

Changing bank rates & its impact on economy

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Abstract

The RBI regularly controls the level of credit supplied by the commercial banks by changing the bank rate. When Bank rates changes it suddenly impacts on Economy. When RBI decrease bank rate it is called 'cheap money policy'. Money supply in the economy is increased. When RBI increases bank rate, it is called 'dear money policy'. Money supply in the economy is decreased. RBI uses bank rate to balance economic growth and inflation. This paper examines Changing bank rates & its impact on Indian economy. This paper Researcher has tried to find out extent changing bank rate facilitated impact on Indian economy. Researcher has focused its analysis on the Movements in Bank Rate during 1991-2016.

Keywords: Indian economy, Inflation & Monetary policy

Introduction

Bank rate is the rate at which banks borrow money from the central bank without any sale of securities. It is usually for a longer era of time. The RBI has the control to raise or decline the bank rate. The RBI regularly controls the level of credit supplied by the commercial banks by changing the bank rate. The commercial banks make loans by discounting bills of exchange accessible to them by companies and merchants. Now if commercial banks do not get sufficient deposit they move toward the RBI for funds and the central bank re-discounts the bill of exchange detained by commercial banks. An increase in the bank rate by the RBI implies that the commercial banks will have to pay higher interest rates while taking loans from the RBI. They will, so, be required to charge higher rates of interest while making loans.

When the RBI increases the bank rate, the commercial banks are forced to pay higher interest rates on the deposits they accept from the public. This also explicates why the commercial banks charge higher rate of interest, while making loans and advances, when the bank rate increases. There is, in reality, an involuntary relation between the bank rate & the market rate. This means that as and when the bank rate increases the market rates of interest automatically raise. The converse is also true. When the central bank decreases the bank rate the commercial banks decrease their lending rates. This means that the market rates of interest involuntarily fall.

When the market rates of interest increase, firms and consumers of durable goods will be less ready to take loans from banks than before & business people finds it less money-making to borrow funds for investment purposes. The banks are also less ready to make loans. It is because if they build more loans they have to move toward the RBI for funds. And the RBI will charge higher rate of interest from commercial banks for making loan. Therefore two things happen when the bank rate increases. First, the market rates of interest increases & the demand for bank loans decrease & Secondly, commercial banks have to get funds from the central bank by paying higher rates of interest. For both the reasons the commercial banks make less loans when the bank rate

increases. The converse is also true. The commercial banks make more loans in the event of a fall in the bank rate. This explains why the bank rate is increased during inflation and is decreased during deflation (recession).

Objective

- To study the Bank Rate of RBI
- To study the changing and importance of bank rate in India
- To analysis on the Movements in Bank Rate during 1991-2016

Research Methodology

This study is fully based on secondary data. Secondary data are collected from the Indian Economic Journal, Economic Times, RBI official statement, RBI Annual Reports, Financial Express etc. The study covers for a phase of 25 financial years starting from 1991. The paper focuses its analysis on the Movements in Bank Rate during 1991-2016. Therefore, the study is fully on the impact of changing bank rates on the Indian Economy.

Literature Review

Bank Rate Policy Used By a Central Bank

The development of credit will raise investment activities, leading to a raise in employment, income and output. Aggregate demand will raise, prices will increase, and profits will raise which, in go round, will boost creation and investment activities further. As a result, an increasing improvement of the economy will enlarge.

Insurers To Pay 2% Interest Above Bank Rate If Claims Delayed-

2017- M Saraswathy Special Correspondent, Moneycontrol"- There has been a grievance to insurance policy documents are complex to understand, IRDAI has understood that in case of unit-linked policies too, insurers in the policy document will need to explain the minimum lock-in, returns offered and too the risks concerned with such investment products.

Rbi Issues Draft Guidelines on Interest Rate Risk Management- “2017-

<http://www.moneycontrol.com/news/economy>”- The draft guidelines are based on principles on IRRBB published by Basel Committee on Banking Supervision (BCBS) in April 2016, the RBI supposed. The norms come months after the RBI initial mooted the need to have such regulations in the statement on development and regulatory policies after the declaration of the bi-monthly policy assessment on October 4, 2016.

50-75% Cut In Bank Lending Rates Likely By September: Bofa-MI- “2017

The raise more sure regarding our identify that

Budget 2017 determination facilitate to cut lending rates by 50-75 bps by September to counterbalance the crash of the demonetization upset in the second half of 2017.

Economic Growth Requires More Than Low Interest Rates-“2016- Frank Shostak & Peter Stellios”-

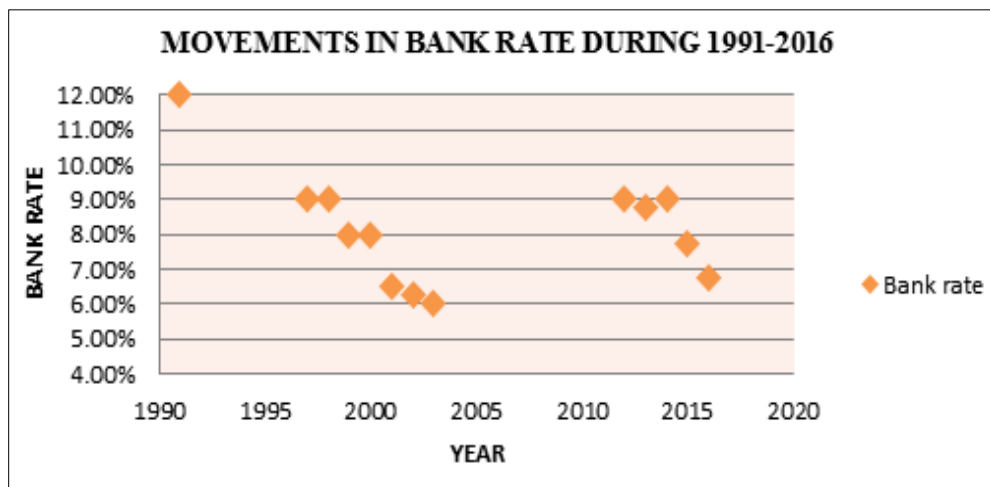
The wealth creating private sector has supervised to create wealth, however as time went by on account of huge money pumping, their capacity to keep the pool of wealth growing at an growing pace has likely been reduced.

Analysis Part

Table 1: Movements in Bank Rate during 1991-2016

Year	Effective since	Bank rate	Change	Impact on Economy
2016	4-Oct-16	6.75	-0.25	Upside risks to 5% Retail inflation inflation target
	5-Apr-16	7	-0.75	Expects inflation at around 5%
2015	29-Sep-15	7.75	-0.5	Benefit of reduction inflation to increase growth in an economy that hasn't been able to getaway global headwinds
	2-Jun-15	8.25	-0.25	Corporate earnings boast been depressing; growth happening bank lending has been the insignificant here about two decades.
	4-Mar-15	8.5	-0.25	Government has certainly paid consideration to the quality of fiscal adjustment.
	15-Jan-15	8.75	-0.25	Potential output rises above the projected pick-up in growth in coming quarters so as to contain inflation
2014	28-Jan-14	9	+0.25	Inflationary pressures reduction since July 2014, says RBI.
2013	29-Oct-13	8.75	-0.25	Money supply in the economy is increased
	7-Oct-13	9	-0.5	Reserve Bank to improve liquidity conditions
	20-Sep-13	9.5	-0.75	Money supply in the economy is increased
	15-Jul-13	10.25	+2.00	Higher interest rates lead to slowdown in the economy. This leads to increase in unemployment because companies start focusing on cost cutting and reduces hiring.
	3-May-13	8.25	-0.25	To keep the rate stable, being a reference rate
	19-Mar-13	8.5	-0.25	To keep the rate stable, being a reference rate
	29-Jan-13	8.75	-0.25	To keep the rate stable, being a reference rate
2012	17-Apr-12	9	-0.5	Money supply in the economy is increased
	13-Feb-12	9.5	+3.50	The Bank Rate will stand increased by 350 basis points, i.e., from 6.00 per cent per annum to 9.50 per cent per annum. This should be viewed and understood as once technical adjustment to align the Bank Rate
2003	29-Apr-03	6	-0.25	There were no relevant policy changes
2002	29-Oct-02	6.25	-0.25	To keep the rate stable, being a reference rate
2001	23-Oct-01	6.5	-0.50	To keep the rate stable, being a reference rate
	2-Mar-01	7	-0.50	To keep the rate stable, being a reference rate
	17-Feb-01	7.5	-0.50	To keep the rate stable, being a reference rate
2000	22-Jul-00	8	+1	To be align with international developments
	2-Apr-00	7	-1	To reduce liquidity support to banks
1999	2-Mar-99	8	-1	To reduce liquidity support to banks
1998	29-Apr-98	9	-1	To reduce liquidity support to banks
	3-Apr-98	10	-0.5	To reduce liquidity support to banks
	19-Mar-98	10.5	-0.5	To reduce liquidity support to banks
	17-Jan-98	11	+2.00	To control broad money expansion
1997	22-Oct-97	9	-1	To reflect the stance of monetary policy, being a signal rate
	22-Jun-97	10	-1	To reflect the stance of monetary policy, being a signal rate
	16-Apr-97	11	-1	To reflect the stance of monetary policy, being a signal rate
1991	9-Oct-91	12	+1.00	To control broad money expansion
	4-Jul-91	11		

Source: Rbi Publications (Various Years)



Source: Rbi Publications (Various Years)

Fig 1: Movements in bank rate during 1991-2016

Findings

In India, the Reserve Bank has changed the bank rate from time to time to meet the changing conditions of the economy. It was raised from 3 to 3.5 percent in November 1951 and increases in the bank rate were adopted to reduce bank credit and control inflationary pressures. As a part of financial sector reforms of 1990s, the Reserve Bank of India has decided to consider the Bank Rate as a policy instrument for transmitting signals of monetary and credit policy. Bank Rate now serves as a reference rate for other rates in the financial markets. With this new role assigned to the Bank Rate and to meet the growing demand for credits from all sectors of the economy under the liberalized economic conditions, the Bank Rate has been reduced in phases in subsequent years. As per the policy announced on April 29, 2003, the Bank Rate in India is 6 per cent. The changes in the bank rates during the period of our present study are as follows:

1992-97

- There were no relevant policy announcements related to bank rate from 1992 to 1997

1997-98

- In order to make the Bank Rate an effective signal rate as well as a reference rate, all interest rates on advances from the Reserve Bank as also the penal rates on short falls in reserve requirements which were specifically linked to the Bank Rate were revised. Interest rates on other categories of accommodation from the Reserve Bank as well as term deposit rates up to one year which were not linked to the Bank Rates, was linked to it. Effective from April 16, 1997, the Bank Rate was reduced by one percentage point, i.e. from 12 per cent per annum to 11 per cent per annum so that changes in the Bank Rate reflect the stance of monetary policy.
- With a view to align the Bank Rate to the changing conditions, effective from June 26, 1997, the Bank Rate was further reduced from 11 per cent per annum to 10 per cent per annum. Simultaneously, the interest rate on deposits having maturity of 30 days and up to one year was reduced from 9 per cent to 8 per cent, i.e. Bank Rate minus two percentage points. All interest rates on advances from

the Reserve Bank such as, Export Credit Refinance and General Refinance to banks which were specifically linked to the Bank Rate was reduced to 10 percent from 11 percent per annum.

- Effective from October 22, 1997, the Bank rate was further reduced by one percentage points to 9 per cent from 10 per cent per annum.
- Effective from January 17, 1998, the Bank Rate was increased by 200 basis points to 11 per cent from 9 per cent. This was to control broad money expansion.
- Effective from March 19, 1998, the Bank Rate was reduced by 50 basis points to 10.5 per cent from 11 per cent. This was to stabilize the broad money.

1998-99

- The Reserve Bank reduced the Bank Rate by one half of one percentage point to 10 percent with effect from close of business on April 2, 1998.
- The Bank Rate was further reduced by one percentage point to 9 per cent.
- Effective from close of business of March 2, 1999, the Bank Rate was reduced by one percentage point to 8 per cent. As a consequence of this change, interest rates on special liquidity support and General Refinance Facility to banks and liquidity support to PDs against their holdings of securities in SGL accounts were reduced by one percentage point.

1999-2000

- There was no relevant policy change during 1999-2000.

2000 -2001

- The Reserve Bank reduced the Bank Rate by 1.0 percentage point to 7 per cent, effective from the close of business on April 2, 2000.
- After a review of the recent developments in the International and domestic financial markets, including the foreign exchange market, the Reserve Bank raised the Bank Rate by 1 percentage points to 8 per cent with effect from the close of business on July 22, 2000.

- The Reserve Bank reduced the Bank Rate by 50 basis point to 7.5 per cent effective from close of business on February 17, 2001.
- On a further review, the Bank Rate was reduced from 7.5 per cent to 7.0 per cent effective from close of business on March 2, 2001.

2001- 02

- Rate was Bank reduced by 0.50 percentage point from 7 percent to 6.50 per cent with effect from the close of business on October 23, 2001.

2002- 03

- A reduction in Bank Rate by 50 basis points to be considered by the Reserve Bank as and when necessary
- Bank Rate was reduced by 25 basis points to 6.25 per cent with effect from close of business on October 30, 2002.

2003-11

- Bank Rate was reduced by 0.25 percentage points to 6.0 per cent with effect from the close of business on April 29, 2003, with a policy bias to keep it stable until the mid-term Review of October 2003. There were no relevant policy changes during 29-Apr-03 to 13-Feb-12.

2012

- The Bank Rate will stand increased by 350 basis points, i.e., from 6.00 per cent per annum to 9.50 per cent per annum. This should be viewed and understood as once technical adjustment to align the Bank Rate

2013

- Over 6 per cent points decline in inflation since late 2013.

2014

- Strategic headed for added moderation command be there facts to authenticate abiding disinflationary pressures. Besides analytical would be there sustained prohibitive class financial consolidation like satisfactorily in the role of steps toward overcome resource constraints in addition to promise availability of major inputs such for example power, land, natural resources plus infrastructure.

2015

- The Bank Rate stands adjusted by 50 basis points from 8.25 per cent to 7.75 per cent captivating benefit of reduction inflation to increase growth in an economy that hasn't been able to getaway global headwinds.
- The Bank Rate stands adjusted by 25 basis points from 8.5 per cent to 8.25 per cent with effect from June 2, 2015. Corporate earnings boast been depressing; growth happening bank lending has been the insignificant here about two decades.
- The Bank Rate stands adjusted by 25 basis points from 8.75 per cent to 8.5 per cent with effect from March 4; 2015. Government has certainly paid consideration to the quality of fiscal adjustment. Aggressive rate cuts are not promising participating in this time for the reason that they obtain by now signed the Memorandum of Understanding along with the RBI going on supple inflation targeting. Furthermore inflation is on the midpoint level.

- The Bank Rate stands adjusted by 25 basis points from 9.0 per cent to 8.75 per cent with effect from January 15, 2015. The fifth bi-monthly monetary policy statement moreover confirmed to facilitate a long time ago the pecuniary strategy stance shifts, succeeding guidelines procedures determination stay uniform plus this stance. Type near auxiliary respite is statistics with the purpose of make firmer ongoing disinflationary pressures. and unsympathetic would be present sustained lofty condition financial consolidation in the same way as positively being steps in the direction of overcome fund constraints along with reassure availability of key in inputs such while power, land, mineral deposits after that infrastructure. The final would transpire wanted on the road to make sure with the aim of probable yield rises more than the projected pick-up in vogue lump participating in introduction quarters accordingly since toward have inflation.

2016

- DR. URJIT R. PATEL maiden policy of announcement facilitates RBI Governor. This was the Central bank's fourth bi-monthly document statement during give preferentiality of the while 2016-17.
- In its policy statement, the inner earlier believed so as to the verdict of the fiscal guidelines board was unflinching among the accommodative stance of the pecuniary policy. Retail inflation is estimated toward transpire 5 apiece cent before strut 2017 along with upside risk.

Conclusion

History of Bank Rate in India is older than the Central Bank of our country. When the Reserve Bank of India started its functioning in 1935, it announced its Bank Rate as 3.5 per cent on July 5, 1935. At the starting of the reform period, i.e. in 1991-92, the rate was 12 per cent and the rate continued till the end of eighth plan period (1992-97). It started diminishing on April 16, 1997 with a rate of 11 per cent and by October 22, it reached 9 per cent. In the next year, i.e. in 1998, it was raised sharply to 11 per cent (Table 1). It was to reflect the stance of monetary policy, being a signal rate.

From 1998 onwards, the Bank Rate was steadily brought down except in the year 2000. This was mainly to reduce liquidity support to banks & Primary Dealers. In the mid-way of 2000, it was slightly increased by one per cent, but again decreased after six months. This was to be aligning with international developments. Since April 29, 2003, it was kept constant at 6 per cent. So it can be understood that even though the Bank rate is a weapon of the monetary authority and playing the role of a reference rate, it was not so active during the beginning and ending of our present study.

The RBI has the control to rise or decline the bank rate Bank rate be on a descending curve during 2000-01 to 2003-04. Bank Rate declined from 7.00% in 2000-01 to 6.00% 2003-04. Thereafter, it remained enduring at 6.00% during 2003-04 to 2010-11. It rises to 9.50% in 2011-12, declined to 8.50% in 2012-13, rise to 9.00% in 2013-14 declined to 8.50% in 2014-15 and finally declined to 7.75% to 6.75% in 2015-16. These rise and fall are a result of the procedures of RBI as the Monetary Authority. Retail inflation is estimated toward transpire 5 apiece cent before strut 2017 along with upside risk.

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