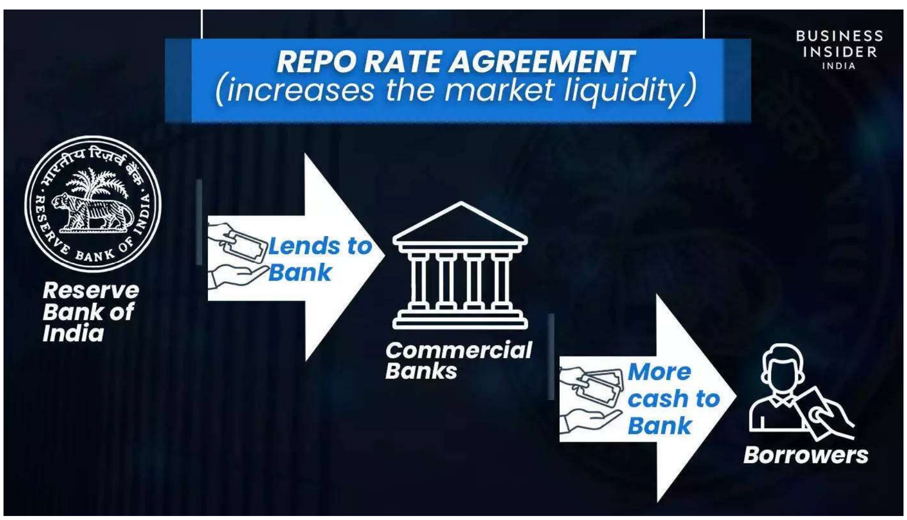
Impact on Loans with Current Rate Hike- October22 Credit Policy RBI

There will be a gradual **increase in EMIs for borrowers** with an **existing loan** and with people planning to take a **new Home, Car, or Personal loan**. The **Reserve Bank of India (RBI)**, in its **monetary policy** meeting held on September 30, decided to **increase the repo rate again by 50 bps (0.5%)**. This is the fourth repo rate hike within 5 months in a series of hikes that started on May 4 this year amounting to a total of 1.90% increase in Repo Rates. Existing borrowers, who have taken loans on a floating rate basis, such as home or Car loans, will see their **EMIs go up** further in the near term between Rs 900 to Rs 1200 for a 30 lacs loan at 8.50% for 20 years. Most new borrowers, whether servicing fixed or floating-rate loans, will need to **pay higher EMIs** for their loans when the banks pass on the latest policy rate hike.

Before understanding the impact on borrowers, we will understand some basic terminologies relating to the lending business, such as **REPO Rate, MCLR, EBLR,** etc.

REPO Rate



The Repo rate is the **rate at which the central bank** of a country (Reserve Bank of India in the case of India) **lends money to commercial banks** in the event of any shortfall of funds. Monetary authorities use REPO Rates to **control inflation**.

In the event of inflation, central banks increase REPO Rate as this acts as a disincentive for banks to borrow from the central bank. This ultimately reduces the money supply in the economy and thus helps arrest inflation. The central bank takes the contrary position in the event of a fall in inflationary pressures. Repo and reverse repo rates form a part of the liquidity adjustment facility.

Marginal Cost of Funds based Lending Rate (MCLR)

The Marginal Cost of Funds Based Landing Rate (MCLR) is the **minimum interest rate a bank can charge for a loan**. Banks are permitted to **issue any category of loan**, such as home, car, personal, and so forth, on a **fixed or floating interest rate** under the MCLR regime. Therefore, for all loans linked to that benchmark, the bank will not lend at a rate lower than MCLR.

"This method uses the marginal cost or latest cost conditions reflected in the interest rate given by the banks for obtaining funds (from deposits and borrowing) while setting their lending rate. This means that the interest rate given by a bank for deposits and borrowing are the decisive factors in calculating MCLR."

External Benchmark Lending Rate (EBLR)

EBLR stands for **External Benchmark Lending Rate**. Most banks have **adopted Repo Rate as the external benchmark** to link their floating rate home loans from 01.10.2019.

The **base rate** was introduced in **July 2010** as a system wherein banks cannot lend below a stated rate, while the **MCLR** came in **April 2016**, wherein the banks were given the formula to calculate their cost of funding and then conduct monthly reviews of their offerings across various tenors. The MCLR was replaced by the **external benchmark linked rate (EBLR)** so that the lending rate moves directly in sync with policy moves. Introduced in **2019**, EBLR was intended to plug the deficiencies in MCLR, which faced criticism of slower than expected rate transmission. EBLR is now widely used in home loans, and recently, banks have started adopting EBLR for other retail products, such as personal loans and educational loans that were earlier based on MCLR.

Impact on Borrowers

With clarity on the various terminologies, let's understand how interest rate hikes will affect borrowers. Till the last RBI monetary policy meeting held on August 5, the repo rate was increased to the extent of **140 bps from 4% to 5.4%** within a **short period of 93 days**. After the recent hike on **September 30**, the repo rate has **increased by a total of 1.9% (140 bps + 50 bps)** since May this year. **Most lenders** have already **passed on a higher rate to their borrowers**, especially the ones who have **opted for EBR-linked home loans**. However, banks **will gradually raise the interest rate** soon in the near future **for other borrowers** who have loans linked to **older rate regimes such as MCLR, base rate, or BPLR**.

The latest hike in repo rates will make funding costlier for existing and new borrowers. **All home, car, personal, and education loans on floating rates will become more expensive for existing borrowers**. **New borrowers** will have to **take loans at a higher price compared to last week**. The Repo rate linked to **EBR loans** will **go up by 50 bps immediately**; however, for **other loans linked to MCLR, base rate, or BPLR, the hike would be less**.

How much our EMI will increase due to Latest Rate Hike

Because of these **rate hikes by the RBI**, **banks, NBFCs, and housing finance** companies have been **raising their lending rates** correspondingly, so our **EMI has gone up**, and with the **recent repo rate hike, it will rise further**. Let us understand the impact of the latest 50 bps interest rate hike on different loans.

If we have a **home loan with Rs 40 lakh** outstanding with a balance tenure of **20 years** at **8.5%** per annum interest, our EMI will go up by **Rs 1276** from **Rs 34,713 to Rs 35,989**. For each lakh rupee of loan, you may have to pay out Rs 31.90 extra for EMI for similar tenure and interest rate. We can see the summary of this Home loan in the table below.

Home Loan	
Outstanding Loan	Rs. 40,00,000
Tenure	20 years
Interest	8.50%
EMI	Rs. 34,713/-
Latest Interest Rate	9.00%
Latest EMI	Rs. 35,989/-

Similarly, for an **auto loan of Rs 10 lakh** for a tenure of **7 years**, if the interest rate rises from **11.00% to 11.5%**, the corresponding increase in EMI will be **Rs 264** from **Rs 17,122 to Rs 17,386**. We can see the summary of this Home loan in the table below.

Auto Loan	
Outstanding Loan	Rs. 10,00,000
Tenure	7 years
Interest	11.00%
EMI	Rs. 17,122/-
Latest Interest Rate	11.50%
Latest EMI	Rs. 17,368/-

On a **personal loan of Rs 5 lakh** with a tenure of **5 years**, if the interest rate rises from **15% to 15.5%**, your EMI will increase by **Rs 132** from **Rs 11,895 to Rs 12,027**. We can see the summary of this Home loan in the table below.

Personal Loan	
Outstanding Loan	Rs. 5,00,000
Tenure	5 years
Interest	15.00%
EMI	Rs. 11,895/-
Latest Interest Rate	15.50%
Latest EMI	Rs. 12,027/-

Even though **rates have been hiked thrice** within a short duration, **it does not look like the end**. The **primary factor** which is fueling these rate hikes is **inflation**. **Retail inflation** in India, which CPI measures, is still on the higher side as **CPI for the month of August was 7%**. Increasing Inflation rates are observed throughout the developed economy, which will have an important impact on our economy as well. The **interest rate spread difference between the US FED Rates and RBI Rates has shrunk**, and at some point in time, **we have to match the rate increase almost equivalent to US FED rates to attract FPIs or FII's money into India**.

I will end this article with valuable tips for sailing through this high-interest rate period.

- **Avoid tenure extension** if you can afford to pay a higher EMI. Only if affordability is an issue, then get the tenure extended.
- **Go for partial prepayment**; this would decrease our interest payment to a significant extent.
- In the case of **high-interest loans** such as Credit Cards, personal loans **foreclose** it.

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