# RBI hikes Repo Rate and CRR

**For Prelims:** RBI, Repo Rate, Reverse Repo Rate, Monetary Policy, Monetary Policy Committee (MPC).

**For Mains:** Monetary Policy, Growth & Development, RBI and its Monetary Policy Tools.

## Why in News?

The **Reserve Bank of India's** Monetary Policy Committee (MPC) has increased the policy **Repo Rate by 40 basis points to 4.40%**, with immediate effect and Cash Reserve Ratio (CRR) of banks by 50 basis points to 4.5% of **Net Demand and Time Liabilities (NDTL).**

This is the first increase in the policy repo rate by RBI since May 2020.

## What is the Monetary Policy Committee?

- It is a **statutory and institutionalized framework** under the **Reserve Bank of India Act, 1934**, for maintaining price stability, while keeping in mind the objective of growth.
- The **Governor of RBI is ex-officio Chairman** of the committee.
- The MPC determines the policy interest rate (repo rate) required to achieve the inflation target (4%).
- An RBI-appointed committee led by the then deputy governor Urjit Patel in 2014 recommended the establishment of the Monetary Policy Committee.

## What are the Rates Now?

- **Policy Repo Rate: 4.40%**
    - Repo rate is the rate at which the central bank of a country (Reserve Bank of India in case of India) lends money to commercial banks in the event of any shortfall of funds. Here, the central bank purchases the security.
- **Standing Deposit Facility (SDF): 4.15%**
    - The SDF is a liquidity window through which the RBI will give banks an option to park excess liquidity with it.
    - It is different from the reverse repo facility in that it does not require banks to provide collateral while parking funds.
- **Marginal Standing Facility Rate: 4.65%**
    - MSF is a window for scheduled banks to borrow overnight from the RBI in an emergency situation when interbank liquidity dries up completely.
        - Under interbank lending, banks lend funds to one another for a specified term.
- **Bank Rate: 4.65%**
    - It is the rate charged by the RBI for lending funds to commercial banks.
- **CRR: 4.50% (Effective from 21st May, 2022)**

- Under CRR, the commercial banks have to hold a certain minimum amount of deposit (NDTL) as reserves with the central bank.
- **SLR: 18.00%**
  - Statutory Liquidity Ratio or SLR is **the minimum percentage of deposits that a commercial bank has to maintain** in the form of **liquid cash, gold or other securities**.

## Why has RBI hiked Repo Rate and CRR?

- The decision has been taken in view of the global scenario, wherein **there has been a sharp rise in inflation due to current geopolitical tensions.**
  - Inflation has risen to its highest level in the last 3-4 decades in major economies with global crude oil prices remaining volatile and above USD 100 per barrel.
- The hike in Repo rate and CRR is aimed **at reining in elevated inflation amid the global turbulence** in the wake of the Ukraine war.
- The RBI aimed to keep inflation – which is already close to 7% — at its desired level and **control and monitor money flow int**o the banking system.
  - There has also been a spike in fertiliser prices and other input costs, which has a direct impact on food prices in India.
  - There was a spike in the headline CPI (Consumer Price Inflation) inflation to 6.95% in March 2022.
- There is the collateral risk if inflation remains elevated at these levels for too long.
  - Collateral Risk: The risk of loss arising from errors in the nature, quantity, pricing, or characteristics of collateral securing a transaction with credit risk.
  - Collateral is an item of value used to secure a loan (credit).

## What would be the Impact of Repo Rate and CRR Hike?

- **Repo Rate:**
  - It is **expected to push up interest rates** in the banking system. Equated Monthly Installments (EMIs) on home, vehicle and other personal and corporate loans are likely to go up.
  - **Deposit rates**, mainly fixed term rates, are also **set to rise**.
  - **Consumption and demand** can be impacted by the Repo rate hike.
- **CRR:**
  - The hike in CRR will suck out Rs 87,000 crore from the banking system. The lendable resources of banks will come down accordingly.
  - It also means the cost of funds will go up and banks' net interest margins could get adversely impacted.
    - Net interest margin (NIM) is a measure of the difference between the interest income earned by a bank or other financial institution and the interest it pays out to its lenders (for example, depositors), relative to the amount of their assets that earn interest.

## UPSC Civil Services Examination, Previous Year Questions

**Q. If the RBI decides to adopt an expansionist monetary policy, which of the following would it not do? (2020)**

1. Cut and optimize the Statutory Liquidity Ratio

2. Increase the Marginal Standing Facility Rate

3. Cut the Bank Rate and Repo Rate

**Select the correct answer using the code given below:**

(a) 1 and 2 only

(b) 2 only

(c) 1 and 3 only

(d) 1, 2 and 3

**Ans: (b)**

- Expansionary monetary policy, or easy monetary policy, is when a central bank uses its tools to stimulate the economy. It increases the money supply, lowers interest rates and increases demand. It boosts economic growth.
- Raising SLR makes banks park more money in government securities and reduce the level of cash in the economy. Doing the opposite helps maintain cash flow in the economy. **Hence, statement 1 is not correct.**
- With the increase of MSF Rate, cost of borrowing increases for banks resulting in reduced available resources to lend. **Hence, statement 2 is correct.**
    - **Under expansionary monetary policy, RBI reduces** repo rate and bank rate to increase liquidity in the banking sector. **Hence, statement 3 is not correct**.
    - **Therefore, option (b) is the correct answer.**

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