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Loan EMIs to go up as RBI raises Repo rate by 40 bps

Banks may also raise deposit rates, bringing some cheer to those planning to open FDs

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By Nachiket Kelkar (<https://www.theweek.in/authors.nachiket-kelkar.html>)

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Get set to pay a higher rate of interest for your mortgages, as the Reserve Bank of India on Wednesday, unexpectedly raised the benchmark Repo rate by 40 basis points to 4.4 per cent. At the same time, banks could also now raise deposit rates, which could bring some cheer for those planning to open fixed deposits.

The Reserve Bank had slashed the Repo rate (rate at which a central bank lends to commercial banks) by 115 basis points between March and May 2020 as a part of several measures taken to mitigate the impact of Covid-19. This reduction in interest rates was on top of the 135 basis points interest rate cuts between February 2019 to February 2020.

This rate reduction, coupled with ample liquidity available in the system, helped banks slash their lending rates, while deposit rates also fell. Several banks have been offering home loans at interest rates as low as 6.5 per cent.

That is now about to change, with the Reserve Bank moving to raise the Repo rate by 40 basis points, while also hiking the cash reserve ratio (CRR) by 50 basis points to 4.5 per cent. This will effectively mop up more liquidity from the system and drive up cost of funds for banks. In recent weeks, some banks had started raising their lending rates amid tightening liquidity conditions. With Wednesday's Repo rate hike, more banks may now follow suit.

"The simultaneous 50 bps CRR hike would tighten liquidity, which would improve the transmission of rate hike in credit and debt market. We expect immediate increase in money market rate, some transmission in the long-term bond market and also credit market (both lending and deposit rates)," said Sujana Hajra, chief economist at Anand Rathi Shares.

Retail borrowers who had floating-rate home loans and those linked to external benchmarks like the Repo may particularly see an immediate impact.

"With inflation edging higher in the aftermath of the Russia-Ukraine war and the surging oil prices, the RBI took a tough unscheduled decision to increase the Repo rate. This was expected as inflation has definitely moved into the threatening zone. Unfortunately, for home buyers, this hike signals imminent end to the all-time low interest regime, which has been one of the major drivers behind home sales across the country since the pandemic began," said Anuj Puri, chairman of real estate consulting firm Anarock.

The surprise rate hike by RBI comes ahead of the meeting of the Federal Reserve later on Wednesday, where the US central bank is expected to raise rates by up to 50 basis points.

"The combination of 40 bps hike in Repo rate and 50 bps hike in CRR is an attempt by the RBI to preempt the rising inflationary pressures and be ahead of the curve. The bigger surprise was the CRR hike, which indicates the RBI's intent on withdrawing liquidity at a sharper pace. Rates across the curve will reprice

factoring in a markedly more hawkish RBI,” said Suvodeep Rakshit, senior economist at Kotak Institutional Equities.

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Governor Shaktikanta Das.

Prices had been rising over the last few months and while the RBI had begun reducing the liquidity in the system, analysts had said an interest rate hike would be eventually necessary. The very fact that the RBI announced the Repo rate hike in an unscheduled meeting, highlights the urgency of the move, said Rajani Sinha, chief economist at CARE Ratings.

“It is very critical at this point to anchor inflationary expectations to avoid wage-price spiral. The global developments in the last few weeks have highlighted that this battle against inflation could be a long-drawn affair and the central bank has aptly accelerated its fight against inflation,” said Sinha.

Looking ahead, interest rates are only expected to harden further. Kotak’s Rakshit, for instance, expects the Repo rate to go up 100-125 bps in the current financial year ending March 2023.

Madhavi Arora, lead economist at Emkay Global Financial Services, feels policy rates could go up 125-150 bps this financial year. She expects a 25 bps rate hike in the next monetary policy committee meeting in June.


“The sharper than expected rate increase by the RBI today paves the way for a more aggressive rate hike cycle than we earlier expected. The renewed focus on inflation and rising inflationary risks makes a case for a higher terminal policy rate in this rate cycle. We expect three more rate hikes in this fiscal by the RBI now with the Repo rate likely to end the year at 5.15 per cent,” said Abheek Barua, chief economist, HDFC Bank.

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