep 2019).
- MCLR from 1 Apr 2016, reset of one year or lower, Base Rate from 1 Jul 2010: RBI Press Release of 17 Dec 2015.
- Standing Deposit Facility as the floor since April 2022: RBI, Monetary Policy overview, [rbi.org.in](https://www.rbi.org.in).

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