

## **CHAPTER – III**

### **Variation of Rate of Interest**

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## **CHAPTER – III**

### **Variation of Rate of Interest**

#### **3.1 Introduction**

A home loan surely solves our immediate need for funds – but it brings along with it the silent entrapment (hidden feature) called the interest rate. Interest rates for Home Loans are undoubtedly the most important parameter for a borrower while considering their loan agreement. The country's housing loan segment has seen various fluctuations in interest rates over the past two years. Home loan seekers have faced dramatic interest rate changes caused by variation in economic parameters. The Reserve Bank of India has played a vital role in influencing home loan rates through its monetary policy tools such as Cash Reserve Ratio, Repo Rate, and Bank Rate etc.

The interest rate hikes by inflation, liquidity, policy rates, economic trends and movement in real estate sector etc. But the most affected by this hike is the borrower.

The rise in the interest rate increases either EMI or stretches the loan tenure, based on our loan structure and eligibility. The rate of interest a Bank charge to its customers depends upon a number of factors like category of customers, schemes, advance amounts etc. All interest rates are depending upon the Prime Lending rate i.e. Base Rate.

### 3.2 What is the base rate?

Before setting the base rate system, banks used another rate system called Prime Lending Rate (PLR) to set their lending rates. The problem with this system is, banks manipulated this PLR to lower level to offer discounted lending rates for the borrowers. It may cause the loss for the banks if they offer loan with much cheaper price. The real intention of the RBI is to make the banking system much stronger after the global financial crisis. The banks meet huge loss because of the default loans. The main reason is, when banks offer loans with cheaper price to attract the customers, most of the customers without adequate financial support to get the loans. **Base rate system** provides more transparency on setting the rates. Each bank uses some criteria to set their **base rates**.

Base Rate System is for the banks to set a level of minimum interest rates charged while giving out the loans. RBI lends money to other banks (or financial institutions). Banks makes a profit by borrowing at a lower rate and lending the same funds at a higher rate of interest. If the RBI hikes the bank rate (this is currently 6 per cent), the interest that a bank pays for borrowing money (banks borrow money either from each other or from the RBI) increases. It, in turn, hikes its own lending rates to ensure it continues to make a profit. It is the minimum rate of interest that a bank is allowed to charge from its customers. Unless permission by the government, RBI rule stipulates that no bank can offer loans at a rate lower than Base Rate to any of its customers. A bank can change its Base Rate every quarter, and also during the quarter.

Each bank decide its own Base Rate, & it is determine by: (i) cost of deposits; (ii) adjustment for the negative carry in respect of Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) (iii) unallocatable overhead cost for banks such as aggregate employee compensation relating to administrative functions in corporate office, directors' and auditors' fees, legal and premises expenses, depreciation, cost of printing and stationery, expenses incurred on communication and advertising, IT spending, and cost incurred towards deposit insurance; and (iv) profit margin.

**Table No. 3.1**

**Base Rates of Different Sector Banks**

SR.NO	NAME OF SECTOR	NAME OF BANK	Base RATE
1	PUBLIC	SBI	7.5%
2	PRIVATE	HDFC	7.25%
3	CO-OPERATIVE	SANGLI URBAN	10.00%

This base rate typically varies from lender to lender

SBI called its Base Rate as a **State Bank Advance Rate – SBAR**.

HDFC call its Base Rate as a **Retail Prime Lending Rate- RPLR**

Co-op. Banks call it as a **Base Rate**.

### **3.3 Repo or Repurchase Rate**

Repo rate is the rate at which banks borrow funds from the RBI to meet the gap between the demands they are facing for money (loans) and how

much they have on hand to lend. As reduction in repo rate will help banks to get money at cheaper rate. When the repo rate increases borrowing from RBI become more expensive

### 3.4 Reverse repo rate

Reverse repo rate is the rate at which RBI borrows money from bank. Banks are always happy to lend money to RBI since their money is in safe hands with good interest. An increase in Reverse Repo Rate can cause the banks to transfer more funds to RBI due to these attractive interest rates. It can help to drawn out excess money of banking system. Due to this fine tuning of RBI using its tools of CRR, Bank Rate, Repo Rate & Reverse repo rate our bank adjust their lending or investment rates for common man.

**Table No 3.2**

**Type of Rates & Ratios (as on June 2011)**

Bank Rate	6.0%
Repo Rate	7.25%
Reverse Repo Rate	6.25%
Cash Reserve Ratio (CRR)	6.0%
Statutory Liquidity Ratio (SLR)	24.0%

**Table No. 3.3**

**Trends in Rates & Ratios**

Year	Bank Rate	Reverse Repo Rate	Repo Rate	Cash Reserve Ratio	Statutory Liquidity Ratio
2004	6.00	4.50	6.00	4.50	25
2005	6.00	5.00	6.00	5.00	25
2006	6.00	5.50	6.50	5.00	25
2007	6.00	6.00	7.75	6.00	25
2008	6.00	6.00	7.75	7.75	25

(Source : RBI Annual Report 2007-2008, part two : the working & operations of the RBI, chap III- Monetary Policy operations.)

From above chart we observe that rates are always changing as per changing market conditions. As we discuss earlier the Base Rate of banks is change when the Repo Rate & Reverse Repo Rate of RBI is change. RBI also changes their rate when Inflation or Deflation prevails in the market.

Inflation occurs when there is an increase in average level of prices in goods & services. Causes of inflation are --

1. The supply of money goes up; the supply of goods goes down;
2. demand for money goes down; demand for goods goes up

RBI needs to control this excess liquidity in our economic system. For this, RBI increases the repo rate which make 'costly credits' & increase in CRR

ratio. This kind of measures by RBI can only control the inflation to a certain extent.

(Cash Reserve Ratio – CRR is the amount of funds that the banks have to keep with RBI. If RBI decided to increase the percent of this, the available amount with banks comes down. RBI is using this method to drain out the excessive money from banks. RBI can vary this rate between 3% to 5%.)

Bank interest rate are depends on many other factors, out of that the major one is inflation. Whenever you see an increase on inflation, there will be an increase of interest rate also.

Deflationary situation when decrease in the prices leads to lower production, lower wages & demand, which leads to further decrease in prices. Statutory Liquidity Ratio (SLR) is the amount a commercial bank needs to maintain in the form of cash, or gold or govt. bonds before providing credit to its customer. So SLR helps to control the expansion of bank credits. By changing SLR rates, RBI can increase or decrease bank credit expansion. So increase or decreases of interest rates depend upon all these factors.

**Table No 3.4**  
**Existing Rate of Interest of Housing Loan**

SR.NO	NAME OF SECTOR	NAME OF BANK	INTREST RATE
1	PUBLIC	SBI	9.75%
2	PRIVATE	HDFC	9.75%
3	CO-OPERATIVE	SANGLI URBAN	12%

The rate of interest on loan will be revised every three months from the date of first disbursement, if there is change in RPLR i.e. the interest rate on loan may change. However if interest rate increase, the interest component in an EMI will increase and the principal component will reduce it will result in an extension of the term of loan & vice versa when the interest rates decreases. The EMI on the Home Loan disburse will not change. But if the tenure crosses a period of 300 months (i.e.25 Years) then the banks increase the EMI.

Today's SBI's Rate of interest is 9.75%, HDFC bank offer home loan at 9.75% interest rate that shows both public sector & private sector are on the same position. But Sangli UCB lent home loan at 12% interest rate which is higher than public and private sector.

**Table No. 3.5**  
**Method of Interest Rate**

SR.NO	NAME OF SECTOR	NAME OF BANK	METHOD OF INTREST RATE APPLIED
1	PUBLIC	SBI	Fixed & Floating
2	PRIVATE	HDFC	Fixed & Floating
3	CO-OPERATIVE	SANGLI URBAN	Reducing Balance Method

Public sector usually offer floating rate of Interest. This is the rate of interest that fluctuates according to the market lending rate. This involves the risk of paying more than the budget in case of the lending rate goes up. It is



profitable to bank as interest rate increase profit of the bank increase but risky also as decrease interest rate decrease profit.

Private sector offers both fixed & floating interest rate method. Private sector have a fixed rate of interest, which means the rate of interest remains unchanged for the entire duration of the loan. Borrower can choose any method as per his requirement. But borrowers give preference to Floating Interest Rate. Alternatively HDFC also avail part of the loan under fixed Int. rate & balance under floating Int. rate. Bank offers borrowers the option to switch between the schemes for nominal fee.

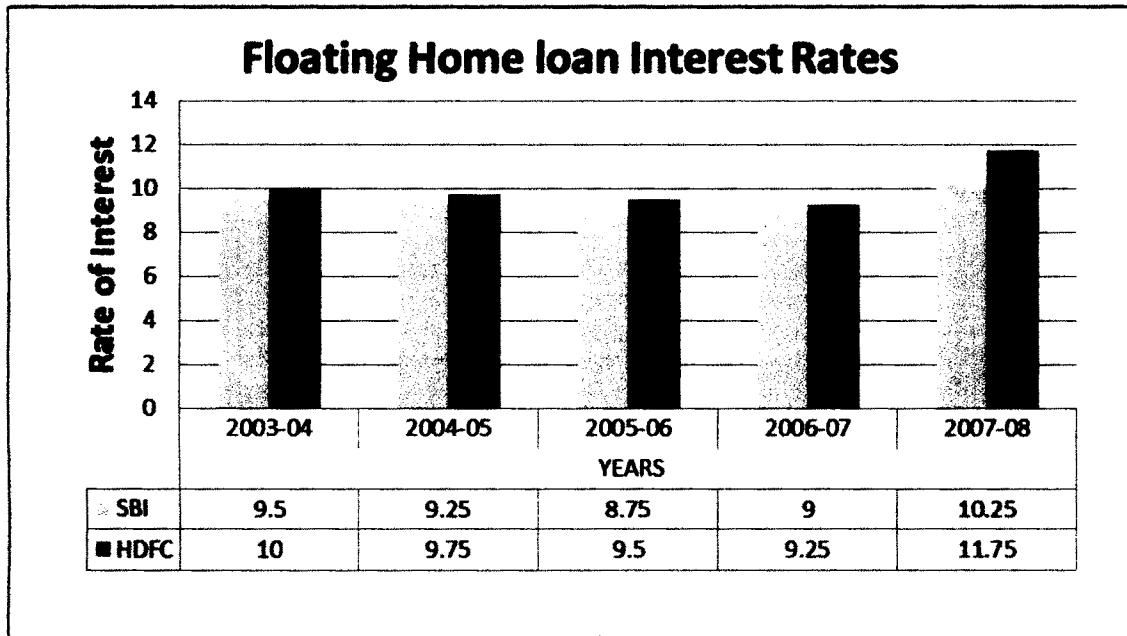
Urban Co-op bank offers Reducing Balance Method. In this system, the principal, for which you pay interest, reduces every month as you pay your EMI. Those who agreed to this Reducing Bal. Method can go towards the Sangli UCB.

A Fixed Rate Home Loan is best suited for those that prefer the stability of fixed monthly payments. When interest rates are on the rise, it makes more sense to go for Fixed Rate Home Loans. But since Floating Rate Home Loans are 1%-2% cheaper and most of the banks in India do not offer true Fixed Rate Home Loans most consumers (in fact more than 90%) go for Floating Rate Home Loans.

**Table No. 3.6**

**Floating Home Loan Interest Rates**

SR.NO	NAME OF SECTOR	NAME OF BANK	INTEREST RATES OF LAST 5 YEARS (in percent)				
			2003-04	2004-05	2005-06	2006-07	2007-08
1	PUBLIC	SBI	9.5	9.25	8.75	9	10.25
2	PRIVATE	HDFC	10	9.75	9.5	9.25	11.75

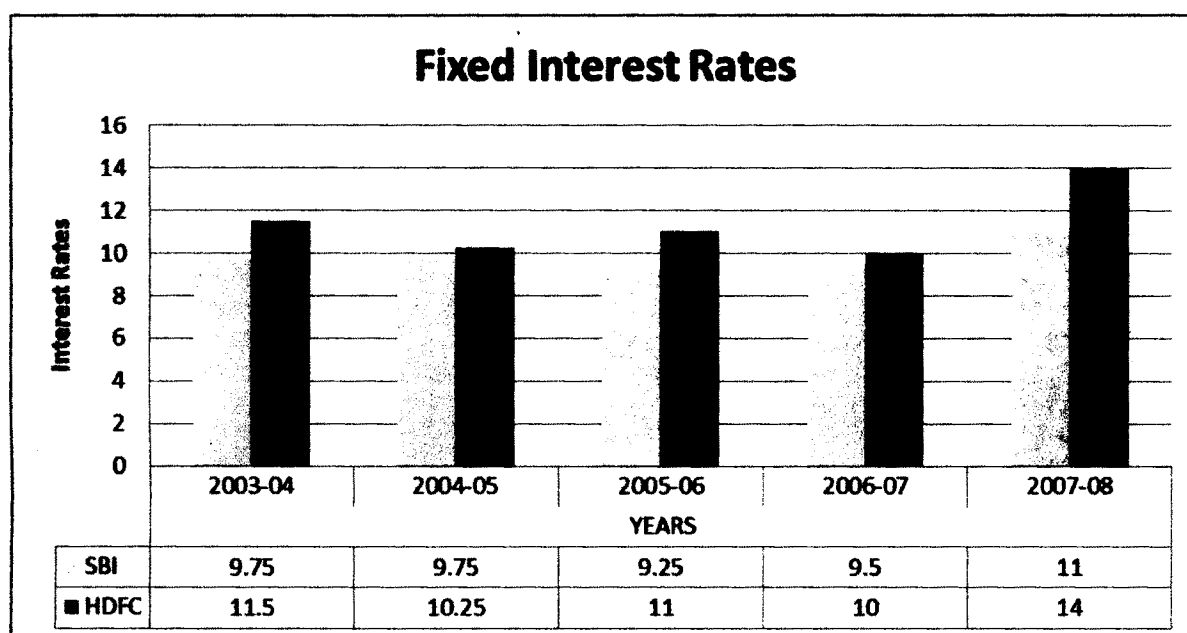


Above chart indicate that there is difference in floating rate of interest in SBI and HDFC bank. SBI's rate of interest rate is always lower than HDFC. SBI's minimum rate of interest is 8.75 in the year 2005-06 and maximum rate of interest is 10.25 in the year 2007-08. HDFC's minimum rate of interest is 9.25 in the year 2006-07 and maximum rate of interest is 11.75 in the year 2007-08.

**Table No. 3.7**

**Fixed Home Loan Interest Rates**

SR.NO	NAME OF SECTOR	NAME OF BANK	INTEREST RATES OF LAST 5 YEARS (in percent)				
			2003-04	2004-05	2005-06	2006-07	2007-08
1	PUBLIC	SBI	9.75	9.75	9.25	9.50	11
2	PRIVATE	HDFC	11.50	10.25	11	10	14



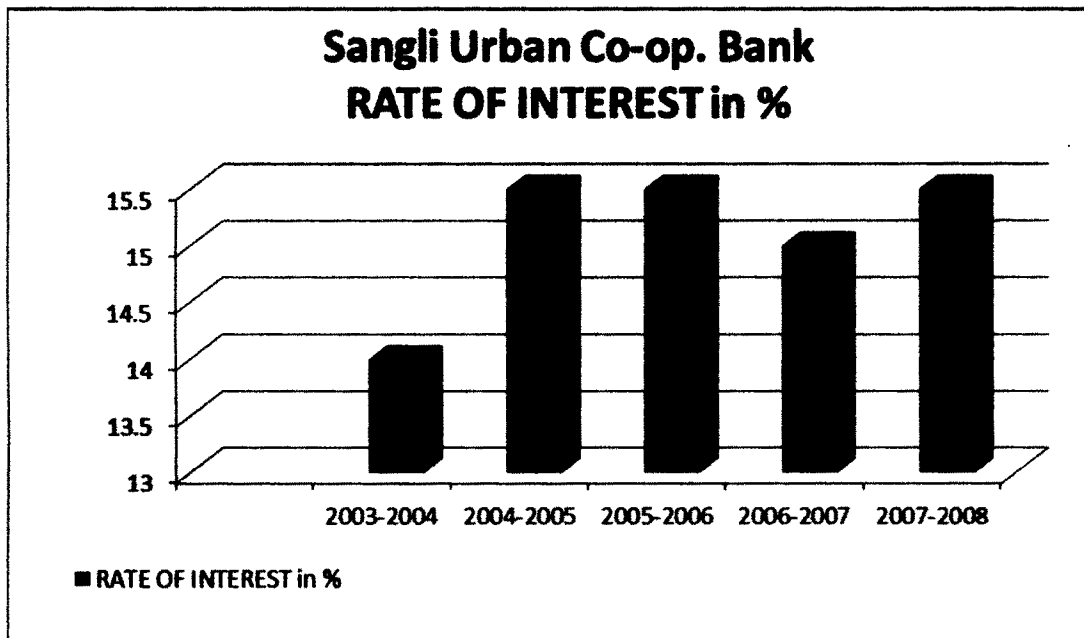
Above chart indicate that SBI and HDFC banks offer fixed rate of interest to customers. SBI's minimum fixed rate of interest is 9.25 in the year 2005-06 and maximum rate of interest is 11 in the year 2007-08. HDFC's minimum fixed rate of interest is 10.25 in the year 2004-05 and maximum fixed rate of interest is 14 in the year 2007-08. HDFC's rate of interest is higher than SBI's rate of interest.

**Table No. 3.8**

**Home Loan Interest Rates of Sangli Urban CO-Op. Bank**

**(REDUCING BALANCE METHOD)**

YEARS	RATE OF INTEREST
2003-2004	14%
2004-2005	15.50%
2005-2006	15.50%
2006-2007	15%
2007-2008	15.50%



Sangli UCB always offer home loan under reducing balance method. There rate of interest is between 14% to 15.50%. In F.Y. 2003-04 rate of interest is 14 % but it increase up to 15.50% in the F.Y. 2004-05 & remain

constant for next year 2005-06. Afterward it reduces up to 15% in 2006-07 & again increases up to 15.50% in F.Y. 20074-08.

**Table No. 3.9**  
**Profitable Avenues of Advancing Loan**

SR.NO	NAME OF SECTOR	NAME OF BANK	Loan Sectors
1	PUBLIC	SBI	Only Home Loans
2	PRIVATE	HDFC	Only Home Loan
3	CO-OPERATIVE	SANGLI URBAN	Home Loan, Business Loan,

In public sector most of the govt. employed reach to get home loans so this type of loan is much safer & profitable to bank so they give stress on providing Home Loans

In Private sector i.e. HDFC provide service only for Housing Development.

In Sangli UCB the Farmers, small businessman, peoples are attracted so they are earn profit by providing not only home loan but also loan to traders, Businessman, industrialist etc.

**Table No. 3.10**  
**Area wise Distribution of Loan**

SR.NO	NAME OF SECTOR	NAME OF BANK	Area Of Distribution
1	PUBLIC	SBI	Rural & Urban
2	PRIVATE	HDFC	Only Urban Area
3	CO-OPERATIVE	SANGLI URBAN	Only those areas where branch of Bank is situated

SBI's branches are mostly situated in the urban area but those applicants who fulfill all requirements as per rules & regulation of the bank will get home loan either he is located in urban or rural area.

HDFC is situated in only District level so they offer loans only to urban area. Sangli UCB open their branches in some cities of Maharashtra so where there is a branch of the bank they offer home loan to that area only.

**Table No. 3.11**

**Rate of Interest of Housing Loan Decided On**

SR.NO	NAME OF SECTOR	NAME OF BANK	INTREST RATE DECIDED
1	PUBLIC	SBI	Loan Tenure & Principle Amount
2	PRIVATE	HDFC	Loan Tenure & Principle Amount
3	CO-OPERATIVE	SANGLI URBAN	Interest rate is fixed

The bank policies are different for determining interest rates for home loan. SBI determine interest rate by considering loan amount and loan tenure.

**I. For SBI**

Loan Amount	Up to 5 years	5 years to 15 years	15 years to 25 years	Fixed Interest Rates
	Floating Interest rate			
Up to Rs 30 lakh	9.75%	10.00%	10.25%	12.00%
Rs 30 lac to 75 lakhs	11.00%	11.25%	11.50%	13.00%
Above 75 lakhs	11.00%	11.25%	11.75%	13.00%

HDFC bank decides interest rates on the principal amount & loan tenure

## II. For HDFC

### (a) In case of Floating Interest Rates

Loan Amount	Up to 5 years	5 years to 15 years	15 years to 25 years
Up to Rs 30 lakh	<b>Scheme I</b> : 10.75% (Fixed for 3 years ) OR <b>Scheme II</b> : 11.25% (Fixed for 5 years ) After that 10.50% rate Or then applicable rate.	<b>Scheme I</b> : 10.75% (Fixed for 3 years ) OR <b>Scheme II</b> : 11.25% (Fixed for 5 years ) After that 10.50% rate Or then applicable rate.	<b>Scheme I</b> : 10.75% (Fixed for 3 years ) OR <b>Scheme II</b> : 11.25% (Fixed for 5 years ) After that 10.50% rate Or then applicable rate.
Rs 30 lac to 75 lakhs	<b>Scheme I</b> : 11.25% (Fixed for 3 years ) OR <b>Scheme II</b> : 11.50% (Fixed for 5 years ) After that 10.75% rate Or then applicable rate.	<b>Scheme I</b> : 11.25% (Fixed for 3 years ) OR <b>Scheme II</b> : 11.50% (Fixed for 5 years ) After that 10.75% rate Or then applicable rate.	<b>Scheme I</b> : 11.25% (Fixed for 3 years )OR <b>Scheme II</b> : 11.50% (Fixed for 5 years ) After that 10.75% rate Or then applicable rate.
Above 75 lakhs	<b>Scheme I</b> : 11.75% (Fixed for 3 years ) OR <b>Scheme II</b> : 11.75% (Fixed for 5 years ) After that 11% rate Or then applicable rate.	<b>Scheme I</b> : 11.75% (Fixed for 3 years ) OR <b>Scheme II</b> : 11.75% (Fixed for 5 years ) After that 11% rate Or then applicable rate.	<b>Scheme I</b> : 11.75% (Fixed for 3years) OR <b>Scheme II</b> : 11.75% (Fixed for 5 years ) After that 11% rate Or then applicable rate.

Source :[www.deal4loans.com/home-loans-interest-rates.php](http://www.deal4loans.com/home-loans-interest-rates.php)

HDFC give option to borrower to choose either 3 years or 5 years interest rate and after that period interest rate is changed as per applicable rate.

Home loan borrowers can avail loan at a fixed rate for the initial three or five years under the new scheme. Thereafter, the loan will switch automatically to HDFC's adjustable rate home loan (ARHL) product, which is an existing floating rate scheme.

**(b) The rates of HDFC for fixed interest rate.**

Loan Amount (in Lakh)	3 Year Rate of Interest	5 Year Rate of Interest
Up to 30	10.75%	11.25%
30 – 75	11.25%	11.50%
Over 75	11.75%	11.75%

Source:[www.deal4loans.com/loans/home-loan/hdfc-fixed-rate-home-loan-scheme-launched/](http://www.deal4loans.com/loans/home-loan/hdfc-fixed-rate-home-loan-scheme-launched/)

Above interest rates table disclose that HDFC bank charge more interest rate than SBI in case of floating interest rate. But in case of fixed interest rate HDFC charge lower interest rate than SBI.

In case of Sangli UCB Interest rate is fixed. It does not change as per change in loan amount and change in loan tenure. Whichever interest rate is decided by bank applicable to Loan amount & loan tenure

**Table No. 3.12**

**Rate of Interest of Housing Loan Is Decided By**

SR.NO	NAME OF SECTOR	NAME OF BANK	INTREST RATE DECIDED BY
1	PUBLIC	SBI	Head Office
2	PRIVATE	HDFC	Head Office
3	CO-OPERATIVE	SANGLI URBAN	Board Of Directors



After confirmation of base rate, bank determines its own interest rate because freedom is given by RBI to decide own interest rates. This interest rate is determined by different authorities in different banking sector.

In case of public sector, SBI interest rate is decided by head office.

In case of private sector, HDFC interest rate is decided by head office.

In case of co-operative sector, Sangli UCB interest rate is decided by board of directors.

**Table No. 3.13**  
**Competitors of Banks In Rate of Interest**

SR.NO	NAME OF SECTOR	NAME OF BANK	NAME OF COMPITITORS
1	PUBLIC	SBI	Financial Institutions
2	PRIVATE	HDFC	Axis Bank, SBI, ICICI Bank
3	CO-OPERATIVE	SANGLI URBAN	Other co-op. Banks, Nationalized Banks, Private Banks

Banks are competing with each other on the basis of interest rate. They offer different interest rates to attract the customers. SBI compete with financial institutions, whereas HDFC compete with ICICI Bank, Axis Bank, SBI Bank etc. and Sangli UCB compete with other co-operative banks, Nationalized bank etc.

**Table No. 3.14**

**Can Borrower Change the Approved EMI**

SR.NO	NAME OF SECTOR	NAME OF BANK	CHANGE THE EMI
1	PUBLIC	SBI	No.
2	PRIVATE	HDFC	Yes
3	CO-OPERATIVE	SANGLI URBAN	No.

Once the Equitable Monthly Installment (EMI) approved by bank borrower cannot change this EMI in SBI and Sangli UCB. But in HDFC, borrower gets the facility of change the EMI as per his demand.

**3.5 Summary**

Interest rate is sensitive parameter of home loan. Borrower always focuses on the interest rate when he decided to take a loan. Which bank charge lower interest rate, customer attracts to that bank. But from point of view of bank interest rate of home loan is only a medium of earning profit. SBI offer home loan to both rural and urban area but HDFC only concentrate on urban area and Sangli UCB gives home loan only those areas where branch of bank is situated. HDFC deals only for housing loan, SBI earn profit by giving home loans and Sangli UCB can get profit by offering home loans, business loans etc.

Before determines interest rate, first upon RBI decide base rate for each bank. This base rate means no bank can offer home loan interest rate below that base rate and if bank offer interest rate below base rate, it may suffer loss to bank. So base rate is minimum level to offer home loan interest

rates. This base rate is affected by repo rate, reverse repo rate; cash reserve ratio (CRR) and statutory liquidity ratio (SLR). RBI gives freedom to each sector bank to determine their interest rates above base rate. So banks compete with each other and attract the customers by providing lower interest rate. SBI's competitors are Financial Institutes, HDFC Competes with Axis Bank, ICICI Bank. Sangli UCB competitors are other co-operative banks, nationalized banks. Today's rate of interest of SBI is 9.75%, HDFC is 9.75% and Sangli UCB is 12%. Banks also applied different policies of interest rate SBI and HDFC offer fixed & floating interest rate method. But Sangli UCB offer only reducing balance method of interest rate.

Bank also determines its rate of interest by considering various parameters like SBI consider rate of interest by considering loan tenure & principal amount. But HDFC's rate of interest is depend upon principal amount and that of Sangli UCB's rate of interest is fixed it is not depend upon loan tenure or principal amount. This determination of rate of interest is in the hands of various authorities in different sector banks. In SBI & HDFC, head office declared rate of interest and in Sangli UCB board of directors declared rate of interest. But once the rate of interest is approved by bank generally in public & co-operative sector it does not change. But in private sector can helps to increase or decrease the EMI as per borrowers demand.