BWR sees a southern trend in interest rates; Looks out for quicker transmission of rates

Brickwork Ratings, 07 August 2019, Mumbai: The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) reduced the key policy repo rate by 35 bps to 5.40%; which is a fourth consecutive cut in the policy rate and the lowest repo rate since April 2010. The MPC decided to keep the stance unchanged as accommodative, in line with BWR expectations.

“The recent 35 bps Repo rate cut by RBI has established southward trend in interest rates. The monetary easing is more on account of factoring the global and domestic slow down, trade tensions and downward risk to the economy and need for boost private investments. At the backdrop of quarter over quarter decline in GDP and some indication of inverted yield curve, the recessionary trend could not be overlooked by RBI leading to the largest cut in the recent past,” **Bal Krishna Piparaiya, Senior Director-Ratings, Brickwork Ratings** said.

Four members including Ravindra H. Dholakia, Michael Debabrata Patra, Bibhu Prasad Kanungo and Shaktikanta Das of the MPC, including the Governor of RBI decided to reduce the policy repo rate by 35 basis points while two members – Chetan Ghate and Pami Dua voted for reducing the rates by 25 bps.

This is largely to address the overall growth concerns by boosting aggregate demand especially private investments. Also, lower inflation provided further room for a rate cut in today's policy review. The Central Bank has revised the country’s real Gross Domestic Production (GDP) growth projections to 6.9% from 7% prior estimated. They have estimated growth to be in the range of 5.8-6.6% for the first half of 2019-20 and 7.3-7.5% for the second half – with risks somewhat tilted to the downside.

The MPC release noted that the transmission of policy repo rate cuts to the weighted average lending rates (WALRs) on fresh rupee loans of banks has improved marginally since the last meeting of the MPC. Overall, banks reduced their WALR on fresh rupee loans by 29 bps during the current easing phase so far (February-June 2019).

“However, historically the transmission of rates has been slower at the back of little legroom with the banks to reduce corresponding existing low deposit interest rate. Another factor restricting the transmission has been that the Term deposits mostly carry fixed rates of interest while Credit is priced at floating rates causing interest rate risk in declining rate scenario. SBI has just announced a 15 bps cut in their interest rates, indicating the trend. Economists and bankers have previously made some suggestions for effecting quicker transmission, and these need a deliberation,” **Piparaiya** added.

The RBI, in its statement on development and regulatory policies, highlighted the steps it has undertaken to enhance credit flow to the Non-Banking Finance Companies (NBFCs) and Housing Finance Companies (HFCs). Further, RBI announced two more key measures to provide further support to these sectors. RBI raised a bank's exposure limit in a single NBFC to 20% of the Tier-I capital of the bank against the current 15%. Further, to aid flow of credit to priority sectors, RBI has allowed bank lending to NBFCs (non MFIs) for on-lending to agriculture, MSMEs and affordable housing (meeting certain exposure thresholds) to be considered as priority sector lending.

Commenting on this development, **Rajat Bahl, Chief Analytical Officer & Head - Financial Institutions, Brickwork Ratings** said, "The raising of exposure limit to NBFCs may not provide much of aid relief to the NBFC sector in the short term, as the currently available 15% is also not fully utilised, given the risk aversion of banks towards NBFCs at the moment". "The other measure of allowing priority sector tag to bank loans extended to registered NBFCs for financing agriculture, MSMEs and homebuyers within specified limits, can increase the credit flow to NBFCs serving these segments to an extent." **Bahl** added.

The RBI also provided a much-needed relief to the banks by easing the capital requirements for consumer credit excluding credit cards, reducing their risk weight from the current 125% to 100%. As per Brickwork Ratings estimate, this would provide a capital relief of ~Rs. 30,000 crore to the banking sector.

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