

# Monetary Policy & Individual's

**Monetary policy**, spearheaded by central banks like the Reserve Bank of India (RBI), is a crucial tool for managing the economy. A key instrument within this policy framework is the repo rate. Let's break down what monetary policy and the repo rate are, and their significant impact on individuals, investment, and the broader economy in India.

## Monetary Policy

Monetary policy refers to the actions undertaken by a central bank to manage the supply of money and credit in an economy. Its primary objectives in India, as set by the RBI, include:

- \* **Price Stability (Controlling Inflation):** This is often the foremost objective. By managing the money supply, the RBI aims to keep inflation within a target range (currently 4% CPI inflation with a 2-6% tolerance band in India).
- \* **Fostering Economic Growth:** Alongside inflation control, monetary policy also aims to support sustainable economic growth and minimize unemployment.
- \* **Maintaining Financial Stability:** Ensuring the health and stability of the financial system is another critical goal.
- \* **Managing Exchange Rate:** The repo rate can also influence the value of the domestic currency.

The RBI employs various tools to implement monetary policy, including:

- \* Repo Rate (Repurchase Rate)
- \* Reverse Repo Rate
- \* Cash Reserve Ratio (CRR)
- \* Statutory Liquidity Ratio (SLR)
- \* Open Market Operations (OMOs)

## Repo Rate

The repo rate is the interest rate at which commercial banks borrow money from the RBI for short-term needs, typically against the pledge of government securities. It is essentially the cost of borrowing for banks.

Think of it as the benchmark interest rate that influences all other interest rates in the economy.

- \* When the RBI increases the repo rate (Contractionary Policy): It makes borrowing more expensive for commercial banks.
- \* When the RBI decreases the repo rate (Expansionary Policy): It makes borrowing cheaper for commercial banks.

## Impact of Repo Rate

The repo rate acts as a critical signalling tool for the central bank and its changes have far-reaching consequences:

## 1. Impact on Individuals

### \* **Loan Interest Rates and EMIs:**

\* **Higher Repo Rate:** When the repo rate rises, banks' cost of funds increases. They, in turn, pass on this increased cost to their customers by raising their lending rates (e.g., home loan, car loan, personal loan interest rates). This leads to higher Equated Monthly instalments (EMIs) for individuals with floating-rate loans. New loans also become more expensive.

\* **Lower Repo Rate:** Conversely, a lower repo rate reduces banks' borrowing costs, prompting them to lower their lending rates. This results in lower EMIs for existing floating-rate loan holders and makes new loans more affordable, encouraging borrowing.

### \* **Fixed Deposit (FD) and Savings Returns:**

\* **Higher Repo Rate:** Banks often offer higher interest rates on Fixed Deposits (FDs) and savings accounts to attract deposits when the repo rate is high, as their cost of borrowing from the RBI is higher. This benefits savers.

\* **Lower Repo Rate:** A lower repo rate typically leads to reduced returns on FDs and savings, as banks have less incentive to attract deposits at high rates. This can prompt individuals to explore other investment avenues.

### \* **Consumer Spending:**

\* **Higher Repo Rate:** Higher loan EMIs and potentially lower returns on savings can reduce disposable income and discourage borrowing, leading to a decrease in overall consumer spending.

\* **Lower Repo Rate:** Cheaper loans and potentially lower returns on savings can incentivize borrowing and spending, boosting consumer demand.

## 2. Impact on Investment

### \* **Business Investment:**

\* **Higher Repo Rate:** Businesses face higher borrowing costs for expansion, capital expenditure, and day-to-day operations. This can lead to a scaling back of investment plans, delaying new projects, and potentially slower growth.

\* **Lower Repo Rate:** Reduced borrowing costs encourage businesses to take on new loans for investment, expansion, and job creation, stimulating economic activity.

### \* **Stock Market:**

\* **Higher Repo Rate:** Higher interest rates can reduce corporate profits (due to increased interest expenses) and make fixed-income investments (like bonds) more attractive compared to equities. This can lead to a subdued or negative sentiment in the stock market.

\* **Lower Repo Rate:** Cheaper borrowing costs can boost corporate earnings and make equities more appealing. Lower interest rates also tend to make borrowing for stock market investments (e.g., through margin trading) more attractive, generally leading to a positive impact on the stock market.

### \* **Foreign Investment (FPI and FDI):**

\* **Higher Repo Rate:** Higher interest rates can make a country's financial assets (like bonds) more attractive to foreign investors seeking higher yields, potentially leading to increased Foreign Portfolio

Investment (FPI). It can also strengthen the domestic currency, which might be favorable for foreign direct investment (FDI) in terms of repatriation.

\* **Lower Repo Rate:** Lower interest rates might reduce the attractiveness of fixed-income instruments for foreign investors, potentially leading to FPI outflows. A depreciating currency might also occur, which could make imports more expensive.

### **3. Impact on the Economy**

#### **\* Inflation Control:**

\* **Higher Repo Rate (Contractionary Policy):** By making borrowing expensive, a higher repo rate reduces the money supply in the economy, curbs demand, and helps in controlling inflation.

\* **Lower Repo Rate (Expansionary Policy):** By making borrowing cheaper, a lower repo rate increases the money supply, stimulates demand, and can lead to inflationary pressures if the economy is already near full capacity.

#### **\* Economic Growth:**

\* **Higher Repo Rate:** While crucial for inflation control, a consistently high repo rate can dampen economic growth by making credit expensive, slowing down investment, and reducing consumer spending.

\* **Lower Repo Rate:** A lower repo rate stimulates economic activity by encouraging borrowing, investment, and consumption, thereby boosting GDP growth.

\* **Liquidity Management:** The repo rate is a key tool for the RBI to manage liquidity (the amount of money available) in the banking system. By adjusting this rate, the RBI can ensure that banks have enough funds to lend, maintaining financial stability.

\* **Currency Value:** Changes in the repo rate can influence the exchange rate of the Indian Rupee. A higher repo rate can attract foreign capital, strengthening the rupee, while a lower repo rate can lead to capital outflows and a weakening rupee.

In essence, the RBI carefully adjusts the repo rate as part of its monetary policy strategy to strike a balance between controlling inflation and fostering economic growth, constantly monitoring various macroeconomic indicators to make informed decisions.

**Source: RBI Portal**

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