Syllabus subtopic: Indian Economy and issues relating to Planning, Mobilization of Resources, Growth, Development and Employment.

Prelims and Mains focus: about LTRO: features and significance

News: The Reserve Bank of India had received Rs.1.71 lakh crore in the third long-term repo operation (LTRO) conducted for an amount of Rs.25,000 crore. The central bank received 66 bids in the three-year tenor LTRO, which has reversal date on March 1, 2023.

Background

- It has already conducted two LTROs for Rs.25,000 crore each on February 17 and February 24.

- In the February 17 LTRO for the three-year tenor, it received bids amounting to Rs.1.944 lakh crore.

What is long-term repo operation (LTRO)?

- The LTRO is a tool under which the central bank provides one-year to three-year money to banks at the prevailing repo rate, accepting government securities with matching or higher tenure as the collateral.

- While the RBI’s current windows of liquidity adjustment facility (LAF) and marginal standing facility (MSF) offer banks money for their immediate needs ranging from 1-28 days, the LTRO supplies them with liquidity for their 1- to 3-year needs.

- LTRO operations are intended to prevent short-term interest rates in the market from drifting a long way away from the policy rate, which is the repo rate.

Why is it important?
Ever since the economic slowdown hit India and the IL&FS fiasco triggered a spike in borrowing costs, the RBI has been trying to stimulate the economy through easy-money policies. Since January 2019, the repo rate (the rate at which banks borrows quick money from RBI) has been cut by 139 basis points. But only a part of these rate cuts have as yet been passed on to borrowers by banks and other lenders.

- When charged with this slow transmission of rate cuts, bankers complained that repo loans constituted only a miniscule portion of their overall funds, making it difficult for them to cut lending rates. Under the LAF, banks could only bid up to a maximum of 0.75 per cent of their net demand and time liabilities.

- The LTRO bidding system, taken with the removal of the 0.75 per cent limit on LAF borrowings, is expected to remove these constraints. The RBI believes that offering banks durable longer-term liquidity at the repo rate (5.15 per cent), can help them lower the rates they charge on retail and industrial loans, while maintaining their margins. The encouraging response to the first auction indicates the banks' high appetite for cheap funds — bids were received for more than 7.7 times the amount auctioned (Rs.25,000 crore). The LTRO will also help bring down the yields for shorter-term securities (in the 1-3-year tenor) in the bond market.

**Features of Long-Term Repo Operations (LTRO)**

- **Maturity period (tenor):** One-year and three-year tenors

- **Total funds to be injected:** Up to Rs 1,00,000 crores

- **Interest rate:** at the prevailing policy rate (Repo rate).

- **Method of fund injection:** CBS (E-KUBER) platform. The operations would be conducted at a fixed rate.

- Banks would be required to place their requests for the amount sought under LTRO during the window timing at the prevailing policy repo rate. Bids below
or above policy rate will be rejected.

- If there is over-subscription of the notified amount, the allotment will be done on pro-rata basis. RBI will, however, reserve the right to inject marginally higher amount than the notified amount due to rounding effects.

- The minimum bid amount would be Rs. 1 crore and multiples thereof. There will be no restriction on the maximum amount of bidding by individual bidders.

- The eligible collateral and the applicable haircuts for LTRO will remain the same as applicable for LAF.

- All other terms and conditions as applicable to LAF operations for the LTRO.