RBI’s Interest Rate Hike

Why in news?

India's central bank has raised the benchmark interest rate for the first time in two years in an attempt to control high consumer prices.

What is the RBI’s move?

- **Repo rate**- The Reserve Bank of India (RBI) raised the repo rate at which it lends money to commercial banks by 40 basis points to 4.4%.
- The rate had been reduced to a record low of 4% during the Covid-19 pandemic.
- **CRR**- The cash reserve ratio (CRR) is the percentage of cash that banks need to keep in reserve against their total deposits to suck out excess liquidity from the system.
- The RBI has announced a 50 basis point increase in CRR.

Why did the RBI hike the interest rate?

- **Ukraine crisis**- Inflation-sensitive items relevant to India such as edible oils are facing shortages due to the conflict in Europe and export bans by key producers.
- **Inflation**- By hiking the Repo rate and CRR, the RBI is aiming to keep inflation (already close to 7%) at its desired level.
- The central banks in advanced economies led by the U.S. Federal Reserve are pursuing a path of policy normalisation.
- **Volatility in financial markets** - But the prospects of volatility in capital flows adding pressure on the exchange rate and heightening the risks of imported inflation have added to the reason.
- **Pandemic**- The fact that the novel coronavirus is still lurking and it could trigger a fresh wave of infections, as seen in China, adds to the uncertainty.
- **Economic Growth**- Recent GDP releases suggest that the global economic recovery is losing pace.

What will be the impact?

- **Impact of Repo rate hike**- The hike in repo rate means the cost of funds for banks will go up thus prompting banks and NBFCs to raise the lending and deposit rates in the coming days.
- SBI and many banks recently raised the MCLR (marginal cost of funds-based lending rate) points anticipating a rate hike.
- MCLR (marginal cost of funds based lending rate) is the lowest interest rate that a bank or lender can offer.
- Some analysts say that consumption and demand can be impacted by the repo rate hike.
- Equated monthly instalments (EMIs) on home, vehicle and other personal and corporate loans are likely to go up.
- Deposit rates are also set to rise after the repo rate hike that came after nearly four years.
- **Impact of the CRR hike-** The 50 bps hike in CRR will suck out Rs 87,000 crore from the

banking system and the lendable resources of banks will come down.
- It also means the cost of funds will go up and banks' net interest margins could get adversely impacted.

If the RBI wants to infuse more liquidity into a system, it lowers the CRR and leaves banks with more liquidity to lend. If the RBI wants to suck out liquidity from the system, it increases the CRR rate.

References

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