



“THE POWER OF INTEREST RATES IN FINANCIAL INSTITUTIONS (WITH A SPECIAL REFERENCE TO REWA DIVISION)”

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ABSTRACT:

The rate of interest is an important price in any economy. If it is determined mainly by the market forces, it may help in taking appropriate decisions about saving, investment, allocation of resources, financial and monetary policy, etc. However, the level and structure of interest rates in India have remained very closely regulated by the authorities. The present study examines the working of this administered system of interest rates, and discusses the issues and considerations which need to form the basis of future interest rate and monetary policies for the Indian economy.



KEYWORDS: *The power, Economy, Interest rates and financial institutions.*

INTRODUCTION:

Interest rate has always been the most debating subject in the economy. Nowadays, almost all central banks implement some kinds of monetary policy to achieve their economic goals. Irving Fisher was amongst the first person to address the concept of the compensation of expected loss in the purchasing power. The Fisher effect states that nominal interest rate is equal to the expected real interest rate, if the expected real inflation rate remains constant over the period. The Fisher effect proposes a one for one relationship between the nominal interest rate and the expected inflation rate in the economy. Theoretically, short-run movement in nominal interest is useful to predict the future inflation. Many, theoretical economic models assume Fisher effect holds. However, in practice the assumption of constant real interest is dubious. Therefore, the evidence of Fisher equilibrium can be an indication of an efficient market, since nominal interest rate fully incorporates new relevant information regarding of inflation.

The amount charged expressed as a percentage of principle, by a lender to a borrower for the use of assets. Interest rates are typically noted on an annual basis, known as the annual percentage rate (APR). The assets borrowed could include, cash, consumer's goods, large assets, such as a vehicle or building the interest rate is sometimes known as the 'base rate'. When borrower is a low-risk party, they will usually be charged a low interest rate, if the borrower is considered high risk, the interest rate that they are charged will be higher. Interest is charged by lenders as compensation for the loss of the assets use. In the case of lending money, the lenders could have invested the funds instead of lending them out. With lending a large asset, the lender may have been able to generate large fund of higher prices.

Interest rate may be defined as the rate charged for the use of money, and this is often expressed as an annual percentage of the principal. Interest rate is charged by lenders as compensation for the loss of the assets use. In the case of lending money, the lender could have invested the funds instead of lending them out. With lending a large asset, the lender may have been able to generate income from the assets.

Interest rate is the price demanded by the lender from the borrower for the use of borrowed money. In other word interest is a fee paid by the borrower to the lender on borrowed cash as a compensation for forgoing the opportunity of earning income from other investments that could have been made with the loaned cash. Thus, from the lender's perspective, interest can be thought of as an "Opportunity cost" or "rent of money" and interest rate as the rate at which interest (or 'opportunity cost') accumulates over a period of time. The longer the period for which is borrowed, the larger is the interest (or the opportunity cost). The amount lent is called the principal. Interest rate is typically expressed as percentage of the principal and in annualized terms. From a borrower's perspective, interest rate is the cost of capital. In other words, it is the cost that a borrower has to incur to have access to funds.

IMPACT OF INTEREST RATES:

There are individuals, companies, banks and even governments, who have to borrow funds for various investment and consumption purpose. At the same time, there are entities those surplus funds to purchase bonds or money market instruments. After-natively, they can deposit their surplus funds with borrowers in the form of fixed deposits/wholesale deposits. Interest rates receive a lot of attention in the media and play an important role in formulation of government policy. Changes in the rate of interest can have significant impact on the way individuals or other entities behave as investors and saving behavior subsequently impact the economic activity in a country. For example, if interest rates raise, some individuals, if interest rates rise, some individuals may stop taking home loans, while others may take smaller loans than what they would have taken otherwise, because of the rising cost of servicing the loan. This will negatively impact home prices as demanded for homes will come down. Also, if interest rate rise, a company planning an expansion will have to pay higher amounts on the borrowed funds than otherwise. Thus the profitability of the company would be affected. So, when interest rates rise, companies tend to borrow less and invest less. On the other hand, a decline in interest rates spurs investment spending and consumption spending activities and the economy tends to grow faster.

Classification of interest rate:

Here is a breakdown of the different types of interest rates offered and how each may affect the principal sum borrowed and the overall repayment.

Fixed interest rate: A fixed interest rate is exactly what it sounds like: a specific, fixed rate tied to a loan that must be paid back along with the principal every month. Fixed rates are the most common type of interest rate for borrowers because they are easy to calculate and simple to understand. The benefit of fixed interest rate is that you know exactly how much you will be paying during the loan tenure. Thus, those who wish to plan their monthly expenses in advance can go for a fixed interest rate on personal loan.

Floating interest rate: A floating interest rate is one that changes over time in reaction to economic variables including inflation, credit supply and demand, and central bank choices about monetary policy. The specific benchmarks for figuring out your variable interest will be set by the terms of your loan. With floating interest rate, your EMI payable will change during the repayment tenure. Floating interest rate is usually charged on products like a home loan.

Simple Interest rate: Simple interest is also known as regular interest. Simple interest is the percentage charged on the principal amount for a specific tenure. It includes the simple calculation of

how much you owe the lender without considering any other factors such as time, inflation, or payment schedule. Simple interest is easy to figure out because of its simple formula:

$$\text{Simple interest} = \text{principal} \times \text{interest rate} \times \text{tenure}$$

Compound interest rate: Compound interest, also known as 'interest on interest', is calculated on the principal as well as the cumulative interest accrued over the time. Compound interest is based on two key elements: the interest of the loan and the principal loan amount. Here, lenders first apply the interest on the principal loan amount, and whatever balance is pending by the next year will be used to calculate the subsequent year's interest payment.

DISCUSSION:

Overview of District Rewa:

It is located in the northeastern corner of the State, and bounded by Satna district in the West, Sidhi district in the South & the State of Uttar Pradesh in the North & East. Rewa town is the district head quarter for administrative purposes. Geographically, the district encompasses a area of 6314 sq km. The district occupies 5th place in the state according to population and 22nd in terms of area. Economy of the district is mainly dependent on agriculture. The district is famous for white tiger. Main source of income in the district is agriculture with per capita income of INR 29886/-. The net sown area in the district is 4 lakh hectares (71%) and the forest area is 14%. Wheat, soybean, maize and channa are the majorly produced crops in the district.

"The power of interest rates in financial institutions" is a concept that encapsulates the significant influence interest rates wield within the financial sector and, by extension, the broader economy. This power manifests in various ways, impacting the behavior of individuals, businesses, and governments. Here's an exploration of the key aspects:

1. Cost of Borrowing:

Power: Interest rates determine the cost of borrowing for entities such as individuals, businesses, and governments.

Impact: Higher interest rates result in increased borrowing costs, influencing spending patterns and investment decisions.

2. Investment Decisions:

Power: Interest rates play a crucial role in shaping investment decisions by affecting the expected returns on investments.

Impact: Lower interest rates may encourage businesses to invest in projects, stimulating economic activity.

3. Consumer Spending:

Power: Interest rates impact the affordability of credit, influencing consumer spending habits.

Impact: Lower interest rates often lead to increased consumer spending, supporting economic growth.

4. Housing Market Dynamics:

Power: Interest rates significantly influence the housing market by affecting mortgage rates.

Impact: Lower rates spur demand for housing, contributing to the construction and real estate sectors.

5. Monetary Policy Tool:

Power: Central banks use interest rates as a key tool in monetary policy to control inflation and stabilize the economy.

Impact: Adjustments in interest rates influence borrowing costs and, subsequently, economic conditions.

6. Inflation Management:

Power: Interest rates are employed to manage inflationary pressures in an economy.

Impact: Higher rates can be used to curb inflation, while lower rates may be employed to stimulate economic activity.

7. Savings and Investment Behavior:

Power: Interest rates influence the returns on savings and investment products.

Impact: Individuals and institutions make decisions based on the interest rates offered by financial institutions, affecting overall savings and investment behavior.

8. Currency Exchange Rates:

Power: Interest rate differentials impact currency exchange rates.

Impact: Changes in interest rates affect the attractiveness of a currency, influencing international trade and capital flows.

9. Government Borrowing Costs:

Power: Governments rely on the bond market, where interest rates determine borrowing costs.

Impact: Higher rates increase the cost of servicing government debt, influencing fiscal policies.

Understanding the power of interest rates in financial institutions requires recognizing their pervasive impact on economic actors and the intricate interconnectedness of financial markets. Central to monetary policy and economic management, interest rates wield substantial influence in shaping financial landscapes and driving economic outcomes.

CONCLUSION:

Interest rate hikes by central banks also impact loan demand of private and public lenders. Higher interest rates can make borrowing more expensive, leading to a decline in loan demand, particularly for home loans and other long-term loans. This IS negatively impact banks that rely heavily on their loan portfolio for revenue. This is exactly the problem that several mid-sized banks are facing in the India. These banks typically have a less diversified portfolio and heavily rely on their lending business.

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