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Editor:	MR. RAJESH DEDHIA	Author:	BANK BAZAAR
Title:	HOW RBI RATE CUTS AFFECT YOUR BANK'S RATES		

Magic tricks and illusions are really difficult to understand until someone gives away the secret to it all and breaks the illusions. Figuring out why different banks react differently to RBI's rate cuts might seem just as difficult to understand but here we break the illusion for you.

It All Comes Down to Cost

Some banks either cut the deposit rates or the lending rates, while some others cut both.

Whether it is the lending rate or the deposit rate, it all depends on the banks overall cost of funding. A bank borrows from their depositors and lends the same money at a higher rate to their borrowers. The difference in these two rates, i.e., the average lending and borrowing rates is called Net Interest Spread. The higher the spread, the better it is for the bank.

A bank's borrowing cost includes the average rate of all time deposits (deposits with a pre-specified time period), such as fixed deposits, and demand deposits (deposits which can be withdrawn anytime), such as those in Current Account and Savings Account (CASA).

Banks pay a higher interest on fixed deposits, while they pay very low or no interest on CASA deposits. In India, the money in the current account earns no interest while money in savings account earns 4-5% interest on an average. In contrast, fixed deposits with one year or more maturity period are currently earning anywhere between 8-9%.

Therefore, if a bank has higher CASA deposits, the overall cost of funding for the bank is lower than a bank where CASA deposits are lower in number.

CASA ratio: What does it say?

The proportion of CASA deposits of a bank (overall deposit) is known as its CASA ratio. Suppose, if a bank has on an average Rs 500 crore in current and savings account during a year and their total deposits (including the fixed deposits) during the year was Rs 1,000 crore. Then the CASA ratio of the bank is 50%.

The higher the CASA ratio, the lower the cost of funding for the bank. This also means lower the chances of the bank reducing the deposit rates as and when the RBI cuts interest rates.

The state Bank of India and HDFC Bank, for example, had a CASA ratio of around 45% as of March 2015, as compared to IndusInd Bank's 34%. This means that chances of IndusInd Bank reducing their deposit rates at a possible trigger are higher than that of SBI or HDFC Bank.

Net Interest Margin

CASA ratio is a crude indicator of how the bank would change its deposit rates in future. A more advanced indicator is the net interest margin (NIM) of the bank.

Reg. Off: 427/429, SVP Road, K. N. Trust Building Prarthana Samaj, Charni Road, Mumbai – 400 004.

Training Centre: 413, 4th Floor, Busa Industrial Estate, Ganpatrao Kadam Marg, Hanuman Lane, Lower Parel (W), Mumbai – 400 013.
Ph: 022 – 022 66340536 / 66100748 Email: info@vantagein.co.in / mail@vantagein.co.in



Net Interest Margin is the net interest earned by a bank vis-à-vis its overall interest earning assets during a year. This is calculated by dividing the difference between interest earned and interest paid by the total interest earning assets that the bank has in its book. NIM is given in percentages and it basically shows how profitable the bank's operation is.

The higher the NIM, the lower the chances of a bank reducing deposit rates at the slightest provocation. Often (though not always), higher the CASA ratio, the higher the NIM.

For example, HDFC Bank with a CASA ratio of 45% had a NIM of 4.43%, while IndusInd Bank with CASA ratio of 34% had a NIM of 3.68%.

So, the next time you wonder why your bank has reduced the deposit rates while others have not, you know where to look at for the possible answers.

However, the bank's decision to change lending or deposit rates may also depend on competition and general interest rate scenario in the country. Therefore, any conclusion made based on CASA ratio or NIM may not always turn out that way. But, who knows, someday the rate cuts might work magic on your deposits when you least expect it.