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# Return on credit higher than return on banks surplus funds deployed with RBI: **Brickwork Ratings**

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The one-year return on credit that banks can earn by lending to corporates is high at about 8 per cent vis-à-vis the return of 3.35 per cent they will earn by parking their excess funds with the Reserve Bank of India (RBI), according to an analysis of return on funds deployed by banks by Brickwork Ratings (BWR).

The additional profit that banks would have earned had they given loans instead of deploying their surplus funds with RBI is about Rs 34,000 crore, the credit rating agency said.

**How?**

Referring to banks deploying about Rs 7 lakh crore (as on May 21) at the RBI's reverse repo window, BWR assessed that this could have fetched them around Rs 23,450 crores as interest. However, if these funds were deployed as loans to corporates ('AA' to 'BBB' rating), the earning for banks would have been around Rs 57,445 crore in a year.

**Return on credit higher**

In the case of funds deployed by banks via lending to corporates, the assumptions are that the weighted average lending rate is 12 per cent; the weighted average default rate is 5 per cent; and the recovery rate is 33 per cent. Taking these three parameters into account, the interest earned works out to Rs 82,343 crore.

As per BWR's analysis, after taking into account the credit cost, based on defaults and recovery (Rs 24,898 crore), banks earn Rs 57,445 crore from deployed funds.

Rajat Bahl, Chief Ratings Officer, BWR, "For a meaningful transmission of RBI measures into higher bank credit, the reverse repo rate has to be brought down sharply and very close to the savings deposit rates offered by banks.

"This will dissuade banks from parking funds with the RBI, and they will start looking out for credit deployment while pricing the risk appropriately".

**RBI rate cut**

In an off-cycle rate cut announced on Friday, the RBI cut the policy repo rate (the interest at which banks borrow funds from the central bank to overcome short-term liquidity mismatches) from 4.40 per cent to 4 per cent. Simultaneously, the reverse repo rate (the interest rate banks earn on deploying surplus funds with RBI) came down from 3.75 per cent to 3.35 per cent.

Along with the repo rate cut, the RBI also announced additional measures, including giving relief on debt servicing for three more months and increasing a bank's exposure to a group of connected counterparties, to further ease financial stress caused by COVID-19 disruptions.

Vydianathan Ramaswamy, Director, BWR, observed that RBI has taken bold measures to counter the impact of COVID-19 and build enough liquidity and credit buffers for India Inc to kickstart business operations as the nationwide lockdown is being lifted in phases.

"However, despite concerted efforts by the RBI, banks' high-risk perception of the current economic environment continues to be a dampener in stepping up credit to India Inc.

"This is clearly evident from the significant jump in excess funds parked by banks with the RBI, which nearly doubled to about Rs.7.2 lakh crore as on 21 May 2020 from about Rs 3.8 lakh crore as on 31 March 2020 and from a relatively low level of about Rs 1.5 lakh crore as of 31 December 2019," Vydianathan said.