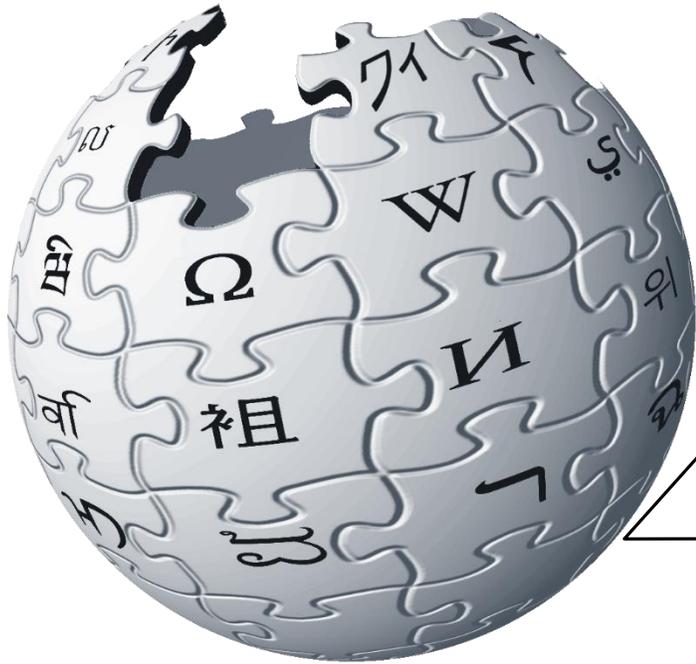


# MONETARY POLICY OF INDIA

And how RBI controls Inflation

# WHAT IS MONETARY POLICY?



Monetary policy is the process by which the monetary authority of a country, like the central bank or currency board, controls the supply of money, often targeting an inflation rate or interest rate to ensure price stability and general trust in the currency.

The Reserve Bank of India (RBI) is vested with the responsibility of conducting monetary policy.

# OBJECTIVES OF THE MONETARY POLICY OF INDIA

Growth with stability

Regulation, Supervision & Development of Financial Stability

Promoting priority sector

Generation of Employment

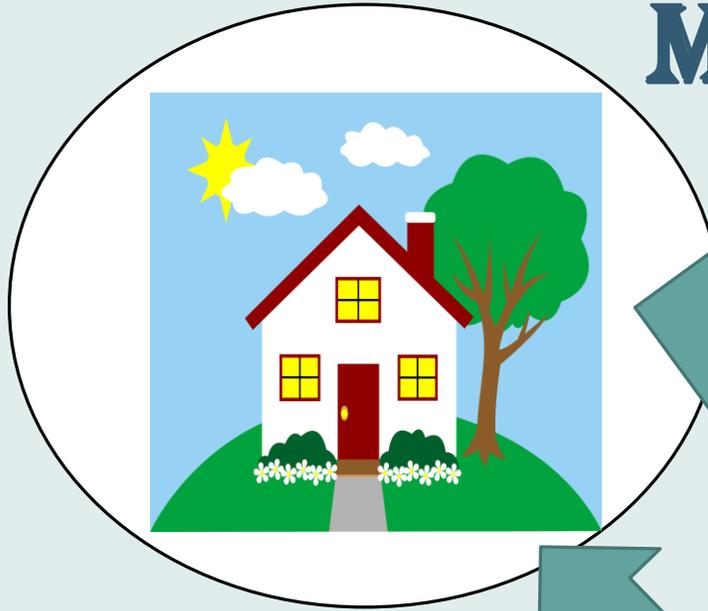
External Stability

Encouraging Savings and Investments

Regulation of Non Banking Financial Institutions

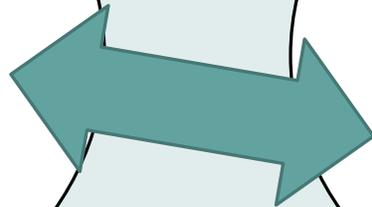
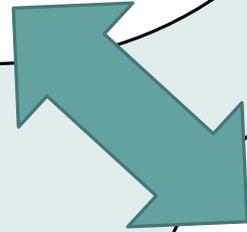
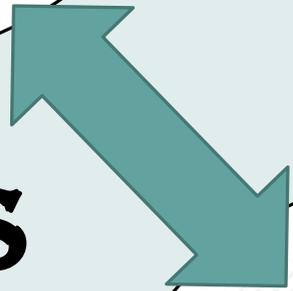
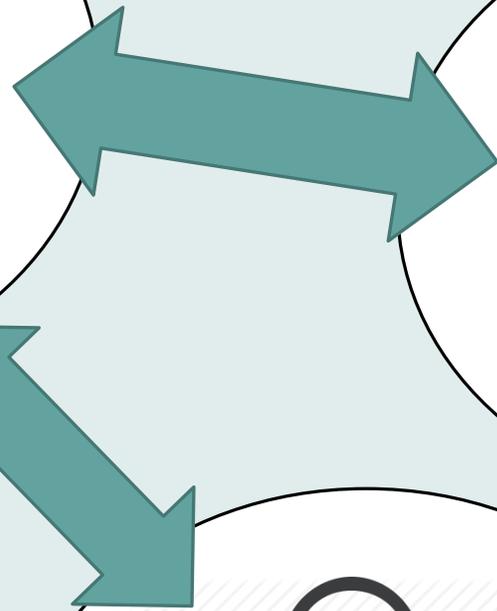
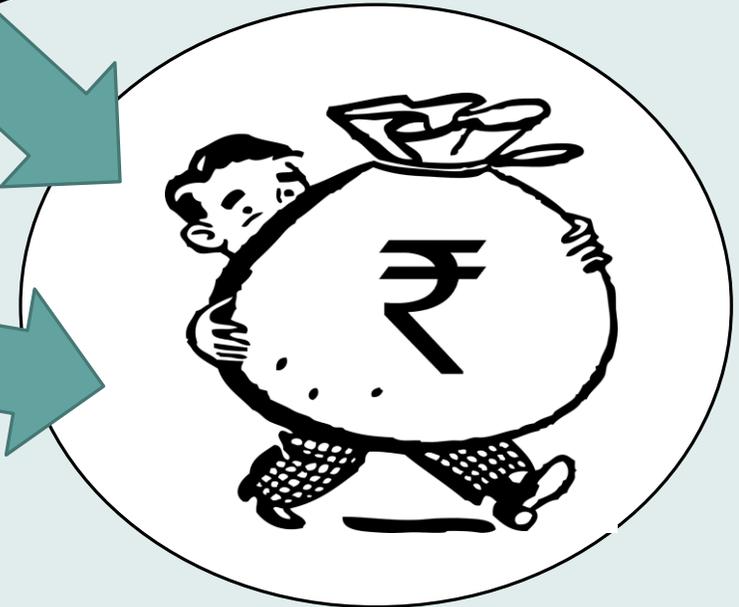
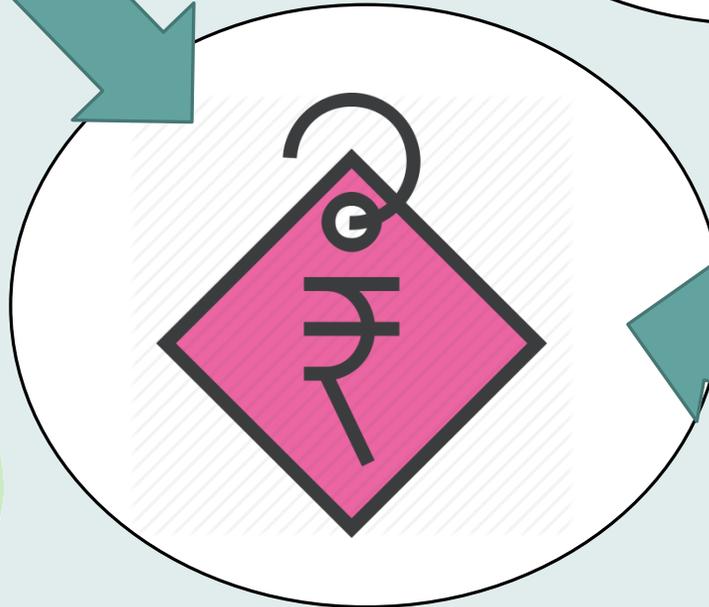


# MONETARY POLICY

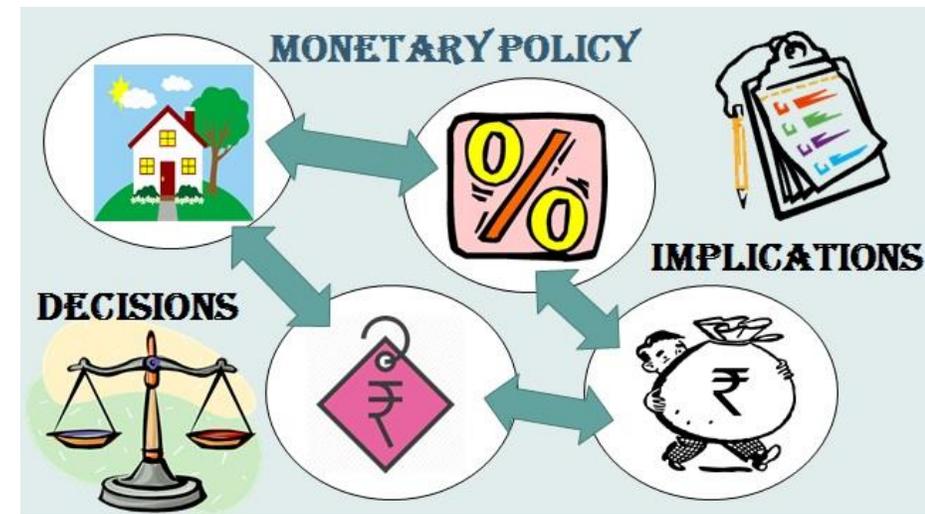


# IMPLICATIONS

# DECISIONS



# TOOLS OF MONETARY POLICY



## Tools of Monetary Policy

### Quantitative Measures

Open Market Operations (OMO)

Bank Rate

Variations in Reserve Ratios

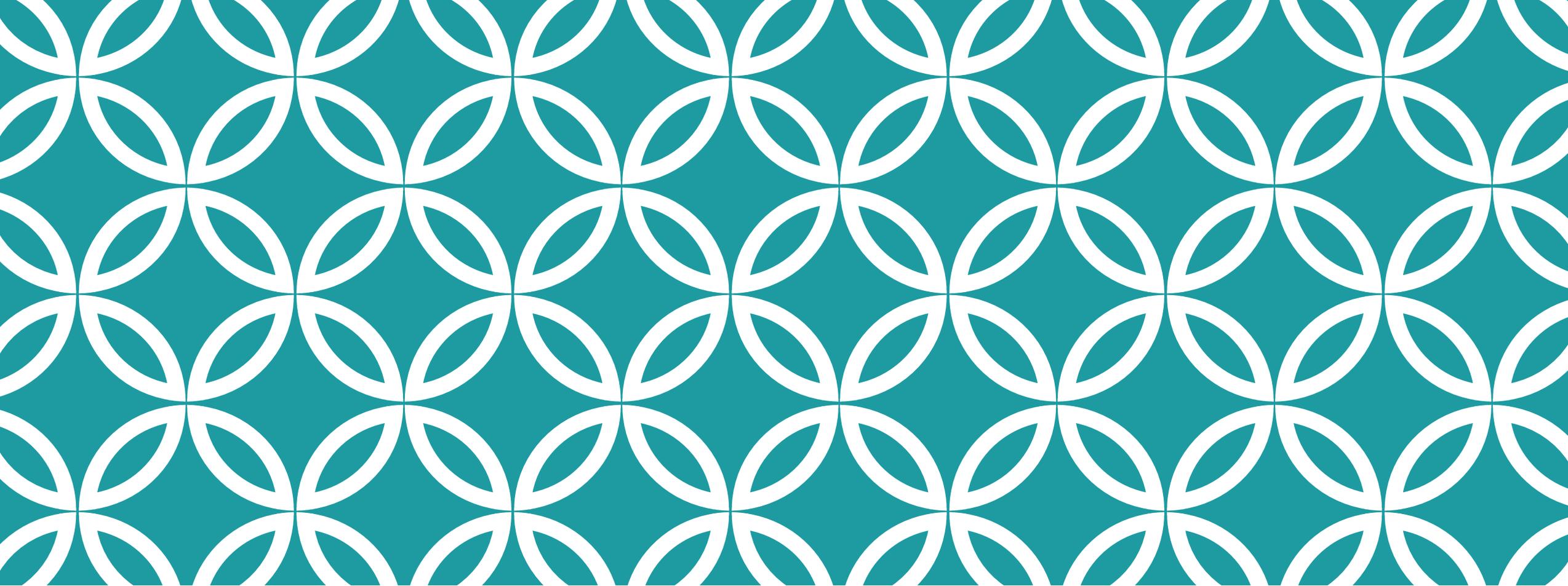
### Qualitative Measures

Credit Rationing

Change in Lending Margin

Moral Suasion

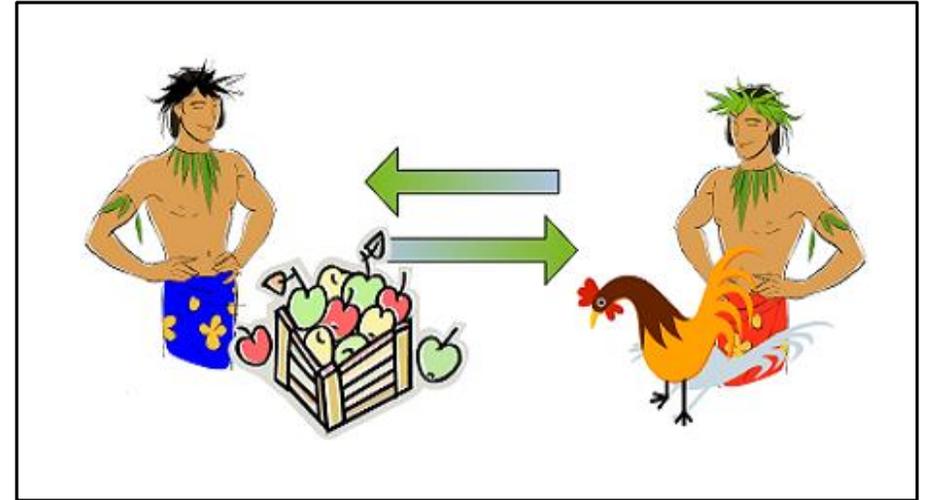
Direct Control



# WHY RBI NEEDS TO CONTROL THE MONETARY POLICY?

# WHY RBI NEEDS TO CONTROL MONETARY POLICY?

Initially people used **Barter System** for trading. But the barter system had many problems. Therefore, people switched to money system.



So, Financial Intermediaries came into the picture.

**Financial Intermediaries** = Middlemen who help in the circular flow of money between households and business firms.

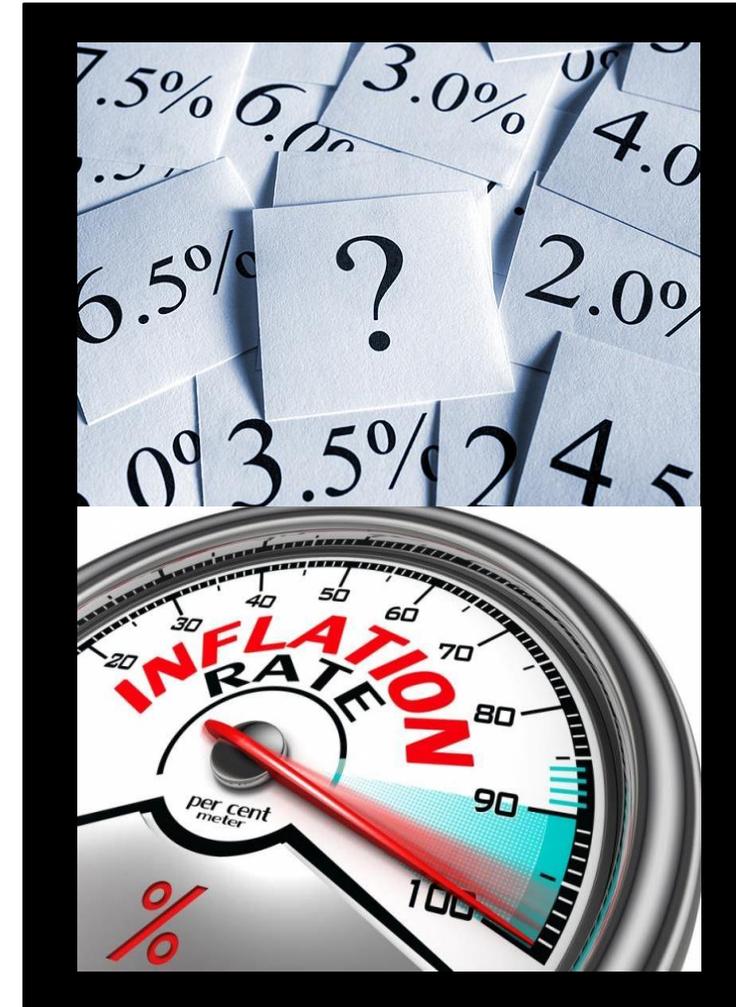
There are two types of financial intermediaries: banking institution and non-banking financial institutions.

- RBI controls (all) banks and (some) non-banking financial institutions.
- RBI's main job is to control Money supply in this game, and thereby fight inflation and deflation.



# WHY RBI NEEDS TO CONTROL MONETARY POLICY?

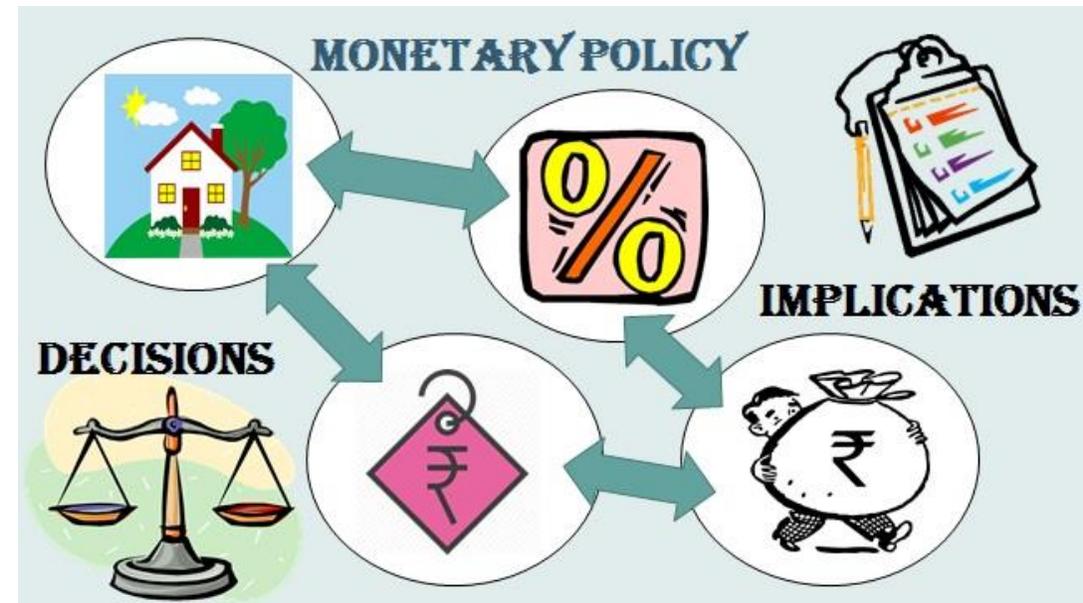
- **Inflation** = price rise = bad for economy, you know that by common sense.
- But **Deflation** = price decrease = we can buy things at a lower price. Isn't that good? Why is deflation bad for economy?
  - Every business has 'fixed cost of production' say minimum light bill, phone bill, office rent, staff salary etc. So, if prices keep falling and falling (say of Nano car), then car maker will suffer losses. He has no motivation to expand business. He wants to cut down his production costs, by firing some of the employees = less new jobs created = unemployment = social unrest.
  - If prices of everything fall- then custom duty, VAT, excise duty, service tax- their collection will also decrease. Then government has less money to spend on education, healthcare, social sector, defense, law and order = poverty, disease, crime.

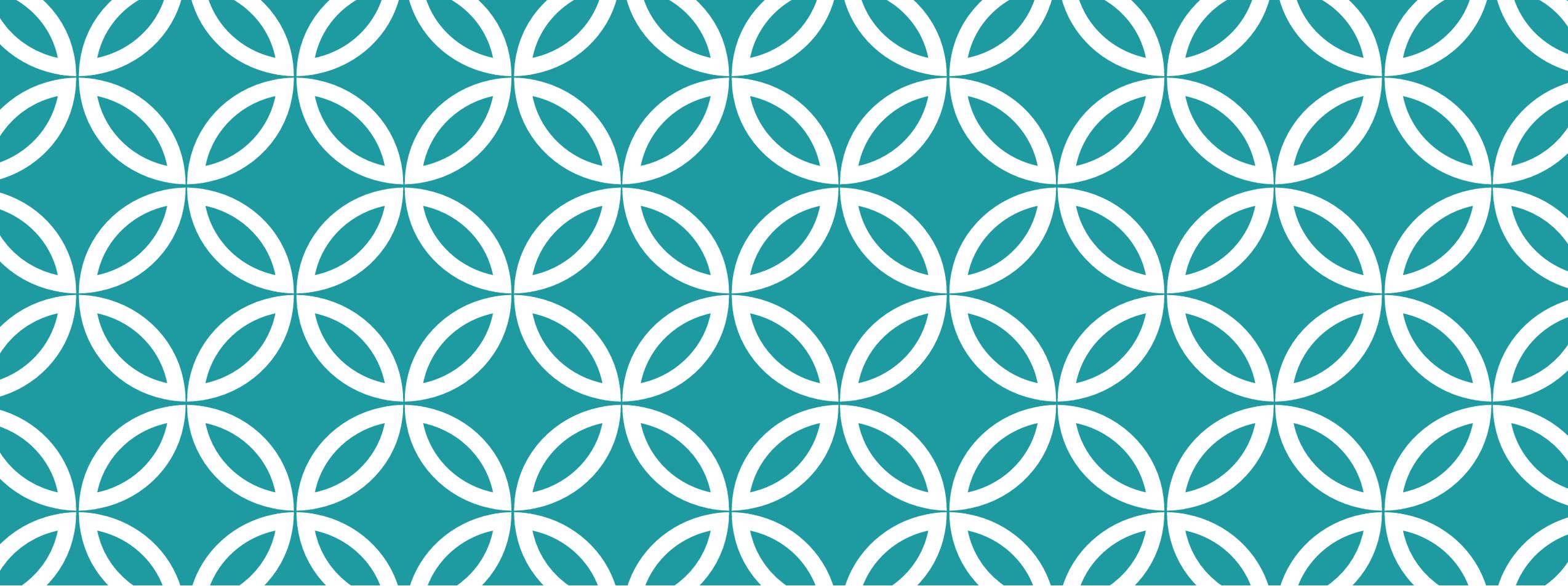


# SO, WHAT IS MONETARY POLICY?

- Policy made by the central bank.
- To control money supply in the economy. (and thereby fight both inflation and deflation).
- RBI implements monetary policy using certain tools. Two types:
  - Quantitative tool
  - Qualitative tools

Let's understand what that means...





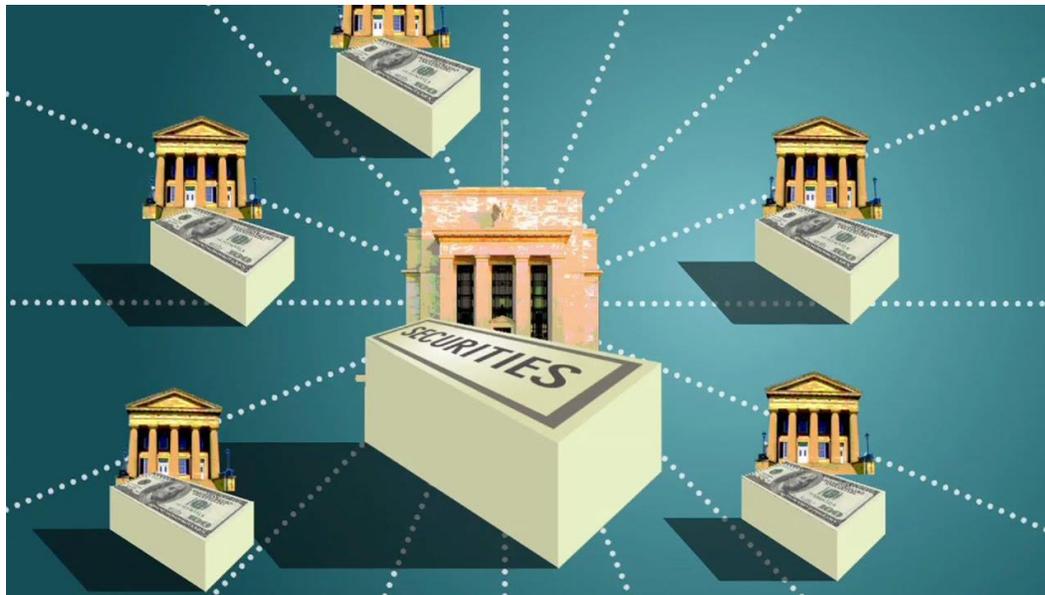
# QUANTITATIVE MEASURES OF MONETARY POLICY



# OPEN MARKET OPERATIONS

OPEN  
MARKET  
OPERATIONS

Open Market Operations or OMO refers to the purchase and/or sale of short term and long term securities by the RBI in the open market.



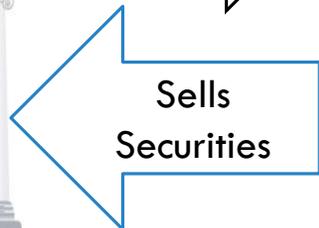
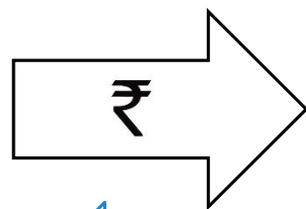
OMO is used to wipe out shortage/excess of Money in Money Market, to influence the term and structure of interest rate and to stabilize the market for government securities.

OPEN MARKET  
OPERATIONS

# OPEN MARKET OPERATIONS



When RBI sells securities in open market, commercial banks and public buy it. This reduces the existing money supply as money gets transferred from the Commercial Banks to RBI.



Individuals



Controls Inflation



# OPEN MARKET OPERATIONS

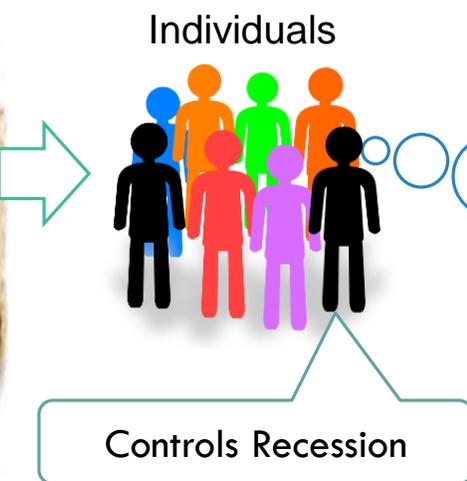


When RBI buys securities from commercial banks in open market, commercial banks sell it and get back the money they had invested in them, thereby increasing the existing money supply.



← Buys Securities

← ₹



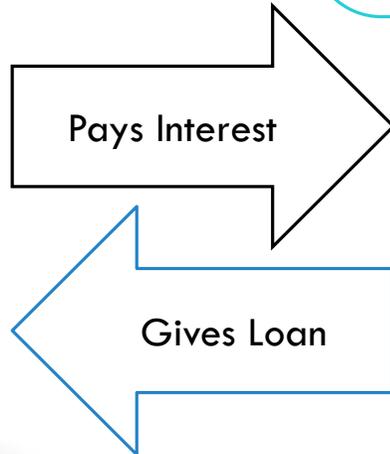
Thus SHORTAGE of MONEY SUPPLY is eased

# BANK RATE



Bank Rate or Discount Rate is the **MINIMUM** rate at which RBI provides loans to the Commercial Banks

Funds are provided either through lending directly or discounting or buying money market instruments like commercial bills and treasury bills.



# BANK RATE



Bank Rate Increases  
= Cost of Borrowing of Commercial Banks Rises  
= Fall in Credit Volume to Banks  
= Reduction in Money Supply

Current Bank Rate of RBI is 6.75%



Pays Interest

Takes Loan



# TEST YOUR KNOWLEDGE!!

Answer the following question:

Which of the following ratios are decided by RBI?

- a) Cash Reserve Ratio
- b) Statutory Liquidity Ratio
- c) Repo and Reverse Repo Rate
- d) All of the above

Let's discuss each one of them in detail:

