

Looking for banks to cut interest rates to take loans? Well, here is something you REALLY need to know

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Despite the 25-bps cut in the policy repo rate on August 2, there has been virtually no reduction in the interest rates on loans. (Image: Reuters)

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Despite the 25-bps cut in the policy repo rate on August 2, there has been virtually no reduction in the interest rates on loans. For their part, banks say they have passed on much of the total cut in the repo, of around 200 bps since January, 2015, in the form of a lower MCLR (Marginal Cost of Funds). That may be so, but what they don't talk about is the fact that the bulk of the loans—around 60-65%—are pegged to the base rate. And no bank is willing to touch that. Instead, they have rushed to cut the interest rate on savings accounts after market-leader SBI trimmed the rate by 50 bps to 3.5% a



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couple of weeks back. If banks are unwilling to lower loan rates, it is because their margins are getting squeezed.

The June quarter results reveal net interest margins for several banks have contracted, even though most loans remain tethered to the base rate.

The contraction has resulted from a combination of the shift to the MCLR, the high level of non-performing assets, an abundance of funds and the subdued loan growth. Deposits are growing at a brisk 10%, but since there are few takers for loans, banks remain reluctant to cut the base rates because it would translate into an immediate fall in yields. Indeed, many lenders have made it unviable for retail borrowers to migrate to the MCLR. Until they are sure a cut in the base rate will be accompanied by a surge in loan volumes, which would compensate for the lower yield, they will not make loans much cheaper.

Transmission might have been faster if the balance sheets of lenders had been in better shape and they had not needed to make large provisions for potential loan losses. Although slippages might be reducing, these remain large in absolute terms; while these are not rising sharply, they are not slowing down. In the meanwhile, banks are content to wait for quality assets rather than take on more risk.

Moreover, they are willing to pick up assets in the corporate bond market or the Commercial Paper (CP) market even if it means lower yields since these would account for a small share of the portfolio. In contrast, a cut in the base rate would mean a significant fall in the interest income and a contraction in margins. RBI has said it plans to review the MCLR mechanism, which was introduced in April 2016. However, given how banks seem determined to protect their margins, it is unlikely that even a new formula will see them lowering loan rates beyond a point.