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நிஃப்டி 50  
**10,594** ▼ -42.35

கோல்டு (எம்சிக்...  
**29,169.00** ▲ 13.00

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## Do interest rate cuts work? What the data tells us

BY ET CONTRIBUTORS | JAN 10, 2018, 06.16 AM IST

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**By Madan Sabnavis**

There are at least four views on interest rates and their impact. The **RBI** maintains that the transmission of rate movements in the past has been sluggish. Therefore, banks should introspect before asking for rate cuts.

Second, banks posit that they face a conundrum because when they lower their lending rates, all loans get repriced while deposits costs change only when they have to be renewed.

Therefore, one cannot expect a oneto-one-correspondence and there would be lags. Third, borrowers always ask for cuts because that is the way to growth as investment increases with low interest rates. Last, obsessive critics argue that the RBI is too conservative and obsessed with inflation which has driven the economy downhill. Does data tell us what exactly is going on?

The data shows several aspects of the story. First, the RBI has lowered rates by 200 bps in the last 3.5 years or so and, hence, the direction is clear and in conformity with the **CPI number**, which has been coming down gradually. Second, banks have been responsive,



*The services sector that is dominated by NBFCs and trade has shown varying trends which are still positive.*

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albeit at a varied pace, and the relation has not been perfect. In 2016-17, banks had lowered the rates by just 7.5 bps when the repo came down by 50 bps. Clearly, commercial considerations, including NPAs, would have influenced such a decision.

### Changes in Interest Rates (bps) and Credit Growth (%)

Period	Repo	Base rate	Credit	Agri	Industry	Services	Retail
2013-14	50	15	13.6	12.9	12.8	16.1	12.5
2014-15	-50	0	8.6	15	5.6	5.7	15.5
2015-16	-75	-62.5	9.1	15.3	2.7	9.1	19.4
2016-17	-50	-7.5	8.4	12.4	-1.9	16.9	16.4
Oct-Mar 17	-25	-22.5	-0.5	-1.1	-3	-3.8	7.7

Third, interestingly the **MCLR** (overnight) came down sharply in 2016-17 from 9.05% to 7.97%, which is by 107.5 bps. Hence, while base rates did not change much, the MCLR came down more than commensurately.



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Fourth, headline growth in credit does not seem to be linked with the changes in lending rate. The highest growth rate was witnessed in 2013-14 (including that to industry) when repo rate was increased. Ever since rates came down, growth has been low indicating that credit does not grow just because of interest rates.

Next, the internals of growth in credit are important. While critics are crying hoarse over investment stagnating, growth to this segment has come down sharply. Low capacity utilisation, stagnant demand, overhang of debt, **NPA** issues in several sectors, etc., are factors which need to change before growth in credit to industry picks up.

Contrary to this picture, the growth in retail credit has been generally buoyant. Lower rates have kept the growth rate ticking (even though they have vacillated, they are the highest). This has been driven by home loans in particular, followed by auto loans. This is a positive sign for the credit scenario, which can in the medium term build linkages with higher demand for other sectors leading to better capacity utilisation and demand from industry.

The services sector that is dominated by [NBFCs](#) and trade has shown varying trends which are still positive.

NBFCs have tended to swing to debt where interest rate transmission has been faster, while trade has been one of the more buoyant sectors for GDP growth. Farm loans on the other side would tend to be driven more by circumstances as there are unavoidable priority sector preemptions.

The picture emerging is that the RBI has been proactive in lowering rates. The introduction of MCLR has improved transmission while base rate changes have been sticky.

Growth in credit will be driven by demand conditions and while lower rates help individuals to borrow, there is limited traction when it comes to credit for industry. Demand is low, while supply will be hesitant until the NPA issue sees some rays of sunshine.

*(The author is Chief Economist, CARE Ratings. Views are personal)*

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