

CRR, Repo Rate and Reverse Repo Rate

The CRR rate expands for the Cash Reserve Ratio rate. It is an essential factor and parameter in monetary policy. It is the cash that is kept as a deposit in the banking sector for the prevention of running out of cash. The amount that is kept reserved either in the vault of the bank or sent to the Reserve Bank of India. In case of a low CRR rate, the money is circulated as loans, in numerous investments. In case the CRR rate surges it influences and impacts the economy in a negative way. The circulation of the economy also reduces and decelerates

Significance Of CRR

There are numerous factors that determine the essentiality of the Cash Reserve Ratio. It plays an instrumental role in determining the circulation of money.

- It keeps a check on the specified amount of money that is reserved in the vaults of banks and is sent to the Reserve Bank of India.
- In inflation the CRR rates surge, to regulate and control the circulation of money.
- When money or funds are needed, the CRR rates are lowered to increase the circulation of money.

What is Repo Rate?

The term repo rate refers to the rates charged by the banks to borrow and lend money. When one goes to a bank and wants to borrow money, they agree with the bank, stating that they will repay the borrowed amount at a specific date (say, one month from now).

As such, the repo rate is usually a floating rate. The period for repayment is variable in tandem with bond maturities and other interest rates.

Significance of Repo Rate

First and foremost, this is the rate used to calculate the amortization of a bond. The annual interest rate on the bond minus the repo rate determines the annual accretion or amortization of a bond.

- The interest is calculated daily for the initial 30 days, reaching its maximum amount on the 30th day.
- From month 31 to maturity, the interest is calculated and compounded only at the end of each month.
- The repo rate represents another primary benchmark to gauge inflation.
- As such, it's often used as a reference rate for many kinds of investments and transactions that have to do with government-issued debt, such as Treasury bills and bonds, municipal securities, home mortgage loans, etc.

What is Reversed Repo-Rate?

The Reverse repo rate is facilitated to the banks by the Reserve Bank of India in case of lending money. This is the money charged by the commercial banks, this also keeps in check the money circulation in the country. The reverse repo rates also gauge inflation, as when the rates of reverse repo rate is lower the local banks deposit more money to the Reserve Bank of India, thus lowering the economy flow and loans.

Sometimes, even after one has completed the transaction and received cash or collateral, you might need to reverse your payment from the deal's proceeds. This is usually because the buyer disagrees with your agreed-upon terms.

This is where a reverse repo rate comes in. An institution that provides reverse-repo services will buy back your securities they had previously sold at a different price, compare that to what they originally bought them for, and then charge you a price in between those two prices known as a rate that is lower than what you originally paid for them. Alternatively, the reverse repo rate may be called an inverse repo rate.

Why Is Reverse Repo Rate Important?

If you're a long-term investor and are eager to buy something at a lower price than what you originally agreed upon with the bank but still want to get your money, a reverse repo rate may be more favorable to your options.

- The reserve repo rates keep a check on inflation while the reverse repo rates are lowered the commercial banks reserve their money with the central banks. This restricts the economy flow, and lending of loans.
- This is especially advantageous on government-issued bonds where they're often used as collateral against home mortgage loans, auto loans, and other more varied real estate transactions.
- While reverse repo rates may not be a good choice for all types of investors, it's an option to consider when buying bonds and other securities deemed as suitable for collateralizing home mortgages.