

[Open Peer Review on Qeios](#)

The Functional Role of the Standing Deposit Facility in Inflation Management

Dr Nikhil Belavadi¹

¹ Woxsen School of Business

Funding: No specific funding was received for this work.

Potential competing interests: No potential competing interests to declare.

Abstract

In the context of controlling inflation within the economic framework, this study examines the fundamental role of the Standing Deposit Facility (STANDING DEPOSIT FACILITY). The investigation centres on the Reserve Bank of India's (RBI) approach and looks into the STANDING DEPOSIT FACILITY's functionality and efficiency in clearing up excess liquidity from the market. The research emphasizes the connection between the RBI's commitment to long-term economic stability and the operational stability of the STANDING DEPOSIT FACILITY through a thorough analysis of inflation patterns and STANDING DEPOSIT FACILITY rates over an extended period of time. The findings make clear how the STANDING DEPOSIT FACILITY influences the control of inflationary pressures and the upkeep of a robust economic environment, underscoring its importance as a tactical instrument in the central bank's monetary policy toolkit.

Keywords: Reserve Bank of India; Monetary Policy; Standing Development Facility; Liquidity; CPI; Collateral securities.

Introduction

The Reserve Bank of India (RBI) established the Standing Deposit Facility as a means of absorbing liquidity from the commercial banking sector and transferring it to the RBI without the need for security. Under the auspices of the Indian government's budget, Standing Deposit Facility initiative—which was outlined in a separate clause of the Finance Act of 2018—was included into the RBI Act.

To commence with the Standing Deposit Facility, it was officially put into operation on April 8, 2022, aligning with the announcement in the statement on development and regulatory policies. It was the result of a recommendation made by the Urjit Patel committee in 2014. This facility, which is situated twenty-five basis points below the policy repo rate, has notably taken the place of the set reverse repo rate. It has established itself as the floor of the liquidity adjustment facility corridor.

The Standing Deposit Facility, also known as a standing facility, enables the RBI to obtain liquidity from commercial banks without requiring the transfer of government securities as payment. It works in tandem with the marginal standing facility, which is used for injecting liquidity while the former is used for absorption of it.

- **Duration and schedule:** At the designated overnight rate, eligible participants can deposit monies with the Reserve Bank of India (RBI). However, if necessary, the Standing Deposit Facility allows central banks to absorb liquidity for longer periods of time at a reasonable cost. This service, which is available to all users of the Liquidity Adjustment Facility (LAF), takes deposits for the night from 17:30 to 23:59 every day, including Sundays and holidays. On the following Mumbai working day, the opposite timetable is in effect.
- **Eligibility for CRR and SLR:** In accordance with Section 42 of the RBI Act, 1934, funds deposited through the Standing Deposit Facility must not be regarded as eligible balances for meeting the cash reserve ratio (CRR) criteria. However, in accordance with Section 24 of the Banking Regulation Act of 1949, these deposits will be acknowledged as suitable assets for satisfying the statutory liquidity ratio (SLR) requirements.
- **Operational Procedures:** The RBI's e-Kuber system will be used for all Standing Deposit Facility activities, giving banks the opportunity to electronically submit their bids. The straight-through processing (STP) option will be used to implement the overnight Standing Deposit Facility. In this mode, bids will be automatically and quickly paid by the e-Kuber system upon receipt. Funds will be debited simultaneously to guarantee quick and easy processing. It is important to understand that all transactions made by participants are final and that bid cancellation or modification requests will not be granted. • The Standing Deposit Facility-ASISO (Automated Sweep-In and Sweep-Out) function is available to participants. Under this feature, bids for the Standing Deposit Facility will be automatically activated at the end of each day, without the need for manual involvement, based on a pre-established limit. Every day, including Sundays and holidays, straight-through processing (STP) operations—including ASISO—will be in place. The reverse will occur on the next working day in Mumbai.
- **Submission of Bids:** For the Standing Deposit Facility, a bid of at least one crore rupees and its multiples is required. The amount of the bid has no maximum limit. Under the STP method, these transactions will be carried out at the current Standing Deposit Facility rate.
- **Settlement and reversal process:** This involves numerous allocations of one crore rupees. Through straight-through processing (STP), transactions for the overnight fixed-rate operation will be settled continuously. Transactions involving the overnight Standing Deposit Facility will be reversed at the beginning of the following working day in Mumbai. If there is an unplanned holiday, the RBI will compensate interest for the extra day(s) and scheduled reversals for that day will be carried out on the next working day in Mumbai.
- **Communication and Disclosure:** On the following working day in Mumbai, information on the overnight Standing Deposit Facility will be made public in the money market operation (MMO) press release.

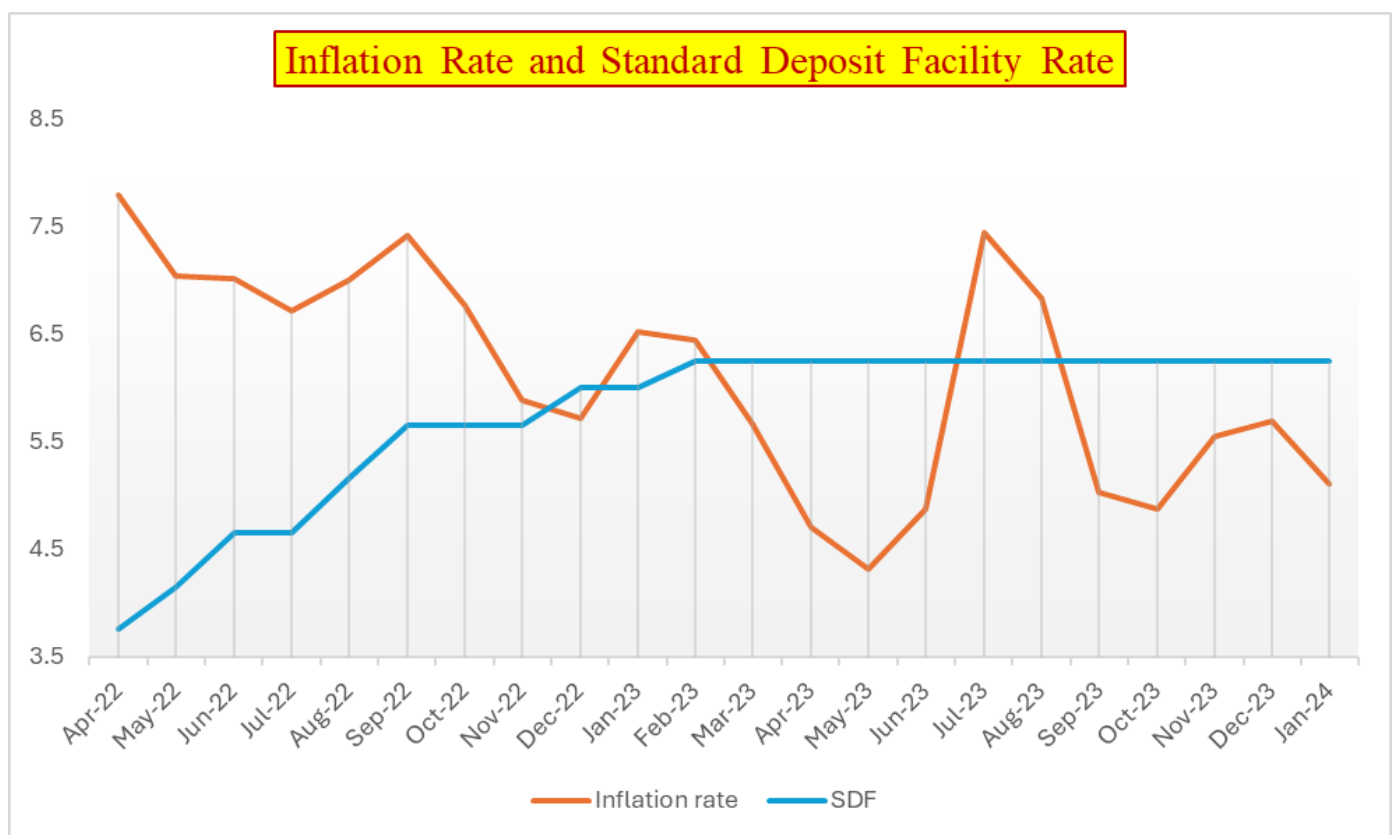
Objective

The main goal of the Reserve Repo Rate (RRR) is to counteract high inflation scenarios in which the Reserve Bank of India (RBI) must use banks to take up excess liquidity due to increasing money circulation in the market. The RBI uses

government securities as collateral in order to acquire deposits from banks through the use of the Reverse Repo Rate. Collateral requirements are crucial because they make it easier for excess money to be absorbed efficiently. The RBI established the Standing Deposit Facility in response to the difficulties that arise when collateral is not available. With the use of this creative approach, the RBI may now accept deposits from banks without requiring collateral, which improves the central bank's ability to control and monitor liquidity in the financial system.

The research emphasizes the role, function, and significance of the Standing Deposit Facility in managing inflation by absorbing excess liquidity present in the economy.

Analysis and Discussion



Graph 1. Inflation rate and Standing Deposit Facility Rate from 01-04-2022 to 31-01-2024. (Source: DBIE-RBI)

From April 2022 to January 2024, the table shows the inflation rate and matching Standing Deposit Facility (STANDING DEPOSIT FACILITY) rates in chronological order. Throughout the time, there have been some variations in the rate of inflation. It fluctuates, peaking at 7.44% in July 2023 and falling to 4.31% in May 2023 after beginning at 7.79% in April 2022. Overall, a noticeable tendency of inflation steadily declining toward the conclusion of the monitored period can be seen, with latter months stabilizing at a rate of five to six percent.

The STANDING DEPOSIT FACILITY rates are quite constant with a few minor adjustments. The STANDING DEPOSIT

FACILITY rate increases gradually over time, starting from 3.75% in April 2022 and rising to 6.25% in January 2024. In June 2022, the STANDING DEPOSIT FACILITY rate is set at 4.65%, and it remains that way until September 2022, when it progressively increases to 6.25%.

In general, the STANDING DEPOSIT FACILITY rate is manipulated in response to inflationary pressures, rising in tandem with periods of higher inflation. Interestingly, even in months when inflation varies, the STANDING DEPOSIT FACILITY rate stays constant, suggesting a more sophisticated use of the STANDING DEPOSIT FACILITY as an inflation management tool.

The two indicators have a negative correlation i.e., -0.644. After excluding all external influences, it is found that a rise in the Standing Deposit Facility Rate will result in a drop in the Inflation rate. Therefore, in addition to other considerations, the Standing Deposit Facility Rate is important in regulating and lowering the rate of inflation in the economy.

Conclusion

Given the rate's sustained stability over a lengthy period of time, the Reserve Bank of India (RBI) has confidence in the Standing Deposit Facility (STANDING DEPOSIT FACILITY) rate's ability to uphold long-term economic stability and lessen inflationary pressures. In conclusion, the data supports the assertion that the Standing Deposit Facility, which eliminates excess liquidity from the market, is a key component of the RBI's inflation management approach. The central bank's dedication to accomplishing its monetary policy goals and promoting a strong economic environment is demonstrated by the constant STANDING DEPOSIT FACILITY rate.

References

- Roberts, J. M. (2004). Monetary policy and inflation dynamics. Available at SSRN 633222.
- De Gregorio, J. (2012). Commodity prices, monetary policy, and inflation. *IMF Economic Review*, 60(4), 600-633.
- Mohanty, D., & John, J. (2015). Determinants of inflation in India. *Journal of Asian Economics*, 36, 86-96.
- Patra, M. D., Kapur, M., Kavediya, R., & Lokare, S. M. (2016). Liquidity Management and Monetary policy: From corridor play to marksmanship. *Monetary Policy in India: A Modern Macroeconomic Perspective*, 257-296.
- RBI press release: [Reserve Bank of India - Press Releases \(rbi.org.in\)](https://www.rbi.org.in/press-releases)