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RECENT TRENDS IN MONETARY POLICY IN INDIA

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ABSTRACT

In recent times money market is undergoing structural change in India. Many steps have been taken by RBI for the development of Indian money market. Some important measures are adopted in this direction; one of them is introduction of innovative instruments i.e. Repo and Reverse Repo transactions. The introduction of Liquidity Adjustment Facility (LAF) has been one of the most important innovations in the Indian money market as a technique of monetary policy in India in the recent year. Liquidity Adjustment Facility (LAF) came into being on June 2000. In view of the Covid–19 pandemic and its adverse impact on economy, the RBI reduced police rates i. e. repo rate and reverse repo rate. RBI noted that the economic activity had started to recover from the lows of April-May. However, the recovery momentum is petering out due to the new trend of rising COVID-19 infections. The purpose of the research paper is to study the recent trends in the repo and reverse repo rates in India. The study showed that repo and reverse repo rates have continuously declined during the recent period of global slowdown or recession, and recently the Covid–19 pandemic.

Key Words: Repos, Liquidity Adjustment Facility, Monetary Policy

Introduction:

In recent times money market is undergoing structural change in India. Many steps have been taken by RBI for the development of Indian money market. Some important measures are adopted in this direction; one of them is introduction of innovative instruments like repo and reverse repo transactions. With this initiative RBI has made money market more active.

Repo transactions are conducted in the money market to manipulate short term interest rate and manage liquidity levels. In India, repos are normally conducted for a period of three

days. The eligible securities for the purpose are decided by RBI. When the RBI announces a fixed repo rate for certain number of days/period, it conveys its intention to maintain the desirable level of short term interest rate. When RBI conducts 'repos' the short term interest rate in the money market may not go below the RBI repo rate. Thus Repo transactions ensure stability in short term interest rates in the money market.

Repo means repurchase agreement. Under this agreement the borrower part with securities to the lender with an agreement to repurchase them at the end of the fixed period at a specified price. At the end of the period, the borrower will repurchase the securities at the predetermined price. In a repo, the borrower agrees to sell immediately a security to a lender and also agree to buy the same security from the lender at a fixed price at same later date. A repo is equivalent to a cash transaction combined with a forward contract. The cash transaction results in transfer of money to the borrower in exchange for legal transfer of the security to the lender, while the forward contract ensures repayment of the loan to the lender and return of the collateral of the borrower. A repo is economically similar to a secured loan, with the buyer (lender or investor) receiving securities as collateral to protect against default of the seller (borrower).

The difference between the purchase price and the original price of the securities is the cost for the borrower. This cost of borrowing is called "Repo Rate" which is little cheaper than pure borrowing. Repo rate is the rate at which banks borrow funds from the RBI to meet the gap between the demand they are facing for many (loans) and how much they have on hand to lend. If the RBI wants to make it more expensive for the banks to borrow money, it increases the repo rate, similarly, if it wants to make it cheaper for banks to borrow money, it reduces the repo rate.

On the other hand reverse repo is exactly opposite to the repo rate. The rate at which RBI borrows money from the banks (or banks lend money to the RBI) is termed the reverse repo rate. The RBI uses this tool when it feels there is too much money floating in the banking system. A reverse repo is simply the same repurchase agreement from the buyer's viewpoint, not the seller's. Hence, the seller executing the transaction would describe it as a "Repo" while the buyer in the same transaction would describe it a "Reverse Repo". So "Repo" and "Reverse Repo" are exactly the same kind of transaction, just described from opposite viewpoints. The term "Reverse Repo and sale" is commonly used to describe the creation of a short position in a debt instrument where the buyer in the repo transaction immediately sells the security provided by the seller on the open market. If the reverse repo rate is increased, it means that the RBI will borrow money from the banks and offer them a lucrative rate of interest. Reverse repo rate signifies the rate at which the central bank absorbs liquidity from the banks, while repo signifies the rate at which liquidity is injected.

Repo stands for repurchase. A transaction is called a Repo when viewed from the perspective of the seller of the securities and Reverse Repo when described from the point of

view of the suppliers of funds. Thus whether a given agreement is termed a Repo or Reverse Repo depends largely on which party initiated the transaction.

Liquidity Adjustment Facility (LAF):

The introduction of Liquidity Adjustment Facility (LAF) has been one of the most important innovations in the Indian money market as a technique of monetary policy in India in the recent year. Liquidity Adjustment Facility (LAF) came into being on June 2000. This is a new short liquidity management technique.

The Liquidity Adjustment Facility (LAF) operates through repo auctions i.e. the buying the government securities by RBI for inject liquidity. Thus Reverse Repo auctions i.e. selling the government securities for absorb liquidity from money market, thereby creating a corridor for the call money rates and other short term interest rates. The funds under Liquidity Adjustment Facility (LAF) are expected to be used by banks for their day to day mismatched in liquidity.

Recent trends in Major Monetary Policy Rates in India: Following table shows the recent trends in Repo and Reverse Repo Rates in Indian money market.

Table I
Major Monetary Policy Rates in India

Effective From	Bank Rate	Cash Reserve Ratio	Statutory Liquidity Ratio	Repo Rate (RR %)	Reverse Repo Rate (%)
03-11-2008	6.00	6.00	25	7.50	6.00
21-04-2009	---	5.00	---	4.75	3.25
19-03-2010	---	5.75	---	5.00	3.50
02-11-2010	---	6.00	24.00	6.25	5.25
26-07-2011	---	---	---	8.00	7.00
25-10-2011	---	---	---	8.50	7.50
17-04-2012	9.00	4.75	---	8.00	7.00
29-01-2013	8.75	4.25	23.00	7.75	6.75
19-03-2013	8.50	4.00	---	7.50	6.50
03-05-2013	8.25	---	---	7.25	6.25
20-09-2013	9.50	---	---	7.50	6.50
29-10-2013	8.75	---	22.50	7.75	6.75
28-01-2014	9.00	---	22.00	8.00	7.00
15-01-2015	8.75	---	21.50	7.75	6.75
04-03-2015	8.50	---	---	7.50	6.50
02-06-2015	8.25	---	21.25	7.25	6.25
29-09-2015	7.75	---	---	6.75	5.75
05-04-2016	7.00	---	19.25	6.50	6.00
04-10-2016	6.75	---	---	6.25	5.75
06-04-2017	6.50	---	---	--	6.00
02-08-2017	6.25	---	19.00	6.00	5.75
06-06-2018	6.50	---	---	6.25	6.00
01-08-2018	6.75	---	---	6.50	6.25
07-02-2019	6.50	---	18.75	6.25	6.00
04-04-2019	6.25	---	---	6.00	5.75
06-06-2019	6.00	---	---	5.75	5.50
07-08-2019	5.65	---	18.50	5.40	5.15
04-10-2019	5.40	---	18.25	5.15	4.90
27-3-2020	4.65	---	---	4.40	4.00
22-5-2020	4.25	3.00	18.00	4.00	3.35

Note: “---” Indicate No change.

Source: www.rbi.org

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Repo and Reverse repo rate become effective since June 2000 under The Liquidity Adjustment Facility (LAF). Above table shows the trends in the Repo and Reverse repo rate in Indian money market. From the table it is clear that initial period of financial crisis (Nov.2008), repo rate was more than 7.50 per cent and the reverse repo rate was near about 6 per cent. Later on repo and reverse repo rates have continuously declined during the period of global slowdown or recession. In the year 2000 repo rate and reverse repo rate were considerably high as that time Indian economy was in a "Boom" trade cycle and there was lot of liquidity. As a result to control liquidity and manage short term interest rate, repo rate and reverse repo rates were maintained at the high level. After the demonetarization and implementation of GST, RBI has declined the repo and reverse repo rates have continuously for injected the liquidity in the economy. In view of the Covid-19 pandemic and its adverse impact on real economic activity, the RBI reduced the policy repo rate by 40 bps on May 22, 2020 i. e. 4 percent. In order to make it relatively unattractive for banks to passively park funds with the RBI and to encourage their development for on lending to productive sectors of the economy, the policy interest rate corridor was widened to 90 bps through a reduction of 25 bps in the reverse repo rate on April 17, 2020. The CRR requirement of banks was reduced by 100 bps from 4 percent to 3 percent on March 27, 2020. . RBI noted that the economic activity had started to recover from the lows of April-May. However, the recovery momentum is petering out due to the new trend of rising COVID-19 infections.

Conclusions:

The global economy plunged into its deepest contraction in living memory in April- June 2020 as COVID-19 took its toll. In India, real GDP fell by a record low. The Covid-19 pandemic has fundamentally altered the setting and conduct of monetary policy across the world. The impact of Covid-19 on various sectors of the economy, the Monetary Policy Committee (MPC) decided to cut the policy repo rate from 4.40 percent to 4.00 percent. The pace of monetary transmission has quickened, but credit growth remains feeble, clouding the outlook. Going forward, liquidity world continue to be calibrated, consistent with the stance of monetary policy while ensuring normalcy in the functioning of financial markets and institutions and conducive financial conditions. Efficient monetary policy transmission, particularly to the credit market, world continue to assume priority in the hierarchy of policy objectives. Thus it is observed that RBI is emphasizing on these new instruments to regulate the money market to stabilize the Indian economy. Compared to traditional monetary tools these new instruments have played the vital role in regulating the money market in India.

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