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RBI policy: Home loans become dearer; short term funds a go to option

Moneycontrol News

The Monetary Policy Committee (MPC) of Reserve Bank of IndiaÂ (RBI) has decided to hike policy rates by 25 basis points, which wouldÂ push interest rate on home loans and have a positive impact on fixed deposits.

The move has made it clear that the benign rates regime is behind us and interest rates are going to go up.

For the uninitiated, RBI raised repo and reverse repo rate by 25 basis points to 6.25% and 6%, respectively.

â€œCrude oil prices are rising and that will ensure that we see higher inflation. That makes a strong case for one more rate hike by at least 25 basis points in CY2018,â€said Abhinav Angirish, founder and CEO of investonline.in.

He was of the view that floating home loan rates would increaseÂ as marginal cost of lending rates would go up for banks in the near future. For example, equated monthly installments (EMI) on a Rs 50-lakh loan for 20-year period would go up by Rs 801 if the interest rate payable moves up to 9% from 8.75%.

The floating interest rate on home loans are linked to MCLR of the bank. As the banks revise MCLR, home loan borrowers will face burden of additional EMI. The floating rate top up loans and auto loans are expected to follow with higher interest rates.

â€œGoing by the global cues the interest rates are going to go up in India. If you have some spare funds, do consider prepaying your home loan,â€ said Vishal Dhawan, founder and Chief Financial Planner at Plan Ahead Wealth Managers.

Experts are of the opinion that this is the beginning of the rate hike cycle. A report published prior to the MPC announcement by HSBC Global Research mentioned that there will be two hikes of 25 basis points each in 2018. The fixed deposit rates too are expected to go up in near future. Banks are already in the process of hiking interest rates on fixed deposits. For example, State Bank of India has raised interest rates by up to 20 basis points on 28 May.

The market also expected interest rates to move up. The expectation of a spike in inflation ensured that yields in the secondary market keep rising. Investors saw the 10-year benchmark bond yield move up to 7.88 percent from a low of 6.18 percent recorded on December 7, 2016. This has resulted in mediocre returns for investors holding long term bonds. For example, long term gilt funds have delivered 0.44% returns over past one year.

â€œInvestors in long term gilt funds and dynamic bond funds should consider switching to short term bond funds,â€ said Dhawan.Â Short term bond funds as a category gave 5.26% returns over the past one year. Investors with a marginally higher risk ability may consider investing in credit opportunities fund.

Investors in the lower income tax bracket would be better off investing in short term fixed deposits up to one year, as they can roll over their deposits at a higher interest rate going forward.