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How have interest costs responded to repo rate cycles?

When we talk about monetary policy cycles, the first thing which pops up in our mind is how these interest rate decisions will impact borrowing costs. When the repo rate is changed it is expected that the lending rate too changes for transmission to be successful. The exercise here is an attempt to capture the same, considering the two recent policy rate cycles of RBI. When the pandemic started in March 2020 there was a dramatic easing in monetary policy, with repo rate hitting record low of 4%. This was also reflected in the Weighted Average Lending rate (WALR), witnessing more than complete pass through in the same period. Subsequently the repo rate has been increased by 250 bps to 6.5%. Both these cycles involved lending rates coming down first and then going up. While borrowers may view this current cycle as imposing an additional burden, this is because abnormal conditions typified by the pandemic had made the interest rates come down to the lowest level. Hence the present level of rates may be viewed as a correction. It is nonetheless interesting to see how interest costs of borrowers have moved and whether presently it is higher than the pre-pandemic times.

Our analysis shows that interest cost on outstanding loans as of Feb 2020 (under certain assumptions) got a benefit of Rs 0.61 lakh crore in FY21 and a further Rs 0.53 lakh crore in FY22 relative to FY21. In FY20 based on the WALR the interest outgo was Rs 10.16 lakh crore on a sum of Rs 101.05 lakh cr. However, in FY22, the cost advantage compared with the base year of FY20 was Rs 1.14 lakh crore while it was Rs 61,000 cr in FY21. Therefore a sum total of Rs 1.75 lakh crore was gained by all borrowers under these assumptions.

However, post pandemic period, with inflation hitting the wrong chord and demand gaining resilience, correction in repo was soon visible. With 250 bps hike in repo in FY23 interest cost on outstanding credit has risen by Rs 0.33 lakh crore over FY22 as interest costs would have been Rs 9.35 lakh crore as against Rs 9.02 lakh crore in FY22. Extrapolating the same for FY24 on the basis of data available for 5 months till August, the interest cost would be Rs 9.91 lakh crore which is still lower than that before the repo rate was lowered in 2020 (Rs 10.16 lakh cr). .

Since pandemic started there has been significant degree of rate action by RBI. During the pandemic, policy rate was reduced to a record low level of 4% to support the growth inflation dynamics, primarily growth requiring more handholding at that juncture. In the pandemic period i.e. between Mar-20 to Apr-22, the pass through was visible in Weighted average lending rate (WALR) as well. In the pandemic period (Mar-20 to Apr-22), WALR on outstanding loans has fallen by 133bps. Thus, it is important to see how interest cost have fared during the same period, to get an idea about debt burden of borrowers.

In this exercise we have captured the recent two monetary policy cycles of RBI – one during the pandemic and the other post May 2022 when the rate hike cycle began. Taking pre-pandemic as the base year i.e. Feb-20 to be the starting point we attempt to capture how interest cost of borrowers have spaced out in consonance with the movement of policy rate. In this context two primary assumptions have been made:

1) Credit outstanding as of Feb-20 is taken to be the base which is Rs 101.05 lakh crore. There is a caveat attached here considering that some loans might have been repaid and fresh loans might be repriced to the corresponding fresh WALR. But for computational convenience and to get a holistic picture, this assumption of fixing the level of outstanding credit deems fit for the purpose of our analysis.

2) WALR on outstanding credit has been used to map the outstanding base credit of Feb-20, to arrive at the annual figures of interest cost, which is then adjusted on a monthly basis. It is assumed that the entire o/s amount is repriced every month at the new WALR.

- In this context, interest cost of the borrowers for the base year before the pandemic translated to Rs 10.16 lakh crore based on the WALR on o/s loans. This is arrived at by applying the outstanding WALR of 10.05% prevalent during that month on the outstanding credit of Rs 101.05 lakh crore. With easing of policy rate, interest cost came down *to Rs 9.55 lakh* crore in FY21. Thus, there was straightaway benefit of Rs 0.61 lakh crore in terms of reduction in interest burden in FY21. Notably, repo rate was reduced by 40bps (115 bps from March 2020) and the outstanding WALR saw a drop of 82bps during the same period (95 bps if March 2020 is also included).
- The same momentum was visible in FY22 as well, in which interest cost came down to *Rs 9.02 lakh crore,* translating to reduction in borrowing cost of Rs 0.53 lakh crore from FY21 and Rs 1.14 lakh crore compared with FY20. In FY22, repo rate was retained at its lowest level of 4%, whereas outstanding WALR was reduced further by 36bps.

With inflation trajectory reversing and demand gaining ground, the roll back of previous stimulus was visible. This marked the beginning of a tightening phase of monetary policy in consonance with global tighter policy response. From May-22 onwards, repo rate started moving up, with total hike amounting to 250bps as of date.

- In FY23, as a response to the tightening cycle, interest cost rose *to Rs 9.35 lakh crore* from Rs 9.02 lakh crore in FY21, an increase of Rs 0.33 lakh crore. In the same period, outstanding WALR has increased by 98bps in response to 250bps increase in repo rate.
- In FY24, we have information available till Aug'23, which states that interest cost in the first 5 months of FY24 translates to Rs 4.13 lakh crore. In the same period, outstanding WALR has risen by 10bps.
- For the remaining part of the year we reckon interest cost at existing WALR on outstanding loans will translate to Rs 9.91 lakh crore as interest cost.

Table 1: Interest cost, repo and WALR

	Δ Repo (bps)	Δ Outstanding WALR (bps)	Interest Cost, Rs lakh crore
FY20	-	10.05*	10.16
FY21	-40	-82	9.55
FY22	0	-36	9.02
FY23	250	98	9.35
FYTD24	0	10	4.13
FY24E	**0**	**0**	**9.91**

Source: RBI, Bank of Baroda Economic Research

*: Absolute WALR for base period

How to interpret these numbers?

Assuming that the o/s credit as of Feb 2010 remained unchanged right through the subsequent period, the following follows.

1. Interest cost for FY20 was Rs 10.16 lakh crore.
2. In FY21 the cost came down to Rs 9.55 lakh crore and declined further to Rs 9.02 lakh crore in FY22. Compared with FY20, the cost was lower by Rs 61,000 crore and Rs 1.14 lakh crore respectively.
3. If these two years are combined the savings in interest costs for borrowers amounted to Rs 1.75 lakh crore.
4. In FY23 as interest costs rose, total payout was Rs 9.35 lakh crore which though higher than that in FY22 is much lower than the FY20 cost. Therefore, as RBI corrected the repo rate towards normal, borrowers were still not worse off compared to pre-pandemic times.
5. In FY24, based on assumption of unchanged WALR, the interest cost will go up to Rs 9.91 lakh crore which is again lower than FY20 by Rs 25,000 cr.

Hence it can be said that the increase of repo rate by RBI and the reaction of banks in terms of transmission has still not pushed interest cost to the pre-pandemic level. There is still some room for upward movement in WALR which will keep interest costs of borrowers at the pre-pandemic level.

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