RBI slashes the lending rates

Part of: GS-III- RBI-INFLATION (PT-MAINS-PERSONALITY TEST)

The RBI Governor Shaktikanta Das said that the six-member Monetary Policy Committee voted 5:1 in favour of 40 bps cut in interest rate. The RBI Governor said, measures announced can be divided into four categories-to improve functioning of markets, to support exports and imports, to ease financial stress by giving relief on debt servicing and better access to working capital and to ease financial constraints faced by State Governments.

Important Points

- Speaking about impact of COVID-19, RBI GOVERNOR said, the GDP growth in 2020-21 goes in negative territory.
- The headline inflation may remain firm in first half of year; ease in the second half, falling below 4 per cent in Q3/Q4 of financial year 20-21.
- Granting relief to people the RBI extended moratorium on loan repayments by three more months in view of COVID-19 starting from 1st of June to 31st of August, 2020.
- The RBI has announced to extend 15,000 crore rupee line of credit to EXIM Bank.
- It has relaxed rules governing withdrawal from Consolidated Sinking Fund (CSF) while at the same time, ensuring depletion of fund balance is done prudently.
- It will enable states to meet about 45 per cent of redemption of their market borrowings which are due in 2020-21.

The RBI Governor said private consumption has seen biggest blow due to COVID-19 outbreak, following investment demand has halted big time impacting the government revenues severely due to slowdown in economic activity. The inflation outlook is highly uncertain with elevated level of inflation in pulses being worrisome and therefore requires review of import duties. The Group Exposure Limit of banks is being increased from 25 to 30 per cent of eligible capital base for enabling the corporates to meet their funding requirements from banks. The increased limit will be applicable up to 30th June, 2021.

Monetary Policy Committee

Usually, the MPC meets six times a year. But, in FY20, it had an extra meeting in view of the pandemic and the urgent need to assess the current and evolving macroeconomic situation.

About MPC:

The RBI has a government-constituted Monetary Policy Committee (MPC) which is tasked with framing monetary policy using tools like the repo rate, reverse repo rate, bank rate, cash reserve ratio (CRR).

It has been instituted by the Central Government of India under Section 45ZB of the RBI Act that was amended in 1934.
Functions:

The MPC is entrusted with the responsibility of deciding the different policy rates including MSF, Repo Rate, Reverse Repo Rate, and Liquidity Adjustment Facility.

Composition of MPC:

1. The committee will have six members. Of the six members, the government will nominate three. No government official will be nominated to the MPC. (PT question)
2. The other three members would be from the RBI with the governor being the ex-officio chairperson. Deputy governor of RBI in charge of the monetary policy will be a member, as also an executive director of the central bank.

Selection and term of members:

Selection: The government nominees to the MPC will be selected by a Search-cum-Selection Committee under Cabinet Secretary with RBI Governor and Economic Affairs Secretary and three experts in the field of economics or banking or finance or monetary policy as its members.

Term: Members of the MPC will be appointed for a period of four years and shall not be eligible for reappointment.

How decisions are made?

Decisions will be taken by majority vote with each member having a vote.

RBI governor’s role: The RBI Governor will chair the committee. The governor, however, will not enjoy a veto power to overrule the other panel members, but will have a casting vote in case of a tie.

What is RBI Monetary Policy?

The term ‘Monetary Policy’ is the Reserve Bank of India’s policy pertaining to the deployment of monetary resources under its control for the purpose of achieving GDP growth and lowering the inflation rate.

The Reserve Bank of India Act 1934 empowers the RBI to make the monetary policy.

What the Monetary Policy intends to achieve?

As per the suggestions made by Chakravarty Committee, aspects such as price stability, economic growth, equity, social justice, and encouraging the growth of new financial enterprises are some crucial roles connected to the monetary policy of India.

1. While the Government of India tries to accelerate the GDP growth rate of India, the RBI keeps trying to bring down the rate of inflation within a sustainable limit.
2. In order to achieve its main objectives, the Monetary Policy Committee determines the ideal policy interest rate that will help achieve the inflation target in front of the country.
Monetary Policy Instruments and how they are managed?

Monetary policy instruments are of two types namely **qualitative instruments** and **quantitative instruments**.

The list of **quantitative instruments** includes Open Market Operations, Bank Rate, Repo Rate, Reverse Repo Rate, Cash Reserve Ratio, Statutory Liquidity Ratio, Marginal standing facility and Liquidity Adjustment Facility (LAF).

**Qualitative Instruments** refer to direct action, change in the margin money and moral suasion.

Consolidated Sinking Fund and Guarantee Redemption Fund of State Governments

State Governments are maintaining the **Consolidated Sinking Fund (CSF)** and the **Guarantee Redemption Funds (GRF)** with the Reserve Bank as buffers for repayment of their liabilities. Currently, State Governments can avail of Special Drawing Facility (SDF) from the Reserve Bank against the collateral of the funds in CSF and GRF. **The rate of interest charged is 100 bps below the Repo Rate at which Ways and Means Advances are extended to the State Governments.** In order to further incentivise adequate maintenance of these funds by the State Governments and to encourage them to increase the corpus of these funds, it has been decided to lower the rate of interest on SDF from 100 bps below the Repo Rate to 200 bps below the Repo Rate.

**What Is a Sinking Fund?**

A sinking fund is a fund containing money set aside or saved to pay off a debt or bond. A company that issues debt will need to pay that debt off in the future, and the sinking fund helps to soften the hardship of a large outlay of revenue. A sinking fund is established so the company can contribute to the fund in the years leading up to the bond's maturity.