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 normalization.
- **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.

Cash Reserve Ratio

- 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.
- 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.

- **Impact of the CRR hike-** The hike in CRR will suck out money 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.

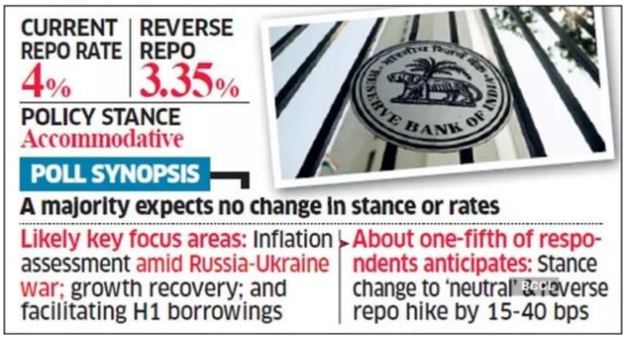
3.4 RBI's Monetary Policy Review

Why in news?

The Reserve Bank of India recently issued its monetary policy report and kept key lending rates (repo rate and reverse repo) unchanged.

What is the monetary policy?

- The monetary policy is a collection of financial tools and measures available with the RBI to safeguard and promote economic growth.
- Monetary policies basically control the overall supply of money available to commercial banks and, indirectly, to individual users and companies.
- The primary objective of a monetary policy is to maintain price stability while keeping in mind objective of growth.



What is the big picture emerging from the monetary policy review?

- **Accommodative stance-** The committee voted to keep the central bank's stance 'accommodative' so that it remains conducive for easier borrowing between the RBI and other banks.