

Bank Rate: Notes for UPSC Indian Economy

Bank rate is also known as the discount rate. Thus whenever a bank suffers from the problem of shortage of funds, it can borrow from the central bank of the country (In India's case, the Reserve Bank of India) on the basis of monetary policy of that country.

Bank Rate is a featured concept in the economy segment of the IAS exam.

What is a Bank Rate?

Bank rate is a rate at which the Reserve Bank of India (RBI) provides the loan to commercial banks without keeping any security. In this instance, there is no repurchasing agreement signed and no collateral is involved. The RBI also arranges for short-term loans to its clients by keeping collateral which is called the repo rate. Bank rate in India is fixed by the Reserve Bank of India. It is generally higher than Repo Rate as it is a significant instrument to regulate liquidity.

How is a Bank Rate determined?

The interest rate that is charged by a country's central or federal bank on loans and advances controls the money supply in the economy and the banking sector. This is typically done on a quarterly basis to control inflation and to stabilize the country's exchange rates. A change in bank rates may trigger a ripple effect, as it impacts every sphere of a country's economy. For instance, stock markets prices tend to react to unexpected interest rate changes. A change in bank rates affects customers as it influences prime interest rates for personal loans.

What is the Bank Rate in India?

In India, the Reserve Bank of India determines the bank rate, which is the standard rate at which it is prepared to buy or re-discount bills of exchange or other commercial bills eligible for purchase under the RBI Act 1934 (sec.49). The Reserve Bank of India also provides short term loans to its clients (keeping collateral) at what is called the repo rate. This rate is revised periodically. However, there is no predetermined schedule. The repo rates are changed reactively depending on the economy. As in other countries, repo rates affect the money flow into the nation's economy and affect the inflation and commercial banks' lending or interest rate. As of May 2020, the Bank Rate is 4.25%, the Repo Rate is 4.00% and Reverse Repo Rate is 3.75%.

Relevant Question Regarding Bank Rate

What is the difference between bank rate and repo rate?

Bank Rate and REPO rate are almost similar in nature. The central bank(RBI for India) lends money to a private bank for which the private bank needs to pay the interest rate. The only difference is that the REPO rate is used to lend money for the short term while the bank rate for the long term.