# RBI Cuts Repo Rate

drishtiias.com/printpdf/rbi-cuts-repo-rate

## Why in News

The **Reserve Bank of India** has **extended the moratorium on loan repayments by three more months** in view of **Covid-19**. Further, **a 40 basis points (bps) cut to both the repo and reverse repo rates** has been announced.

- The decision has been taken by the **RBI's Monetary Policy Committee** which met ahead of its scheduled meeting in early June.
- The latest moves are expected to ease the financial burden on businesses due to the extended lockdown.

## Key Points

- **Repo Rate and Reverse Repo Rate:**
    - **Decision:** The **repo rate** is presently at **4%,** while the **reverse repo rate** stands at **3.35%.**
    - **Impact:** This will make funds cheaper for banks, thus aiding them to bring down loan lending rates. **Repo rate** is the rate at which a country's central bank (RBI) lends money to commercial banks.
        - The cut in reverse repo rate will prompt banks to lend more rather than keeping their funds with the RBI. **Reverse repo** rate is the rate at which the central bank of a country borrows money from commercial banks within the country.

- **Extension of Moratorium on Loan Repayments by Another 3 Months:**
    - **Decision:** The lending institutions have been permitted to extend the moratorium (suspension) on term loan instalments by **another three months,** i.e., from 1st June, 2020 to 31st August, 2020.
        - A **term loan** is a loan from a bank for a specific amount that has a specified repayment schedule and either a fixed or floating interest rate.
    - **Impact:** This is expected to help borrowers, especially companies, which have halted production and are facing cash flow problems, to get more time to restart their units.
    - Earlier, the **RBI announced the moratorium for a three-month period** — 1st March to 25th May.
    - **All Conditions Unchanged:** All conditions related to the extension remain unchanged, that is, the loan will not be classified by the lender as a **'non-performing asset'** and there will not be any impact on the creditworthiness of any individual/firm.
        - A **Non Performing Asset (NPA)** is a loan or advance for which the principal or interest payment remained overdue for a period of 90 days.
- **Conversion of Interest Charges into a Term Loan:**
    - The RBI has allowed borrowers and banks to convert the interest charges during the moratorium period (from 1st March to 31st August) into a term loan which can be repaid by March 2021.
    - This is expected to reduce the burden on borrowers who have gone for moratorium.
- **Group Exposure Limit Raised:**
    - The group exposure limit of banks has been **increased from 25% to 30% of the capital base** for a temporary period till 30th June, 2021.
    - Group exposure limit determines the maximum amount a bank can lend to one business house. Under the existing guidelines on the Large Exposures Framework, the exposure of a bank to a group of connected counterparties should not be higher than 25% of its capital base.
    - The decision was taken to facilitate flow of resources to the companies as many of them were unable to raise funds from capital markets and are predominantly dependent on funding from banks.

- **For Boosting Foreign Trade:**
    - **A Rs. 15,000 crore line of credit for a period of 90 days would be extended to the Exim Bank** to boost the foreign trade. Export-Import (Exim) Bank is the premier export finance institution of the country.
    - The **maximum permissible period** of pre-shipment and post-shipment export **credit sanctioned by banks has been increased from the existing one year to 15 months** (for loan disbursements made up to 31st July, 2020).
        - This was done to help exporters support their production and realisation cycles. Simply put, any exporter who has taken credit from a bank can repay it in 15 months instead of one year.
- **Views on GDP and Inflation:**
    - The **RBI refrained from providing a Gross Domestic Product (GDP)** growth forecast for the year, or likely trajectory for inflation.
    - GDP growth will **slip into negative territory** this year, blaming it on the collapse in demand due to a fall in private consumption following the Covid-19 lockdown.
    - The central bank has, however, pointed to the likelihood of **some pick-up in growth impulses beginning the second half of 2020-21.**

## Criticism

- Some believe that the latest cut **may be no more than a sentiment booster** as economic activity is at its nadir (worst) and there are not many investment proposals that may benefit from the lower interest rate. Existing borrowers may be the only beneficiaries of the rate cut at this point in time.
- The smaller **Non-Banking Financial Companies (NBFCs) and corporates** may remain stressed, despite liquidity being provided.
- Bankers **expect a spurt in Non-Performing Assets** down the road as nearly six months of non-payment of debt would likely affect credit culture.
- RBI **did not permit a one time restructuring of existing loans** to the seriously affected sectors such as real estate, hotels etc. as demanded by banks.

## Way Forward

- The stress in the economy will continue. The government can provide subvention on existing loans.
- The banks are unwilling to take risks in the current scenario. Thus, there is a need to remove risk averseness in the financial system.

**Source: TH**