

Prospects and Impacts of Increasing RBI Repo Rate

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SUMMARY

The Reserve Bank of India (RBI) was established in the year 1935 in accordance with the Reserve Bank of India Act, 1934. The Reserve Bank of India is the country's central bank, having a multifaceted role. It performs important monetary functions from issue of currency note to maintenance of monetary stability in the country. The Reserve Bank of India began as a private company with private shareholders before being nationalized in 1949. The Central Board of Directors, which is appointed by the Indian government, oversees the company's operations. Since its inception the Reserve Bank of India had played an important role in the economic development and monetary stability in the country. This paper is an attempt to explore into the prospect and impacts of increasing RBI repo rate in Indian Economy.

INTRODUCTION

The Royal Commission on Indian Currency and Finance, which was established on August 25, 1925, recommended the establishment of a central bank in India and the Indian Central Banking Enquiry Committee which was established in 1931. The Reserve Bank of India (RBI) was founded in 1935 by the Reserve Bank of India Act of 1934. The Reserve Bank of India is the country's central bank, having a multifaceted role. It is responsible for a various monetary functions including the issuance of currency notes and the maintenance of monetary stability in the country. The Reserve Bank of India has played a significant role in the country's economic development and monetary stability since its creation. The Reserve Bank of India started off as a private shareholder's organization before being nationalized in 1949. The Central Board of Directors which is appointed by the Indian government oversees the company's operations.

Repo Rate

In the incident of a cash shortage, the Repo Rate is the rate at which a country's central bank lends money to commercial banks. The Repo Rate is used by monetary authorities to control inflation. To prevent banks from borrowing from the central bank during times of inflation, central banks raise the Repo Rate. As a result, the money supply in the economy is reduced, which aids in inflation control. In case that inflationary pressures decrease, the central bank takes the opposite stance. The liquidity adjustment facility includes Repo and Reverse Repo rates.

Current Repo Rate

After a lengthy period of time, the Reserve Bank of India increased the Repo Rate by 40 basis points to 4.40 per cent in May 2022. Since May 2021, the Reserve Bank of India's repo rate has stayed unchanged at 4 per cent. This is the rate at which the Reserve Bank of India lends short-term money from Indian banks. If inflation fears persist and there are no growth shocks, interest rates will most likely be hiked later this year.

Table1. Changes in Repo rate at different months in details

Change in Repo Rate (Month)	Repo Rate (%)	Change in Repo Rate (Month)	Repo Rate (%)
June 2019	5.75	March 2020	4.40
August 2019	5.40	May 2020	4.00
October 2019	5.15	May 2022	4.40

Source: www.rbi.org.in

Reverse Repo Rate

The rate at which a country's central bank borrows money from domestic commercial banks is known as the Reverse Repo Rate. It is a monetary policy tool employed by the Reserve Bank of India to control a country's money supply. If the Reverse Repo Rate rises, the money supply goes down and providing all other factors remains

same. If the Reverse Repo rate rises, Commercial banks will be more enticed to deposit their funds with the RBI, limiting the amount of money accessible in the market.

Current Reverse Repo Rate in India

The Reserve Bank of India absorbs liquidity from banks on an overnight basis in exchange for eligible government assets as collateral under the liquidity adjustment programme at the Indian Reverse Repo Rate. The Reverse Repo Rate in India is now at 3.75 per cent, as declared by Shaktikanta Das the Governor of the Reserve Bank of India. The Reverse Repo Rate has been at 3.35 per cent for over two years.

Table2. Change in Reverse repo rate at different months in details

Change in Reverse Repo Rate (Month)	Reverse Repo Rate (%)	Change in Reverse Repo Rate (Month)	Reverse Repo Rate (%)
May 2019	5.75	March 2020	4.00
June 2019	5.50	April 2020	3.75
August 2019	5.15	May 2020	3.35
October 2019	4.90	May 2022	3.75

Source: www.rbi.org.in

Prospects

It is advantageous for those who wish to borrow from banks because the repo rate is at its lowest level in the last two decades. Because of this, anyone who want to borrow money from the bank will be able to do so at a cheaper interest rate. Customers will benefit from low equated monthly installments on loans tied to the Marginal Cost of Funds based Lending Rate (MCLR) or external benchmark-linked rates. This would be useful for individuals who are paying off current home loans at a time when monthly household incomes have been affected owing to the Covid-19 epidemic. The lower interest rate will also benefit the real estate and housing industries, as more people will look to buy homes because nominal borrowing rates are lower. It will also benefit the real estate industry.

Repo Rate Affect the Economy

The apex bank's repo rate is an effective tool for controlling and monitoring inflation, liquidity and money supply in the market. The cost of borrowing by banks is also affected by changes in the repo rate. The RBI increases the repo rate in an effort to control inflation. The cost of borrowing for businesses increases along with the repo rate, which lowers market investment and cash flow. In the event of a liquidity constraint in the economy, the RBI lowers the repo rate, lowering the cost of borrowing and enhancing the economy's cash flow. It also contributes to economic growth by increasing cash availability for retail customers.

Impact of RBI Repo Rate Increase

To combat growing inflation, the RBI raised the repo rate. As the RBI repo rate rises, the cost of credit rises, making loans more expensive for commercial banks. This increase in the RBI repo rate causes commercial banks to limit their borrowing, resulting in an increase in the rate of interest for retail borrowers. Increasing in the repo rate is the key efforts to increase the cost of bank loans for a client that limits their ability to borrow money. The cash flow in the market is also reduced as a result of this. This reduction in cash flow aids in the containment of growing inflation. As a result, the apex bank employs it as a powerful instrument for containing the economy's rising inflation.

Repo Rate Impact Home Loan Rates

A House loan rate which was directly connected to the house loan rate, every change in the repo rate has a significant influence on the real estate sector. Interest rates for home loans are linked to an external standard rather than being determined by commercial banks and home finance businesses. As a result, any adjustment in the repo rate affects the interest rate on a mortgage. In 2019, the Reserve Bank of India (RBI) published a circular instructing banks and lending institutions to offer house loans linked to a new external benchmark and the majority of lenders chose the repo rate as the external benchmark following the Repo Rate Linked Lending Rate model

(RLLR). As a result, changes in the repo rate have an influence on house loan borrowers because it directly affects their interest payments. The repo rate plus the base spread or margin are usually the components of home loan rates connected to the repo rate. A spread, sometimes known as a margin is a component of a repo linked house loan that customers pay in addition to the repo rate set by their lender. There are two sorts of spreads: basic and extra spreads, which are determined by banks based on factors such as loan size or borrower risk. When the Reserve Bank of India increases its repo rate, the interest rate on a repo rate linked home loan changes by the same amount. If the repo rate fluctuates, your EMIs would fluctuate as well. However, your EMI will fluctuate based on the reset date you choose when you took out the loan. Though the RBI has established a maximum reset frequency of three months for repo rate related house loans.

Impact in stock market

Interest rates and the stock market have an adverse relationship. When the central bank raises the repo rate, it has an immediate effect on the stock market. This shows that businesses are reducing their investment in expansion as a result of the repo rate increase, which will slow growth, have a negative effect on earnings and future cash flows, and ultimately cause a decline in stock prices. In a nutshell, higher interest rates lead to increased savings and a reduction in the flow of money into the economy resulting in a stock market fall. Capital-intensive industries, such as capital goods, infrastructure and others are particularly exposed to these shifts due to large capital or debt on their books. Stocks in sectors information technology (IT) and fast-moving consumer goods (FMCG) are typically less affected.

Industrial sector

This is a major boost to the industrial sector, in addition to benefiting general borrowers. Because of the lower repo rate, industries may be able to obtain loans from lenders at lower interest rates. This is expected to result in lower commodity prices as a result of lower interest rates which will again benefit you the end consumer.

CONCLUSION

The Reserve Bank of India was established with the intention of encouraging rather than restricting the growth of the banking sector. Its powers under Section 22 are different from those of a regular Bank official. The conditions for exercising the power are outlined in Section 22 of the Act. The Reserve Bank, a nonpartisan organization, is in charge of managing the nation's finances. It is reasonable to assume that when such a body is granted authority under a statute that specifies the rules for a banking company, the authority will be used to allow legitimate banking concerns to operate as banks while weeding out institutions that pose as banks, those run on questionable principles, or those that would harm the public interest. The Reserve Bank's developmental function includes providing loans to productive sectors of the economy, establishing institutions to construct financial infrastructure and increasing access to inexpensive financial services. It also encourages effective customer service within the banking industry, as well as the introduction of banking services to the general public, through the focus on financial inclusion.

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