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Will last week’s policy rate cut get transmitted to consumers?

- Transmission of rates has been taking place and will continue to take place going forward.
- Deposit rates will fall at a slower pace as a result of competition against small savings rates, coupled with higher credit growth vis-a-vis deposit growth.

The Reserve Bank of India last week cut the repo rate by 35 basis points with the intent to support the economy’s growth by boosting aggregate demand and private investment. The unconventional rate cut figure of 35 bps has raised hopes of a transmission to the end consumer in terms of loans and deposits rates. Until now, the transmission has been slow though this is the fourth rate cut in a row—the policy rate is down from 6.25% in February 2019 to 5.4% now. Disha Sanghvi asks experts whether the lower policy rate will finally get transmitted and increase consumption, giving the much-needed fillip to the economy

Policy rate transmission is not enough to boost economy

—Shanti Ekambaram, president, consumer banking, Kotak Mahindra Bank

From February 2019, interest rates have seen a downward trend and we have seen both deposit and lending rates coming down. Transmission of rates has been taking place and will continue to take place going forward. As deposit rates come down and, consequently, cost of funds for banks, the pace of transmission will increase. With a 35 basis points rate cut, expect this trend to continue.

Policy rates have been coming down since February 2019 and liquidity in the system has increased significantly. However, consumption and demand has slowed down. So the key question is whether interest rate alone is sufficient to boost consumption, demand and investment that are needed for growth. A look at the current trends in the auto sector clearly indicates that a lower rate alone is not sufficient. We also need measures to restore consumer confidence and boost investment and demand.

The move to reduce risk weightage for certain types of consumer loans from 125% to 100% is another step in the right direction, which will give further boost to retail credit.

Borrowing rate cuts will remain lower than RBI rate cuts
—Vishal Dhawan, certified financial planner and founder, Plan Ahead Wealth Advisors

Transmission of interest rate movements tends to be limited, and this is likely to be a challenge this time too. The transmission has been only 29 basis points thus far, in spite of the rate cuts being 75 basis points before the current cut. If you add the accommodative stance, the effective impact should have been higher.

Small savings rates remain high, and rate cuts on small savings have been limited due to the dependency of the government on them to fund their spending plans. Deposit rates will fall at a slower pace as a result of competition against small savings rates, coupled with higher credit growth vis-a-vis deposit growth. Borrowing rate cuts will remain lower than RBI's rate cuts. Banks will only be in a position to protect their margins in this manner, especially with a slowdown in their fee business

The sharp fall in consumption has been driven by a combination of domestic factors as well as global fears emanating from the trade wars resulting in lower exports. Thus, rate cuts will have to be accompanied by private and public sector investments to bring growth back.

Deposit, credit growth rate gap slowing down transmission
—Naveen Kukreja, CEO and co-founder, Paisabazaar.com

Despite the nudge from the central bank, transmission of policy rate cuts to the end borrower has not happened in entirety.

Since February this year, the repo rate has been cut by 75 basis points (110 bps if we include the latest rate cut), whereas the reduction in fresh loan rates during the same period has only been 29 bps.

One of the major factors for such slower transmission is the gap between deposit and credit growth rates. This gap along with the higher interest rates offered by small savings schemes has prevented banks from aggressively reducing their deposit rates.

Moreover, the proportion of funds sourced through the repo window is very small when compared to the funds mobilized through bank deposits.

Both the factors have limited the transmission of rate cuts in the same proportion. I hope this 35 bps cut translates into a reduction of at least 20 bps in MCLR, if not more. Swifter rate transmission will play a crucial role in reviving consumption and increasing competitiveness of our producers through reduced cost of capital.

Reducing costs of banks will lead to better transmission
—Saugata Bhattacharya, chief economist, Axis Bank

The surprisingly unconventional 35 basis points repo rate cut raises two issues. First, the likely transmission into lending rates and second, the boost to consumption and investment to lower loan rates. Transmission is currently a work in progress. The momentum is likely to accelerate with the current surplus liquidity. RBI infusion of durable funds and other structural drivers will keep conditions comfortable over the year, leading to a reduction in the cost of funds. Relaxations in micro prudential norms will incrementally increase funds to credit-squeezed sectors.

The response of consumption and investment to lower borrowing costs will depend on the slowdown causes—cyclical or structural. The proximate reasons, with global and domestic drivers, are cyclical, but there are some underlying structural shifts. Reforms and regulatory changes seems to have adversely affected consumer confidence. Hence, in addition to lower borrowing costs, reviving sentiment and, thereby, capex will require a more coordinated approach to a stimulus, using fiscal, tax, industry, trade and other levers.