INDIAN ECONOMIC ENVIRONMENT,401
MBA, IV SEMESTER,
TOPIC-MONETARY POLICY AN OVERVIEW,
MMHA&PU.

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MONETARY POLICY-MEANING

- Monetary policy refers to the central banks programme of changing monetary variable viz., total supply of money, interest rate and credit rationing.
- In India, monetary policy of the Reserve Bank of India is aimed at managing the quantity of money in order to meet the requirements of different sectors of the economy and to increase the pace of economic growth.
- For instance, liquidity is important for an economy to spur growth. To maintain liquidity, the RBI is dependent on the monetary policy.

MONETARY POLICY-DEFINITION

- Monetary policy is the macroeconomic policy laid down by the central bank.
- It involves management of money supply and interest rate and is the demand side economic policy used by the government of a country to achieve macroeconomic objectives like inflation, consumption, growth and liquidity.
- The measures taken by the central bank and treasury to strengthen the economy and minimize cyclical fluctuations through the availability and cost of credit, budgetary and tax policies, and other financial factors and comprising credit control and fiscal policy.

OBJECTIVES OF MONETARY POLICY

- To Regulate Money Supply in the Economy.
- To Attain Price Stability
- To promote Economic Growth
- To Control Business Cycles
- To Promote Employment
- To promote Economic Growth
- To Promote saving and Investment
- To Ensure more Credit for Priority Sector
- To Promote Exports and Substitute Imports

TOOLS AND INSTRUMENT OF MONETARY POLICY

- Monetary policy is a way for the RBI to control the supply of money in the economy. So these credit policies help control the inflation and in turn help with the economic growth and development of the country. So now let us take a look at the various instruments of monetary policy that the RBI apply to control the money market.
- Open Market Operations-Open Market Operations is when the RBI involves itself directly and buys or sells short-term securities in the open market. This is a direct and effective way to increase or decrease the supply of money in the market. It also has a direct effect on the ongoing rate of interest in the market.

- Bank Rate-One of the most effective instruments of monetary policy is the bank rate. A bank rate is essentially the rate at which the RBI lends money to commercial banks without any security or collateral. It is also the standard rate at which the RBI will buy or discount bills of exchange and other such commercial instruments.
- Variable Reserve Requirement-There are two components to this instrument of monetary policy, namely – The Cash Reserve Ratio (CRR) and the Statutory Liquidity Ratio (SLR). Let us understand them both. Cash Reserve Ratio (CRR) is the portion of deposits with the commercial banks that it has to deposit to the RBI. So CRR is the percent of deposits the commercial banks have to keep with the RBI.
- The RBI will adjust the said percentage to control the supply of money available with the bank. And accordingly, the loans given by the bank will either become cheaper or more expensive. The CRR is a great tool to control inflation.

- The Statutory Liquidity Ratio (SLR) is the percent of total deposits that the commercial banks have to keep with themselves in form of cash reserves or gold. So increasing the SLR will mean the banks have fewer funds to give as loans thus controlling the supply of money in the economy. And the opposite is true as well.
- liquidity Adjustment Facility-The Liquidity Adjustment Facility (LAF) is an indirect instrument for monetary control. It controls the flow of money through repo rates and reverse repo rates. The repo rate is actually the rate at which commercial banks and other institutes obtain short-term loans from the Central Bank.

- Moral Suasion-This is an informal method of monetary control. The RBI is the Central Bank of the country and thus enjoys a supervisory position in the banking system. If there is a need it can urge the banks to exercise credit control at times to maintain the balance of funds in the market. This method is actually quite effective since banks tend to follow the policies set by the RBI.

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