Cash Reserve Ratio (CRR)- Repo Rate & Reverse Repo Rate (UPSC Notes)

CRR is an important tool of the Monetary Policy. Monetary Policy is the process of regulating the supply of money in an economy by the monetary authority of the country. A specific CRR is provided to each commercial bank in India by the RBI. The Reserve Bank of India is authorised to make monetary policy under the Reserve Bank of India Act, 1934 and can set the cash reserve ratio between 3% and 15%.

5 Important Rates (Updated)

The below-given table shares the updated details of 5 important rates fixed by the Reserve Bank of India (RBI) (as of 4th May, 2022).

Reverse Repo Rate	3.35%
Repo Rate	4.40
Cash Reserve Ratio (CRR)	4%
Bank Rate	4.65%
Statutory Liquidity Ratio (SLR)	18.00%

What is a Cash Reserve Ratio?

Cash Reserve Ratio (CRR) is a specific part of the total deposit that is held as a reserve by the commercial banks and is mandated by the Reserve Bank of India (RBI). This specific amount is held as a reserve in the form of cash or cash equivalent which is stored in the bank's vault or is sent to the RBI. CRR ensures that the banks do not run out of money.

Cash Reserve Ratio in India is decided by the Monetary Policy Committee (MPC) under the periodic Monetary and Credit Policy. If the CRR is low, the liquidity with the bank increases, which in turn goes into investment and lending and vice-versa. Higher CRR creates a negative impact on the economy and also lowers the availability of loanable funds. As a result, it slows down the investment and reduces the supply of money in the economy.

Significance of CRR

CRR is an important tool of the Monetary Policy which provides the following benefits:

- CRR regulates the money supply and the level of inflation in the country.

- CRR ensures the security of the reserved amount as the specific amount of the bank's deposit is stored with the Reserve Bank of India which can be readily available as per the need of the customers.
- CRR also has a major role to play during high inflation. During high inflation, the Reserve Bank of India increases the CRR rate to reduce the amount of money that is available with the banks. This reduces the excess flow of money in the economy.
- During the need of funds, the government can lower the rate of the CRR to help the banks in providing loans to various businesses and industries for investment. A low rate of CRR also increases the growth rate of the economy.

Repo Rate and Reverse Repo Rate

Repo rate can be defined as an amount of interest that is charged by the Reserve Bank of India while lending funds to the commercial banks. The word 'Repo' technically stands for 'Repurchasing Option' or 'Repurchase Agreement'. Both the parties are required to sign an agreement of repurchasing which will state the repurchasing of the securities on a specific date at a predetermined price. The repo rate in India is controlled by the Reserve Bank of India.

Any changes in the repo rates can directly impact the economy. A decrease in the repo rates helps in improving the growth and economic development of the country. A decline in the repo rate can lead to the banks bringing down their lending rate which is beneficial for retail loan borrowers.

Reverse Repo Rate

The reverse repo rate is the rate of interest that is provided by the Reserve bank of India while borrowing money from the commercial banks. In other words, we can say that the reverse repo is the rate charged by the commercial banks in India to park their excess money with RBI for a short-term period. The current reverse repo rate in India as of March 2021 is 3.35%. Reverse repo rate is an important instrument of the monetary policy which control the money supply in the country.

Components of Repo Transaction

Some of the major components of the Repo Transaction which is important for the agreement of the RBI for executing any transaction with the banks are as follows:

- **Preventing economy squeezes:** The Reserve Bank of India can increase or decrease the repo rate depending on the inflation and thus, it can control the economy of the country.
- **Short-Term Borrowing**: RBI can lend money to the commercial banks for a short period of time provided that the banks must buy back their deposited securities at a predetermined price.
- **Collaterals & Securities:** Collaterals in the form of gold and bonds are also accepted by the RBI.
- **Liquidity:** The funds borrowed by the banks from the RBI are kept as a precautionary measure to maintain liquidity.

CRR, Repo rates and Reverse Repo Rates are important tools of Monetary Policy. Candidates preparing for UPSC are also advised to keep a track on the latest current affairs related to several economic developments in the country.