

RBI cuts interest rate, raises hopes of cheaper home loans, EMIs

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The Reserve Bank of India (RBI) cut a key lending rate to a six-year low in a surprise move on Tuesday, raising hopes of cheaper home loans and EMIs that could help fire demand ahead of the festive season.

The decision to slash the repo rate – the rate at which banks borrow from the central bank -- to 6.25% from 6.50% was the first by the newly-formed Monetary Policy Committee (MPC) headed by RBI governor Urjit Patel, who took over from Raghuram Rajan on September 6.

The RBI – which said all six members voted in favour of the cut -- cited falling inflation as the reason for the move, surprising markets that were widely expecting a status quo.

“On the whole, this is a decision which will go down well with all sections of the economy,” Union finance secretary Ashok Lavasa said in Delhi.

Banks are expected to pass on the rate cut benefits to their customers by offering home and vehicle loans at cheaper rates. The EMIs -- equated monthly instalments -- of existing customers are also likely to come down.

The central bank has reduced the key interest rate by 175 basis points since January 2015, but banks – saddled with bad loans totaling billions of dollars -- have been reluctant to pass on the entire benefits to consumers.

On Tuesday, the RBI nudged banks to take a cue from cut in small saving schemes – announced by the government last week -- and pass on benefit of the interest rate cut to consumers.

“We shall continue to watch out for economic data and accordingly address transmission of interest rates,” said Shanti Ekambaram, president of Kotak Mahindra Bank’s consumer banking division.

Along with the unexpected rate cut, analysts feel, a massive pay out for government employees will leave extra cash in people’s pocket at the beginning of the festive season.

The markets reacted positively to the RBI announcement with the BSE Sensex rising 0.33% while the broader NSE Nifty was up 0.34%. The rupee extended gains to 66.40 per dollar from 66.47 in afternoon trading.

Retail inflation eased to a five-month low of 5.05% in August, within the committee’s 2-6% objective, and is expected to ease further in the months ahead after a good monsoon has sent food prices sharply lower, the bank said.

“The decision of the MPC is consistent with an accommodative stance of monetary policy in consonance with the objective of achieving consumer price index inflation at 5% by Q4 of 2016-17 and the medium-term target of 4%, while supporting growth,” the RBI explained.

The RBI and the government have set a new retail inflation target of 4% for the next five years with an upper tolerance level of 6% and lower limit of 2%.

High inflation hurts people's buying power, while low levels can indicate poor demand and weak economic activity. The government has also been pushing for cut in the repo rate to spur economic growth.

Patel credited the government for actions that had helped reduce structural constraints on supply that typically drive up inflation in India, including through investments in railways and roads.

"The proactive food management has played a crucial role in the past two years and will continue to play a crucial role in time to come."

The central bank, however, warned of risks to growth next year due to muted private investments and weak global demand coupled with geopolitical risks.

"The inflation outlook for 2016-17 has improved, but close vigilance is required to achieve the prospects of reaching 4 per cent. Robust consumption brightens the outlook for real gross value added growth in 2016-17, but muted private investment and weak global demand may restrain the pace of growth in 2017-18," the bank said in its monetary policy report.