

COMMENT

As RBI pauses, borrowers in for a long wait

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The fall in lending rates still falls short of the reduction in deposit rates.



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While lending rates may come down in the coming months, a sharp fall from hereon is unlikely

BL Research Bureau:

After seeing lending rates fall by about 60-70 basis points over the past year or so, borrowers may be in for a long wait until rates start to move lower once again. The RBI chose to hold its policy repo rate-- at which banks borrow short-term funds from the RBI--- on Tuesday, after a 25 basis points cut in its April policy. Sharper-than-expected surge in inflationary pressures and uncertainty over achieving its 2016-17 inflation target of 5 per cent, has led the RBI to pause this time around.

But even if inflation worries ease, the RBI is left with little ammunition to carry on its monetary easing policy---with most expectations around a further 25 basis points reduction this year. As we near the fag end of the rate easing cycle (150 basis points cut since the beginning of 2015), borrowers are unlikely to see sharp lending rate cuts from hereon.

Lower MCLR, but not lending rates

From the beginning of January 2015 (when the rate easing began) until now, banks have reduced their base rate-- erstwhile benchmark lending rate--by about 70 basis points; the lowest currently at 9.3 per cent offered by SBI and HDFC Bank. Weighted average lending rate (WALR) on fresh loans sanctioned, according to RBI's latest report has actually fallen by about 95 basis points during this period. But the decline in lending rates still falls short of the

reduction in deposit rates. The deposit rates have been reduced by 1.5 per cent or even more in some banks across tenures during this period.

Hence, while any further rate cut by the RBI will pave way for banks to lower their deposit rates, much of the reduction in lending rates for now, will be leftovers of the pass through of the earlier (150 basis point) cuts in policy rate. With banks now pricing loans with reference to the new marginal cost of funds-based lending rate (MCLR), a further 10-15 basis points fall in MCLR cannot be ruled out, given that deposit rate decreases immediately reflect on the banks' cost of funds.

But any cuts in MCLR will not impact lending rates for existing borrowers immediately. This is because existing borrowers (for loans taken before April 1) continue to be charged interest on loans based on the earlier base rate system. Even new borrowers under the MCLR regime will see lending rates reset at specific intervals, corresponding to the tenure of the MCLR.

Still a lag?

The RBI's measures in its April policy to ease up liquidity has helped bring down overnight rates and interest rates on money market instruments such as certificates of deposit (CDs) and commercial paper (CPs) rates. MCLR (as against the base rate system) has also to some extent forced banks' hand to reduce lending rates. Most banks have set their benchmark MCLR, 10-20 basis points lower than the existing base rate.

But after the RBI cut its repo rate by 25 basis points in the April policy very few banks have reduced their MCLR. One of the reasons for this is that many banks have maintained status quo on deposit rates over the past two months, giving them less leeway to tweak lending rates. IDBI Bank, Bank of India, IOB, Indian Bank, PNB and Andhra Bank, for instance have not lowered their benchmark-MCLR rates.

The other reason for not cutting lending rates could also be the sharp rise in bad loans for many PSU banks (post the RBI's asset quality review) in recent quarters. This has given them lower headroom to cut lending rates, as it would only pressure margins further. Hence, banks such as IOB, Indian Bank and Andhra Bank have not been able to lower rates (MCLR) despite cutting deposit rates by 20-25 basis points over the last two months.

Leading banks such as SBI, HDFC Bank and ICICI Bank have lowered their one-year MCLR by a mere 5 basis points to 9.15 per cent in the last two months.

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