Repo Rate Unchanged

Why in news?

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The Reserve Bank of India has kept the benchmark interest rate unchanged at 6.5%. Click here to read on the latest rate hike.

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What is the decision?

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- The RBI's rate setting Monetary Policy Committee (MPC) has kept the repo rate unchanged at 6.5%.
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- The RBI has also changed its stance from ‘neutral’ to ‘calibrated tightening’.
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- This indicates that there will not be a rate cut in the near future.
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- So rates could either go up or stay steady in the coming months.
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What was expected?

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- It was highly expected that the RBI would raise rates by at least 25 basis points.
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- It was anticipated in the backdrop of the weakening trend in rupee.
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- The rupee weakened past the 74-mark to the U.S. dollar for the first time ever after the RBI's decision on interest rate.
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Why is the decision justified?

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- **Inflation** - The Monetary Policy Committee has decided to stick to its inflation-targeting mandate.
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- The RBI has kept the rates unchanged to keep domestic inflation just around 4%.
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- The decision, notably, comes in spite of other risks facing the economy.
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- **Stability** - The rate pause allows the MPC to respond to other important objectives like financial stability.
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- There are already concerns over the ability of NBFCs (Non Banking Financial Company) and HFCs (Housing Finance Company) to meet their liabilities.
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- Given this, the assurance of stable rates and sufficient liquidity was required to calm the markets.
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- The change in stance from neutral to "calibrated tightening" also puts to rest any speculation about cut in rates.
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- **Government** - The decision to keep rates steady might also work in favour of the government.
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- As, the government would prefer to borrow at cheaper rates in the run-up to the general elections next year.
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What is the shortfall?

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- It is uncertain if the MPC factored in the impact of duty cuts on oil products on the fiscal deficit.
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- The MPC has assumed that the government will stick to the deficit target as recently assured, despite the duty cut.
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- Shifting of government borrowing from the market to small savings may have some impact on bond yields. Click here to know more.
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- But the impact of overall borrowing on crowding out will be the same.
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- Moreover, the government will have to pay the higher cost of moving market borrowing to small savings.
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What lies ahead?

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- The challenge now for RBI is to parallelly manage the various other risks to financial stability.
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- For now, the RBI seems to prefer piecemeal measures, such as easing foreign investment norms and mild intervention in the forex market.
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- This is in terms of addressing the financial risks posed by the weakening rupee.
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- The biggest challenge facing the RBI will be the prospect of further rate hikes by the U.S. Federal Reserve and central banks in other developed economies. Click here to know more
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- This could possibly force the central bank to look beyond its inflation mandate.
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Source: The Hindu, BusinessLine

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Quick Facts

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- **Repo rate (Repurchase rate)** is the rate at which the RBI lends money to commercial banks which avails it in the event of any shortfall of funds.
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- **Reverse repo rate** is the rate at which the RBI borrows money from commercial banks within the country.
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