Repo Rate vs Reverse Repo Rate

Compare Repo Rate and Reverse Repo Rate

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- Repo rate is the rate at which the Central Bank grants loans to commercial banks against government securities.
- Reverse repo rate is the interest offered by RBI to banks who deposit funds with them.
- Repo Rate is higher than the reverse repo rate.
- While Repo Rate helps to manage short term deficiency of funds, reverse repo rate aims to reduce the overall supply of money in the economy.
- Presently, the current repo rate & reverse repo rate is 4.00% & 3.35%.

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What is Repo Rate?

Repo rate is the interest rate at which the RBI grants funds to commercial banks for short-term against government securities. In this case, a repurchasing agreement is signed by both parties, stating that the securities will be repurchased at a predetermined price at a given date. It helps the Central Bank to control the money supply, liquidity, and inflation in the economy. As of Aug 2021, the repo rate is set at 4.00%.

Reverse repo rate is the interest offered by the Central Bank to commercial banks who deposit funds with them. For instance, when banks generate excess funds, they may deposit it with the RBI and earn interest on the same. This is another financial tool used by the RBI to control money supply in the economy. Currently, the reverse repo stands at 3.35%.

Repo Rate Vs Reverse Repo Rate

Here are the major differences between the Repo Rate and Reverse Repo Rate:

Parameters	Repo Rate	Reverse Repo Rate
Meaning	Repo rate is the rate at which the Central Bank grants loan to the commercial banks against government securities.	Reverse repo rate is the interest offered by RBI to banks who deposit funds with them.
Rate of interest	Higher than the reverse repo rate.	Lower than the repo rate.
Mechanism of operation	RBI grants funds to commercial banks against government bonds as collateral.	Commercial banks deposit their excess funds with RBI and receive interest on their deposits.
Controls	Inflation	Money supply in the economy.
Purpose	To fulfill the deficiency of funds.	To ensure liquidity in the economy
Borrower's objective	To manage short term deficiency of funds.	To reduce overall supply of money in the economy.
Impact of higher rate	Cost of funds increase for commercial banks and hence loans become expensive.	Money supply in the economy decreases as commercial banks park more surplus funds with RBI.
Impact of lower rate	Cost of funds reduce for commercial banks and loans become cheaper for them.	Money supply increases in the economy as banks lend more and reduce their deposits with central bank.
Charged on	Repo rate is charged on Repurchase agreement.	Reverse repo rate is charged on Reverse Repurchase agreement.
Current rate	4.00%	3.35%

Historical Repo Rate v/s Reverse Repo Rate

Date	Repo Rate	Reverse Repo Rate
06th Aug 21	4.00%	3.35%
[illegible]	[illegible]	3.35%
07th Apr 21	4.00%	3.35%
05th Feb 21	4.00%	3.35%
04th Dec 20	4.00%	3.35%

09th Oct 20	4.00%	3.75%
06th Aug 20	4.00%	3.75%
22nd May 20	4.00%	3.75%
27th Mar 20	4.40%	3.75%
06th Feb 20	5.15%	4.90%
05th Dec 19	5.15%	4.90%
04th Oct 19	5.15%	4.90%

Impact of Change in Repo Rate by RBI

Following is the impact of change in repo rate by RBI.

- **Increase in Repo Rate:** An increase in repo rate makes borrowing from the RBI more expensive for commercial banks, leading to an increase in rates applicable to loans. As the interest rates on various loans increase, fewer loans are applied for disbursement, restricting the money supply and may adversely affect the country's economic growth.
- **Repo Rate Cut Impact:** A cut in repo rate allows banks to borrow from the RBI at a cheaper rate. Banks, thus, reduce the lending rates for customers. Therefore, with the increase in repo rate RBI infuses higher liquidity in the banking system. Also, as the loans get cheaper purchasing power of the consumer increases as they can borrow & spend more which boosts consumption.

Impact of Reverse Repo Rate by RBI

The increase/decrease in the reverse repo rate has the following impact.

- **Increase in Reverse Repo Rate:** With the increase in reverse repo rate, the commercial banks can earn more interest on the funds deposited with the RBI. Thus they prefer to keep more surplus funds with the RBI instead of letting it out in the market. RBI thus increases the reverse repo rate to cut out excessive liquidity in the banking system.
- **Reverse Repo Rate Cut Impact:** RBI decreases the reverse repo rate to infuse liquidity in the banking system. With the decrease in Reverse Repo Rate banks earn less on their excess money deposited with the Reserve Bank of India.

FAQs

No, reverse repo rate is always lower than repo rate. Currently, the reverse repo rate is 3.35%, while repo rate is 4.00%.

Why is reverse repo rate lower than repo rate?

Reverse repo rate is lower than the repo rate because RBI cannot pay higher interest on deposits than charging interest on loans. This is to facilitate cash flow from RBI to commercial banks, which in turn will increase the purchasing power of the market.

What happens when reverse repo rate decreases?

When reverse repo rate decreases, commercial banks reduce their deposits with RBI. Instead, they earn higher interest by lending more money. This leads to increasing purchase power and cash inflow in the economy.

What is the reverse repo rate at present?

At present, the reverse repo rate stands at 3.35%.

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