Standing Deposit Facility

Why in news?

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The Standing Deposit Facility, proposed by the RBI and under examination by the Centre, is viewed as a **strong tool to suck out the surplus liquidity.**

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What is it?

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- This concept, **first recommended by the Urjit Patel committee** report in 2014, may soon become part of the central bank's toolkit to manage liquidity.
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- Standing deposit facility is a remunerated facility that **will not require the provision of collateral for liquidity absorption.**
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- Banks, at different points in time, may be short of funds or flush with money.
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- When they need money for the short-term, they borrow from the RBI (Repo Rate) for which they pledge government securities.
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- When banks have excess funds they lend it to the RBI at the **reverse repo rate** that is lower than the repo rate. Here too, government securities act as collateral.
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Why the facility is introduced now?

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- The demonetisation exercise has left banks flush with funds.

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- The past two months, banks have been lending left, right and centre to the RBI under the reverse repo window.
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- And with the RBI increasing the reverse repo rate by 25 basis points to 6 per cent in the April policy, banks now earn more on these funds.
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- The worry is there may be only so much (limited) collateral to go around.
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- **Collateral may become a constraining factor** if the central bank runs out of securities to absorb liquidity under the reverse repo window.
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- Enter the Standing Deposit Facility. **This will allow the RBI to absorb surplus funds from banks without collateral.**
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- Banks too continue to earn interest (though possibly lower than the existing reverse repo rate). In effect, it will empower the RBI to suck out as much liquidity as needed.
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Why is it important?

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- **Liquidity plays a key role in transmission of policy rates.**
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- In a falling rate cycle, pass-through of rate cuts will happen quickly if there is sufficient liquidity, as banks will be able to lower deposit rates comfortably.
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- The reverse holds true now. Excess liquidity has led to short-term market rates slipping below the RBI's policy repo rate.
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- Now, RBI would want to keep a tight leash on rates. The RBI would want its key policy rate i.e., the repo rate, to be the operational rate.
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- The RBI's management of rates **impacts the rates on your deposits and loans**.
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- The immediate fallout of excess liquidity in the past few months has been the sharp cuts in bank deposit rates.
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- If the RBI curbs excess liquidity and halts the fall in short-term rates, then

the depositors can breathe a sigh of relief.
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\n**Source: Business Line**

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