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Why don't banks cut lending rates after RBI repo rate cuts? Well, they do, only some time later

By: [Surbhi Jain](#)

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In the last financial year 2019-20, the Reserve Bank of India first cut repo rates thrice, announcing one cut of 35 bps, and two of 25 bps each, bringing the policy rate down from 6% in April 2019 to 5.15 per cent



In May this year, in another unscheduled meeting, [RBI's Monetary Policy Committee \(MPC\)](#) slashed the policy repo rate by 40 basis points

Interest rate transmission and the efficacy of repo rate cut have always been a matter of debate in India. Do banks follow up RBI's monetary policy rate cuts with matching cuts in lending rates, as is usually expected? It's the banks' interest rate cuts that help borrowers and enhance lending. However, there is an argument that the transmission is not as swift as it should be, [CARE Ratings](#) said in a report.



Repo rate, bringing the policy rate down from 5% in April 2019 to 4.4% per cent. Later, amid the nationwide lockdown in the last week of March, the apex bank further cut the policy repo rate by 75 bps in a surprise move, ending FY20 with a total reduction of 160 bps in repo rate to 4.4 per cent, in an attempt to spur the faltering economic growth in the aftermath of the COVID-19 pandemic. In May this year, in another unscheduled meeting, RBI's Monetary Policy Committee (MPC) slashed the policy repo rate by 40 basis points to contain the economic fallout of the coronavirus-induced lockdown.

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But do these repo rate cuts result in bank lending rate cuts?

According to the CARE Ratings report, there is a theoretical reason for the interest rate transmission to be slow, which can take over six months, provided banks lower the deposit rates. But, such deposit rate cuts may not happen across the board, depending on the funds situation of various banks. After looking at the response rate of market yields, lending rates and deposits rates to the quantum of repo rate cuts for the

period April 2019 to May 2020, CARE Ratings' analysis showed that the transmission process has been responsive to policy cuts and sharper for lending rates than deposit rates. "We can hence expect monetary policy to wield considerable power over the movement of overall lending rates in the system," it said.

How banks' deposit rates move after RBI repo rate cuts?

RBI presented data on the weighted average monthly term deposit rate on outstanding deposits which provided an insight into how banks repriced their deposits following the repo cuts. "According to the data, the first stage of FY20 when the repo rate was lowered by 85 bps the weighted average term deposit rate for all banks came down by around 50 bps with foreign banks and private banks being more aggressive in lowering these rates," CARE Ratings said.

However, CARE Ratings highlighted that on the lending side, the transmission had been swifter. Following a 160 bps cut in 14 months, the weighted average lending rate (WALR) came down by 122 bps. "Monetary policy action hence can be said to have been quite effective in terms of transmission and depending on the evolving situation can be expected to play an important part in guiding the direction of interest rate movements.



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