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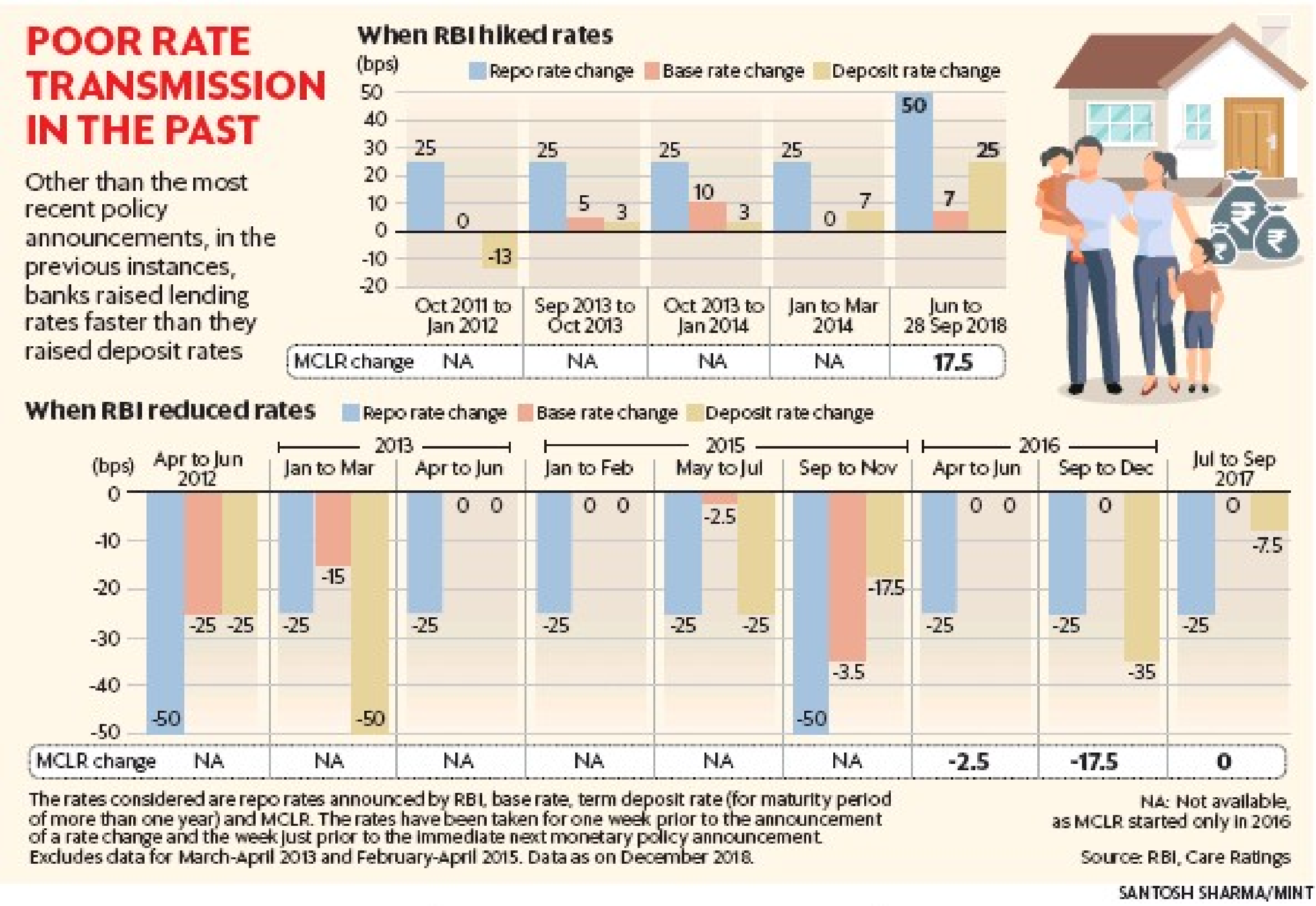
NO CHANGE IN RETAIL LENDING, DEPOSIT RATES ANYTIME SOON

Historically, when RBI reduces policy rates, deposit rates go down immediately, but that's not expected this time

RBI's next policy review is slated for April and analysts are already expecting a rate cut of another 25 bps

The Reserve Bank of India (RBI) on Thursday announced a reduction in its benchmark repo rate by 25 basis points, taking it down to 6.25%. The repo rate or the repurchase rate is the rate at which RBI lends money to banks when they face shortage of funds. A reduction in policy rates could be read as a positive development for borrowers and a negative one for depositors. However, the actual changes in lending and deposit rates may not be in line with the movement in the policy rate, particularly this time.



DEPOSIT RATES

Past experience suggests that banks increase lending rates at a faster pace when RBI increases its policy rates compared to increase in their deposit rates. On the other hand, when RBI reduces rates, the pace of reduction of lending rates by banks is slower compared to the pace of reduction of deposit rates.

However, the situation is expected to be different this time, and deposit rates, too, are not expected to go down immediately. Madan Sabnavis, chief economist, Care Ratings, said this time there may be some sluggishness on this front as growth in deposits has been slow this year and banks may only selectively lower rates. “Deposit rates will not come down too soon as today the liquidity issue has arisen mainly due to credit growing faster than deposits,” he said.

Other analysts, too, are expecting the same. “Transmission of cut in polmeet icy rates may be a challenge for banks given slow incremental build-up in their deposits,” said Anil Gupta, sector head, financial sector ratings, Icra Ltd.

This is because there is high credit demand at present and there is not sufficient growth in deposits to fulfil credit demand. “At a time when the banking system deposits are growing at 9% and banking system credit is growing at 14-15%, there will be an emphasis on raising resources. So it will be difficult for banks to cut deposit rates. So probably it may not immediately result in transmission. The transmission might happen after 31 March,” said Ashutosh Khajuria, executive director and CFO, Federal Bank. According to a Crisil report, growth in bank credit in the next two financial years is expected to be around 13-14% compared to a bank credit growth of 8% in 2017-18. To this credit growth, banks will have to raise about □25 trillion over the two FYs. “While □5-6 trillion is expected to become available through the release of statutory liquidity ratio (SLR) funds, about □20 trillion would need to be raised through fresh deposits,” the Crisil report said. This would result in an upward pressure on interest rates banks offer on deposits.

The prevailing small savings rate will also deter banks from reducing deposit rates immediately, said Vishal Dhawan, founder, Plan Ahead Wealth Advisors.

BORROWING RATES

While historically a rate cut transmission in lending rates have been slower, it may not have any immediate impact this time given that the banks may not lower deposit rates, which impact lending rates of banks. Accordingly, if there is no impact on deposit rates, lending rates are also unlikely to go down. The lending rates for new loans since April 2016 are decided based on the marginal cost of funds-based lending rate (MCLR). The deposit rate determines the cost of funds for banks and if the deposit rates do not go down, then the cost of funds does not reduce and, hence, the lending rate would also not come down.

Even for existing borrowers, the new rate is applicable from the date of reset of loans, which typically happens once a year. So borrowers expecting a reset in the near future will not see the benefit of the rate cut.

WHAT HAPPENS NEXT

Though deposit and lending rates are not expected to go down immediately, another 25 bps rate cut is expected in the next financial year, starting April. RBI’s next monetary policy review is slated for April.

RBI has also changed its stance from “calibrated tightening” to “neutral”. Calibrated tightening refers to a situation where a rate cut is ruled out in the existing rate cycle. A neutral policy will mean that depending upon the situation, RBI can increase or decrease interest rates. This was apparent in what RBI governor Shaktikanta Das said in the post-policy press conference—that decisions of the committee will be data driven.

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