RBI Hikes Repo Rate and CRR

Background: Reserve Bank of India (RBI) Governor ShakthiKanth Das announced a 40-basis point hike in the policy rate and increased the Cash Reserve Ratio (CRR) by 50 basis points.

Monetary Policy Committee:

Monetary policy is a set of tools that a nation's central bank has available to promote sustainable economic growth by controlling the overall supply of money that is available to the nation's banks, its consumers, and its businesses**.**

- The Reserve Bank of India (RBI) is vested with the responsibility of conducting monetary policy.
- This responsibility is explicitly mandated under the Reserve Bank of India Act, 1934.

Committee:

- The Monetary Policy Committee (MPC) constituted by the Central Government under Section 45ZB determines the policy interest rate required to achieve the inflation target.
- The Reserve Bank's Monetary Policy Department (MPD) assists the MPC in formulating the monetary policy.
- Views of key stakeholders in the economy, and analytical work of the Reserve Bank contribute to the process of arriving at the decision on the policy repo rate.
- The Financial Market Committee (FMC) meets daily to review the liquidity conditions to ensure that the operating target of monetary policy (weighted average lending rate) is kept close to the policy repo rate.

Failure to Control Inflation:

The Central Government notified the following as factors that constitute a failure to achieve the inflation target:

- The average inflation is more than the upper tolerance level of the inflation target for any three consecutive quarters.
- The average inflation is less than the lower tolerance level for any three consecutive quarters.

Prior to the amendment in the RBI Act in May 2016, the flexible inflation targeting framework was governed by an Agreement on Monetary Policy Framework between the Government and the Reserve Bank of India.

Instruments of Monetary Policy:

- **Repo Rate:**
  - The (fixed) interest rate at which the Reserve Bank provides overnight liquidity to banks against the collateral of government and other approved securities under the liquidity adjustment facility (LAF).
- **Reverse Repo Rate:**
  - The (fixed) interest rate at which the Reserve Bank absorbs liquidity, on an overnight basis, from banks against the collateral of eligible government securities under the LAF.
- **Liquidity Adjustment Facility (LAF):**
  - The LAF consists of overnight as well as term repo auctions. Progressively, the Reserve Bank has increased the proportion of liquidity injected under fine-tuning variable rate repo auctions of a range of tenors.
  - The aim of the term repo is to help develop the inter-bank term money market, which in turn can set market-based benchmarks for the pricing of loans and deposits, and hence improve the transmission of monetary policy.
  - The Reserve Bank also conducts variable interest rate reverse repo auctions, as necessitated under the market conditions.

- **Marginal Standing Facility (MSF):**
    - A facility under which scheduled commercial banks can borrow an additional amount of overnight money from the Reserve Bank by dipping into their Statutory Liquidity Ratio (SLR) portfolio up to a limit at a penal rate of interest.
    - This provides a safety valve against unanticipated liquidity shocks to the banking system.
- **Corridor:**
    - The MSF rate and reverse repo rate determine the corridor for the daily movement in the weighted average call money rate.
- **Bank Rate:**
    - It is the rate at which the Reserve Bank is ready to buy or rediscount bills of exchange or other commercial papers.
    - The Bank Rate is published under Section 49 of the Reserve Bank of India Act, 1934.
    - This rate has been aligned to the MSF rate and, therefore, changes automatically as and when the MSF rate changes alongside policy repo rate changes.
- **Cash Reserve Ratio (CRR):**
    - The average daily balance that a bank is required to maintain with the Reserve Bank as a share of such percentage of its Net demand and time liabilities (NDTL) that the Reserve Bank may notify from time to time in the Gazette of India.
- **Statutory Liquidity Ratio (SLR):**
    - The share of NDTL that a bank is required to maintain in safe and liquid assets, such as unencumbered government securities, cash, and gold.
    - Changes in SLR often influence the availability of resources in the banking system for lending to the private sector.

- **Open Market Operations (OMOs):**
  - These include both, outright purchase and sale of government securities, for injection and absorption of durable liquidity, respectively.
- **Market Stabilisation Scheme (MSS):**
  - This instrument for monetary management was introduced in 2004.
  - Surplus liquidity of a more enduring nature arising from large capital inflows is absorbed through the sale of short-dated government securities and treasury bills.
  - The cash so mobilized is held in a separate government account with the Reserve Bank.

Open and Transparent Monetary Policy Making:

Under the amended RBI Act, the monetary policymaking is as under:

- The MPC is required to meet at least four times a year.
- The quorum for the meeting of the MPC is four members.
- Each member of the MPC has one vote, and in the event of an equality of votes, the Governor has a second or casting vote.

Current Rates:

Reverse Repo Rate	3.35%
Repo Rate	4.40%
Cash Reserve Ratio (CRR)	4%
Bank Rate	4.65%
Statutory Liquidity Ratio (SLR)	18.00%

Importance of CRR:

- CRR regulates the money supply and the level of inflation in the country.
- CRR ensures the safety of the reserved amount as the bank-specific deposit amount is stored in the Reserve Bank of India which is readily available as per the needs of the customers.

Fiscal Policy	Monetary Policy
Fiscal policy is nothing but money policy of the government i.e; generation of money and expenditure of money.	it is concerned with supply of money. i.e; controlling inflation and ensuring liquidity.
It has two sides- income and expenditure	It is about money supply and Demand
It is generally formulated by the executive i.e; Ministry of Finance.	It is formulated by central bank of the Country i.e. Reserve bank of India
Its main tool is budget through which government tries to bring dynamism in the economy.	it has its own tools like Repo rate, Reverse Repo rate, OMO, etc
Expenditure Reforms -FRBM Act Income side Reforms - GST	Monetary Policy reforms- Monetary Policy Committee.

- CRR also plays an important role when inflation is high.
- When inflation is high, the Reserve Bank of India raises the CRR rate to reduce the amount of money available in banks.
- This reduces the excess cash flow in the economy.
- During funding needs, the government can lower the CRR rate to help banks lend to various companies and industries for investment.
- A low CRR rate also increases the growth rate of the economy.

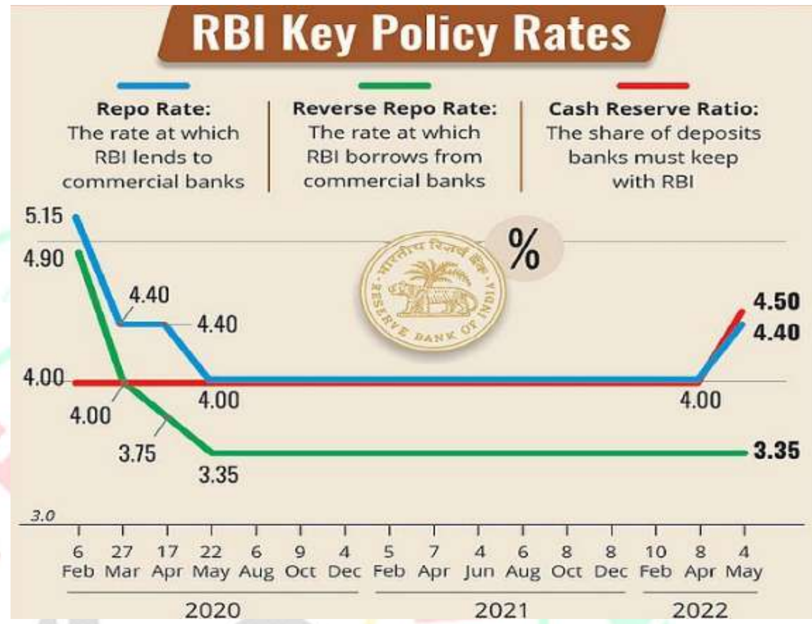
Types of Monetary Policy:

- **Contractionary Monetary Policy:**
  - The goal of a contractionary monetary policy is to decrease the money supply in the economy.
  - It can be achieved by raising interest rates, selling government bonds, and increasing the reserve requirements for banks.
  - The contractionary policy is utilized when the government wants to control inflation levels.
- **Expansionary Monetary Policy:**
  - This is a monetary policy that aims to increase the money supply in the economy by lowering interest rates, central banks buying government securities, and loweringreserve requirements for banks.
  - Expansionary policies reduce unemployment and stimulate business activity and consumption.

- The general goal of an expansionary monetary policy is to boost economic growth.
- But it can also lead to higher inflation.

Objectives:

- The main goals of monetary policy are to control inflation or unemployment and to maintain exchange rates.
- Foreign exchange rates measure the strength of one currency relative to another.



- The strength of a currency depends on several factors, such as the rate of inflation, the interest rates prevailing in its country of origin, or the stability of the government, to name a few.

Inflation and Unemployment:

- **Inflation:**
  - Monetary policy can target inflation levels. Low inflation is considered healthy for the economy. When inflation is high, contractionary policies can address this problem.
- **Unemployment:**
  - Monetary policy can affect the level of unemployment in the economy.
  - For example, the expansionary monetary policy generally reduces unemployment as the increased money supply stimulates business activities that lead to an expansion of the labor market.

Currency Exchange Rate:

With its fiscal sovereignty, a central bank can regulate exchange rates between domestic and foreign currencies.

- For example, the central bank can increase the money supply by issuing more currency.
- In such a case, the domestic currency becomes cheaper compared to its foreign counterparts.

Why does RBI Increase Repo Rate?

- The RBI hiked the repo rate due to rising inflation, geopolitical tensions, high crude oil prices, and global commodity shortages that have hit the Indian economy.
- The aim of the monetary policy measures is to contain the inflation peak and to anchor inflation expectations again.
- It is well known that high inflation is detrimental to growth.

What will the Impact of Increasing Repo and CRR?

- **Costlier Loans:**
  - The direct effect of increasing the repo rate is increasing the interest rates that banks charge on home loans and all other loans.
  - Most banks have already raised their interest rates.
  - Now that the RBI is announcing the rate hike, rates are expected to rise.
- **Rise in Interest inDeposits:**
  - For depositors, however, this could prove to be a boon.
  - Interest rates on deposits, including savings accounts, postal savings accounts, time deposits (FDs), and others, are also likely to rise.
- **Rise in Bond Yields:**
  - Along with savings, bond yields should also rise.
  - On 5th May alone, the 10-year government bond yield rose 25 basis points.

- **Slow-down in Economic Recovery:**
  - In the recent MPC announcement, RBI Governor Das said demand has not yet returned to pre-pandemic levels.
  - As credit becomes more expensive, the demand recovery is likely to face greater difficulties.
  - According to a BusinessLine report, "private consumption has yet to go well beyond pre-pandemic levels."
- **Fall in Inflation:**
  - With the increase in the CRR, the RBI wants to absorb excess liquidity from the economy.
  - The inflation numbers for March and April have worried the authorities.
  - Due to the ongoing war between Russia and Ukraine, the prices of most basic products have increased.
  - Oil prices are burning. With all of this, increased demand also drives up inflation.
  - Through CRR, the RBI aims to remove Rs 87,000 crore from the economy to control prices.

Conclusion:

Accordingly, the MPC decided to increase the policy repo rate by 40 basis points to 4.40 percent. The MPC also decided to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.