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RBI’s push for MCLR regime

What is the issue?

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- Bank customers in India continue to pay for the systemic inefficiencies in monetary policy transmissions.
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- In this context, RBI’s push for the comprehensive embrace of MCLR regime is a positive despite the reluctance of banking majors.
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What are some of RBI’s actions to enhance Monetary Transmission?

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- “Monetary Transmission” is a qualitative measure of the impact of central bank’s policy decisions on the banking system and the larger economy.
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- Currently, India fares low on the effectiveness of monetary transmission as RBI’s policy directives aren’t being reflected sufficiently in bank interest rates.
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- To improve the transmission efficiency, the central bank introduced the “Marginal Cost of funds-based Lending Rate” (MCLR) regime in 2016.
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- MCLR is a cost plus module, where banks choose a “fixed percentage margin” over and above whatever the RBI mandated bank rate is.
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- This replaced the “Base Rate” regime which was in place since 2010, in which banks were free to fix any interest rate above RBI’s bank rate.
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- In this context, recently, RBI has said that it would instruct banks to switch pre-existing ‘base rate customers’ also to the new MCLR regime by April 2018.

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- But the stated intent hasn't been effectuated yet, primarily due to the reluctance of banks that stand to lose revenue.
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- Notably, even now, base rate customers can shift to the MCLR regime but it is only after paying a fee, which is proving a deterrent.
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What would've been the likely impact of RBI's latest MCLR push?

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- The latest move was supposed to push banks to lower lending rates, which currently under the base rate system is considerably higher.
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- Notably, State Bank of India's lending under the base rate system is about 8.7%, whereas the one-year MCLR rate is just about 8.25%.
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- This difference of 45 basis points could make a significant difference in borrowing costs, especially for smaller firms and retail consumers.
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- Significantly, it is to be noted that a large proportion of outstanding loans and advances continue to be linked to the base rate system.
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What is the way ahead?

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- The RBI has been facing flak from multiple quarters for ineffective monetary administration, which is affecting the larger economy.
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- From a consumer perspective too, an unfair situation has emerged as new borrowers get lower MCLR interest rates while older ones continue on the higher Base rates.
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- Banks are reluctant as they are already saddle with immense pressure due to record losses and mounting levels of Non-performing Assets (NPAs).
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- An RBI study estimates that public sector banks could take a Rs. 40,000-crore hit on revenue if they allow all base rate borrowers to switch to the MCLR rate.

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- Nonetheless, given the need to revive the economy through consumption and fresh investment, monetary transmission needs to become effective.
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- Hence, the push for MCLR is inevitable and needs to be implemented.
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Source: The Hindu

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