Indian Economy CLASS - 14

Date 18/Aug

Topics - BPLR, Base Rate, MCLR, Type of Costs
Intro to Fiscal Policy

* Bank Rate

Under Section 49 of the RBI Act 1934, the Bank Rate has been defined " the Rate at which the RBI is prepared to buy or re-discount bills of Exchange or other commercial paper eligible for purchase under the Act on introduction of LAF, discounting/ rediscounting of bills of exchange by the RBI has been discontinued As a result, the Bank Rate became dormant as an intruments of monetary management. It is now aligned to MSF rate and used for calculating penalty on default of the CRR & SLR.

* Bond

A bond is a debt instrument in which an investor loans money to an entity (Corporate OR Government which borrows the funds ~~for~~ a specified period of time at a variable or fixed interest rate. Bonds are used by companies, muncipalities, state govt and ~~centre~~ central Government.

to raise money to finance a variety of projects and activity owners of bonds are known as ~~date~~ debt -holders or creditors.

Government Security (G-Sec)

A G-Sec is a tradable debt instrument issued by the central govt or the state govt. It represents the Govts debt obligations. Short term G-Secs are known as treasury bills or T-bill ~~Short term G-Secs are~~ with original maturity period of less than 1 year.

Long term G-Secs are known as Govt. bonds or dated securities with original maturity period of one year or more. In India the central govt. issues both T-bills and Govt bonds or dated securities while the state govt only issues Bonds, which are known as state development Loan (SDLs). G-Secs carry practically no risk of default and hence are called risk free gilt-edged instrument.

T- Bills

T-Bills are short term debt instrument issued by the state government in different time period in 91 day, 182 days, 364 day. T-bills are zero coupon Securities and pay no interest rate. In state they are issued at a discount and redeemed at the phase value at maturity. for example a 91 days T bills of 100 rupees face value may be issued at says 98.20 that is at a discount say 1.80 and would be redeemed at the face value of 100. The return to the investor is the difference b/w the maturity value and face value at the issue price.

Government Bonds & Dated Security

Dated G-Sec are securities which carry a fixed or floating coupon (Interest Rate) which is paid on the face value on Half yearly basis. Generally the maturity period of dated securities ranges from five years to 40 years. The public debt office (PDO) of the RBI acts as the registory/ depository of G-Secs and deals with the issue, interest payment and repayment of principal amount at maturity. Most of the dated

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security are fixed coupan securities.

₹ 100

RBI → Bank

RBI ← Bank

G-Sec

5% ← C. Govt ₹ 105

10% ← S. Govt ₹ 110

Pricing of all securities including T-bills, be at face value. Interest as on the date of transaction will be ignored for the purpose of pricing of the security.

Operation Twist

US Federal Bank

Monetary Policy / T-Bills

GoI

G Bonds / Dated Securities

Dec, 2019

① On 2019, Dec 19, RBI decided to conduct Operation twist through simultaneously to sale and purchases of govt securities under Open market operation for 10,000 Crore each on Dec 23, 2019.

Marginal Cost(MC) - is defined as change in total cost due to increase in one unit of production.

It is the addition cost incured due to increase one addition unit.

$$q \rightarrow TC = TVC + TFC$$

$$\Delta q \rightarrow \Delta TC = \Delta TVC + \Delta TFC$$

$$\Delta q \rightarrow \Delta TC = \Delta TVC$$

$$MC = \frac{\Delta TC}{\Delta q} = \frac{\Delta TVC}{\Delta q}$$

1:50

MC → Lending Rate
AC → Base Rate

MCLR (Marginal Costs of funds based lending Rate)

Introduced in 1st April, 2016

The MCLR refers to the minimum interest of a bank (lending rate) below which it can not lend.

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BPLR $\xrightarrow{2003}$ Transparency

⇓

Base Rate $\xrightarrow{2010}$ Lending Rate

⇓

MCLR $\xrightarrow{2016}$ Lending Rate

Base Rate & MCLR these two are internal benchmark.

External Benchmark lending rate introduced.

The Marginal cost of fund based on lending rate refer~~r~~es to minimum rate of interest below which it can not lend, except in some cases allowed by the RBI. It is an internal Benchmark or reference rate for the bank MCLR introduced by the RBI which is effective from 1 April 2016.

The RBI decided to implement MCLR because the lending rates based on marginal cost of funds are more sensitive with change in policy rates ie: repo rate. this is very essential for the effective implementation of monetary policy.

External Benchmark based Lending Rate

Reserve bank had constituted an internal study group (ISG) to examine various step of MCLR system. ISG Observed that internal benchmark such as Base rate and MCLR have not delivered effective transmission of monetary policy. The study Groups (ISG) had recommended a switch over to an external Benchmark in a time bound manner. The RBI issued a circular on 4 Sep 2019 making it mandatory for bank to link all new floating rate or personal loan rate to an external benchmark effective from 1 Oct 2019. ~~Bank~~

Banks can choose from any of the four external benchmark.

i) Repo Rate
ii) Three months T-Bills Yield
iii) Six Months T-Bills Yield
iv) Any other Benchmark published by the financial Benchmarks India Private Limited. (FBIPL)

- Adoption of multiple benchmarks by the same bank is not allowed within a loan category.
- While banks are free to decide "spread over" on the external benchmark credit risk premium can change only when borrower credit assessment undergoes a substantial change, adding other components on spread over including operating cost could be altered once in three years.
- The interest rate under external benchmark ~~may~~ can be reset at least once in three months.

7.5%] 0.5% — Spread over
7.0%