

Impact of RBI Repo Rate on Select Borrowers in India

Venu Kesireddy* and Kushini Prasad**

ABSTRACT

The RBI focuses on formulating and enforcing a sound monetary policy that has clearly defined goals, objectives, and tools to be put into action. The repo rate is one of the most important tools that the Reserve Bank of India (RBI) uses in their monetary and credit policy, and this paper makes an attempt to study it. As a mechanism for managing liquidity, it allows the RBI to either increase or decrease the repo rate in order to maintain stability in the economy. This helps combat inflationary movements that may have led to a sudden increase in the prices of goods and services that people use on a day-to-day basis and slows down the investment-related activities that are taking place in the country. On the other hand, when there is an economic downturn, the Reserve Bank of India lowers the repo rate. This, in turn, causes banks to lower the interest rates they charge on loans to the general public.

Keywords: Repo rate; Monetary and credit policy; Control inflation; Basis points; Monetary policy committee.

1.0 Introduction

The Reserve Bank of India (also known as RBI) is India's central bank. RBI carefully monitors the state of the Indian economy in order to arrive at a conclusion regarding the appropriate level for the repo rate. The rate at which the Reserve Bank of India (RBI) provides commercial banks with credit in exchange for their treasury bills is known as the Repo rate. The six-person Monetary Policy Committee is responsible for determining the repo rate. This committee meets twice a month to discuss whether the repo rate should be increased, decreased, or kept the same. In May 2022, the RBI raised the repo rate to 4.4%, and then they raised it again in June 2022 to 4.9% by increasing it by another 50 basis points. The reverse repo rate in the country is currently sitting at 4.9% as of right now. The interest rate that your bank charges you to borrow money through loans is directly influenced by the repo rate. Let's get into the nitty-gritty of what the repo rate is and how it impacts the interest rate that regular people pay on loans.

*Corresponding author; Assistant Professor, Department of Business Management, Vaagdevi College of Engineering, Warangal, Telangana, India (E-mail: kesireddyvenu@gmail.com)

**Associate Professor, Department of Business Management, Balaji Institute of Management Sciences, Warangal, Telangana, India (E-mail: kushiniprasad7730@gmail.com)

1.1 Objectives of the study

- To study and analyze the effect of changes in Repo rate on borrowers with reference to personal loans, auto loans, home loans and education loan.
- To offer conclusions and suggestions.

1.2 Data and methodology

The study is based mostly on secondary data from official sources. Information regarding the changes in Repo rate had been obtained from official website of RBI and publication from newspapers and journals

2.0 Review of Literature

There have been a lot of studies that have been looked at, and the ones that have been looked at the most closely are the works that are closely related to the shift in the interest rates that are used in the Indian monetary policy. Prof. Pallavi Ingal (2012) According to the findings of her research, which she presented, “Despite RBI’s desperate attempt to bring the monster of inflation under control, it connotes a good sign in controlling inflation.” The Reserve Bank of India (RBI) is continually working to raise interest rates, which will most likely slow economic expansion in the near term but is unquestionably a step that will assist in correcting numerous anomalies that are currently afflicting the economy. As a result, the Indian industry at the macro level helps an economy to get back on the growth track, which enables it to expand at the rate that is most consistent with its true potential.

Nitya Dawra (2014) In her study, titled “An Empirical Analysis,” she demonstrated that the RBI’s repo rate and reverse repo rate are monetary policy instruments that can be used to control the money supply in the country. Both of these rates were discussed in her case study. The Reserve Bank of India (RBI) is a reliable borrower for money, so financial institutions have no qualms about giving it to them. The seminal work of Taylor (1993) the monetary policy reaction function has been discovered. It states that the nominal interest rate will be increased by central bankers if inflation is higher than the target (referred to as an inflation gap) and/or output is higher than the potential (referred to as an output gap), and vice versa.. Selim (2011) Inflation-targeting countries take into account the exchange rate as they construct their monetary policy in order to account for the impact that the exchange rate has on the decision-making process regarding monetary policy.

3.0 Borrowing of Repo Rate

In the same way that a borrower is required to pay interest on the loan they receive from their bank, banks are also required to pay interest on the money they borrow. The Reserve Bank of India (RBI) extends loans to any and all commercial banks in exchange for the sale of eligible securities like treasury bills. When faced with a shortage of cash and a demand for liquidity in order to carry out their regular banking operations, banks typically

turn to borrowing money in the form of loans. The rate at which commercial banks are required to make interest payments to the Reserve Bank of India is referred to as the Repo Rate. Repo is an abbreviation that can refer to either the Repurchase Option or the Repurchase Agreement.

RBI Hikes Repo Rate - How Will It Impact You?

The monetary policy panel of the Reserve Bank of India raised the key lending rate, which is also known as the Repo Rate and interest rates, by 25 basis points to 6.50% in order to combat inflation for the fourth time in a row. This move brings India in line with a long line of financial institutions and central banks that have taken similar actions in order to combat the effects of a rising dollar and rising costs.

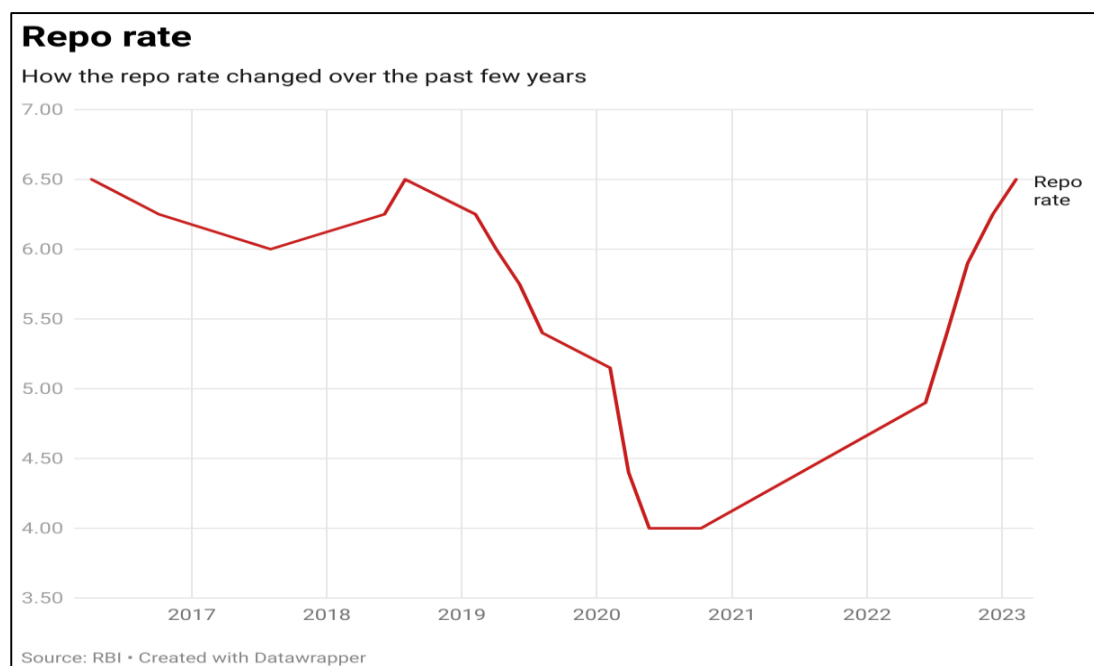
Five of the six members of the monetary policy committee (MPC) voted in favor of the increase in the reserve requirement ratio. The MPC is made up of three members from the Reserve Bank of India (RBI) and three members from outside the RBI.

Table 1: RBI Repo Rate as of 08 February 2023

Repo Rate	6.50%
Reverse Repo Rate	3.35%
Bank Rate	6.50%
Marginal Standing Facility Rate	6.50%

Source: <https://www.rbi.org.in>

Figure 1: RBI Repo Rate Changed Over the Past Few Years



Listed below is the Repo Rate increase history of 2022:

- On December 7, 2022, the Repo Rate was increased by the Reserve Bank of India (RBI) by 35 basis points, bringing the rate up to 6.25% and marking the fourth hike or increase in the Repo Rate in 2022.
- Earlier today, the Reserve Bank of India (RBI) announced that they will be increasing the Repo Rate by 50 basis points to 5.9% on September 30, 2022.
- Earlier in the day on August 05, 2022, the Federal Reserve Bank had also increased the Repo Rate to 5.4%.
- Following the announcement, the Reverse Repo Rate remained unchanged at 3.35%, whereas the most recent information regarding the RBI Repo Rate indicated that the new repo rate is currently 6.50%.

In this article, which is based on recent news from the Reserve Bank of India (RBI), we have discussed how an increase in the Repo-Rate by the RBI will have an effect on the Economic Growth of the country, as well as its influence on Inflation, as well as its effect on Loans, EMIs, Deposits, Fixed Deposit Rates, Mutual Funds, Savings, and Consumer Spending, etc.

The change in repo rate in India since October 2005 can be summed up as follows:

Table 2: RBI Repo Rate Cut History 2023 -2005 (Current and Past Repo Rates)

Effective Rate	Repo Rate
8 February 2023	6.50%
7 December 2022	6.25%
30 September 2022	5.90%
5 August 2022	5.40%
8 June 2022	4.90%
May 2022	4.40%
09 Oct 2020	4.00%
06 Aug 2020	4.00%
22 May 2020	4.00%
27 March 2020	4.40%
6 February 2020	5.15%
07 August, 2019	5.40%
06 June, 2019	5.75%
04 April, 2019	6.00%
07 February, 2019	6.25%
01 August, 2018	6.50%
06 June, 2018	6.25%
02 August, 2017	6.00%
04 October, 2016	6.25%
05 April, 2016	6.50%
29 September, 2015	6.75%

02 June, 2015	7.25%
04 March, 2015	7.50%
15 January, 2015	7.75%
28 January, 2014	8.00%
29 October, 2013	7.75%
20 September, 2013	7.50%
03 May, 2013	7.25%
17 March, 2011	6.75%
25 January, 2011	6.50%
02 November, 2010	6.25%
16 September, 2010	6.00%
27 July, 2010	5.75%
02 July, 2010	5.50%
20 April, 2010	5.25%
19 March, 2010	5.00%
21 April, 2009	4.75%
05 March, 2009	5.00%
05 January, 2009	5.50%
08 December, 2008	6.50%
03 November, 2008	7.50%
20 October, 2008	8.00%
30 July, 2008	9.00%
25 June, 2008	8.50%
12 June, 2008	8.00%
30 March, 2007	7.75%
31 January, 2007	7.50%
30 October, 2006	7.25%
25 July, 2006	7.00%
26 October, 2005	6.25%

Source: <https://www.rbi.org.in>

3.1 RBI repo rate on personal loans

The rate at which the Reserve Bank of India (also known as the RBI) lends money to commercial banks is known as the repo rate. The term “Repo rate” refers to the “Repurchase Rate.” The Repo rate is the interest rate at which the Reserve Bank of India (RBI) provides commercial banks with credit in exchange for collateral such as government securities. According to the terms of the agreement, these collaterals will be repurchased at some point in the future at a predetermined price. The CRR refers to the portion of deposits that are made to the RBI by commercial banks.

A reduction in the Repo rate will bring about a reduction in the cost of borrowing money for both commercial banks and individual borrowers. The interest rate at which financial institutions provide credit, such as personal loans, mortgage loans, and so on, is

referred to as the cost of credit. Alternately, the interest rates on loans will be lowered. This will also result in a decrease in the Cash Reserve Ratio (CRR), which will result in an increase in the amount of credit that is available to individuals.

3.2 RBI has increased the repo rate to 4.40%

The Reserve Bank of India (RBI) increased the benchmark lending rate, also known as the repo rate, by forty basis points (bps) on Wednesday, May 5, 2022, bringing it up to 4.40%. Since August 2018, this is the first hike since then. The unexpected increase in the repo rate marks the very first time that the Monetary Policy Committee (MPC) has done something like this. Inflation, which had been consistently higher than the target of 6% for the previous three months, required a hike of this magnitude in order to be brought under control.

The decision made by the RBI will have an effect on individuals who have taken out loans to purchase homes or vehicles. In order to retrieve Rs.87,000 crore from the banking system, the MPC, which is led by the Governor of the RBI and is named Shaktikanta Das, increased the required deposit amounts that banks must keep as a cash reserve by increasing it by 50 basis points to 4.5%. On May 21st, the increased CRR will become fully operational.

Given this, it is expected that lenders will pass on this rate cut to borrowers. As a result, if you have borrowed loans for which the interest is calculated on a floating basis, your payable EMI is likely to reduce. That said, although the reduced repo rate is expected to lower the interest charged by lenders, the actual quantum of change in the interest rate will depend on a number of other factors such as the lender's operating costs and the cost of deposits, among other things.

Thus, if you are looking to borrow a personal loan, you could benefit from a reduced interest rate due to the Reserve Bank of India's recent rate cut.

Example, if the repo rate is 5% and the loan amount that the bank has availed from the RBI is Rs. 1000, then the interest paid out by the bank on the same would be Rs. 50. Therefore, a lower repo rate indicates lower interest rate charged on loans availed from these banks by regular customers.

Repo Rate cuts influence the lending rate or rate of interest on all mortgages such as personal loans, car loans, housing loans, etc. This reduction in the rate of interest is expected to increase demand for these products. A reduction in the Cash Reserve Ratio would enhance the availability of funds and bring in more liquidity to the banking system. This will alternately affect the economy as well, which is one of the reasons why RBI introduces such a change.

However, it is important to note that repo rate cut would lead to a reduction in the rate of interest only if the loan has been offered on a floating interest rate basis. If the personal loan has been offered on a fixed interest rate basis, then the interest rates would not be affected by any changes in the repo rate. Therefore, repo rate cuts will benefit new personal loan borrowers when the banks implement the changes but existing borrowers who have opted for the fixed rate of interest would not benefit from the same.

The other side of the coin is an increase in repo rate. When the Reserve Bank of India (RBI) decides to raise the repo rate, the cost that commercial banks must pay to borrow money from the RBI also rises. Another option would be for these banks to raise the interest rates on loans that are made available to the general public. This only applies to loans that are made available with a variable interest rate.

The CRR cut causes a long-term impact on personal loan products. The interest rates are lowered with repo rate cuts. The cost of borrowing would reduce drastically for both corporates as well as individual customers. With a reduction in lending rates, personal loans will become more affordable for borrowers. However, it is also essential to have a moderate transmission in the rate of growth of credit. Otherwise, the overall effect of the repo rate cut will stay neutral¹.

3.3 Affect of home loan EMIs increase repo rate

On February 8, 2023, the benchmark repo rate was increased by 25 basis points (bps) by the Reserve Bank of India (RBI). Since May 2022, the Reserve Bank of India (RBI) has increased the interest rate a total of six times, bringing the total quantum of the hike to 250 basis points (bps). This increase was primarily motivated by external factors, such as the conflict between Russia and Ukraine. Meetings of the Monetary Policy Committee (MPC) are attended by three RBI officials and three members of the public who have been appointed by the central government.

This is the first MPC meeting since the presentation of the Union Budget by finance minister Nirmala Sitharaman in Parliament a week earlier on February 1, 2023. With the hike in repo rate, because banks may choose to pass on the increase in rates of interest to customers, existing home loans with variable rates of interest are likely to become more expensive. This will result in an increase in the equated monthly instalments (EMIs) for home loans taken out by buyers.

According to experts, inflation should moderate in the long run which would have a mellowing effect on home loan installments gradually this year.

So, what will the hike in repo rate entail for the customer?

3.4 How much Will EMIs increase

The repo rate has a one-to-one correlation with the interest rates that lenders provide for loans. As a result, an increase in the repo rate will result in an increase in the cost of borrowing, and vice versa. “The rate hike of 25 basis points that took place today will make EMIs approximately 2-4 percent more expensive. According to V Swaminathan, executive chairman of Andromeda Sales and Aapnapaisa.com, both of which are companies that distribute loans, borrowers will be required to “either shell out additional money to repay their loans or will be required to extend the tenure.”

“Taking into account the most recent hike of 25 basis points, the equated monthly installment payment (EMI) for a home loan with a principal amount of Rs 70 lakh and a rate of 9.25 percent was Rs 64,111. However, after taking into account the 25 basis points, the

interest rate rises to 9.50 percent, which results in an increase in the EMI to Rs 65,249. The person who takes out such a loan will be required to make an additional payment of Rs 1,138 every single month. However, over the course of the past three quarters, there has been a rise of 250 basis points in the repo rate. Therefore, the monthly installment payment (EMI) for a home loan of Rs 70 lakh taken out in May 2022 at a rate of seven percent was Rs 54,271. When we take into account the rate increase of 250 basis points that has occurred since May, the interest rate rises to 9.50 percent, which brings the EMI up to Rs 65,249. According to Swaminathan, the borrower of such a loan will be required to make an additional payment of Rs 10,978 every single month.

Says Adhil Shetty, CEO, BankBazaar, a financial services website: “Let us take a loan of Rs 50 lakh, with a tenure of 15 years. The original interest rate in May 2022 was seven per cent after which we have seen six rate hikes. For the above loan, the EMI was Rs 44,941 at a seven per cent interest rate and before the rate hike today, it was Rs 51,460. After the 25 basis points rate hike today, the EMI will go up to Rs 51,211. Also, if someone wants to increase the tenure and keep the EMI the same, after today’s hike, the tenure will become 270 months, instead of 180 months when the rate of interest was seven per cent. Before this rate hike, the tenure had to be 254 months to keep the EMI the same.”

Says Chenthil Iyer, founder and chief strategist, Horus Financial Consultants: “If a loan of Rs 30 lakh currently has an interest rate of 8.5 per cent and tenure of 20 years, then EMI would be Rs 26,034.7. With the increase in repo rate of 25 bps, the EMI would increase to Rs 26,511.32, an increase of approximately Rs 500. Alternatively, if someone decides to keep the EMI same, the tenure increases by one year.”

When banks increase benchmark lending rates for home loans, you will be left with two options- to continue with the ongoing repayment schedule or switch to a higher tenure of the loan.

What Should You Do: According to financial planners, the only way to control the rising costs of borrowing is to make pre-payments. It is essential that you do not rush into selling off any of your investments or making any prepayments. Instead, you could work toward it by making plans. You have a number of options available to you, and the one that you choose should be based on how your finances currently stand.

“For instance, if you pre-pay five percent of the loan balance every year, a loan with a 20-year term can be repaid in 12 years rather than the full 20 years. In the alternative, you might have to pay an additional five to ten percent on top of your regular EMI each month. You could also make an additional two to five payments per year, or you could make an additional payment every three months. According to Shetty, any and all of these things would make it easier for you to manage your loan burden.

Moreover, he explains, what matters is the timeframe in which you intend to repay the loan. “Let’s say, for instance, that you planned to repay a loan with a term of twenty years in ten years, but the rate increases extended your repayment period to twenty-five years. In this particular scenario, you should make it a priority to pay off at least ten percent of the loan over the course of the next ten years by making a combination of EMIs and prepayments.

This will ensure that you remain on track to achieve your goal. It is essential that you carry out these actions in a well-organized and planned manner, as this will ensure that your financial resources are not put under unnecessary strain while simultaneously allowing you to reduce the amount that you owe on your loan,” adds Shetty. Iyer suggests that increasing the EMI is always the right thing to do. “Only in extreme situations where the revised EMI is unaffordable, the tenure may be increased,” he adds².

3.5 RBI repo rate hike will affect on auto loans

Planning to book your dream car? But have you ever thought of how the RBI repo rate hike affects your auto loan? It is crucial to understand the relationship between the two to make an informed choice. However, before delving deep into the concept, let us comprehend some vital financial jargon. It includes concepts related to the repo rate, fixed rate, and floating rate. Eventually, it will help you to understand how the central bank’s repo rate can alter your auto loans.

Moreover, the number of financial institutions offering auto loans is expanding along with the demand for vehicle loans. In such a context, it is essential to comprehend how your auto loan is affected by the RBI repo rate hike. Thus, you can plan a wise monthly budget by adjusting the calculations. When the repo rate rises, banks are bound to increase their lending rate to the customers. This is because these commercial banks get a loan from the RBI at a higher repo rate. Consequently, the interest rate for auto loans also rises. But it varies depending on the interest rate you select. A cursory knowledge of two types of interest rates is imperative to comprehend how the RBI repo rate hike impacts your auto loan EMI. Hence, let us leaf through the concepts of fixed and floating interest rates.

What is a fixed rate, and how does the RBI repo rate hike affect the fixed rate?

If your auto loan has a fixed rate, the interest rate stays the same throughout the loan period. It implies that the interest rate stays the same, notwithstanding the changes in the RBI repo rate or bank lending rate. Accordingly, a hike or dip in the RBI repo rate will not affect auto loans with fixed rates. Hence, the fixed interest rate enables you to manage your monthly budget precisely.

What is the floating rate, and how does the RBI repo rate hike affect the floating rate? The scenario differs when your auto loan has a floating interest rate. The floating interest rate varies with the market changes. The current RBI repo rate decides the basis of floating rate interest. Therefore, the floating rate interest could rise in response to an increase in the RBI interest rate. Also, if the repo rate falls, so will the floating interest rate. Accordingly, a rise in the floating interest rate will increase your auto loan EMI amount. Consequently, you need to make amends to your monthly budget³.

So, the next time you hear about the RBI repo rate increase, pay close attention. In light of the current inflationary trend, the repo rate hike is a certainty. As a ripple effect, auto loans at a floating rate will get costlier. Further, the repo rate hike will affect the new vehicle buyers rather than the existing buyers. Hence, it is better not to delay applying for your auto loans.

3.6 Affect of recent repo rate increase on education loan

In India, amidst the ongoing inflation and economic crisis, accumulating enough funds to bear the cost of abroad education is still a milestone for many students and their families. Parents and students servicing education loans may have a tough time ahead as RBI had increased the repo rate thrice previously and now it is further increased by 0.5% in September 2022 for the fourth time in a row. This surge will cause a hike in the rate of interest for education loans also, and the students who were planning to go abroad for higher studies by taking education loans will now have to take the hit of this hike. As the interest rate for education loans will be increased subsequently.

Most of the banks and NBFCs have already increased their benchmark rates post the 0.4 percent hike by the RBI last month and now another rate hike can be expected. Already, the cost of education, both domestically and internationally, is rising. Now, even the cost of financing education is on the way up. The new education loan interest rates may increase by 1.25 percent to 1.5 percent or even higher, from their existing values, depending on the borrower's profile, lending institution, the course, and the institution where the course is being conducted. You can get in touch with the Financial Officers of WeMakeScholars and get your education loan profile analyzed to know the lowest interest rate that can be offered to you on your education loan according to your profile.

3.7 How to get a cheap education loan

As per the study by NCES, the cost of higher education, whether in India or overseas, has been rising, and education loans have become crucial for study-abroad aspirants. With the support of education loans, students feel handy to fulfill their dream of studying abroad. While there are many lenders ready to fund your education abroad, ranging from public banks, private banks, and NBFCs to fintech companies, it is crucial to find out which is the most suitable lender for your education loan.

3.8 Indian lenders vs foreign lenders

Indian lenders are Public and Private banks in India that fund Indian students to pursue their studies abroad while foreign lenders are those foreign institutions that offer funds to international students to come and study in their country. Here the catch is that in the case of foreign lenders, you will have to repay the education loan in the same currency, in which you have borrowed from them, say suppose the dollar. But, since the price of dollars is shooting up compared to the rupee. You will have to repay more money as interest if you take an education loan from foreign lenders in the USA. Therefore, we suggest students take an education loan from Indian lenders only. We are partnered with 14+ public and private banks in India and can connect you directly to them after you fill out and submit your loan eligibility form.

3.9 The interest rate offered by various lenders

If you take a collateralized education loan from a public bank then the average interest rate starts at around 9.0 percent, while, in a private bank, the interest rate starts from

around 12 percent. So clearly public banks are a good option when you have collateral to pledge, but when you do not have collateral and loan processing time is your deciding factor then you must process your loan with We Make Scholars and get the best deal at the lowest rate of interest at the earliest.

3.10 Lender's expectation in exchange for the loan

As mentioned earlier there are two options to get a secured loan that is, immovable property or liquid security, the type of security you pledge for a collateralized loan also plays an important role as their methods of valuation are different and that could alter your decision. So lenders' expectations about collateral should also be considered before choosing an education loan⁴.

4.0 Conclusion

A reduction in the Repo rate will bring about a reduction in the cost of borrowing money for both commercial banks and individual borrowers. The interest rate at which financial institutions provide credit, such as personal loans, mortgage loans, and so on, is referred to as the cost of credit. Alternatively, the interest rates on loans will be lowered. This will also lead to a reduction in CRR (Cash Reserve Ratio) which would increase the availability of credit to individuals.

When banks increase benchmark lending rates for home loans, you will be left with two options- to continue with the ongoing repayment schedule or switch to a higher tenure of the loan. A cursory knowledge of two types of interest rates is imperative to comprehend how the RBI repo rate hike impacts your auto loan EMI. Hence, let us leaf through the concepts of fixed and floating interest rates. It is suggested to students take an education loan from Indian lenders only. We are partnered with 14+ public and private banks in India and can connect you directly to them after you fill out and submit your loan eligibility form.

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