BHARAT SCHOOL OF BANKING
REPO, MSF, BANK RATE, REVERSE REPO

Money Market

It generally provides **investment** avenues of **short time** tenor, by definition for a maximum **one year**. Money market **transactions** are generally used for **funding** the transactions in **other markets** including **Government securities** market, **Capital market** and meeting short term **liquidity mismatches**.

The **one year** tenor can be **classified** into -

1. **Overnight** market - tenor of transactions is **one working day (**also called **Call Money** market)
2. **Notice Money** market - tenor from **2 days** to **14 days**
3. **Term Money** market - tenor from **15 days** to **1 year**

Instruments used

Money market instruments include **Call Money, Repos, T-Bills, Commercial Papers (CP), Certificate of Deposits (CD)**, and Collateralized Borrowing and Lending Obligations (**CBLO**).

Borrowing money from RBI

Banks can borrow money from **RBI** with or without **securities,** and for 1 day to 1 year period. Depending on these, there are 3 ways to **borrow** money from **RBI,** and hence **3 rates -**

1. Repo (Repurchase) rate -

This is a type of **collateral lending** by **RBI**. Here, banks **sells securities** (gov. securities) to RBI with a **repurchase agreement** (meaning banks will **buy back** those securities at **future** date with extra **interest**). The **rate** charged by **RBI** is known as **Repo rate**.

It comes under **Liquidity Adjustment Facility (LAF)** of **RBI** monetary policy (i.e., a way to **adjust** market **liquidity,** along with **reverse repo**).

Banks borrow money by **repo** to meet their **daily mismatches. Repo auctions** are conducted by **RBI** on a daily basis, except Saturdays. Here, minimum **bid size** is of **Rs. 5 crore** and multiple. All **commercial banks** (except **RRB**s) can borrow through **repo** facility. **Repo** borrowings have a **tenure** of **1 day** to **90 days**.

2. Marginal Standing Facility (MSF) -

Now think what will happen if **banks** are not able to maintain their **daily mismatches** even with **repo (**it happens!). Hence **RBI** provided (from **2011**) one more facility to banks - **Marginal Standing Facility (MSF)**. Albeit its a **penalty** rate (because banks are not able to maintain their mismatches with repo), and always **higher** than **repo rate** (currently **100 basis point** higher).

In this scheme, **banks** borrow money with minimum **bid size** of **Rs. 1 crore** and multiple. The **tenure** is of **1 day only**, and banks can borrow **1 %** of their respective **NDTL** under this scheme.

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3. Bank Rate -

For the **long term,** i.e., **90 days** to **1 year**, banks can borrow money from **RBI** with **bank rate**. As it is a long term borrowing, the rate is higher than **repo rate**.

Banks **doesn't** need any **collateral** or **security,** while borrowing for a **long term** under **Bank Rate**. It is not used as a **monetary policy** to adjust the market, rather used to **re-discount Bills of Exchange** (refer our previous article on **Discounting Bills of Exchange**), or other **Commercial Paper**.

Lending money to RBI

Now come to the lending part. Now think, what is the purpose of **Reverse Repo?** Why banks will lend money to RBI, and when?

If a **bank** is able to maintain its money requirements properly, and has **surplus** money, then it would be better for the bank to **lend** to **RBI**, rather than keeping it with itself. Because, **lending money** will give the bank **interests** in **reverse repo** rate.

Its again a **collateralized lending** to RBI with **repurchase agreement**, as **repo** (works as opposite to **repo**).

Liquidity Adjustment Facility (LAF)

Repo and **Reverse Repo** together forms the **Liquidity Adjustment Facility**. It is a very essential and efficient **tool** of **RBI** to **adjust** the **market liquidity**. Since raising or reducing the **rates**, will make the **banks** raise or reduce its own **rates** to its **customer (public),** and of a **short term tenure**.

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