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Que Explain in detail about Monetary Policy of Reserve Bank of India?

Introduction

The Reserve Bank of India is the central bank of India, established in 1935. Its main function is to maintain economic stability in India, of which monetary policy is an important part. Through monetary policy, the RBI influences economic growth, inflation control, employment and financial sector stability. This policy is decided by the Monetary Policy Committee (MPC) of the RBI, which was formed in 2016 and consist of 6 members (3 RBI and 3 government nominees).

What is Monetary Policy?

A set of tools that a nation's central bank has available to promote sustainable economic growth by controlling the overall supply of money that is available to the nation's banks, its consumers, and its businesses.

Types of Monetary Policy

1. Expansionary Monetary Policy
2. Contractionary Monetary Policy
3. Neutral Monetary Policy

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These three types of monetary policies produce different effects on a country 's internal economy and on economic trade with other countries.

1. Expansionary Monetary Policy
"Increase money, reduces interest rates, drives the economy."
During times of slowdown or a recession, an expansionary policy supports economic activity. By lowering interest rates, savings becomes less attractive, business and consumer borrowing increases as does business and consumer spending.

Characteristics	Description
Objectives	Increasing economic growth, reducing unemployment, recession removal
Use of equipment	• Repo rate cut • Decrease CRR / SLR • Buy Bonds through OMO, • Reduce Reverse Repo.
Effect	• Loan cheap → Investment ↑ • Expenditure rise → Industries run • GDP growth ↑
Danger	Inflation may increase (if it becomes too high)
Example	In Covid 19 Repo rate reduce to 4%. CRR 3% Liquidity added of Rs 10 lakh crore

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2. Contractionary Monetary Policy

"Reduce money, Increased interest, stop inflation."

A Contractionary policy increases interest rates and limits the outstanding money supply to slow growth and decrease inflation, where the prices of goods and services in an economy rise and reduce the purchasing power of money.

Characteristics	Description
Objective	Inflation control. "Over heating" the econom[y] prevent from happening.
Use of Equipment	• Increase repo rate • Increase CRR/SL[R] • Bond sales through OMO • Increase reverse repo rate
Effect	• Loans expensive -> Expenditure decrease • Credit decrease -> Demand decrease • Inflation↓
Danger	Growth may be slow down
Example	Repo rate increased to 6.50% at inflation of 7.8%. ₹ 2 Lakh crore absorbed from OMO. CPI fell by 5%.

3. Neutral monetary Policy

"Maintain balance - neither increase nor decrease."

Characteristics	Description
objectives	Balance between inflation and growth
Condition	When the economy is stable. CPI-4% GDP-7%
Tools	• No change in rates • keep liquidity stable • Limited use of OMO/MSF
Effects	The economy runs at a steady prices
Example	October 2025 Repo rate 6.50% but stable CPI - 4.8% GDP 7% Neutral stance

Main objectives of monetary Policy

The main objectives of RBI's monetary policy are as follows:

1. Inflation Control: RBI's primary goal is to maintain inflation at 4% (CPI based) with a tolerance of ±2%. This has been fixed under the 2016 Monetary Policy Framework.

2. Economic growth: Promoting GDP growth, especially in times of weak growth.
3. Financial stability: Capital adequacy in banks, liquidity and financial sector risk mitigation.
4. Employment and Exchange rate: Increasing employment and stabilizing the value of rupee.

Instruments of Monetary Policy.

The Reserve Bank of India uses both direct (Quantitative) and indirect (Qualitative) tools to implement its monetary policy. Through these tools, the RBI controls liquidity (money supply), interest rates and ability of banks to lend.

Quantitative Tools These tools directly affect the money supply and have an impact on entire economy.

Repo rate: When the commercial banks are in need of funds for a short period, they can borrow from central bank against approved securities. The rate of interest charged by the central bank on such lending is called Repo rate. Objective of Repo rate is to control inflation and determination of interest rates.

. Rising repo rate to control inflation (by reducing money supply) Repo rate ↑ → Loans expensive → credit reduces → Inflation decrease.
Repo rate ↓ → Loans cheap → Credit increase → growth increase. Example 2025 october 6.50% rate.

Reverse Repo rate When the commercial banks have surplus funds they can deposit the same with the Central bank and earn interest. The rate of interest paid by the central bank on such deposits is called reverse repo rate. Main objective of it is to absorb money from market. To control inflation by reducing money supply. Reserve repo rate ↑ → encourages commercial bank to park surplus funds with central bank. Negative effect on lending capability of commercial bank → Demand for credit reduces → less money in economy. AD falls and excess demand is corrected and visa-versa to control deflation. Example 6.25%.

Bank rate / Discount rate: It is the minimum rate at which the Central Bank of a country ~~goi~~ gives credit to commercial bank to meet their long term needs. To control inflation / Excess demand by (reducing money supply). Bank rate ↑ → Interest rate ↑ → Credit Costlier → demand for credit reduces → less money in economy → AD↓ and visa versa to control deflation / deficient demand.

Varying legal reserve requirements Legal reserve requirement is that fraction of deposits of commercial banks which is legally compulsory for them to maintain on two accounts.

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Cash Reserve Ratio: It is minimum percentage of deposits of commercial banks (net of demand and liabilities) which is kept in cash form with RBI. Main objective is to increase / decrease banks ability to provide credit. To control Excess demand (by reducing money supply) CRR is increased → Less money will flow in the system → Purchasing power reduces → AD falls. and visa-versa to control deficiend demand. Example 4.50%.

Statutory Liquid Ratio: It is the percentage of deposits of commercial banks (net of demand & time liabilities) which every bank is required to maintain with itself in form of designated liquid assets.

Liquid assets may be:
- Excess cash reserves.
- Unencumbered government and other approved securities.
- Current account balances with other banks.

Marginal standing facility: In the time of emergency commercial banks get Repo rate + 0.25% Loans from RBI. Main objective is that it help in liquidity crises. It effect as last option for Bank. Example 6.75% in 2025.

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Open Market Operations: It refers to purchase and sale of government securities in the open market (public and commercial banks) by Central Ba[nk]. Objective is increase/decrease liquidity in market. When central bank sold government securities to control excess demand by reducing money supply, then less money will flow in system. Purchasing power in economy reduces & AD falls. Vica-Vers[a] to control deficient demand by increasing money supply.

Qualitative Tools These measures affect allocation of credit between alternatives uses.

Imposing margin requirement: A margin is the difference between market value of security offered by borrower against loans and the amount of loan granted. It is also defined as the discount fixed by RBI on the assets mortagaged as security to commercial banks. If the margin requirement is 20% then bank is allowed to give loans only upto 80% of the have to securities. To control Excess demand (By reducing money supply) To control. Margin ~~requistr~~ requirement is increased to correct Excess demand → Less money → Purchasing Power in economy reduces. AD falls.

Moral suasion and direct action: It is combinatio
of persuation and pressure that the Central ban
applies to other banks in order to get them fal
in line with its policy. It is done through
letters, speeches and hints to the banks.
Central bank may take direct action against
member banks which do not comply with its
policies of credit expansion or contraction.
For example banks gives more loans to agricultur
sector.

Selective credit control : This can be applied i
both a positive as well as negative manner.

- In a positive manner, the credit will be channelised to particular priority sectors.
- In a negative manner, the flow of credit wil be restricted to particular sectors. Simplily Credit ceilings is tools is use, means setting maximum limits on bank lending against specific securities. The main objective is to control credit to specific "sensitive" commodities and sectors to prevent speculation, hoaring and inflationary pressures, supporting essential economic activities instead. SCC targets where money goes, influencing the quality or direction of credit. Decrease credit in unnecessary sector. For example limit loans on luxury cars.

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Liquidity Adjusting Facility is the principles operating monetary policy tool that allows banks to borrow money through repurchase agreements. This means, in order to meet short-term cash needs, bank borrow money against government approved securities with an agreement to repurchase the same at a pre-determined rate and date. The LAF is used to aide banks in emergence arising out of severe cash shortage or acute liquidity crisis. It is used for modulating the short term liquidity (daily) & transmitting the interest rate into the market. It is combine of Repo rate and reverse repo rate. Example control daily liquidity.

Short term repo operations (Repurchase agreement) are short term central bank tools to managing money supply involving banks selling securities (like gov. bonds) to central bank with an agreement to buy them back later at a higher price, effectively functioning as secured, very short term (overnight - few days) loans to inject or absorb liquidity influencing short term interest rate, crucial for market stability and monetary policy implementation.

Variable Repo rate is a tool used by RBI to manage liquidity in banking system. Rate determined by market auctions, typically longer than one day.

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flexibility adjusts based on market demand, purpose to manage liquidity dynamically. It's impact on economy more responsive to market op conditions.

* Monetary Policy Committee *

The Monetary Policy Committee (MPC) is the body that decides a country's monetary policy, mainly interest rates, to control inflation and support economic growth. It is constituted by Central Government and led by the Governor of RBI. MPC was constituted under the 45ZB Section Reserve Bank of India ACT 1934 as an initiative to bring more transparency and accountability in fixing the Monetary Policy of India. MPC conducts meeting at least 4 time a year and monetary policy is published after every meeting with each member explaining his opinion.

Urjit Patel committee first proposed the idea for formation of five member Monetary Policy Committee. The monetary Policy committee came into force on 27th June 2016. The first meeting of MPC was conducted on 3rd October 2016 in Mumbai. Each member of MPC has one vote, and event of equality of votes, the Governor has a second or casting vote. Once every six months, RBI is required to published a document called Monetary Policy Report to explain inflation for 6-18 months ahead

India's Monetary Policy Committee has six members: three from the Reserve Bank of India RBI governor (chairperson), RBI Deputy Governor (incharge of monetary policy), One RBI official nominated by Governor. External members (appointed by government).

Current members of MPC include Shaktikanta Das (Governor), Michael Debabrata Patra (Deputy Governor, in charge of MP). Rajiv Ranjan (Executive Director RBI Government appointed (4 year term, not re-eligible) Ram Singh (director Delhi School of Economics), Saugata Bhattacharya (Economist), Nagesh Kumar (Director & CEO, ISID).

Estimated decision process mostly based on inflation targeting, in which economic data (GDP, CPI, IIP) is analysis. By 2025, the focus of MPC meetings has shifted to inflation and global impacts (such as US Fed rates, oil prices).

Various effect of Monetary Policy

Monetary policy is a policy adopted by a central bank to influence the economy by controlling the money supply, interest rates, and the flow of credit. It main effects on the economy are as follows:

1. Economic Growth
- Expansionary Policy: Investment and spending increase by lowering interest rates and increasing the money supply, which leads to GDP growth.
- Contractionary Policy: Reduces spending and investment by raising interest rates, which can slow growth.

2. Inflation
- Low interest rates increase demand, which can lead to increased inflation (Deman Pull Inflation).
- High interest rates reduce demand, which keeps inflation in check.

3. Unemployment
- Expansionary policy causes businesses to invest more which increases job and reduces unemployment.
- Contractionary policy reduces investment, which can increase unemployment.

4. Exchange Rates
- High interest rates attract foreign capital which strengthens the rupees. • Low interest rates causes capital to flow out, which weakens the rupee.

5. Investment and Savings
- Low interest rates makes loans cheaper, which encourage investment. • Higher interest rates increases saving's, but decrease investment.

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6. Banking & Financial Stability
Banks' liquidity is controlled through instruments like CRR, SLR. • Overexpansion can lead to financial instability (such as bubble).

Effects of Monetary Policy on Exports & Imports

Monetary policy mainly affects imports and exports by influencing the exchange rates, interest rates, and demand in the economy. Its effect depends on expansionary and contracdionary policies.

1. Effects on exchange rates (primary effect)
- Expansionary policy low interest rates
- Foreign capital flow out, weakening local currencie (such as rupee).
- For exporters Exporters becomes cheaper, competetion in foreign markets increases, export increase, profit increases.
- For importers, imports are tight + Cost increase Margins fall or import fall.

- Contractionary Policy high interest rates
- Foreign capital is attracted, which strengthens currency.
- Exports becomes more expensive for exporters, competition in foreign markets reduces exports & profit decreases.
- Imports became cheaper for importers, costs fall, margine rise or import increase.

2. Impact on demand & Inflation (direct imp)
- Expansionary policy: Demand in economy increases, which increases demand for domestic goods → import may increase (if domestic supply is insufficient). B If inflation increases, exporters' costs increase.
- Contractionary policy Demand falls → imports fall (due to less consumption). If inflation is kept under control, exporter benefit from stable prices.

3. Impact on credit & investment
- Low interest rate makes loans cheaper → Both exporters and importers can expand business, but impact of exchange rate is more pronounced.
- High interest rate make credit expensive → bottlenecks in business sector, which affects importers and exports.

Impact of Monetary Policy on Common Man
Monetary policy (changes in repo rates, CRR etc by RBI directly affects banks, but it also has an impact on the daily lives of common man.

Areas of Effect	Expansionary policy (Rates ↓)	Contractionary (Rate ↑)
Loans and EMIs	Home / Car loan ↓ → EMI ↓ (₹ 50 lakhs loans at ₹500 - 1000/month savings	As EMI increases burden increases

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Areas of Effects	Expansionary	Contractionary
Savings & FD	Interest on saving account/FD↓ -> returns↓	Interest on FD↑ -> benefit to senior citizens
Spending & Purchase	Cheap loans -> Car, home, Mobile Purchase ↑	Expensive loans -> costs↓ Budget deteriorates
Job and Income	Business grows -> jobs increase -> salaries ↑	Recession lay off. Salary freezes
Inflation & Prices	Things are expensiv -> Prices of pulses & vegetable are ↑.	Budget relief as prices fall
Stock market Mutual Funds	Investment increases -> market rises	Decrease in investment decrease in market

Impact of Monetary Policy on traders

Monetary policy (RBI's repo rates, CRR, OMO, etc) affects traders in stock, commodity, forex, bond and derivates market directly and indirectly. The effect depend on expansinary and contractionary policy.

Area of Effect	Expansionary Policy	Contractionary Policy
Stock Market	Cheaper loans, rising corporate profit, bull market	Bear market (volatility ↑) as loan costs fall
Commodity Gold/Crude	Less rate → Gold investment ↑ inflation hedge food demand ↑	High rate reduce gold Food demand ↓
Forex IND/USD	Weak rupee → exporters benefit (IT, pharma). harm importer	Strong rupee benefit importers ; harms exporters
Bond/Debt market	Bond yeild fall → bond prices rise	Yields rise, bond prices fall
Volality	Low uncertainty → Low volatility	High uncertainty → High volatility