Linking of Interest Rates by SBI

Why in news?

SBI recently decided to link its interest rate on savings bank deposits and short-term loans, both over Rs.1 lakh, to the repo rate.

What was the existing condition?

- Till now banks have been linking interest rates to their own cost of funds.
- So banks have not been in a position to reprice their deposits all at once.
- Hence policy rate cuts by the RBI have not been passed on in equal measure to borrowers.
- Even previous efforts like the base-rate regime or marginal cost-based lending rate helped only new borrowers.
- The issue of deposit rates was not tackled at all.

What is the current move?

- Starting May 1, savings deposits will earn interest at 2.75 % below the repo rate.
- Similarly, cash-credit accounts and overdrafts over Rs 1 lakh have also been welded to the repo rate plus a spread of 2.25%.
- The threshold of Rs 1 lakh on both the deposit and lending side is to ensure that smaller savers and borrowers are not penalised due to the changes in the repo rate.
- It is now near-certain that other bigger banks will follow suit as they can improve and reduce the volatility in their interest margins.

What should be done?

- In post-demonetisation phase many people who invested in retail-term deposits, opted to invest in physical assets like housing, gold and in offers from both mutual funds and tax-saving insurance schemes.
- So how mutual funds and insurance companies react to this measure is yet to be seen.
- Yet, Current and savings bank deposits (CASA) still account for 42% of total deposits.
- So it also remains to be seen how larger investors in them now react after a cut in the repo rate.

- Experts feel that the move may face some resistance from depositors at a present because the inflation trend is downward.
- They said that SBI should have waited for a cycle where interest rates are going up so that customers get used to the structure.

Source: Business Standard

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