Repo rate

May 25, 2020

- The (fixed) interest rate at which the Reserve Bank provides **overnight** liquidity up to a certain **limit(0.25% of** their **NDTL)** to banks against the collateral of government and other approved

What are Net Demand and Time Liabilities (NDTL)?

- When we deposit money in banks then for banks it is a liability. If we keep money in Demand form it is demand liability for bank and if we keep money in time form (Fixed deposit) then it is Time liability for Bank. And If we deposited Rs. 50 in-demand (savings deposit) and Rs. 50 in Time deposit, Then Banks Net Demand and Time Liability (NDTL) will be Rs. 100 which is also equal to publics total deposit.

Some points

- Repo Rate is called the "Policy Rate"
- Repo Rate and Reverse Repo Rate come under "Liquidity Adjustment Facility (LAF)" introduced in June 2010.
- Only Repo Rate is announced by the RBI and Reverse Repo Rate, Bank Rate and MSF rate are linked to the Repo Rate in the following way:
- Reverse Repo Rate = Repo Rate – 0.25%
- MSF Rate = Repo Rate + 0.50%
- Bank Rate = MSF Rate
- As of Feb 2020→ Repo rate= 5.15%

Who decides the Repo rate/policy rate? → Monetary Policy Committee (MPC)

- Monetary Policy Committee is defined in Section 2 of the Reserve Bank of India Act, 1934
- MPC was set up consequent to the agreement reached

between Government and RBI to task RBI with the responsibility for price stability and inflation targeting (Currently→ E.g.:6+/- 2% of CPI).

Composition of MPC

- The MPC has 6 members, 3 from RBI (including the RBI Governor) and 3 appointed by the Government of India.
- All the members have one vote and in the event of an equality of votes, the Governor gets a second or casting vote.
- The decision of the MPC is ***binding*** on the RBI.
- MPC has the authority to decide the repo rate only and not CRR or SLR.
- Earlier, the RBI Governor individually used to decide the Repo Rate.

What is the monetary policy framework?

- "**Monetary Policy Framework" Agreement** was signed between the Government of India and RBI in Feb 2015.
- The primary objective→ to maintain price stability,(while keeping in mind the objective of growth)
- The monetary policy framework is operated by RBI
- The inflation target is 4% with a band of +/- 2%
- The inflation target is decided by the Government of India in consultation with RBI
- The inflation is the "Consumer Price Index (CPI) – Combined" published by National Statistical Office(Central statistical office and National Sample Survey Office have been merged into NSO)
- The RBI shall be seen to have failed to meet the target if inflation is more than 6% or less than 2% for **3 consecutive quarters**
- In case RBI fails to meet the target, it will have to give a written report to Government of India explaining the reasons of failure, remedial actions to be taken and an estimated time period within which the Target would

be achieved

- **Monetary Transmission** is the pass-through of RBI’s policy actions to the economy at large in terms of asset prices and general economic conditions.

Some recent announcements during the Feb 2020 monetary policy review by RBI→ Exemptions to CRR + Term repo

- **Term repo**
- RBI lends to banks @repo rate only up to 0.25 per cent of banks NDTL (it is called repo operations)
- RBI further lends from time to time above the repo rate up to 0.75 per cent of overall NDTL in the system.
- In this case interest rate is decided by auction, if more banks want money, the interest rate will go higher, if fewer banks are competing for RBIs money then the interest rate will be less but it will always be above the repo rate.
- This is called “term repo” which means RBI giving money for a fixed term.

Recent Announcement related to term Repo

- The RBI has said that it will conduct a term repo of 1 year to 3 years but at the repo rate.
- It means banks will be able to get more money at the repo rate.
- These Long Term Repo operations(LTROs) will be in addition to the existing liquidity adjustment facility (LAF) and marginal standing facility (MSF) operations
- LTROs will be conducted on the CBS (E-KUBER) platform.
- The operations would be conducted at a fixed rate
- The minimum bid amount would be ₹1 crore and multiples thereof.
- There will be no restriction on the maximum amount of bidding by individual bidders.
- This will help in reducing the interest rate in the market. So it will help in ***monetary transmission.***

- Long Term Repo is also called Variable Repo Operation

Exemptions to CRR

- Banks have been exempted from CRR of 4% on ***home, auto and MSME (I took AUTO to my HOME from my MSME office)*** loans which will be extended between Jan 31 to July 31.
  - CRR is 4% of deposits (NDTL) and the RBI is saying that whatever loan is given to home, auto, MSME, on that CRR not to be maintained.

Let us understand with an example.

- **Case I:** before this measure was announced If you deposited Rs. 100 in a bank, the bank should keep Rs. 4 as CRR with RBI and Rs. 18.25 as SLR with banks and the rest Rs. 77.5 can be lent.
- **Case II:** After this measure is announced If you deposited Rs. 100 in a bank and the bank kept Rs. 4 as CRR with RBI and Rs. 18.25 as SLR with banks and the rest Rs. 77.5 it lent. Now out of this if Rs. 50 is home, auto or MSME loan then, on this Rs. 50 banks don’t need to keep CRR. That means 4% of Rs. 50 is Rs. 2. So overall the bank will keep CRR Rs. 2 only rather than Rs. 4. So banks will have extra Rs. 2 to lend which will bring down the banks “Cost of Funds” because earlier this Rs. 2 was lying idle with RBI on which RBI was not paying interest and now the bank can lend, so the bank will be in a position to reduce the overall lending rate.

OPERATION TWIST

- **Operation Twist** is when the central bank uses the proceeds from the sale of short-term securities to buy long-term government debt papers, leading to easing of interest rates on the long term papers.
- **Objective →** to decrease the interest on long term lending → so that the companies are able to borrow at

cheaper rates for the long term to promote economic growth

- Hence, the RBI purchases debt papers of long term maturity of govt. → when RBI is purchasing the debt paper, that means RBI is giving loan/money for the long term→ this results in easy availability of money for long term→ decreasing in long term interest rate.