5. RBI keeps interest rates unchanged

Prelims Level: Inflation

Mains Level: GS-III Indian Economy and Issues Relating to Planning, Mobilization of Resources, Growth, Development and Employment.

Why in News?

- The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) decided to keep the interest rate unchanged at 5.15% in the fifth bimonthly policy review, citing inflation concerns despite economic growth continuing to slow down.

Instruments for implementing 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 term repo is to help develop the inter-bank term money market, which in turn can set market-based benchmarks for 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 percent 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 mobilised is held in a separate government account with the Reserve Bank.

About Monetary Policy Committee:

- The policy interest rate required to achieve the inflation target is decided by the Monetary Policy Committee (MPC).
- MPC is a six-member committee constituted by the Central Government (Section 45ZB of the amended RBI Act, 1934) - three officials of the Reserve Bank of India and three external members nominated by the Government of India.
- The MPC is required to meet at least four times in 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.
- The resolution adopted by the MPC is published after the conclusion of every meeting of the MPC.
- Once in every six months, the Reserve Bank is required to publish a document called the Monetary Policy Report to explain: (1) the sources of inflation and (2) the forecast of inflation for 6-18 months ahead.

Decisions Taken by MPC:

- The MPC recognises that there is monetary policy space for future action.
- However, given the evolving growth-inflation dynamics, the MPC felt it appropriate to take a pause at this juncture.
- The MPC also decided to continue with the accommodative stance as long as it is necessary to revive growth, while ensuring that inflation remains within the target".

Current Economic Situation:

- Inflation forecast had been raised to 5.1-4.7% for H2:2019-20 and 4.0-3.8% for H1:2020-21, with risks broadly balanced, the RBI said.
- In October, CPI inflation was projected at 3.5-3.7% for H2:2019-20 and 3.6% for Q1:2020-21.
- Growth forecast for the current financial year was revised downward sharply — from 6.1% projected in October policy to 5%.