Date
16/Aug/2020

Economy Class CLASS-12

Topics - Credit Creation, SLR, Bank Rate, Repo Rate, Reserve Repo Rate, MSF, OMO,

CRR = 3%

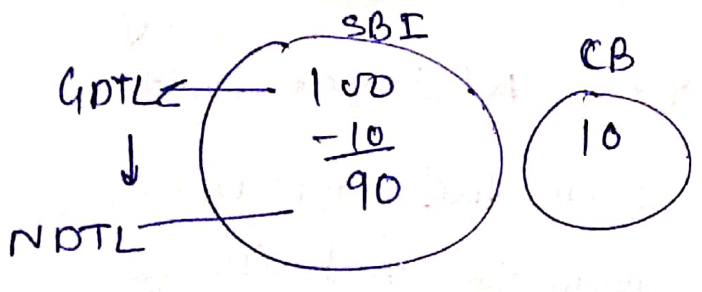
SLR = 18.00%

$\left.\begin{array}{l}\text{Repo Rate} = 4.00\% \\ \text{Reserve Repo Rate} = 3.35\%\end{array}\right\}\ 0.65\%$

MSF Rate = 4.25%

Bank Rate - 4.25%

GDTL & NDTL



Credit Creation

$M_1 = Cu + DD + OD$

SLR - Statutory Liquidity Ratio

NDTL → 18%

→ G-Sec (Govt. Securities)

→ Gold

→ Cash

Main objective - funding to government.

Changes in SLR will Change the availability of resources in the banking system for lending to the private sector. Minimum SLR limit ~~was~~ 25% and upper maximum of NDTL is 40%..

RBI amendment Act 2006 in 1934 amended and lower was removed but upper limit continued

This amendment Authorised RBI to decide any lower limit of SLR as per the RBI act 1934,

Banks have to maintain Cash with the RBI under CRR provision but the SLR requires holding of assets in the above categories by the bank itself.

If a bank fails to maintain its SLR obligation a penalty in the form of penal rate is imposed.

SLR is used ~~as~~ a monetary Policy instrument for controlling liquidity in the economy.

Repo Rate + 3%
5%

Penal Rate of intereset

4% + 3% = 7%
4% + 5% = 9%

Bank Rate + 5%

4.25 + 5 = 9.25%

SLR and Money Supply / liquidity

SLR ↑ → Lending Potential of Bonds ↓ ⇒ Credit Creation ↓ ⇒ M^s ↓

due to SLR ↑ lending potentials of Banks ↓ decreas. Credit creation will decrease. and Money supply will also decreases.

Bank Rate

It is a rate at which the RBI ready to buy or rediscount Bills of of Exchange or other commercial paper under section 49 of the RBI act 1934.

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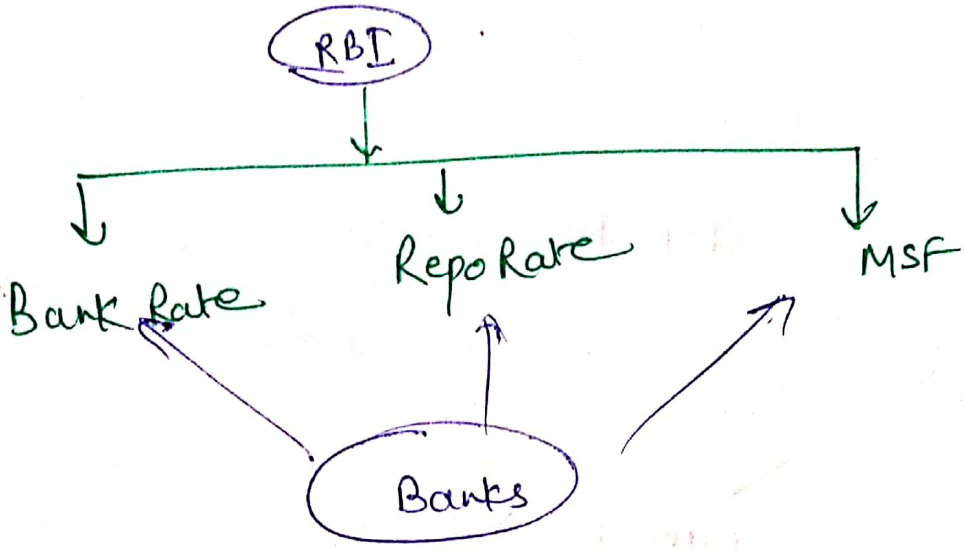
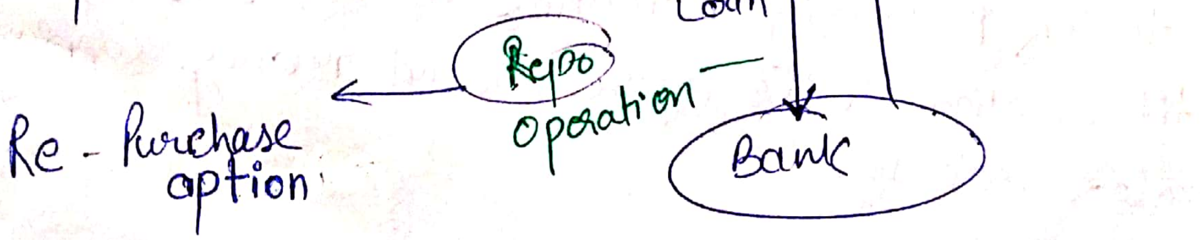
Bank rate is the rate of interest at which banks borrow money from the RBI for long term.



Liquidity Adjustment facility

(LAF)
introduced - 1999
Implemented - 2000

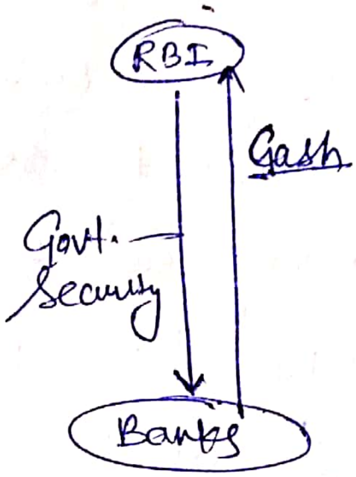


Repo Rate

Rate of interest at which RBI lending to Banks on the basis of Govt. Securities.

Reverse Repo Rate

Rate of interest at which RBI borrowing from the banks.



LAF is a monetary Policy tool which allows banks to borrow money through repurchase agreement or Repo. LAF is the facility extended by the RBI to the schedule bank excluding RRB to avail liquidity in the case of requirement or park excess funds with the RBI in case of excess liquidity on an overnight basis against the collateral of govt. securities. Basically LAF enable liquidity management on a day to day basis

The operations of LAF are conducted by way of repurchase agreement between banks and RBI.

Reporate is a rate of interest at which banks borrow money from RBI to meet short term (long term) needs. by selling govt. securities to RBI with in anagreement to repurchase the same at predetermine rate (price) and date. Repo operation injects liquidity in the economy.

Reverse Repo Rate

It is the rate of interest at which RBI borrows from the bank on the basis of Government securities. In other words Bank reverse repo rate is the Rate of interest at which banks park their excess fund with RBI.

Since Oct 2013, the RBI has introduced Term Repo under the LAF for 14 day and 7 days duration for bank in addition to adjusting overnight borrowing.

Liquidity adjustment facility has emerged as the principle operating instrument for controlling short term liquidity in the economy. Repo rate has become key policy rate which signals the economy about monetary policy.

It absorbs the liquidity from the RBI.

In March 2020

Targeted Long-Term Repo Operation (TLTROs)

Targeted Long term Repo operation RBI has announced in march 2020 to conduct Auction of targeted Long ter Repos of upto three years period at a floating rate of Interest. linpe to the policy repo rate. Liquidtity availed by banks under this operation should be deployed in investment like Corporate bonds, commercial paper and non covertable ~~expenditure~~ debentures over and above outstanding level of their investment in these bonds.

Repo Rate and Money Supply

Repo Rate ↓ ⟹ Bank will Borrow More ↑

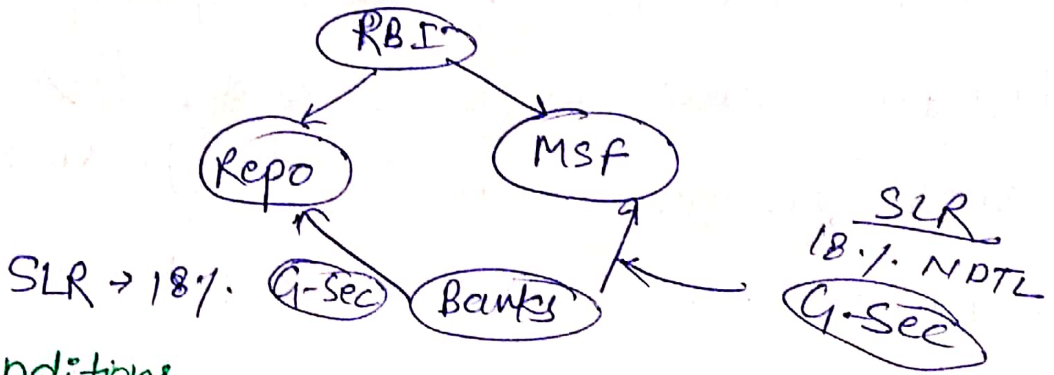
Repo Rate ↓ ⇒ Cost of Borrowing funds ↓ → Banks will Borrow More ⇒ Lending Potential of Banks ↑ ⇒ Credit Creation ↑

⇓

MS ↑

Repo Rate ↑ → Cost of Borrowing funds ↑ → Banks will less funds ⟹ Low Lending Poatential ⟹ Credit Creation ↓ ⟸ MS ↓

MSF → Marginal Standing facility.



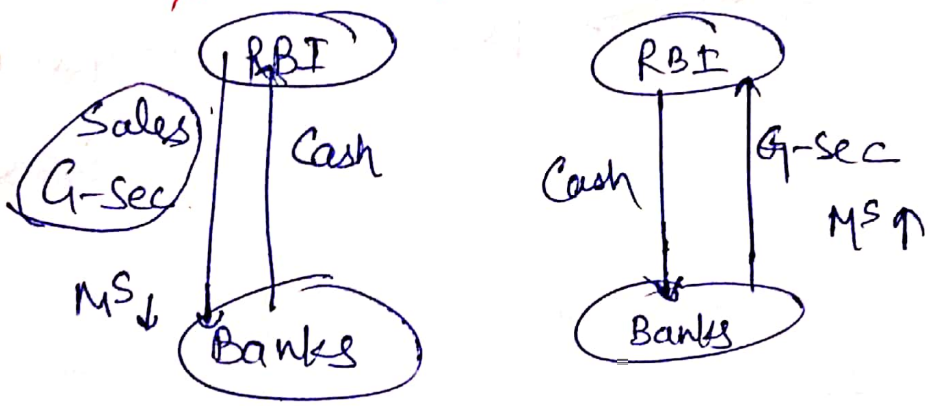
Conditions

1. 2%. of NDTL
2. Mutual funds 0.5% fund Value
3. Maximum limit of 2%. of NDTL not applicable if you ~~borrow on the basis of~~ more than SLR required G-Sec.

MSF was announced by the RBI in its monetary Policy 2011-12 at which banks can borrow money from the RBI which is effective from 9th May, 2011. The MSF is the last resort for the banks once they exhausted all borrowing options including LAF or repo window.

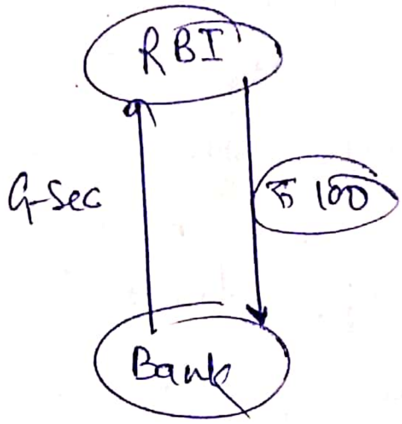
Under the facility the bank can avails fund over the night upto 2% of their respective NDTL on the basis Govt-Sec which kept under SLR provisions. If banks are operating mutual funds than 0.5% of fund value that much extra amount can borrow. If a bank has excess amount of Govt. securities, that is more than SLR required Govt Securities then this 2% criteria will not be applicable.

OMO (Open Market Operation)



If RBI sales govt. securities to banks and other financial institution and money or cash goes from financial institution or banks to RBI is known as open market operation. and also if RBI purchasing the government securities from the banks and financial institution and paying the prize it is also known as OMO.

In other world's OMO means Buying and selling of Government Securities by the RBI.



G-Sec → GoI → Margin 5%
₹ 105 - G-sec

G-Sec → State Govt → Margin 10%
₹ 110 - G-Sec

G-Sec → 1 yrs → T- Bills

G-Sec → =1 yrs and above → Govt Bonds/ Bonds.