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Original Research Paper

Management

IMPACT OF REPO RATES IN THE INDIAN SCENERIO

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ABSTRACT RBI concentrates on formulating and executing a healthy monetary policy with clear- cut goals, objectives and tools to be implemented. The paper attempts to study whether policy rates have any impact on Indian scenario or not .To regulate the monetary policy of the economy, RBI imposes various rate policies such as Bank rate or prime lending rate, SLR, CRR, Repo rate and Reverse repo rate, etc .These rates assists the central bank to control buying and lending, safeguarding the investors interests with profitable return .These rates also helps to control inflation .Accelerating inflation and uplifting nation as Asia's third largest growing economy prompted, the RBI's six-member committee MPC (Monetary Policy Committee), headed by governor Urjit Singh Patel, hiked the repo rate under the Liquidity Adjustment Facility by 25bps (basis points) to 6.50 percent from 1 August 2018. It is the first time since four years that the rates were hiked. The repo rate is the rate at which the RBI lends short-term money to the banks. The central bank also increased the reverse repo rate – rate at which RBI borrows from commercial banks to 6.25 percent. The monetary policy is an important tool for setting the pace of economic activity.

KEYWORDS : Monetary Policy, Policy Rate, Repo rate, Reverse repo rate, Credit demand, Inflation.

INTRODUCTION

The Indian banking system started its functioning with the establishment of RBI in 1 April, 1935 under RBI Act 1934. This bank was setup as an Apex bank for the control of monetary transactions of all the banks. Its objective is to control the commanding heights and the progressive development of the economy. The RBI's most important goal is to maintain monetary stability in Indian banking system. In 19 July 1969, 14 large commercial banks whose reserves were more than Rs 500 million were nationalized. Again in 1 April 1980, 6 more private sector banks whose reserves were more than Rs 2 billion were nationalized. With this initiative, the newly nationalized banks got rapid growth and expansion in the economy. The RBI uses monetary policy to maintain price stability and an adequate flow of credit. Rates which the Indian central bank uses for this are bank rate, repo rate, reverse repo rate and the CRR. When reference is made to the Interest rate that the commercial banks pays for the borrowings from the central bank is the repo rate. If the banks are short of funds, they borrow from RBI at the repo rate- the interest rate with one day maturity. On the other hand, the reverse repo rate is the rate of interest that the commercial banks receive if they deposit money with the Central bank. It is risk free. The reverse repo rate is always lower than the repo rate. Banks use repo rate to determine deposit rate, lending rate or base rate. The increase or decrease in the repo and the reverse repo rate have an effect on the interest rate on banking instruments such as loans, mortgages and savings. Higher cost will keep in check the demand for funds. If the central bank hikes its repo rate, it becomes costly for the commercial banks to borrow from RBI. To curb these rates, the commercial banks in turn hike the loan interest rates at which customers borrow from them to compensate for the hike in the repo rate. Impact of changes in policy rate of interest on demand for bank credit is examined for seven emerging economies including India for the period 2002 to 2010. The results revealed that when other determinants, like domestic demand pressure, export demand and impact of stock market signals are controlled for change in policy rate of interest is an important determinant of firm's demand for bank credit.

Review of Literature:

Various studies have been reviewed to those works which are closely related to the change in the various interest rates in the Indian monetary policy. Prof. Pallavi Ingal (2012) in her study presented that "Despite RBI's desperate attempt to bring the monster of Inflation under control, it connotes a good sign in controlling inflation. RBI is continuously increasing interest rate which probably hinders the growth in the near term but is definitely a step which will help in setting straight various anomalies that are currently inflicting the economy and in turn the Indian industry at the macro level makes an economy to run back on the growth track helping it to grow at its true potential rate. Nitya Dawra (2014) in her case study – 'An Empirical Analysis': RBI's repo rate and reverse repo rate presented that it is monetary policy instrument which can be used to control the money supply in the country. Banks are always happy to lend money to RBI since their money is in the safe hands with good interest. The seminal work of Taylor (1993) found out monetary policy reaction function. It states that central bankers increase the nominal interest rate if the inflation is above the target (inflation gap) and /or output is above the potential (output gap) and vice-versa. Selim (2011) analysed the impact of exchange rate on monetary policy decision, inflation targeting countries take into account exchange rate while they build up their monetary policy.

Imperativeness of repo rates:

Banks prefer to lend their money to RBI which is always safe instead of lending it to others (people, companies, etc.) which is always risky. Almost all the rates, it is the repo rate which influences most the given money supply in the economy. It is secured. It can be beneficial at the event of shortage of funds. The implementation of repo rates is beneficial under certain factors. These are:

- **To control inflation:** It is an important tool to control liquidity in the market of that people who don't buy things just because money is easily available at cheaper rates. RBI increases the borrowing rates for banks so as to drain money from them which in turn leads banks to increase their lending rates to make the borrowings for the people dearer and people will have to pay more for the same amount of money. This is expected to influence people to save more money and to spend less on credit, which in turn should reduce inflation.
- **To cure depression:** In order to cure depression, central bank decreases the repo rates which leads the commercial banks to borrow at a reduced rate, because of reduced rates commercial banks can acquire funds at a lower cost and in order to acquire new customers and markets they pass their benefit to consumer by decreasing their Prime Lending Rates on loans and advances. Since lending is cheap, this induces the people to borrow from banks and start new venture or expand the existing market.
- **To generate employment:** When consumers get loans on cheap rate, they purchase capital goods and expand or start their business. This will lead to the demand for employment in the market.
- **To maintain liquidity :** If the value of currency is increasing or the money supply is increasing, so as to control the supply, reverse repo rate is implied by RBI. When the banks have more deposits, it wants to earn more interest as well as risk free return it keeps money with RBI by way of loans. Also to reduce the borrowings, the central bank raises the interest rates and makes the borrowings expensive.

Impact of repo rates on different sections:

- **Impact on commercial banks:** When RBI increases the repo

rate it simultaneously increases the reverse repo rate as well. Commercial banks borrow from RBI by selling securities or bonds with an agreement to repurchase these securities on a certain date at a predetermined price. Similarly, when commercial banks have excess funds they can deposit the same in central bank. The interest paid by central bank in this is called reverse repo rate.

- **Impact on customers:** When banks fall short of funds they approach central bank for financial assistance. The central bank provides finance to these banks at certain rate of interest called as repo rate. To decrease their burden of interest, commercial banks raise the interest rate on loans that it lends to its customers. Commercial banks raise the interest rate on personal loan, home loan, etc.
- **Impact on GDP:** Repo rate and GDP of a country are inversely related. That is if the repo rate decreases, the GDP of a country increases. This is because of increase in the money supply in economy leading to increase in demand of goods in economy. Thus resulting in increase in GDP. The coast of loan increases, the cost of operations which will be passed on to consumers.
- **•Impact on stock exchange:** The relationship between the interest rates and the stock market can help investors understand how changes might affect their investments and how to make batter financing decisions. If the company is having less profits or growth either through higher debt or less revenue- the estimated amount of future cash flows will drop. This results in decline in the price of a company's stock. If the companies experience decline in their stock prices the whole market will go down. With a lowered growth and future cash flows of the company, investors will not get as much growth from stock price appreciation, making stock ownership less desirable. Moreover, investing in stock market can be viewed as too risky as compare to other investors.
- **·Impact on business:** Businesses are also affected greatly by way as they also borrow money from banks to run and expand their operations. When the commercial banks makes borrowings expensive, the companies might not borrow as much and have to pay higher returns for their borrowings. This forces the banks to spend less on market. Less business spending can slow down the growth of the company. This leads to a decrease in their earnings and returns. On the other hand, with the low repo and reverse repo rates, industry gets to borrow more and even gets to pay lower interest rates on its borrowings. Therefore, those businesses that are in a position to secure additional lending from the banking system will benefit from lower repo and reverse repo rates.

Impact of CRR on commercial banks

CRR is that portion of deposits that every scheduled commercial banks need to maintain with the RBI as reserves. Each bank will be asked to retain a specific amount of its deposits in the current account of the RBI. When RBI cuts CRR rate, it encourages banks to lends, thereby more credits are available to industries to accelerate their operations. If the CRR is raised, banks will have lesser money to lend. RBI uses CRR to absorb excess liquidity or to release funds needed for economic growth. The present rate of CRR is 4 percent.

Impact of SLR on commercial banks

SLR is that portion of deposits that banks need to invest in government securities. These securities are highly liquid and can be sold at any point of time to raise money. It ensures liquidity and solvency of banks which is fundamental for the sound banking system. Every scheduled commercial bank require to maintain liquid assets in the form of cash, gold and marketable securities, the value of which shall not be less than 25 percent of the demand and time liabilities. An increase in the SLR rate means that commercial banks shall have to invest more money in government and other approved securities which depletes lendable source of the banks. The present rate of SLR is 19.5 percent.

CONCLUSION:

The central has to make sure that the money supply does not exceed or fall grossly short of excepted demand in the market. The Monetary Policy Committee has attributed the hike in repo and reverse repo rates in the recent meeting in June 2018.The new values are: Repo rate – 6.50%

Reverse repo rate- 6.25%
Marginal Standing Facility- 6.75%

The decision is consistent with the neutral stance of monetary policy with the objective of achieving the medium target for CPI (Consumer Protection Index) inflation of 4%. Amongst all the rates, it is the repo rate which influences most the given money supply in the economy. RBI raises repo rate to increase the overall cost of funds in the banking system. Higher cost will keep in check the demand for funds. If the central bank hikes its repo rate, it becomes costly for banks to borrow money from RBI so they in turn hike the loan interest rates at which customers borrow from banks to compensate for the hike in repo rate. The policy of reducing repo and reverse repo rates is good in short run, but is bad for the economy in the long run because it greatly aids the creation of the business cycle.