RBI Repo Rate explained in Simple Words

What is Repo Rate:

Repo Rate or Repurchase Rate is the benchmark Interest Rate at which Reserve Bank of India lends money to the Commercial Banks in India for maximum period of 90 Days.

How does Repo Rate Impact Banking and Economy?

If repo rate increases, the borrowing rate from RBI increases and it becomes difficult for the banks to borrow from RBI or carrying out business.

Also, when the RBI wants the country to progress in Banking and Economy, it reduces the Repo Rate. So, it becomes easy for Banks to borrow money and grow economically.

How Does Repo Rate Work? (With Example)

In Order to borrow money, Banks need to provide government at least worth or more the amount of Government Secruities.

The government securities which are provided by banks as collateral can not come from SLR quota .

For eg, ABC Bank wants to borrow ₹1000 crore from RBI, so they need to provide government securities at least worth ₹1000 crore or more because of margin requirement. And they also agree to Repurchase the same with the Interest Rate. So, if a Bank borrows ₹1000 crore from RBI, they will repurchase the Securities at ₹1060 crore if the Repo Rate is 6.00%.

Controlling Inflation with Repo Rate

RBI also controls Inflation with Repo Rate. In order to Curb Inflation in the economy, Reserve Bank of India increases the Repo Rate.

So, borrowing from RBI becomes costly for the Commercial Banks. As a result, Banks pass this increased burden of Repo Rate to the customers by increasing Interest Rate. So, the borrowing for common man becomes costly, thus making the entire borrowing function of the economy costly.

As a result, inflation comes down gradually.