REPO and CRR Rate Cuts – What Should You Understand?

Reserve Bank of India has cut REPO and CRR rates together for the first time in 9 months on Jan 29, 2013. The cut was by 25 basis points (.25%), and now the REPO rate stands at 7.75% while CRR stands at 4%.

What is REPO rate?

REPO denotes **Re Purchase Option** – the rate by which RBI gives loans to other banks. In other words, it is the rate at which banks buy back the *securities* they keep with the RBI at a later period. Bank gives loan to the public at a higher rate, often 1% higher than REPO rate, at a rate known as **Bank Rate** (now bank rate will be 8.75%). RBI at times borrows from banks at a rate lower than REPO rate, and that rate is known as **Reverse REPO rate** (now 6.75%).

What is CRR rate?

CRR corresponds to Cash Reserve Ratio. It corresponds to the percentage of cash each bank have to keep as cash reserve with *RBI* (in their current accounts) corresponding to the deposits they have. For example, say if State Bank of India(SBI) got a total deposit of Rs. 1 crore with them, they need to keep 4 % of that as cash reserve with RBI (around 4 lakh rupees).

Need to reduce the CRR ?

The problem with high CRR is that commercial banks lose a significant amount to be locked up in RBI lockers with out getting any interest. Banks lose profit as they cannot spend this amount as loans to the public. There was a debate regarding CRR between SBI chief and RBI governor before. A .25% reduction in CRR will pump around 18000 crore rupees back to the banks, which they can use to give loans.

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Why there was a fuss around REPO rate cut?

There was a cry from industrial sector to reduce the REPO rate by RBI as high REPO makes the loans which the corporates take to run their business be costly. Considering that our industrial and service sector was going through a troubled phase, with low growth rate, a rate cut in REPO was in great demand. Lowering the REPO rate means cheap loans for the public, but that also means high liquidity in the market – so it can lead to inflation – which will turn the whole act counterproductive.

Why did RBI lower the REPO and CRR?

The fear of inflation was the reason why RBI didn't lower REPO rate for last 9 months. But now since the inflation rates seem to have eased a little bit by various scales like CPI inflation, WPI inflation and core inflation, Reserve Bank of India has attempted to lower the REPO and CRR.

More than the inflation easing factor, RBI has started to give priority to the growth of Indian economy. India's growth rate has been decreasing (now around 5.5%) for a couple of years, due to external and internal factors. As India's growth is mainly driven by private players, a high interest rate (REPO) cannot do any help. The capital intensive industries need cheap capital and for that they need cheap loans. Growth is coupled with development in many sectors – and growth not only provides better employment but more taxes too – which can be used for social sector initiatives by the government.

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