Cash Reserve Ratio (CRR), Objectives, Impact, CRR vs SLR

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Cash Reserve Ratio (CRR) is the share of a bank's total deposit that it keeps with the Reserve Bank of India (RBI) in the form of cash only. However, the RBI doesn't provide any interest on the CRR, and the banks cannot use this amount for lending or investment purposes.

Statutory Liquidity Ratio (SLR) is the percentage of deposits that the banks have to keep with themselves in the form of liquid cash, gold deposit, or government securities. This SLR is used to control inflation and increasing SLR reduces the money supply, which helps in controlling inflation.

What is Cash Reserve Ratio?

The Cash Reserve Ratio (CRR) is a monetary policy tool of the **Reserve Bank of India** (RBI) in which banks are required to keep a percentage of their total deposit with the central bank, i.e., RBI. This reserve is used to control the money supply, manage inflation, and to make sure that banks have enough funds to meet the withdrawal demands.

The banks cannot use these amounts for any other purposes, such as lending and investment purposes.

The Cash Reserve Ratio (CRR) applies only to commercial banks and regional rural banks, and Non-Banking Financial Companies (NBFC) are excluded.

The RBI Act 1949, Section 42, gave a provision for the RBI to announce a Cash Reserve Ratio (CRR) between 3%-15%. This was amended in 2007 by removing the lower ceiling making it 0-15%.

Cash Reserve Ratio Objectives

- **Ensure safety of depositor money:** CRR keeps a part of bank deposits with the RBI so banks don't run out of cash during emergencies.
- **Control money supply:** By raising or lowering CRR, RBI can instantly increase or reduce the amount of money banks can lend.
- **Manage inflation:** Higher CRR reduces excess money in the system, helping control rising prices.
- **Maintain financial stability:** It acts as a buffer so banks remain healthy and the financial system stays stable.
- **Improve liquidity discipline:** It ensures banks don't over-lend and always maintain a minimum level of ready cash.
- **Support RBI's monetary policy:** CRR works as a key tool for RBI to regulate credit flow in the economy.

Incremental Cash Reserve Ratio

- The Incremental Cash Reserve (I-CRR) is a temporary additional reserve requirement imposed by the Reserve Bank of India (RBI) on only the incremental (new) deposits, not the total deposits of banks.
- It is used when there's a sudden surge in bank deposits/liquidity (for example, due to currency circulation changes), so that the RBI can absorb surplus liquidity and prevent potential macroeconomic disruption.
- On 10 August 2023, RBI mandated that all scheduled banks maintain an I-CRR of 10% on increases in their Net Demand and Time Liabilities (NDTL) during the period 19 May 2023 to 28 July 2023.
- This action was taken due to surplus liquidity in the banking system, caused by, among other things, the return of old currency notes (₹ 2,000 notes) to banks.

Impact of Cash Reserve Ratio on the Indian Economy

Cash Reserve Ratio (CRR) plays a key role in managing liquidity and controlling money supply in the Indian economy. Changes in CRR directly influence **inflation**, the lending capacity of banks, and overall economic activity.

Impact of Increasing CRR

- Liquidity in banks decreases as more funds must be kept with the RBI.
- The lending capacity of the banks reduces, which slows down credit growth to businesses and households.
- Interest rates may rise due to tighter liquidity conditions.
- It helps in controlling inflation by reducing excess money supply in the economy.

Impact of Decreasing CRR

- Banks gain more liquidity as fewer funds are with the RBI.
- Lending increases, promoting credit growth and supporting investment and consumption.
- Interest rates may ease due to better liquidity conditions.
- Boosts economic activity and supports growth during slowdowns.

CRR vs Statutory Liquidity Ratio (SLR)

CRR and Statutory Liquidity Ratio (SLR) are two key **monetary tools** used by the RBI to regulate liquidity and ensure stability in the banking system. CRR requires banks to keep a portion of their deposits as cash with the RBI, while the Statutory Liquidity Ratio (SLR) mandates banks to hold a percentage of deposits in liquid assets like gold or government securities with itself. Together, they control money supply, influence lending capacity, and maintain financial discipline in the economy.

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