

FRANKBANKER RESEARCH

RBI Monetary Policy Instruments: A Banker's Guide

Compiled by FrankBanker Research · Last reviewed March 2026

Sources: Reserve Bank of India (rbi.org.in) and IMF/BIS reference frameworks

WHAT IS MONETARY POLICY

Monetary policy refers to the use of instruments under the control of the central bank to regulate the availability, cost, and use of money and credit in the economy. In India, the **Reserve Bank of India (RBI)** is mandated under *Section 45ZA of the RBI Act, 1934 (as amended in 2016)* to maintain price stability while keeping in mind the objective of growth. The **Monetary Policy Committee (MPC)**, a six-member body comprising three RBI officials and three external members nominated by the Central Government, determines the policy repo rate required to achieve the inflation target. The CPI inflation target is **4% with a tolerance band of $\pm 2\%$** . RBI implements MPC decisions through a set of direct and indirect instruments that act on the availability and cost of money in the banking system.

QUICK REFERENCE: CURRENT POLICY RATES

As of February 2026 (RBI MPC, February 2026 meeting). Rates effective from December 5, 2025 except CRR (June 2025).

Instrument	Rate	Direction	Key Purpose
Policy Repo Rate	5.25%	Inject	Policy signalling; short-term liquidity injection
Standing Deposit Facility (SDF)	5.00%	Absorb	Floor of LAF corridor; uncollateralised absorption

Marginal Standing Facility (MSF)	5.50%	Inject	Ceiling of LAF corridor; emergency overnight borrowing
Bank Rate	5.50%	Inject	Penal rate for CRR/SLR shortfalls; aligned with MSF
Reverse Repo Rate	3.35%	Absorb	Legacy tool; largely replaced by SDF since April 2022
Cash Reserve Ratio (CRR)	3.00%	Direct	Reserves held with RBI; no interest paid
Statutory Liquidity Ratio (SLR)	18.00%	Direct	Liquid assets held in govt securities, cash or gold

Source: RBI Monetary Policy Statement, December 2025; RBI MPC Resolution, February 2026

HOW TO USE THIS GUIDE

Part A covers the monetary policy framework: the MPC, inflation targeting, and the classification of instruments into direct and indirect categories. Read this for foundational understanding.

Part B covers each instrument in detail: definition drawn from RBI's own language, current rate, how it operates, and what practitioners need to understand about it.

Part C covers the LAF corridor: how the instruments fit together as a system, and how RBI uses them in combination to manage liquidity.

Estimated reading time: Part A: 10 minutes. Parts B and C: 25 minutes.

PART A: THE MONETARY POLICY FRAMEWORK

1. Objectives and Legal Mandate

The RBI Act, 1934, as amended by the Finance Act 2016, gives the RBI a formal inflation targeting mandate. The primary objective is to maintain price stability, defined as CPI inflation at 4% with a tolerance band of $\pm 2\%$, while keeping in mind the objective of growth. This dual mandate distinguishes the RBI from purely inflation-focused central banks, requiring it to balance price stability against supporting economic activity.

The MPC holds six meetings per year. At each meeting, each member votes publicly and the majority decision prevails. If the RBI fails to maintain inflation within the tolerance band for three consecutive quarters, it must explain the reasons and remedial measures to the Central Government. This is a formal accountability mechanism introduced by the 2016 amendment.

2. Classification of Instruments

RBI's monetary policy instruments are broadly classified into two categories. Understanding this classification is essential for practitioners, as the two types work through entirely different transmission channels and operate on different time horizons.

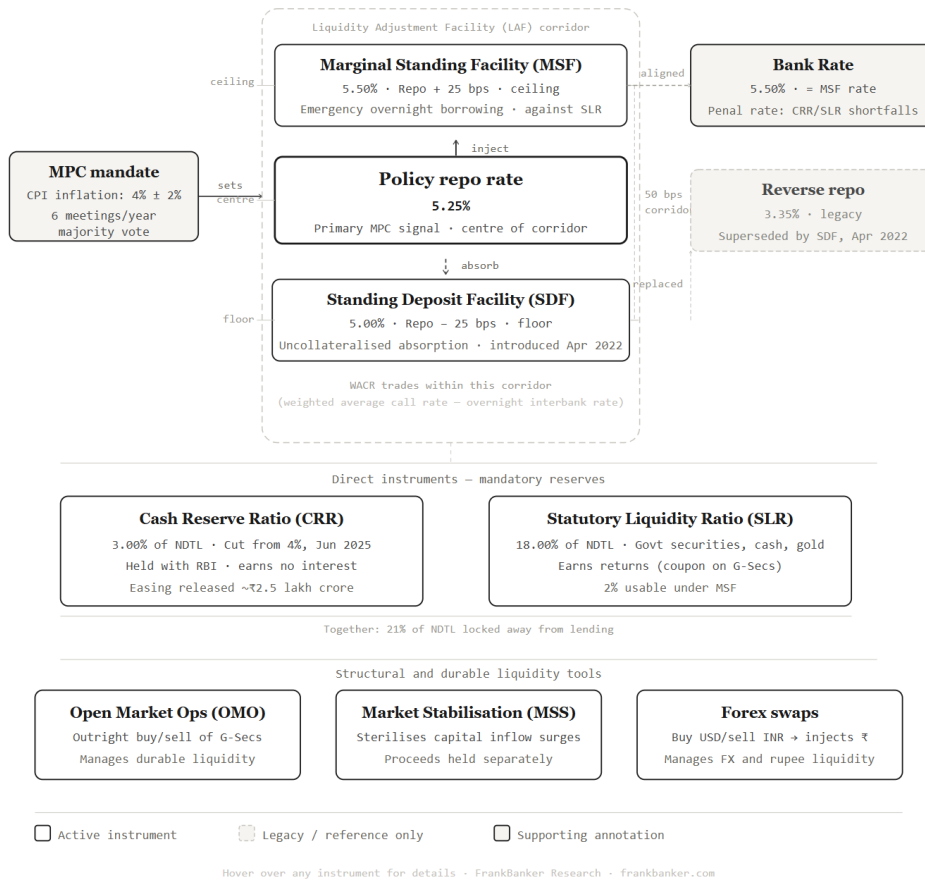
Type	Instruments	Mechanism
Indirect	LAF (Repo, SDF, MSF, Reverse Repo), Bank Rate	Influence cost and availability of funds through price signals; operate via market mechanism
Indirect: Open Market	OMO, MSS, Forex Swaps	Manage structural and durable liquidity through outright securities transactions or foreign exchange operations
Direct	CRR, SLR	Mandatory reserve requirements that directly reduce the lendable surplus of banks regardless of market rates

The distinction matters operationally. Indirect instruments work through incentives: they change the cost of borrowing or depositing, which banks then transmit (imperfectly and with a lag) to the real economy through their lending rates and deposit rates. Direct instruments bypass this transmission mechanism entirely and immediately reduce the pool of money banks can deploy as credit.

A third category of structural liquidity tools (OMO, MSS, Forex Swaps) operates beyond the daily LAF window and manages durable, long-term liquidity positions rather than day-to-day frictional flows.

RBI monetary policy: instruments and how they connect

Rates as of February 2026 · Source: rbi.org.in



PART B: THE INSTRUMENTS IN DETAIL

Policy Repo Rate

Current rate: **5.25% (effective December 5, 2025)**

The interest rate at which the Reserve Bank provides liquidity under the Liquidity Adjustment Facility (LAF) to all LAF participants against the collateral of government and other approved securities. Source: RBI Overview of Monetary Policy Instruments, rbi.org.in

The repo rate is the centrepiece of RBI's monetary policy framework. Banks borrow overnight funds from RBI by pledging eligible securities under a repurchase agreement. The bank agrees to repurchase the securities at a pre-determined price on the following business day.

Standard repo operations are conducted overnight or for a 14-day term. The 14-day variable rate repo (VRR), conducted fortnightly in alignment with the CRR maintenance cycle, serves as the main liquidity management tool for frictional requirements. In

exceptional circumstances such as the COVID-19 pandemic, longer-tenor Targeted Long-Term Repo Operations (TLTRO) of up to 3 years have been deployed to support specific sectors.

Practitioner note: The repo rate is the primary monetary policy signal. Every repo rate change is accompanied by an automatic adjustment of the MSF rate (Repo + 25 bps) and the SDF rate (Repo – 25 bps), maintaining the symmetry of the LAF corridor. Changes in the repo rate transmit to market rates, particularly repo-linked lending rates (RLLR) on loans, typically within one to three months.

Standing Deposit Facility (SDF)

Current rate: **5.00% (Repo – 25 bps; effective December 5, 2025)**

The rate at which the Reserve Bank accepts uncollateralised deposits, on an overnight basis, from all LAF participants. The SDF is also a financial stability tool in addition to its role in liquidity management. The SDF rate is placed at 25 basis points below the policy repo rate. Source: RBI Overview of Monetary Policy Instruments, rbi.org.in

Introduced in April 2022, the SDF replaced the fixed-rate reverse repo as the floor of the LAF corridor. The critical structural distinction from the reverse repo: the SDF is uncollateralised: banks park surplus funds with RBI without receiving government securities in return. This removes the constraint that RBI needed to hold sufficient eligible securities to conduct absorption operations.

The SDF was introduced under Section 17(1)(b) of the RBI Act, 1934. Its introduction also strengthened the symmetry of the LAF corridor: both the floor (SDF for absorption, at banks' option) and the ceiling (MSF for injection, at banks' option) are now standing facilities accessible at banks' discretion at any time.

Practitioner note: Banks with surplus funds that cannot be profitably deployed will park them with RBI at the SDF rate. This creates a floor below which the overnight rate (WACR) will not fall. A bank with surplus funds will not lend in the interbank market at a rate below what RBI offers through the SDF. The SDF rate therefore anchors the lower bound of short-term rates in the market.

Marginal Standing Facility (MSF)

Current rate: **5.50% (Repo + 25 bps; effective December 5, 2025)**

The penal rate at which banks can borrow, on an overnight basis, from the Reserve Bank by dipping into their Statutory Liquidity Ratio (SLR) portfolio up to a predefined limit (2 per cent of NDTL). This provides a safety valve against unanticipated liquidity shocks to the banking system. The MSF rate is placed at 25 basis points above the policy repo rate. Source: RBI Overview of Monetary Policy Instruments, rbi.org.in

The MSF is the emergency borrowing window, functioning as the lender of last resort facility within the LAF system. Banks access the MSF when they cannot meet their overnight funding needs through the regular repo window or interbank market. What makes the MSF distinctive is the collateral provision: banks can pledge securities from their SLR portfolio, securities they are otherwise required to hold, subject to a cap of 2% of NDTL.

Because the MSF rate sits above the policy repo rate, it is more expensive than regular repo borrowing. This makes it a last-resort facility: a bank will exhaust its regular repo limit and interbank borrowing options before accessing the MSF.

Practitioner note: The MSF creates the ceiling of the LAF corridor. No bank will pay more than the MSF rate in the overnight interbank market (WACR), because RBI is willing to lend at that rate to any eligible bank. This gives the RBI a hard upper bound on short-term market rates. The symmetry with the SDF (floor) means the policy corridor is exactly 50 basis points wide.

Bank Rate

Current rate: **5.50% (aligned with MSF; effective December 5, 2025)**

The rate at which the Reserve Bank is ready to buy or rediscount bills of exchange or other commercial papers. The Bank Rate acts as the penal rate charged on banks for shortfalls in meeting their reserve requirements (CRR and SLR). The Bank Rate is published under Section 49 of the RBI Act, 1934, and is aligned with the MSF rate, changing automatically whenever the MSF rate changes. Source: RBI Overview of Monetary Policy Instruments, rbi.org.in

The Bank Rate has a dual identity. Historically it was the rate at which RBI provided long-term refinance to banks, a function now largely dormant. Its active role today is as the penal rate: when a bank fails to maintain the required CRR or SLR, the penalty interest is charged at the Bank Rate.

Since the Bank Rate is automatically aligned with the MSF rate, it changes every time the MPC adjusts the policy repo rate. Practitioners rarely encounter the Bank Rate in normal operations. It becomes relevant primarily in compliance contexts when reserve shortfalls occur.

Reverse Repo Rate

Current rate: **3.35% (unchanged; legacy rate, largely superseded by SDF)**

The interest rate at which the Reserve Bank absorbs liquidity from banks against the collateral of eligible government securities under the LAF. Following the introduction of SDF, the fixed rate reverse repo operations will be at the discretion of the RBI for

purposes specified from time to time. Source: RBI Overview of Monetary Policy Instruments, rbi.org.in

Prior to April 2022, the reverse repo was the floor of the LAF corridor, the rate at which RBI absorbed surplus liquidity from banks by selling them government securities temporarily. It required RBI to hold sufficient eligible securities as collateral, creating a constraint on absorption capacity.

Following the introduction of the SDF in April 2022, the fixed-rate reverse repo has been retained in the RBI's toolkit but is no longer the primary absorption instrument. Variable Rate Reverse Repo (VRRR) auctions, where the rate is market-determined, continue to be used as a fine-tuning tool.

Practitioner note: The disconnect between the fixed reverse repo rate (3.35%) and the current SDF rate (5.00%) is intentional. The reverse repo is now a dormant rate. It no longer functions as the LAF floor. Practitioners should not use the reverse repo rate as the operative floor; the SDF rate is the relevant floor for understanding short-term rate dynamics.

Cash Reserve Ratio (CRR)

Current rate: **3.00% (effective June 7, 2025; reduced by 100 bps from 4.00%)**

The average daily balance that a bank is required to maintain with the Reserve Bank as a per cent of its Net Demand and Time Liabilities (NDTL) as on the last Friday of the second preceding fortnight that the Reserve Bank may notify from time to time in the Official Gazette. Source: RBI Act 1934 (Section 42); RBI Master Direction on CRR/SLR (July 2021, updated December 2024)

The CRR is the most direct of all monetary policy instruments. Banks must maintain the required proportion of their NDTL as balances with RBI, not in their own vaults or as other liquid assets, but specifically as deposits with the central bank. Crucially, no interest is earned on CRR balances.

CRR is calculated based on a bank's NDTL as of the last Friday of the second preceding fortnight. The balance must be maintained on an average daily basis over the reporting fortnight. This means a bank can hold more on some days and less on others, provided the average over the fortnight meets the requirement.

The June 2025 cut from 4% to 3% was a significant easing move that released approximately ₹2.5 lakh crore into the banking system, directly expanding the lendable surplus of banks.

Practitioner note: Unlike SLR assets which earn a return (through government securities coupon payments), CRR balances earn nothing. This makes CRR a direct tax on bank

profitability relative to their deposit base. Every percentage point of CRR at 3% of NDTL represents a meaningful cost: lendable funds locked away without any return. RBI uses CRR for rapid, high-impact liquidity adjustment when market-based tools would be too slow or too incremental.

Statutory Liquidity Ratio (SLR)

Current rate: **18.00% of NDTL (current; gradually reduced from 25%+ in the 1990s)**

Every bank shall maintain in India assets, the value of which shall not be less than such percentage of the total of its net demand and time liabilities in India as on the last Friday of the second preceding fortnight, as the Reserve Bank may, by notification in the Official Gazette, specify from time to time. Such assets shall typically include unencumbered government securities, cash, and gold. Source: RBI Act 1934 (Section 24); RBI Master Direction on CRR/SLR (July 2021, updated December 2024)

SLR requires banks to hold a minimum proportion of their NDTL in specified liquid assets, principally unencumbered government securities (G-Secs, T-bills, SDLs), but also cash and gold. Unlike CRR, SLR assets earn returns. A bank holding G-Secs earns the coupon on those securities.

The SLR serves a dual purpose. First, it ensures banks maintain a buffer of liquid assets that can be quickly converted to cash in a stress scenario. Second, and historically more important in India, the SLR ensured a captive demand for government securities, helping fund the fiscal deficit. As financial markets deepened and the fiscal situation improved, the SLR has been progressively reduced from over 25% in the early 2000s to 18% currently.

The MSF facility specifically allows banks to borrow against their SLR portfolio (up to 2% of NDTL), creating a direct link between the SLR and the emergency liquidity framework. In practice, this means the 18% SLR is not entirely locked away; 2 percentage points of it serve as contingent liquidity that can be mobilised in an emergency.

Practitioner note: The SLR and CRR together determine the non-deployable portion of a bank's NDTL: funds that cannot be lent out. Combined, they constrain credit growth significantly. A 3% CRR and 18% SLR means at least 21% of NDTL is pre-committed. For a bank with ₹1 lakh crore in NDTL, that's ₹21,000 crore unavailable for lending. This is why every CRR or SLR cut is immediately interpreted as a credit easing measure.

Open Market Operations (OMO), MSS and Forex Swaps

Beyond the LAF, RBI employs three additional tools for managing structural and durable liquidity. These are conditions that persist over weeks or months rather than fluctuating daily.

Tool	When Used	Effect
OMO Purchase	Durable liquidity deficit	RBI buys govt securities → cash flows into banking system → injects liquidity
OMO Sale	Durable liquidity surplus	RBI sells govt securities → cash absorbed from banking system → drains liquidity
MSS Issuance	Sustained surplus (e.g. large capital inflows)	RBI issues dedicated securities; proceeds held in separate account, not used for govt spending
Forex Buy/Sell Swap	Rupee liquidity management with forex dimension	RBI buys USD (sells INR) → rupee injected. Reverse swap absorbs rupee liquidity

OMO: Outright purchases or sales of government securities in the open market. When RBI buys securities, it credits banks' accounts and money flows into the system. When it sells, it debits accounts and money is absorbed. OMOs are powerful and immediate, but their use is announced in advance, making them less suited for surprise interventions.

MSS: The Market Stabilisation Scheme was introduced in 2004 to manage liquidity surges from large capital inflows (e.g., foreign portfolio investment). The MSS proceeds are sterilised, held in a separate government account, preventing them from financing fiscal spending. This maintains the distinction between monetary and fiscal operations.

Forex Swaps: When RBI buys USD and sells INR in the spot market, it injects rupee liquidity. The forward leg (buy-back) absorbs that liquidity at the agreed future date. Forex swaps allow RBI to manage both rupee liquidity and the rupee's exchange rate simultaneously. This is particularly useful when capital flows create both a currency appreciation pressure and excess rupee liquidity.

PART C: THE LAF CORRIDOR AS A SYSTEM

How the LAF Instruments Fit Together

The Liquidity Adjustment Facility (LAF) is not a single instrument. It is the overall framework through which RBI manages short-term liquidity. The various instruments discussed above, Repo, SDF, MSF, Reverse Repo, and associated variable-rate operations, are all components of the LAF.

Position in Corridor	Instrument	Description
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Ceiling (Upper bound)	MSF Rate	Banks borrow from RBI at MSF when other channels exhausted. Rate: Repo + 25 bps
Centre (Policy rate)	Policy Repo Rate	The rate at which RBI lends under LAF. This is the primary monetary policy signal.
Floor (Lower bound)	SDF Rate	Banks park surplus funds with RBI. Uncollateralised. Rate: Repo – 25 bps

The LAF corridor creates a bounded range within which the overnight interbank rate (the Weighted Average Call Rate, or WACR) is expected to operate. No bank will lend in the interbank market at a rate below the SDF rate (it would simply park funds at RBI instead). No bank will borrow in the interbank market at a rate above the MSF rate (it would borrow directly from RBI instead). The WACR therefore trades within a 50-basis-point corridor anchored at the policy repo rate.

The repo rate at the centre of the corridor is the primary monetary policy signal. Not because it mechanically determines all rates, but because it defines the midpoint of the range within which the overnight rate trades, and because the MPC's repo rate decision communicates the direction of monetary policy to financial markets.

How RBI Manages the Day-to-Day

On any given day, the banking system as a whole will either be in a liquidity deficit (needing to borrow from RBI) or a surplus (wanting to park funds with RBI). RBI uses the following layered approach:

- Primary tool, 14-day VRR/VRRR: Conducted fortnightly, aligns with the CRR maintenance cycle, handles the bulk of frictional liquidity needs.
- Fine-tuning: overnight and short-tenor operations Fill the gap between the fortnightly operation and daily needs.
- Standing facilities (SDF/MSF): Available at banks' discretion at any time. Banks access these when they have unusually large surpluses or deficits outside the regular auction windows.
- Structural tools (OMO/MSS/Forex Swaps): Used periodically when durable liquidity conditions (not just day-to-day fluctuations) need correction.

This layered structure gives RBI flexibility to address liquidity needs at multiple horizons, overnight, fortnightly, and structural, without being forced to intervene in the market every single day.

The Corridor Post-SDF Introduction (April 2022)

Before April 2022, the LAF corridor ran from the fixed reverse repo rate (floor) to the MSF rate (ceiling), with the policy repo rate in the middle. The corridor was 50 bps wide

(25 bps below repo to 25 bps above). The fixed reverse repo required RBI to provide collateral for absorption operations, which constrained the scale of absorption.

The SDF introduction removed this constraint. With the SDF as the uncollateralised floor, RBI can absorb any amount of surplus liquidity without needing to provide securities in return. This was particularly significant post-COVID, when the banking system was flooded with excess liquidity from RBI's own pandemic-era asset purchases. The SDF allowed RBI to normalise the corridor cleanly and efficiently.

The key implication for practitioners: the relevant LAF corridor since April 2022 runs from SDF rate (floor) to MSF rate (ceiling), with the repo rate at the centre. The fixed reverse repo rate at 3.35% is no longer an operational boundary.

KEY TAKEAWAYS

- The RBI Act (as amended 2016) mandates a 4% CPI inflation target with $\pm 2\%$ tolerance. The MPC sets the policy repo rate to achieve this target while supporting growth.
- The LAF corridor runs from the SDF floor to the MSF ceiling and is 50 bps wide, symmetrically around the policy repo rate. Since April 2022 the floor is the SDF rate, not the fixed reverse repo rate.
- The repo rate is the primary policy signal. Every repo rate change automatically adjusts the SDF rate (Repo - 25 bps), MSF rate (Repo + 25 bps), and Bank Rate (= MSF).
- The SDF (introduced April 2022) replaced the fixed reverse repo as the operative floor. It is uncollateralised, a structural improvement that removed the constraint on RBI's absorption capacity.
- CRR (3%) and SLR (18%) are direct instruments. Together they lock up 21% of a bank's NDTL. CRR earns nothing; SLR earns returns through government securities.
- OMO, MSS, and Forex Swaps manage structural and durable liquidity, conditions persisting over weeks or months, unlike the LAF which handles daily and fortnightly frictional needs.
- Rate cuts since February 2025 total 125 bps. Repo rate as of March 2026 is 5.25%, SDF is 5.00%, MSF and Bank Rate are 5.50%. CRR was cut to 3% in June 2025.
- Transmission from policy rate to lending rates is imperfect and lagged. Repo-linked lending rates (RLLR) transmit faster than MCLR-linked rates.
- The Bank Rate's primary operational relevance today is as the penal rate for CRR and SLR shortfalls, not as a refinance rate.

FURTHER READING: RBI DOCUMENTS

- *RBI Overview of Monetary Policy Instruments*. rbi.org.in/scripts/fs_overview.aspx (primary source for definitions used in this guide)
- *Monetary Policy Statement, December 2025 (Governor's Statement)*. rbi.org.in/rbidocs
- *Master Direction on CRR/SLR (DOR, July 2021; updated December 2024)*. rbi.org.in
- *Statement on Developmental and Regulatory Policies, April 2022 (SDF introduction)*. rbi.org.in
- *RBI Act, 1934 (as amended 2016). Sections 17, 24, 42, 45ZA, 45ZB*. indiacode.nic.in
- *Master Circular on Cash Reserve Ratio and Statutory Liquidity Ratio*. rbi.org.in

FURTHER READING: IMF AND BIS REFERENCE

- *IMF, 'Monetary and Financial Statistics Manual and Compilation Guide' (2016)*. imf.org
- *BIS, 'Central bank operating frameworks and collateral markets', BIS Working Papers*. bis.org
- *IMF Working Paper, 'India: Strengthening the Monetary Policy Framework'*. imf.org

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