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Incremental cash reserve ratio

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Why is in news? The Reserve Bank of India (RBI) on Friday (September 8) announced that it would discontinue the incremental cash reserve ratio (I-CRR) in a phased manner. The central bank will release the amount which banks have maintained under I-CRR in stages.

ICRR:

I-CRR was introduced on August 10, 2023, as a **temporary measure by RBI to absorb surplus liquidity**.

Banks were **required to maintain an I-CRR of 10%** on the increase in their Net Demand and Time Liabilities (NDTL) between May 19, 2023, and July 28, 2023.

It came into effect from the fortnight starting August 12, 2023.

The RBI has the **authority to implement an additional measure** called Incremental Cash Reserve Ratio (ICRR), in addition to the standard CRR.

ICRR is employed during periods characterized by excess liquidity in the financial system.

Essentially, ICRR mandates that banks park even more liquid cash with the RBI than what is required under CRR.

This serves as a means to further manage and control liquidity in the banking system.

Reason for I-CRR:

Excessive liquidity emerged due to factors like the return of Rs 2,000 banknotes, RBI's surplus transfer to the government, increased government spending, and capital inflows.

The **daily liquidity absorption** by RBI in July reached Rs 1.8 lakh crore.

Managing surplus liquidity was necessary to maintain price and financial stability.

Impact on Liquidity Conditions:

I-CRR was **expected to absorb over Rs 1 lakh crore of excess liquidity** from the banking system.

It **temporarily shifted** the banking system's liquidity from surplus to deficit on August 21.

Factors like GST outflows and central bank selling of dollars contributed to tight liquidity.

However, liquidity conditions reverted to surplus from August 24.

On September 8, RBI absorbed Rs 76,047 crore of surplus liquidity from the system.

What has RBI said?

The RBI said that after a review, it has decided to **discontinue the I-CRR in a phased manner**.

“Based on an assessment of current and evolving liquidity conditions, it has been decided that the amounts impounded under the I-CRR would be released in stages so that **system liquidity is not subjected to sudden shocks and money markets function in an orderly manner**,” the RBI said in a release.

As per the schedule, the RBI will release the 25 per cent of funds maintained by lenders under the I-CRR on September 9.

Another 25 per cent of the amount maintained under I-CRR will be released on September 23 and the balance 50 per cent on October 7, the RBI said.

This will mean that banks will have sufficient funds to meet higher credit demand during the upcoming festival season.

Cash Reserve Ratio:

The Cash Reserve Ratio (CRR) is **the minimum percentage of total deposits** (ie. NDTL) that **a commercial bank is required to retain as cash reserves with the RBI**.

It has to be in the **form of Cash**.

It is applicable to **all Scheduled commercial banks**.

When a central bank raises the CRR, the amount of money accessible to banks reduces or falls and vice-versa.

It has to be placed in a vault in the bank or placed with the RBI.

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

As of December 2021, the CRR is maintained at 3%.