RBI’s $5 billion dose may make loans cheaper; here’s how liquidity injection will work

By: Eram Tafsir | Published: March 15, 2019 1:18 PM

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The Reserve Bank of India’s decision to inject $5 billion through foreign exchange reserve swap will likely help banks cut interest rates faster in line with the monetary policy, possibly making home loans and car loans cheaper. RBI has taken the reserve swap action in a bid to improve the pace of monetary transmission and improve the liquidity in the economy.

Under the foreign exchange swap, the RBI will buy up to $5 billion from the market through auction for three years on March 2019. However, it will sell the same amount back to the respective counterparties in March 2022.

Even after the RBI’s rate cut of 25 basis point in its last monetary policy, there were apprehensions regarding banks passing the benefit of rate cut with public. RBI Governor Shaktikanta Das also convened a meeting of chief executives of public sector banks to discuss the issue of monetary policy transmission.

Brass tacks

The move is expected to put a downward pressure on the interest rates along with preventing a sharp fall in the exchange rate, which is likely to happen due to increasing foreign fund inflows. Lower interest rate are important to spur private investment in the economy which has been lacklustre for years.

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"A lower hedge cost should incrementally incentivize offshore flow into Indian 'carry' assets (corporate bonds chiefly)," said Suyash Choudhary, Head – Fixed Income, IDFC AMC, speaking to The Indian Express.

The amount of dollars mobilised through this move will reflect in the RBI's foreign exchange reserves for the tenor of the swap while also reflecting in RBI's forward liabilities, said the RBI.

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