

Answer on Question #40616 – Economics – Economics of Enterprise

Assignment

What is Marginal standing facility? How reducing its value helps?

Solution

Marginal Standing Facility (MSF) is a new scheme announced by the Reserve Bank of India (RBI) in its Monetary Policy (2011-12) and refers to the penal rate at which banks can borrow money from the central bank over and above what is available to them through the LAF window.

MSF, being a penal rate, is always fixed above the repo rate. The MSF would be the last resort for banks once they exhaust all borrowing options including the liquidity adjustment facility by pledging through government securities, which has lower rate of interest in comparison with the MSF. The MSF would be a penal rate for banks and the banks can borrow funds by pledging government securities within the limits of the statutory liquidity ratio. The scheme has been introduced by RBI with the main aim of reducing volatility in the overnight lending rates in the inter-bank market and to enable smooth monetary transmission in the financial system.

MSF represents the upper band of the interest corridor and reverse repo as the lower band and the repo rate in the middle. To balance the liquidity, RBI intend to use the sole independent "policy rate" which is the repo rate and the MSF rate automatically gets adjusted to a fixed per cent above the repo rate (MSF was originally intended to be 1% above the repo rate).