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Is credit growth impacted by repo rate changes?

There is often discussion on whether or not monetary transmission percolates to the real sector of the economy through change in the pace of growth in credit. Literature suggests that transmission happens with a lag which varies depending upon various factors such as growth, inflation, liquidity and underlying macro structure of the economy.

With ceteris paribus assumption we have looked at movement in WALR on outstanding loans and the corresponding credit growth for the last 7 years (FY15-22). Ideally a lower interest rate regime should boost credit demand as it lowers borrowing cost. But does this mean that easy money makes every segment borrow more? Probably not, as borrowing is normally linked with state of demand in various segments and capacity utilization rates, which in turn are linked with the overall state of the economy.

Interestingly in this time period, the interest rate cycle has been in the downward direction with an about turn only in FY23 when RBI has started raising the repo rate since May 2022 (repo rate was also raised in 2018-19). There have, however been phases of volatility in credit demand which is explained by faltering growth conditions due to pandemic induced slowdown. In fact, data shows the credit cycle moved more closely with the corresponding growth cycle rather than WALR.

On sectoral basis, credit growth in industry largely remains unaffected by falling interest rates as the uptick in credit growth is not significant. In fact government schemes such as ECLGS have been more successful in boosting credit for these sectors than a lower interest rate regime. For other sectors such as services, NBFC credit demand has moved in tandem with WALR. Within the personal loan segment, credit off take has generally been high and stable over the period studied.

It should be mentioned here that there are limitations to our study as WALR cannot be taken to be the sole variable for credit transmission. This is so because loans are given on a multiple criteria of interest rates with corporates generally getting it at MCLR and retail and MSMEs at a rate linked with an external benchmark. But WALR can still be an indicative rate and suggestive of how transmission has fared across sectors. (Table 1)

- In the 7 years period ending FY22, WALR has fallen by 310 bps before increasing in Fy23 when the RBI started increasing the repo rate. On an average, the fall in WALR has been around 44bps in each year with FY19 being one where it remained virtually unchanged. FY21 was the pandemic period, where fall in WALR was the sharpest on record (by 82bps).
- Theory suggests that credit demand is likely to pick up in a falling interest regime as both consumption and investment picks up, on account of lower borrowing cost. In 4 out of the 8 years analyzed credit growth has improved with fall in interest rates. However, in FY17, FY20 and FY21, credit growth faltered despite a favourable lower interest rate. In FY23, even though rates went up, growth in credit has been sharp. If we juxtapose the GVA growth rate (excl. Agri and public admin and defence at constant prices) we will see that in all these years, growth has been volatile in the downward direction. Hence it has impacted the credit demand in the economy. FY17 faced the brunt of demonetization; FY20 was on account of contagion impact of US-China tariff war and also beginning of Covid induced slowdown which had spillover effects in FY21 as well.
- Between FY15-22, credit growth averaged ~9.1% with the highest growth visible in FY19 at 13.4% and lowest growth visible in the pandemic period at 5.5%.

Table 1. Movement in WALR and Credit growth

	WALR: O/s Rupee Loans: SCBs, %	Non-food Credit, YoY%	GVA excl. Agri and public admin etc YoY%
FY15	11.8	9.3	8.8
FY16	11.2	10.9	10.1
FY17	10.8	9.0	8.0
FY18	10.3	10.2	5.8
FY19	10.2	13.4	6.3
FY20	9.9	6.1	3.0
FY21	9.1	5.5	-6.4
FY22	8.7	8.7	8.5
FYTD22	8.9	0.9	-
FYTD23	9.4	8.7	-

Source: RBI, CEIC, Bank of Baroda Research, FYTD: Apr-Oct, WALR for FYTD as on Oct'22

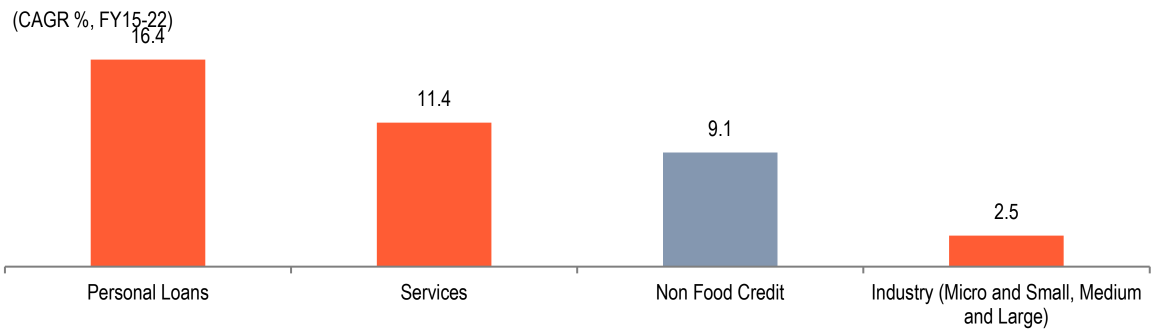
The above table shows that in the three years when growth in credit slowed down despite falling WALR was more to slowdown observed in GDP growth indicating low demand conditions. In the years, when lower rates led to an increase in growth rate in credit, GDP growth was also relatively buoyant indicating positive economic conditions with the only exception being FY18. And also in FYTD23, growth in credit has been swift at 8.5% even while the WALR has increased, thus severing the link between rate change and growth in credit. But growth was still closer to the 6% mark.

What sectoral composition data reveals:

Sectoral data shows, that in these 8 years, personal loan segment has grown at the fastest pace within nonfood credit segment. Even in case of services, growth in credit has exceeded that of overall credit. Industry has however been a laggard. A look at the share of these sectors in overall credit shows that share of industry in overall non-food credit has come down. From around 51% in FY15, it fell to ~26% currently, while for personal loan segment the share has improved considerably from ~22% in FY15 to ~30% currently. For services sector, it has remained broadly stable at ~30%. Clearly, there is a leap frogging aspect here as well, where personal loan and services are outpacing industry credit demand. This is despite India's per capita GNI growing at only 3.1% (CAGR-FY17-21, excl. the Covid period, CAGR is 5.5%, at constant prices).

For responsiveness of sectors, we have also tried to look at the CAGR for these last eight years. Here also we get a similar trend, personal loans and services have outpaced overall non-food credit growth while industry fell short.

Figure 1: Performance in terms of CAGR



Source: RBI, CEIC Bank of Baroda Research

Sensitivity of sectors with regard to movement of WALR:

The WALR would vary across sectors as corporates normally work on the MCLR and retail and MSMEs on an external benchmark. However, in the absence of sector-wise WALR, the average has been used to assess credit growth response to these changes. This admittedly is a limitation in this analysis.

For Industry, the movement of WALR and industry credit demand is sketchy. Table 2 gives growth in credit across the three segments and where growth in credit is negative or lower than the preceding year is marked in red. As can be seen there are more red markings in the table.

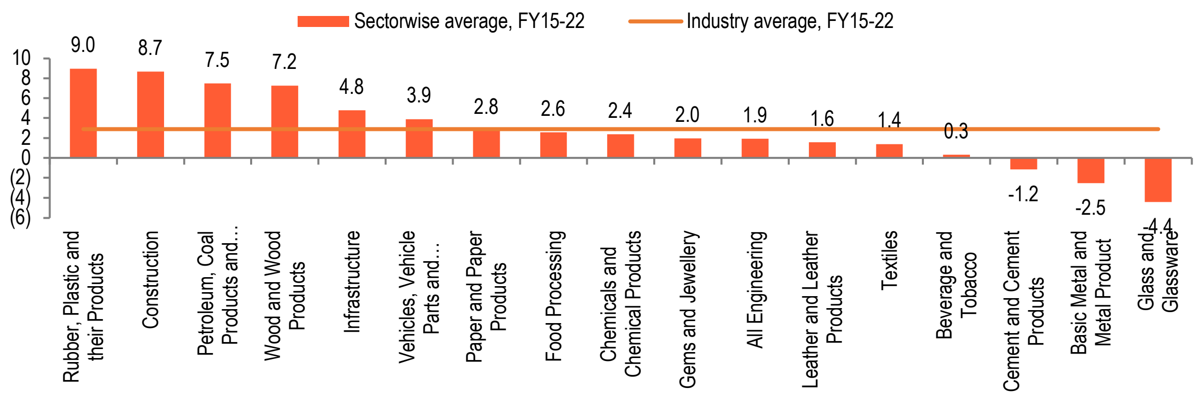
Table 2. Industry credit growth not in tandem with WALR

	WALR: O/s Rupee Loans: SCBs, %	Micro & Small enterprise credit growth, YoY %	Medium enterprise credit growth, YoY %	Large enterprise credit growth, YoY %
FY15	11.8	9.1	0.4	5.3
FY16	11.2	-2.3	-7.8	4.2
FY17	10.8	-0.5	-8.7	-1.7
FY18	10.3	0.9	-1.1	0.8
FY19	10.2	-0.4	-2.8	6.4
FY20	9.9	8.5	4.6	3.1
FY21	9.1	7.2	31.3	-3.2
FY22	8.7	23.1	54.5	1.9
FYTD22	8.9	5.8	21.8	-3.9
FYTD23	9.4	3.6	3.3	4.5

Source: RBI, CEIC, Bank of Baroda Research, FYTD: Apr-Oct, WALR for FYTD as on Oct'22

Charting industry wise data, also gives us important conclusions. Out of the 18 industries which we have monitored, 11 of those industries had average credit growth between FY15-22, lower than the industry average of 2.9%. So this poses concern. Among them the industries which have the major share are basic metal and metal products (9.4% share in industry credit), textile (6.5% share), engineering (5.2%), food processing (4.8% share) and gems and jewelry (2.4% share).

Figure 2: Industry wise performance



Source: RBI, CEIC, Bank of Baroda Research

- Credit growth of industries such as cement and cement products, basic metals, engineering and infrastructure, were not related much with WALR movement. This is because these industries are mostly hit by production related issues or issues related to growth and inflation.
- It is important to mention that in CAGR terms as well, credit offtake to industry has been a drawback. If we exclude the pandemic period where government's support through ECLGS was provided, credit growth has indeed declined in the MSME segment. A lot of procedural hurdles and ailing health of this segment can be attributed to the same.

Table 3. Industry credit growth not in tandem with WALR

Industry	Micro & Small enterprise credit, %	Medium enterprise credit, %	Large enterprise credit, %
CAGR (FY15-19)	-0.6	-5.2	2.4
CAGR (FY15-22)	4.9	8.0	1.6

Source: RBI, CEIC, Bank of Baroda Research

Within services, transport operators and NBFC credit demand have moved in line with WALR movement. For other important sectors within services such as trade (22% share in services credit) and commercial real estate (9.2% share in services credit), a clear relation between their credit demand and WALR is not observed. Notably, NBFC which comprises of the major share of services credit demand (37.8% currently from 22% in FY15), has reacted better to changes in WALR though admittedly their business is similar to banks where lending activity gets tied to the demand for funding.

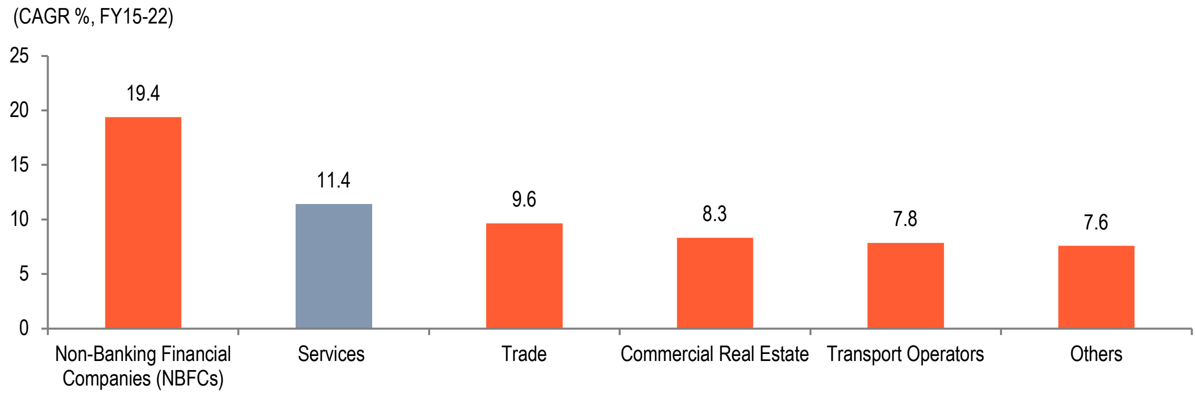
Table 3. Services credit growth and WALR

	WALR: O/s Rupee Loans: SCBs	Transport Operators	Trade	Commercial Real Estate	Non-Banking Financial Companies (NBFCs)	Others
FY15	11.8	-0.8	12.2	8.6	6.1	1.1
FY16	11.2	8.9	4.2	6.7	13.2	10.9
FY17	10.8	10.7	12.3	4.5	10.9	29.7
FY18	10.3	9.8	9.1	0.1	26.9	13.5
FY19	10.2	-5.4	2.8	22.7	51.3	-1.7
FY20	9.9	15.5	16.1	26.5	26.6	-3.1
FY21	9.1	7.9	12.8	0.47	2.0	0.3
FY22	8.7	8.6	10.8	0.54	11.2	6.8
FYTD22	8.9	-0.7	1.5	-4.4	-6.2	0.0
FYTD23	9.4	3.5	7.2	4.8	16.4	7.2

Source: RBI, CEIC, Bank of Baroda Research, FYTD: Apr-Oct, WALR for FYTD as on Oct'22

In terms of CAGR, for the past eight years services lending is driven by credit to NBFC segment. If we delve deeper into the lending profile of NBFC's there also it is clear that the share of MSME is miniscule (out of 40% of credit by NBFC which goes to industry, within that 94% is dominated by large industry as of H1FY22). So there is a serious gap in credit demand by MSMEs in all sources of funding.

Figure 3: Performance in terms of CAGR



Source: RBI, CEIC, Bank of Baroda Research

Within **personal loan segment**, credit growth in the housing (48% share in personal loan) and auto sector (12% share in personal loan) along with credit cards did link well with WALR. Although rate of growth has varied in terms of direction, absolute numbers have been in the higher range. In FY21 home loans continued to perform relatively well with growth of 9.6%. Education loans however came down as the restrictions on students going overseas to study had constrained such admissions. In FY19 and FY23 (YTD) where WALR has increased, retail demand has tended not be unduly affected as such loans appear to be more need based. Also those taking long term loans on a house are prepared to face different interest rate cycles during the loan tenure.

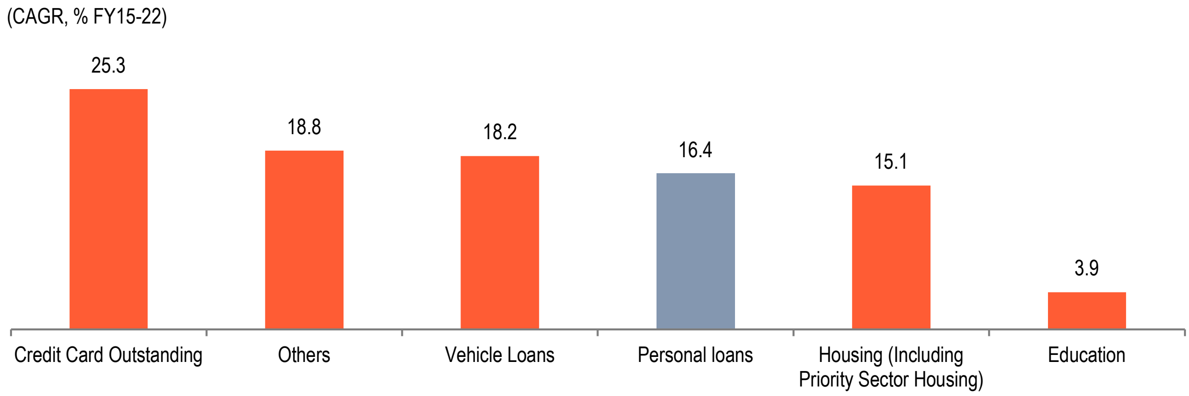
Table 4. Industry credit growth not in tandem with WALR

	WALR: O/s Rupee Loans: SCBs	Housing (Including Priority Sector Housing)	Credit Card Outstanding	Education	Vehicle Loans	Others
FY15	11.8	16.7	22.5	5.5	17.2	14.1
FY16	11.2	18.8	23.7	7.7	22.7	21.0
FY17	10.8	15.2	38.4	2.7	11.5	20.8
FY18	10.3	13.3	31.6	-0.5	11.3	29.7
FY19	10.2	20.7	27.8	9.6	50.3	11.8
FY20	9.9	15.8	36.8	2.0	19.0	22.2
FY21	9.1	9.6	9.4	0.5	8.5	13.2
FY22	8.7	12.9	12.7	5.7	9.3	14.0
FYTD22	8.9	5.3	6.3	3.0	2.6	3.6
FYTD23	9.4	8.4	21.2	9.3	14.6	14.0

Source: RBI, CEIC, Bank of Baroda Research FYTD: Apr-Oct, WALR for FYTD as on Oct'22

In terms of CAGR, personal loans segment growth was driven by credit card outstanding, pick up in loan against gold jewelry and also vehicle loan. Credit for housing has also fared well with growth of 15.1%.

Figure 4: Performance in terms of CAGR



Source: RBI, CEIC, Bank of Baroda Research

Conclusions:

- Ideally, a lower interest rate regime should boost credit demand.
- In our exercise where we have tried to look at the movement of WALR and credit growth, this relation holds for some years. However for others, credit demand is more in tune with growth of the economy.
- For important sectors of the economy such as industry, there has been no clear relation between credit demand and interest rate movement.
- In case of services, a clear picture is not obtained with changing interest rates especially when they increase as in FY23 (YTD).
- For sectors such as housing, auto, credit card outstanding, especially the consumer driven segment; the relation between lower borrowing cost and credit demand has fared relatively better. But even in rising rate scenarios, growth in credit has not been dampened.

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