A PROJECT REPORT ON

"STUDY ON MONETARY POLICY OF CENTRAL BANK IN INDIA"

A Project Submitted to

University of Mumbai for Partial Completion of the Degree

of Bachelor in Commerce (Banking and Insurance)

Under the Faculty of Commerce

By

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Under the Guidance of

'ASST. PROF. DR. KISHOR CHAUHAN'

JNAN VIKAS MANDAL'S

Mohanlal Raichand Mehta College of Commerce

Diwali Maa College of Science

Amritlal Raichand Mehta College of Arts

Dr. R.T. Doshi College of Computer Science

NAAC Re-Accredited Grade 'A+' (CGPA : 3.31) (3rd Cycle)

Sector-19, Airoli, Navi Mumbai, Maharashtra 400708

FEBRUARY, 2024.

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CERTIFICATE

This is to certify that **MR.**_____has worked and duly completed his Project work for the degree as Bachelor in Commerce (Banking and Insurance) under the Faculty of Commerce in the subject of **Banking** and his project is entitled, "_____". Under my supervision.

I further certify that the entire work has been done by the learner under my guidance and that no part of it has been submitted previously for any Degree or Diploma of any University.

It is his own work and fact reported by her personal finding and investigations.

Guiding Teacher,

ASST. PROF. DR. KISHOR CHAUHAN.

Date of submission:

DECLARATION

I the undersigned **MR. AMAN RAMESH GUPTA** here by, declare that the work embodied in this project work titled **"STUDY ON MONETARY POLICY OF CENTRAL BANK IN INDIA"**, forms my own contribution to the research work carried out by me under the guidance of **ASST. PROF. DR. KISHOR CHAUHAN** is a result of my own research work and has been previously submitted to any other University for any other Degree/ Diploma to this or any other University.

Wherever reference has been made to previous works of others, it has been clearly indicated as such and included in the bibliography.

I, here by further declare that all information of this document has been obtained and presented in accordance with academic rules and ethical conduct.

(AMAN GUPTA)

Certified by:

ASST. PROF. DR. KISHOR CHAUHAN.

ACKNOWLEDGEMENT

To list who all have helped me is difficult because they are so numerous and the depth is so enormous.

I would like to acknowledge the following as being idealistic channels and fresh dimensions in the completion of this project.

I take this opportunity to thank the **University of Mumbai** for giving me chance to do this project.

I would like to thank my I/C **Principal, Dr. B.R. Deshpande Sir** for providing the necessary facilities required for completion of this project.

I take this opportunity to thank our **Coordinator** for their moral support and guidance.

I would also like to express my sincere gratitude towards my project guide **Asst. Prof. DR. Kishor Chauhan** whose guidance and care made the project successful.

I would like to thank my **College Library**, for having provided various reference books and magazines related to my project.

Lastly, I would like to thank each and every person who directly or indirectly helped me in the completion of the project especially **my Parents and Peers** who supported me throughout my project.

EXCUTIVE SUMMARY

The Monetary policy is a policy formulated by the central bank. i.e RBI (Reserve Bank Of India) and to the relates to the monetary matters of the country. The policy involves measurestaken to regulate the supply of money availability and cost of credit in the economy.

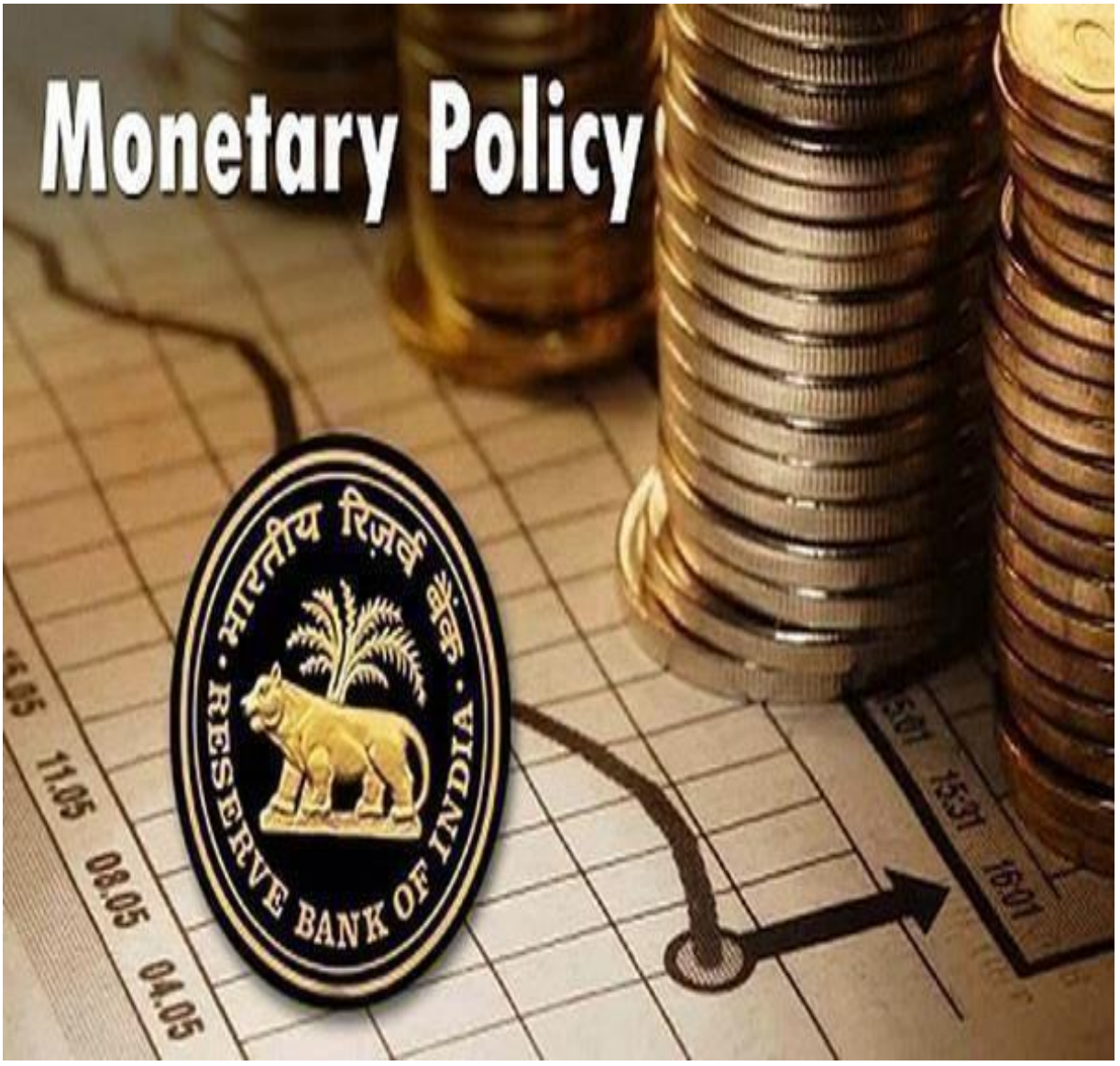
The policy also oversees distribution of credit among uses as well as the borrowing and lending rates of interest. In a developing country like India, the monetary policy is significantin the promotion of economic growth.

The various instruments of monetary policy include variation in bank rates, other interest rates, selective credit controls, supply of currency, variation in reserve requirement and open market operations.

The current repo rate is 6.50% while the reverse repo rate is 3.35%. The Bank Rate and the marginal standing facility (MSF) rate has increased to 6.75% .The Standing Deposit Facility rate is now 6.25%. This is the sixth hike in repo rate since may 2022 leading to a total increase of 250 basis points.

CHAPTER 1

INTRODUCTION



INTRODUCTION

Reserve Bank Of India (RBI) is the apex bank and monetary authority of India. As a Central Bank of the country it performs all the function of a monetary authority of the nation. RBI asthe monetary has been entrusted with the task of maintaining the value of the monetary unit (rupees). In other words maintaining price stability is its responsibility. Being the Central Bank of a developing country the RBI has also responsibility of promoting economic growth. it discharge its responsibilities through the monetary police

The Central Government would appoint a Monetary Policy Committee (MPC) as per RBI act (amended 2016). The committee comprises (1) RBI Governor (2) deputy Governor (3) One Officer of the Bank (all ex officio) and the 3 other member appointer by central government. The MPC will determine the policy interest rate required to achieve the inflationtarget rate.

Monetary Policy in India is developed by the Reserve Bank of India as it is the central bank of India. Hence, it is extremely important for the RBI Grade B Exam aspirants, to know about it at length! So, without further ado, let's get started

Monetary policy is the procedure by which the monetary authority of a nation, normally the central bank or currency board, controls either the expense of short - term borrowing or the cash supply, focusing on inflation or the loan fee to guarantee value strength and general trust in the currency. Further goals of monetary policy are:

- to contribute to the stability of the gross domestic product,
- to achieve and maintain low unemployment, and
- to maintain predictable exchange rates with other currencies.

In India, the monetary policy is developed by the Reserve Bank of India. Hence, it is also called the Monetary Policy of RBI

1.1 INTRODUCTION OF RBI MONETARY POLICY OF INDIA

The conduct of monetary policy has been engaging considerable attention in the context of the current slowdown in the Indian economy. From financial markets and industry, the case for easy monetary policy has been expressed in terms of lower interest rates. With the upturn remaining elusive, an intellectual advocacy for monetary activism *via* monetisation of the fiscal deficit has been gaining ground. It is argued that neither credit nor commodity markets in India are supply-constrained and monetisation of the fiscal deficit does not cause inflationary pressures when the economy is demand-constrained (Patnaik, 2001). It is also pointed out that maximising seigniorage revenues may, in fact, be optimal in a situation where the budget constraint is hard. The revival of the call for monetary activism in India *via* the fiscal deficit is not new; indeed, it characterised the debate in the mid-1990s on some unpleasant monetarist arithmetic and why gentlemen prefer bonds (Moorthy, 1995). Against the welling tide of arguments for monetary easing, it is important to take note of a near solitaryview that interest rate reductions in India have gone too far and it is necessary torecognise the country's specific vulnerabilities while formulating monetary policy response.The debate remains unsettled, and it is plausible that as the economy continues to be bound by the inertial dynamics of the downturn, more heat would be generated

The Reserve Bank Of India (RBI) the central bank authority of our country is the regulator for the financial sector. The monetary policy affects the real sector through long and variable periods while the financial markets are also impacted through short term implication. Keeping in view the changes in macro economics environment of the country, international environment and our exposure , price level and other key parameters, RBI announce biannual monetary and credit policy twice in a year, in April and October. A slack season policy (April to September) is a historically enunciated in the month of April , where as a busy sector credit policy (October to March) is announced in the month of October. The period of policy declaration was matching with the agricultural cycles in the country as agriculture was predominant in the past. With industrialization, reforms liberalization the contribution by industries and services sector is soaring up as a result of which the share of agriculture is coming down and there has been perennial credit flow to industries on large scale.

- Regular supply of money in the economy
- Stabilised cost of funds through rate of interest charged by banks
- Ensure price stability for the economy through money , interest rates and inflation control
- Announces norms for the banking and financial institutions, NBFCs, primary Dealers of money market and dealer in Foreign Exchange Markets
- Announces norms for the banking and financial sectors and to the institutions governed by it
- Ensure adequate flow of credit to the productive sector of the economy

1.2 DEFINITION OF RBI MONETARY POLICY

Monetary policy is formulated and administered by the central bank of a country. Accordingto professor James Tobin (American economic 1918 – 2002), "Central bank are powerful everywhere, central bank actions are the most important government policies affecting economics activity from quarter to quarter or year to year

Monetary Policy, according to Mankiw, refer to the setting of the money supply in the economy by the central bank. According to Stanlake , it is any deliberate action by the monetary authorities which is designed to change the availability (money supply) or the costof the money (rate of interest)

According to RBI , Monetary Policy refers to the policy of the central bank with regard to the use of instrument under its control to achieve the goals specified in the (RBI) act

The objectives are maintaining price stability while keeping in mind the objective of growth. This responsibility is mandated under RBI Act amended in 2016

Monetary Policy can be contractionary or expansionary. It is contractionary when its seeks to reduce the availability of money or increases the cost of money. It is expansionarywhen it seeks to increase the availability of money or reduce the cost of money

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

1.3 OBJECTIVE OF RBI MONETARY POLICY

THE MAIN GOALS OF MONETARY POLICYOF RBI

- The primary goal of monetary policy of RBI is to maintain price stabilitykeeping in mind the objective laid out in the economic plan.
- Price stability is extremely important for attaining sustainable growth.
- To maintain price stability.
- Inflation must be kept in check.
- Stability in foreign exchange.
- It also focuses on enhancing financial access and financial literacy, also tries to avoid financial crises.
- Sustaining a moderate structure of interest rate to encourage investments
- Helping with the development of infrastructure, the monetary policy allowsconcessional funding for the development of infrastructure within country.

1.4 TYPES OF MONETARY POLICY

- Inflation

Inflation levels are highly affected by monetary policies. For a healthy economy, a low level of inflation is considered to be good. In case the inflation is high, a contractionary policy can be used to address it.

- Unemployment

Monetary policies are one of the reasons for influencing the level of unemployment in the economy. Expansionary monetary policy decreases unemployment because a higher money supply increases business expansions that lead to an increase in the number of jobs in the market.

- Cuíiency Exchange Rates

The central bank has the fiscal authority to regulate the exchange rates between domestic & foreign currencies. For example, if the central bank issues more currency than it may increase the money supply in the markets. In such a case, the domestic currency becomes cheaper.

- Interest Rate Adjustment

By changing the discount rates, the central bank can influence the interest rates. The discount rate is an interest rate charged by the central bank for short term loans. E.g. if the central bank increases the interest rate, the rate of borrowing loans will also increase.

- Change Reserve Requirements

Central bank usually set up the amount of reserves that must be held by the commercial banks. The money supply in the economy can be directly influenced by changing this required amount. If the amount of holding reserves is increased by the central bank, then the commercial banks find less money available to lend as loans. This decreases the money supply in the markets.

- Open Market Operations

The central bank can sell or purchase securities issued by the government will affect the money

Monetary policies are seen as either expansionary or contractionary depending on the level of growth or stagnation within the economy

Contractionary

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

Expansionary

During times of slowdown or a recession , an expansinory policy grows economic activity. By lowering interest rates, saving becomes less attractive consumer spending and borrowingincreases

1. **Interest rate adjustment**

A central bank can influence interest rates by changing the discount rate. The discount rate (base rate) is an interest rate charged by a central bank to banks for short-term loans. For example, if a central bank increases the discount rate, the cost of borrowing for the banks increases. Subsequently, the banks will increase the interest rate they charge their customers. Thus, the cost of borrowing in the economy will increase, and the money supply will decrease.

2. **Change reserve requirements**

Central banks usually set up the minimum amount of reserves that must be held by a commercial bank. By changing the required amount, the central bank can influence the money supply in the economy. If monetary authorities increase the required reserve amount,commercial banks find less money available to lend to their clients, and thus, money supplydecreases.

Commercial banks can't use the reserves to make loans or fund investments into new businesses. Since it constitutes a lost opportunity for the commercial banks, central banks pay them interest on the reserves. The interest is known as IOR or IORR (interest on reserves or interest on required reserves).

3. **Open market operation**

The central bank can either purchase or sell securities issued by the government to affect themoney supply. For example, central banks can purchase government bonds. As a result, banks will obtain more money to increase the lending and money supply in the economy

DIFFERENT TYPES OF MONETARY POLICY TOOLS

The tools used to implement monetary policy can be broadly categorized into three types:

- Open market operations: This involves the central bank buying or selling government securities in the open market to increase or decrease the money supply.

DIFFERENT TYPES OF MONETARY POLICY TOOLS:

The tools used to implement monetary policy can be broadly categorized into three types:

- Open market operations: This involves the central bank buying or selling government securities in the open market to increase or decrease the money supply.
- Interest rates: The central bank can change the benchmark interest rate, which is the rate at which banks can borrow from the central bank. This influences other interest rates in the economy, affecting borrowing and spending.
- Reserve requirements: The central bank can change the reserve requirements for banks, which affects the amount of funds banks must hold in reserve and can lend out.

Other tools used less frequently include discount window lending, moral suasion and directcontrols on bank lending.

1.5 LIMITATION OF CREDIT CONTROL BY CENTRAL BANK

1. Selective credit control is applicable, when everything is considered to commercial banks and to bank credit only

- Non-banking financial institutions generally remain out of the purview of the central bank, and, to that extent, the desired objectives of selective credit control is also weakened by alternative sources of credit, outside the organised money sector, such asmoneylenders, black (or unaccounted) money with the people, etc.

- 2. It is very difficult for banks to ensure advances made to the borrowers are not spent on unintended purposes. Thus, qualitative credit control cannot materialise, in its real sense.

- 3. Bank money also has its velocity. Thus, an amount once lent for a genuine purpose may next be spent on undesirable purposes.

- 4. Moreover, there are no restrictions on clean credit under the selective control policy as a result of which measures like higher margin requirements can be adjusted by the borrowers through a clean loan. Thus, "the comparative lack of efficacy of the selective measures by themselves results in the difficulties of securing compliances bybanks when control imposed after excessive lending has already taken place, or the difficulties of adopting the controls on advances to the future pattern of production, that is to say, of imparting the requisite flexibility in relation to changing credit demands in system of control which is primarily regulated with reference to a base period of curbing accumulation of inventories through alternative sources of finance, so long as the initiating cause of a speculative wave, viz., scarcity of supplies in relation to demand, persists.

- The central bank policy:

Loans are taken only when sound investment opportunities are available. During recessionsand depressions, deposits tend to go down. The business situation in the bank

The policy regarding open market operations etc. may affect the total cash reserves of thebanking system and may make the total created credit less or more than what it would otherwise

Banks cannot expand deposits by granting loans and advances unless proper securities are available. Crowther observes: "The bank does not create money out of thin air; it transmutes other forms of wealth into money." The total volume of income- yielding securities available in the country sets the overall limit to the process of credit creation

- **Lack Of Cash**

The total amount of cash, available to the banking system limits the volume of credit that can be created. Credit is based on cash. The banks must keep a certain percentage of cash reserve. The total volume of credit cannot ordinarily be larger than the total amount of cash available multiplied by the customary reserve-ratio. The Central Banks control credit by measures, like open market operations and variations of the reserve ratio, which affect the quantity of cash in the hands of the banks and thereby influence their lending policy

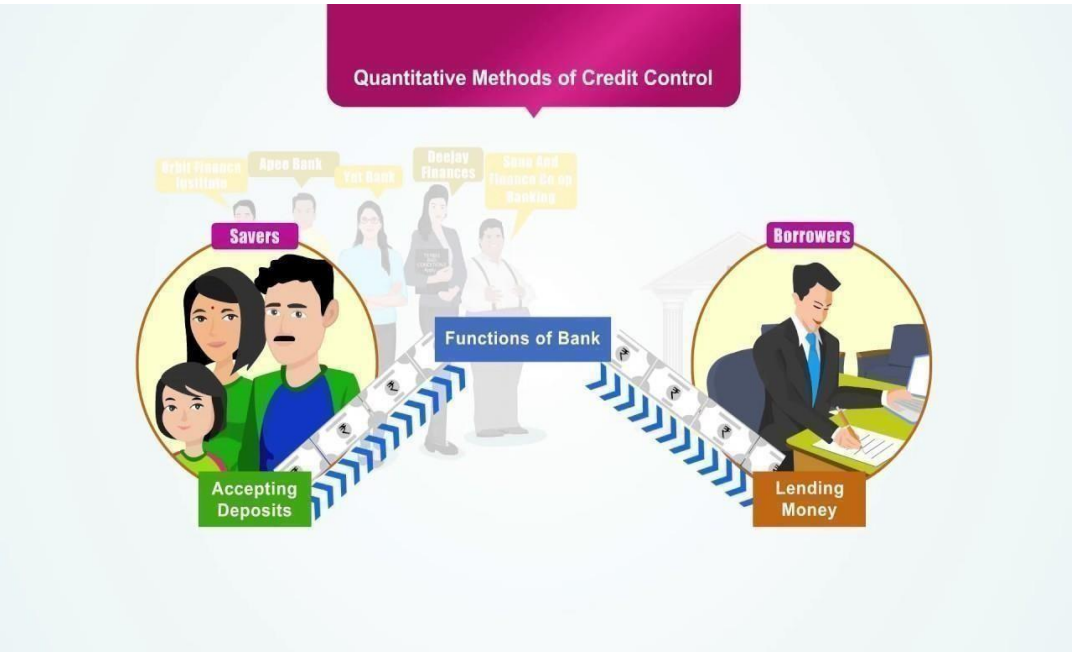
- **The Habit Of The People:**

The habit regarding the holding of cash can affect credit creation. If liquidity-preference increases, there will be less cash in the hands of the bank and they will be forced to lend less. In countries with an under-developed banking system, the people tend to hoard cash. This reduces the power of banks to create credit.

- **Leakages**

In the chain of deposit creation, as shown in the example given above, there may occur leakages. Some borrowers may keep a part of their money in hand without putting it in a bank. The total volume of deposits will then be lower than the maximum possible. A similar leakage may occur at the bank's vaults. A particular bank in the chain may choose to keep a higher reserve ratio and lend less

1.6 QUANITATIVE METHODS OF CREDIT CONTROL



The most commonly used quantitative techniques include the following

- The Bank Rate
- The Open Market Operation
- The Reserve Requirement

Bank Rate (also know as the discount rate)

The bank rate is the interest rate on the loan that the central bank advance to commercial banks. It is the minimum rate at which the central bank of a country provided loans to the commercial banks of the country. Bank rate is also called discount rate because the central bank provides finances to the commercial bank by rediscounting the bills of exchanges

As central bank uses discount rate lending not only to control money supply but also to help finances institution when they are in troubles

Limitation:

- The bank rate policy can only succeed if a well organised money exists in theeconomy
- It is used during the tomes of inflation but it does fulfil its purpose during the time of recession or depression

OPEN MARKET OPERATION

A central bank conducts open market operation when it buys or sells government securities, bonds. To increases money supply or expend credit it buys bonds and to decreasemoney supply or contract credit it sells securities ,bonds

Open markets operations are easy to conduct and can be used to change the money supply by a large or small amount on any day without major changes in the banking laws or regulations. Therefore, open market operations are the tools of monetary policy which central bank uses most often

LIMITATION

- Commercial banks expand and contract credit according to prevailing economics and political circumstances and not merely reference to their cash reserve
- When the commercial bank cash balance increases the demand for loan and advance should increase. This may not happen due to economics and political uncertainly.

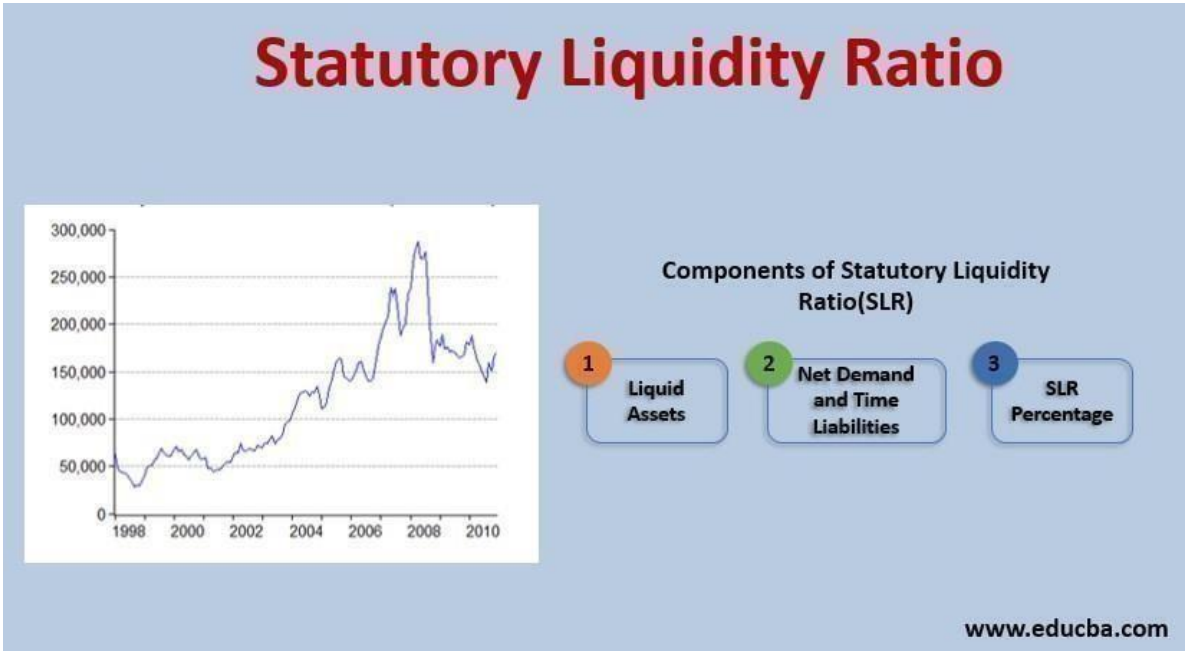
VARIABLE RESERVE REQUIREMENT

Reserve requirement are regulations for banks about the minimum amount of reserve that banks must hold with the central banks and with themselves as reserve against deposit. Reserve requirement influence how much money the banking system can create with eachrupee of reserves

LIMITATION

- The effectiveness of the CRR depends on the financial strength of the bank. Larger bank with excess reserve are often unaffected by CRR regulation
- Through commercial banks earn an interest on the CRR deposits with the central bank the amount is not equivalent to the market rate of interest and therefore an increase CRR is equivalent to a loss in income

1.7 RBI NEW TECHNIQUES OF LIQUIDITY MANAGEMENT



Beside the traditional instrument such as bank rate, OMO, VRR (CRR and SLR) and other qualitative instrument , RBI in recent year has introduce certain new instrument

- **The Repo Rate**

  The repo or repurchases agreement refers to agreement for a transaction between Reserve Bank Of India and commercial bank through which RBI supplies funds immediately against government securities and commercial bank simultaneously agree to repurchases the same or similar securities after specified time which may be one day to 14 days

  The repo rate is the rate at which bank borrow from Reserve Bank of India against government and other approval securities

- **Term Repo**

  The term repo is a repo of more than one day duration. The would term denotes a longer period. It is a way for banks to avails money from the RBI for more than one day duration. As in the case of repo, the loan seeking bank should submit securities to the RBI.

  It is called variable rate of repo as the interest rate of varies depending upon the auction rate. The duration of term repo are 7days, 14days, 28days.

- **Market Stabilization scheme (MSS)**

  with the increasing amount of capital inflow the Reserve Bank Of India has had to resort to sterilization operation to manager liquidity in the short run. Towards this end the market stabilization scheme was introduce in April 2004 to deal with surging capital inflows. Under MSS, Reserve Bank Of India is allowed to issues treasury bill and government of India securities.

LONG RUN LIQUIDITY MANAGEMENT THE RBI ISSUES

- Six monthly calendar of auction of government securities (that is actually more gearedto government of India borrowing requirement)
- Every Wednesday there is an auction of 91days treasury bills
- On the last Wednesday of every month there is an auction of 364day treasury bills

Recently some additional instrument have been added by the RBI for examplesStanding Deposit Facility (SDF) to absorb liquidity.

- **Marginal Standing facilities (MSF)**

  The Reserve Bank of India in its monetary policy for 2011-2012 introduce the Marginal Standing Facilities under which bank could borrow funds RBI at 9.0%, which was 1% above the liquidity adjustment facility.

1.8 QUALITATIVE TECHNIQUES OF CREDIT CONTROL

1. Ceiling on Credit

The Ceiling on level of credit restricts the lending capacity of a bank to grantadvances against certain controlled securities.

2. Margin Requirements

A loan is sanctioned against Collateral Security. Margin means that proportion of the value of security against which loan is not given. Margin against a particular security is reduced or increased in order to encourage or to discourage the flow of credit to a particular sector. It varies from 20% to 80%. For agricultural commodities it is as high as 75%. Higher the margin lesser will be the loan sanctioned.

3. Discriminatory Interest Rate (DIR)

Through DIR, RBI makes credit flow to certain priority or weaker sectors by chargingconcessional rates of interest. RBI issues supplementary instructions regarding granting of additional credit against sensitive commodities, issue of guarantees, making advances etc.

4. Directives

The RBI issues directives to banks regarding advances. Directives are regarding the purpose for which loans may or may not be given.

5. Direct Action

It is too severe and is therefore rarely followed. It may involve refusal by RBI to rediscount bills or cancellation of license, if the bank has failed to comply with the directives of RBI.

6. Moral Suasion

Under Moral Suasion, RBI issues periodical letters to bank to exercise control over credit in general or advances against particular commodities. Periodic discussions are held with authorities of commercial banks in this respect.

OPERATION OF MONETARY POLICY

INSTRUMENT	OPERATION	EFFECT
Bank Rate	Reduce	Cheap money decreases in cost ofborrowing
OMO	Purchases of securities	More money in circulation
CRR	Reduce	Increasing in cash with the bank – increases in lending
SLR	Reduce	More money with the bank- increases in lending

CHAPTER 2

RESEARCH METHODOLOGY

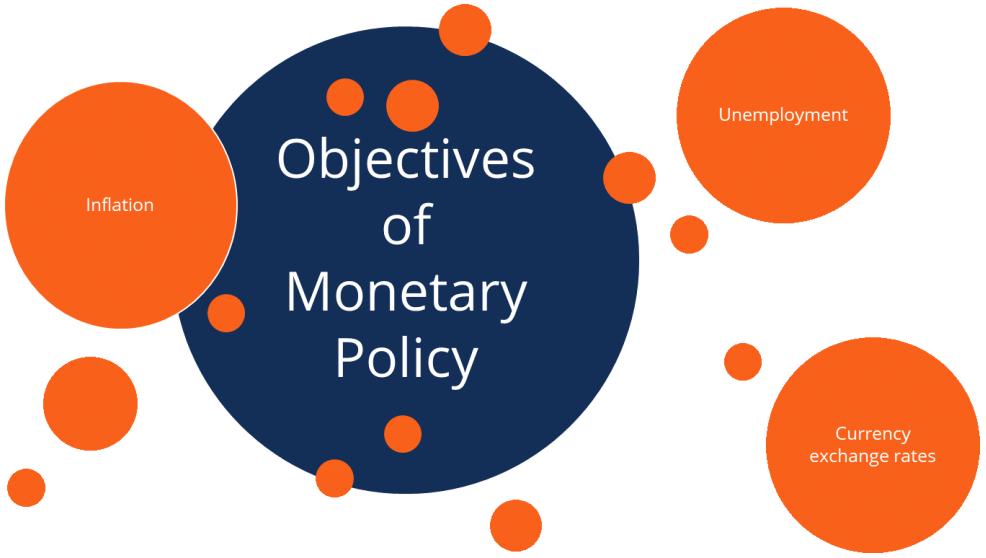
RESEARCH AND METHODOLOGY

- Provide reliable, data-driven and evidence-based information for policy and decision-making
- Supply accurate and timely data to facilitate academic research as well as to the general public
- Undertake regular updated assessment of the state of the Indian economy
- Conduct research on contemporary and medium-term macro-financial issues
- Provide support for collaborative research to research institutions/universities
- Develop and maintain robust statistical data reporting systems
- Conduct forward-looking surveys for monetary policy
- Educate the public

- The Reserve Bank's economic research focusses on the study and analysis of domestic and international macroeconomic issues. This is mainly done by the Department of Economic and Policy Research and the Department of Statistics and Information Management.

- The Reserve Bank has over time established a sound and rich tradition of conducting policy-oriented economic research and an effective mechanism for disseminating data and information. Like other major central banks, the Reserve Bank has also strengthened its own research capabilities in the field of economics, finance, modelling, and statistics, which contribute to a better understanding of the functioning of the economy and the ongoing changes in the policy transmission mechanism.

2.1 OBJECTIVE OF STUDY



Monetary Policy of India: Main Elements and Objectives!

Monetary Policy of India is formulated and executed by Reserve Bank of India to achieve specific objectives. It refers to that policy by which central bank of the country controls(i) the supply of money, and (ii) cost of money or the rate of interest, with a view to achieve particular objective.

In the words of D.C. Rowan, "The monetary policy is defined as discretionary act undertaken bythe authorities designed to influence (a) the supply of money, (b) cost of money or rate of interest, and (c) the availability of money for achieving specific objective."

THE FOLLOWING ARE THE MAIN ELEMENT OF THE MONETARY POLICY IN INDIA

i. It regulates the stocks and the growth rate of money supply.

i. It regulates the entire banking system of the economy.

ii. It determines the allocation of loans among different sectors

THE FOLLOWING ARE THE MAIN OBJECTIVE OF MONETARY POLICY

i. To Regulate Money Supply in the Economy:

Money supply includes both money in circulation and credit creation by banks. Monetary policy is farmed to regulate the money supply in the economy by credit expansion or credit contraction. By credit expansion (giving more loans), the money supply can be expanded. By credit contraction (giving less loans) money supply can be decreased.

II. TO ATTAIN PRICE STABILITY

The main aim of the monetary policy of the Reserve Bank was to control the money supply insuch a manner as to expand it to meet the needs of economic growth and at the same time contract it to curb inflation. In other words monetary policy aimed at expanding and contracting money supply according to the needs of the economy

Another major objective of monetary policy in India is to maintain price stability in the country. It implies Control over inflation. Price level, is affected by money supply. Monetarypolicy regulates money supply to maintain price stability.

iii. To promote Economic Growth:

An important objective of monetary policy is to make available necessary supply of money and credit for the economic growth of the country. Those sectors which are quite significant for the economic growth are provided with adequate availability of credit.

iv. To Promote saving and Investment:

By regulating the rate of interest and checking inflation, monetary policy promotes saving and investment. Higher rates of interest promote saving and investment.

v. To Control Business Cycles:

Boom and depression are the main phases of business cycle. Monetary policy puts a check on boom and depression. In period of boom, credit is contracted, so as to reduce money supply and thus check inflation. In period of depression, credit is expanded, so as to increase money supply and thus promote aggregate demand in the economy.

HYPOTHESIS

A research cannot be rightly under taken without laying down appropriate set of hypothesis. Here are hypotheses regarding the monetary policy of the Reserve Bank of India (RBI) formulated in a null (H0) and alternative (H1) format:

H0: The RBI's monetary policy does not affect the unemployment rate in the economy.

H1: The RBI's monetary policy has a significant impact on the unemployment rate in the economy.

H0: There is no long-term relationship between RBI's monetary policy and economic growth.

H1: There is a long-term relationship between RBI's monetary policy and economic growth

H0: Changes in RBI's policy rates do not lead to changes in consumer spending behavior

H1: Changes in RBI's policy rates lead to changes in consumer spending behavior.

H0: Changes in RBI's interest rates do not affect the level of investment in the economy.

H1: Changes in RBI's interest rates have a significant impact on the level of investment in the economy.

H0: The RBI's monetary policy does not influence exchange rate stability.

H1: The RBI's monetary policy significantly influences exchange rate stability.

H0: The RBI's monetary policy has no significant impact on controlling inflation.

H1: The RBI's monetary policy has a significant impact on controlling inflation.

2.1 SCOPE OF STUDY

With the rupee at a record low, the spotlight is on the RBI: will it continue to leverage its dwindling forex reserves to prop up the rupee? Though the central bank has intervened aggressively this year by selling more than $ 80 billion to prevent a massive slide in the rupee, it did not prop up the domestic currency on Thursday when it fell to 80.87 against thedollar following hawkish comments by US Fed chair Jerome Powell.

Japan intervened in the forex market on Thursday to buy yen for the first time since 1998, in an attempt to shore up the battered currency after the Bank of Japan stuck with ultra-low interest rates. The move, which occurred in late Asia hours, saw the dollar plunge more than 2 per cent to around 140.3 yen

The RBI intervention led to the country's forex reserves falling to $550.87 billion on September 9 from $631.53 billion in February. The key question is how long and to what extent will the central bank draw down the reserves to stabilise or protect the rupee.

Ritesh Bhansali, vice-president at Mecklai Financial Services, said the RBI can deploy up to $100 billion more from the reserves to control a fall in the rupee. The present level of forex reserves covers around nine months of imports from a peak of 16 months.

The lowest the RBI could go is around six months. During the taper tantrum in 2013, the import cover was seven months. Bhansali said while the RBI recently defended the 80 levels,it remains to be seen if the new floor is 81 or 82.

Anindya Banerjee of Kotak Securities said another fall of 90 paise in the rupee in a single session is unlikely and the RBI will continue its intervention. ``The RBI has ample reserves and will use them to control volatility. The $550 billion of reserve is more than sufficient to ensure that the volatility is contained

2.2 POSTIVE IMPACT OF RBI MONETARY IN SERVICE

Monetary policy has become a kind of a routine affair in India every two months. Since monetary policy virtually holds the levers of interest rates and liquidity in the financial system, it does have an impact on markets. So, exactly how does monetary policy affect the stock market? Is there a relationship between monetary policy and stock market? It is hard topin-point the impact of monetary policy as there are a plethora of other factors that also impact the equity markets.

To gauge this better let us look at the CAGR returns of Nifty and the Bank Nifty since January 2015 when the RBI first embarked on its rate cuts. During this 3 year period, the Nifty has given a CAGR return of 7% while the Bank Nifty has given a CAGR return of 12%. Clearly, the banking and financial sector appears to have outperformed the overall market during a period of interest rate cuts. After all, between Jan 2015 and Jan 2018 the RBI has cut repo rates by 200 basis points. Additionally, there has been an additional 75 basis points reduction in the bank rate due to spread compression. With a total rate cut of 275 bps, financials have been the clear performers in the last 3 years. Remember, this was at a time when PSU banks were in a deep NPA mess and if that had not been the case the outperformance of the Bank Nifty could have been much bigger

Monetary policy also signals liquidity and that is the key to equity markets..

Back in 2013 when the US Fed indicated for the first time that it would look to taper its bond purchases, there was a massive sell-off globally and even Indian markets were not spared. Equity markets are always wary of a liquidity crunch and it typically leads to a run onequities and a run on the currency. That is exactly what we saw in 2013 when both these factors formed a vicious cycle of market correction. Today global markets are worried that if the central banks of the world start compressing liquidity then global markets will take a hit. In India the domestic liquidity is a function of the RBI monetary policy and RBI usually signals liquidity management through its Open Market Operations (OMOs). Typically, the RBI has tried to keep liquidity in the system comfortable so that markets do not feel the crunch

By signalling lower rates, the RBI brings down the cost of capital..
This is a slightly complex argument but offers an important insight into the relationship between monetary policy and stock market trading. Cost of capital has two components viz. cost of debt and cost equity. When we value a stock, we discount future cash flows using the cost of capital. When the interest rates come down, the cost of debt also comes down and that brings the cost of equity down. That means that future cash flows are now being valued with a lower discount rate. Since your stock value is the present value of future cash flows, this

enhances the value of the stock. On the other hand, when the RBI signals higher rates, stock values tend to get impacted negative

The Reserve Bank of India (RBI) announced a rise in the policy rate on Friday morning with immediate effect. As per the RBI governor, the Indian economy is showing signs of broadening. There were other important updates post the RBI's three-day Monetary Policy Committee (MPC) meeting. Let us look at the details of the meeting outcome.

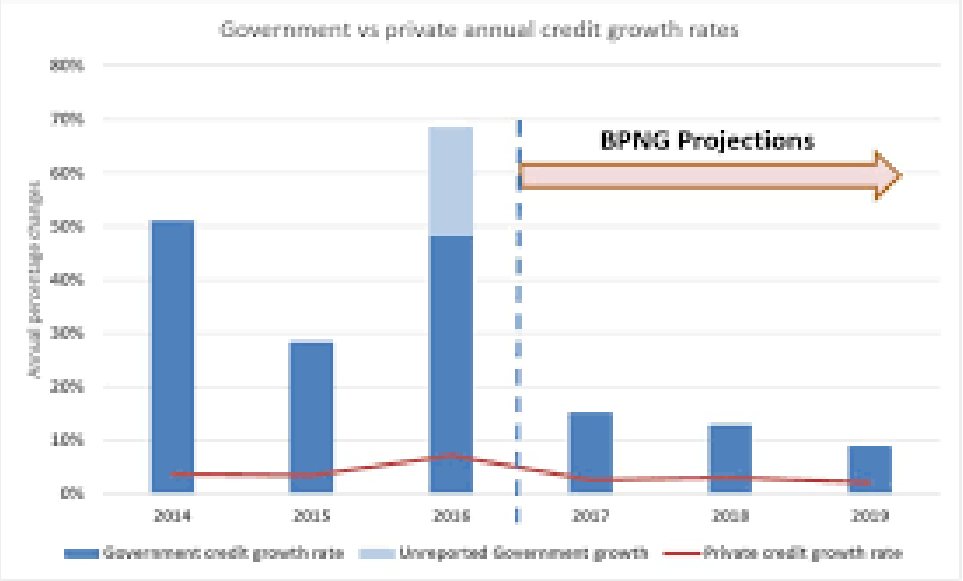
RBI Monetary Policy update: Repo and other rate increase

Repo rate refers to the rate at which commercial banks borrow money by selling their securities to the Central bank - the Reserve Bank of India (RBI) to maintain liquidity, in case of a shortage of funds or due to some statutory measures.

The MPC decided to raise the rates on the back of inflationary pressures and higher supply shocks. The RBI has **hiked the policy repo rate by 50 basis points to 5.4%**. In June, RBI increased the repo rate by the same amount. In a span of 4 months, the repo rate has been increased by130 basis points. Repo rate is now back to pre-pandemic level and highest since August 2019. RBI Policy stance is retained at **Withdrawal of Accommodation.**

The rate increase will directly impact the fixed deposit investors as banks will eventually increase fixed deposit rates for depositors. It has also decided to raise **MSF (Marginal Standing Facility)** and Bank Rate to 5.65% from 5.15%. **Standing Deposit Facility (SDF)** rates have been revised from 4.65% to 5.15%

2.3 ANNUAL MONETARY POLICY



The Annual Policy for 2013-14 is formulated in an environment of incipient signs of stabilisation in the global economy and prospects of a turnaround, *albeit* modest, in the domestic economy.

2. In the advanced economies (AEs), near-term risks have receded, aided by improving financial conditions and supportive macroeconomic policies. But this improvement is yet to fully transmit to economic activity which remains sluggish. Policy implementation risks and uncertainty about outcomes continue to threaten the prospects of a sustained recovery. Emerging and developing economies (EDEs) are in the process of a multi-speed recovery. However, weak external demand and domestic bottlenecks continue to restrain investment in some of the major emerging economies. Inflation risks appear contained, reflecting negative output gaps and the recent softening of international crude and food prices.

3. Domestically, growth slowed much more than anticipated, with both manufacturing and services activity hamstrung by supply bottlenecks and sluggish external demand. Most lead indicators suggest a slow recovery through 2013-14. Inflation eased significantly in Q4 of 2012-13 although upside pressures remain, both at wholesale and retail levels, stemming from elevated food inflation and ongoing administered fuel price revisions. The main risks to the outlook are the still high twin deficits accentuated by the vulnerability to sudden stop and reversal of capital flows, inhibited investment sentiment and tightening supply constraints, particularly in the food and infrastructure sectors.

4. This Statement, set in the above global and domestic context, should be read and understood together with the detailed review in *Macroeconomic and Monetary Developments* released yesterday by the Reserve Bank

Domestic Economy

10. With output expansion of only 4.5 per cent in Q3 of 2012-13, the lowest in 15 quarters, cumulative GDP growth for the period April-December 2012 declined to 5.0 per cent from 6.6 per cent a year ago. This was mainly due to the protracted weakness in industrial activity

aggravated by domestic supply bottlenecks, and slowdown in the services sector reflecting weak external demand. The Central Statistics Office (CSO)‟s advance estimate of GDP growth for 2012-13 of 5.0 per cent implies that the economy would have expanded by 4.7 per cent in Q4.

11. The growth of industrial production slid to 0.6 per cent in February 2013 from 2.4 per cent a month ago, mainly due to contraction in mining and electricity generation and slowing growth in manufacturing. Consequently, on a cumulative basis, growth in industrial production decelerated to 0.9 per cent during 2012-13 (April-February) from 3.5 per cent in the corresponding period of the previous year. The Reserve Bank's order books, inventories and capacity utilisation survey (OBICUS) suggests that capacity utilisation remained flat. *Rabi* production, particularly of pulses, is expected to be better than a year ago. However, it may not fully offset the decline in *kharif* output. Consequently, the second advance estimates of crop production *(kharif* and *rabi)* for 2012-13 indicate a decline of 3.5 per cent in relation to the final estimates of the previous year. The composite purchasing managers‟ index (PMI), which encompasses manufacturing and services, fell to a 17-month low in March 2013. Thus, most recent indicators suggest that growth in Q4 of 2012-13 would have remained low.

12. On the demand side, the persisting decline in capital goods production during April 2012 – February 2013 reflects depressed investment conditions. The moderation in corporate sales and weakening consumer confidence suggest that the slowdown could be spreading to consumption spending.

13. Headline inflation, as measured by the wholesale price index (WPI), moderated to an average of 7.3 per cent in 2012-13 from 8.9 per cent in the previous year. The easing was particularly significant in Q4 of 2012-13, with the year-end inflation recording at 6.0 per cent. Notwithstanding the moderation in overall inflation, elevated food price inflation was a source of upside pressure through the year owing to the unusual spike in vegetable prices in April 2012 followed by rise in cereal prices on account of the delayed monsoon and the sharp increase in the minimum support price (MSP) for paddy. Fuel inflation averaged in double digits during 2012-13, largely reflecting upward revisions in administered prices and the pass-through of high international crude prices to freely priced items. Non-food manufactured products inflation ruled above the comfort level in the first half of 2012-13 but declined in the second half to come down to 3.5 per cent by March, reflecting easing of input price pressures and erosion of pricing power.

14. Largely driven by food inflation, retail inflation, as measured by the new combined (rural and urban) consumer price index (CPI) (Base: 2010=100), averaged 10.2 per cent during 2012-13. Even after excluding food and fuel groups, CPI inflation remained sticky, averaging 8.7 per cent. Other CPIs also posted double digit inflation.

15. Significantly, inflation expectations polled by the Reserve Bank's urban households‟ survey, showed slight moderation in Q4 of 2012-13, even as they remained in double digits, reflecting high food prices. Wage inflation in rural areas, which rose by an average of close to 20 per cent over the period April 2009 to October 2012, declined modestly to 17.4 per cent in January 2013. House price inflation, as measured by the Reserve Bank's quarterly house price index, continued to rise on a y-o-y basis.

16. An analysis of corporate performance during Q3 of 2012-13, based on a common sample of 2,473 non-government non-financial companies, indicates that growth of sales as well as

profits decelerated significantly. Early results of corporate performance in Q4 indicate continuing moderation in sales though profit margins increased slightly.

17. Money supply (M_3) growth was around 14.0 per cent during Q1 of 2012-13 but decelerated thereafter to 11.2 per cent by end-December as time deposit growth slowed down. There was some pick up in deposit mobilisation in Q4, taking deposit growth to 14.3 per cent by end-March. Consequently, M_3 growth reached 13.3 per cent by end-March 2013, slightly above the revised indicative trajectory of 13.0 per cent.

18. Non-food credit growth decelerated from 18.2 per cent at the beginning of 2012-13 and remained close to 16.0 per cent for the major part of the year. By March 2013, non-food credit growth dropped to 14.0 per cent, lower than the indicative projection of 16.0 per cent, reflecting some risk aversion and muted demand. While the Reserve Bank's credit conditions survey showed easing of overall credit conditions, there was some tightening for sectors such as metals, construction, infrastructure, commercial real estate, chemicals and finance in Q4 of 2012-13.

19. The total flow of resources to the commercial sector from banks, non-banks and external sources was higher at `12.8 trillion in 2012-13 as compared with `11.6 trillion in the previous year. This increase was accounted for by higher non-SLR investment by scheduled commercial banks (SCBs), increase in credit flow from NBFCs, gross private placement and public issues by non-financial entities, and higher recourse to short-term credit from abroad and external commercial borrowings.

20. In consonance with the cuts in the policy repo rate and the cash reserve ratio (CRR) during 2012-13, the modal term deposit rate declined by 11 basis points (bps) and the modal base rate by 50 bps. While the decline in the term deposit rate occurred mostly during the first half, the modal base rate softened by 50 bps to 10.25 per cent in two steps of 25 bps each during Q1 and Q4 of 2012-13. During Q4, 39 banks reduced their base rates in the range of 5-75 bps. The weighted average lending rate of banks declined by 36 bps to 12.17 per cent during 2012-13 (up to February).

21. Liquidity remained under pressure throughout the year because of persistently high government cash balances with the Reserve Bank and elevated incremental credit to deposit ratio for much of the year. The net average liquidity injection under the daily liquidity adjustment facility (LAF), at `730 billion during the first half of the year, increased significantly to `1,012 billion during the second half. In order to alleviate liquidity pressures, the Reserve Bank lowered the CRR of SCBs cumulatively by 75 bps on three occasions and the statutory liquidity ratio (SLR) by 100 bps during the year. Additionally, the Reserve Bank injected liquidity to the tune of `1,546 billion through open market operation (OMO) purchase auctions. The net injection of liquidity under the LAF, which peaked at `1,808 billion on March 28, 2013 reflecting the year-end demand, reversed sharply to `842 billion by end-April 2013.

22. The revised estimates (RE) of central government finances for 2012-13 show that the gross fiscal deficit-GDP ratio at 5.2 per cent was around the budgeted level and within the target set out in the revised roadmap. Budget estimates (BE) for 2013-14 place the gross fiscal deficit-GDP ratio at 4.8 per cent. The envisaged correction is expected to be achieved through a reduction of 0.6 percentage points in the revenue deficit-GDP ratio.

23. On the back of the policy rate reduction and the announcement of a slew of reform measures by the Government and a firm commitment to fiscal consolidation, the 10-year benchmark yield eased from 8.79 per cent on April 3, 2012 to 7.79 per cent on April 30, 2013.

24. The current account deficit (CAD) came in at an all-time high of 6.7 per cent of GDP in Q3 of 2012-13. There are indications that it may have narrowed in Q4. The narrowing was largely on account of the trade deficit declining, with exports returning to positive growth after contracting in the first three quarters and non-oil non-gold imports and gold imports declining. Even as the CAD expanded, the surge in capital inflows in the second half of the year ensured that it could be fully financed

25. For GDP growth during 2012-13, the CSO"s advance estimate of 5.0 per cent is lower than the Reserve Bank's baseline projection of 5.5 per cent set out in the Third Quarter Review (TQR) of January 2013, reflecting slower than expected growth in both industry and services.

26. During 2013-14, economic activity is expected to show only a modest improvement over last year, with a pick-up likely only in the second half of the year. Conditional upon a normal monsoon, agricultural growth could return to trend levels. The outlook for industrial activity remains subdued, with the pipeline of new investment drying up and existing projects stalled by bottlenecks and implementation gaps. With global growth unlikely to improve significantly from 2012, growth in services and exports may remain

27. By March 2013, WPI inflation at 6.0 per cent turned out to be lower than the Reserve Bank's indicative projection of 6.8 per cent, mainly due to a sharp deceleration in non-food manufactured products inflation in the second half of the year. The global inflation outlook for the current year appears more benign compared to last year on expectations of some softening of crude oil and food prices. Accordingly, imported inflation is likely to be lower provided the exchange rate remains broadly stable. Indicators of corporate performance, industrial outlook and PMIs are pointing to a declining pricing power. On the other hand, food inflation is likely to be a source of upside pressure because of persisting supply imbalances. Also, the timing and magnitude of administered price revisions, particularly of electricity and coal, will impact the evolution of the trajectory of inflation in 2013-14.

28. Keeping in view the domestic demand-supply balance, the outlook for global commodity prices and the forecast of a normal monsoon, WPI inflation is expected to be range-bound around 5.5 per cent during 2013-14, with some edging down in the first half on account of past policy actions, although there could be some increase in the second half, largely reflecting base effects

The Policy Stance

33. The Reserve Bank began exiting from the crisis driven expansionary policy in October 2009. Between January 2010 and October 2011, the Reserve Bank cumulatively raised the CRR by 100 bps and the policy repo rate 13 times by a total of 375 bps, with the monetary policy stance biased towards containing inflation and anchoring inflation expectations.

34. In view of slowdown in growth, especially investment activity, and some moderation in inflation, the Reserve Bank paused in December 2011. It indicated that no further tightening might be required and that future actions would be towards lowering the rates. In January 2012,

the Reserve Bank signaled a shift in the policy stance towards addressing increasing risks to growth by reversing the tightening cycle. The CRR was reduced cumulatively by 125 bps during January-March 2012 to prepare liquidity conditions for a front-loaded 50 bps reduction in the policy repo rate in April.

35. Through much of 2012-13, the Reserve Bank persevered with efforts to ease credit and liquidity conditions through a 100 bps reduction in the SLR in August 2012, a cumulative 75 bps reduction in the CRR and 50 bps reduction in the repo rate during September 2012-March 2013.

36. Cumulatively, during the full year 2012-13, the policy repo rate was reduced by 100 basis points, the SLR by 100 bps and the CRR by 75 basis points, supported by liquidity injections through OMOs of the order of `1.5 trillion. After reducing the policy repo rate by 25 bps in its Mid-Quarter Review (MQR) of March 2013, the Reserve Bank noted that in view of the policy easing already effected, the sluggish ebbing of inflation and widening CAD, the headroom for further monetary easing was quite limited.

37. Against the backdrop of global and domestic macroeconomic conditions, outlook and risks, the policy stance for 2013-14 has been guided by the following considerations:

38. First, growth has decelerated continuously and steeply, more than halving from 9.2 per cent in Q4 of 2010-11 to 4.5 per cent in Q3 of 2012-13. The Reserve Bank's current assessment is that activity will remain subdued during the first half of this year with a modest pick-up, subject to appropriate conditions ensuing, in the second half of 2013-14.

39. Second, although headline WPI inflation has eased by March 2013 to come close to the Reserve Bank's tolerance threshold, it is important to note that food price pressures persist and supply constraints are endemic, which could lead to a generalisation of inflation and strains on the balance of payments.

40. Against this backdrop, the stance of monetary policy is intended to:

• continue to address the accentuated risks to growth;

• guard against the risks of inflation pressures re-emerging and adversely impacting inflation expectations, even as corrections in administered prices release suppressed inflation; and

• appropriately manage liquidity to ensure adequate credit flow to the productive sectors of the economy

Financial Stability

Assessment of Financial Stability

The sixth Financial Stability Report (FSR), released in December 2012, observed that the overall macroeconomic risks in the Indian financial system had increased since the assessment made in June 2012. Apart from risks to global growth and financial stability, domestic factors such as decline in growth coupled with relatively high inflation, fall in domestic saving, and particularly household financial saving, were found to have increased risks to macroeconomic stability. In addition, the high CAD along with weakening external sector parameters, the

stressed fiscal situation, and increasing corporate leverage, especially external commercial borrowings with unhedged exposures were identified as other challenges to macroeconomic stability. For the banking sector, concerns relating to tight liquidity conditions and deteriorating asset quality remain, though the sector has remained resilient to credit, market, and liquidity risks and capable of withstanding macroeconomic shocks, given the comfortable capital to risk-weighted assets ratio (CRAR) for the system as a whole. The inter-linkages among diverse sectors of the financial system were, however, found to be strong with risk of contagion in case of a failure of an institution in the core remaining high. Mutual funds and insurance companies were identified as a potential source of liquidity contagion, being lenders in the financial system.

Sub-Committee of the Financial Stability and Development Council – Recent Initiatives

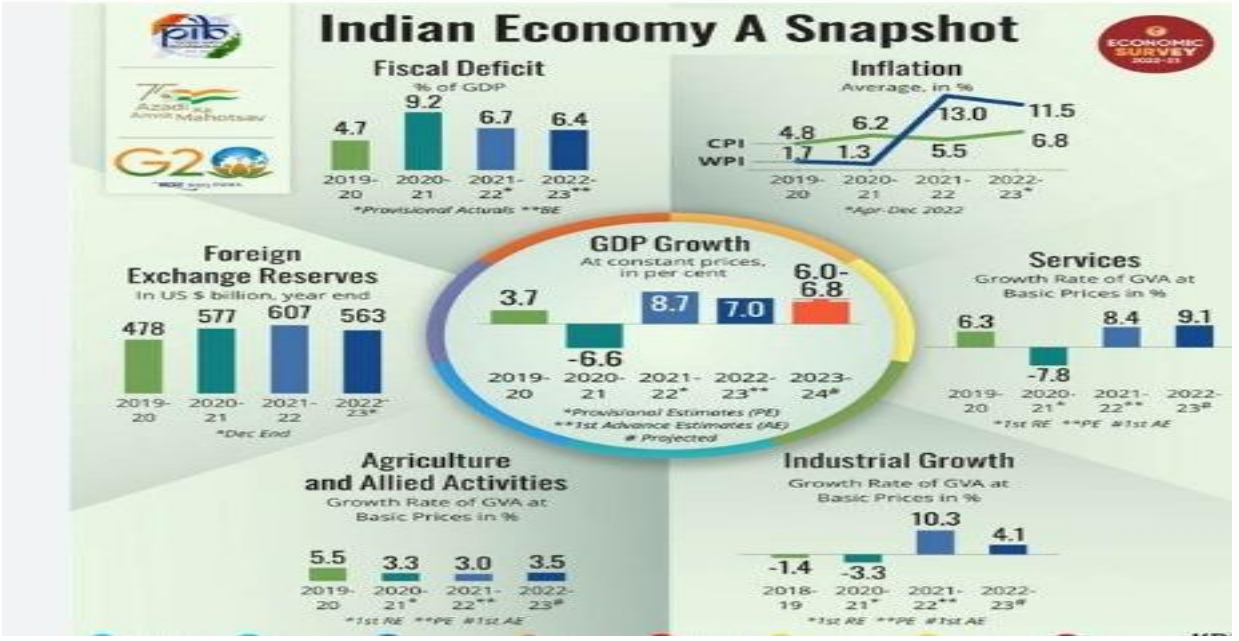
. Under the aegis of the Sub-Committee of the Financial Stability and Development Council (FSDC), a Memorandum of Understanding (MoU) was signed by the financial sector regulators (Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority and Pension Fund Regulatory and Development Authority) on March 8, 2013 with a view to forging greater cooperation in the field of supervision. The MoU envisages cooperation in the field of consolidated supervision and monitoring of financial groups identified as financial conglomerates.

The Sub-Committee of the FSDC approved the National Strategy for Financial Education (NSFE). The NSFE entails provision of financial education for all Indians so as to understand the need and use of saving, the advantages of using the formal financial sector and various options to convert saving into investment, protection through insurance and a realistic recognition of the attributes of these options. The NSFE has been revised, incorporating the feedback received from public consultations and from a global peer review

2.4 CHALLENGES TO MONETARY POLICY MAKING IN INDIA

the most distinguishing feature of recent domestic developments is the pace at which economic activity is expanding. On February 7, 2007 the advance estimates of the Central Statistical Organisation (CSO) placed India's real GDP at 9.2 per cent in 2006-07 on top of 9.0 per cent in 2005- 06 and reaffirmed the robust optimism that has been building around India's macroeconomic performance. In retrospect, it is evident that there has been a pervasive sense of the gathering momentum of growth, reflected in the direction of revisions in projections by various forecasters during the year. For instance, real GDP growth projections of the Reserve Bank were raised from 7.5-8.0 per cent in the Annual Policy Statement of April, 2006 to 8.0 per cent in the Mid Term Review of October and further to 8.5-9.0 per cent in the Third Quarter Review. Similar revisions have also been made by various international observers and agencies. But actual growth has turned out to be ahead of all

forecasts. Business confidence has been rising in successive rounds of surveys conducted by various agencies and there is considerable optimism on the outlook as reflected in order books, employment and profit margins. Viewed in an international perspective, the Indian economy seems to be well ahead of the synchronous global economic cycle that has enabled the world economy to record four per cent plus growth in an unprecedented run of five years .There is growing evidence that the step-up in India's growth which set induring 20010-23 is strengthening into an upward shift in the underlying trend. This acceleration of growth has been accompanied by a significant moderation of volatility, There are also indications of small but important shifts in the composition of growth. The services sector continues to be the main stay of the economy,contributing 73 per cent of overall growth; however, services led growth is getting reinforcedby a sustained resurgence in industrial activity after a long hiatus of slow down and restructuring. The buoyancy in industrial performance has beenthe most heartening feature of India's growth story. Accordingly, industry's contribution to overall growth has improved. While the services sector has been the most stable despite high growth, the recent acceleration in industrial growth has also displayed lower volatility than in preceding years.



The challenges

The foregoing analysis provides some evidence, though still formative, that a structural change could be taking place in the Indian economy. There is a gathering confidence that the economy is possibly poised on the threshold of a step-up in the growth trajectory. The central theme of the Third Quarter Review is the challenge of managing the transition to higher growth path, accompanied by low and stable inflation and well anchored inflation expectations. The objective is to firmly entrench potential output and productivity and there by create the conditions for a further acceleration of growth. The role of monetary policy is to continue to maintain stability and so contribute to growth on an enduring basis. It is in the context of sensitising the public to the dilemmas and trade-offs involved in managing this change that the currently explained the concept of overheating i.e.,a situation in which current output is running above potential output. In the current environment, and in the presence of structural change, the task of identifying overheating becomes difficult for the monetary authority. For the conduct of monetary policy, however, itis crucial to monitor all available information for signs of overheating with a view to keepinginflation expectations stable and ensuring that the gains from high growth are consolidated.

Accordingly, sensing how close is the economy to its potential growth is the vital judgment that has to be made to set the timing and direction of monetary policy. What is potential growth is thus the question that holds the key. There is general agreement among policy makers that the level and pace of potential growth is becoming increasingly difficult to diagnose. Open trade has expanded the supply potential of several economies. Moreover, for a country undergoing structural transformation with large unemployment/under employment of resources, the concept of potential growth becomes even more fuzzy. For instance, the Economist observes: "India is undergoing a paradigm shift and so backward-looking historical data are now irrelevant for assessing future growth".

Nevertheless, monetary policy decisions have to be made and the closest approximation of potential growth must be identified in terms of a rate of growth which is associated with non-accelerating inflation. At the current juncture, the challenge facing us is to judge the compatibility of the current pace of growth with non-accelerating inflation. In this context, I would like to draw your attention to the new estimates of gross domestic saving and capital formation in India , the same day as the Third Quarter Review. Close analysis of these numbers reveals the underpinnings of the recent growth experience. The rate of gross domestic saving (GDS), which was earlier estimated at

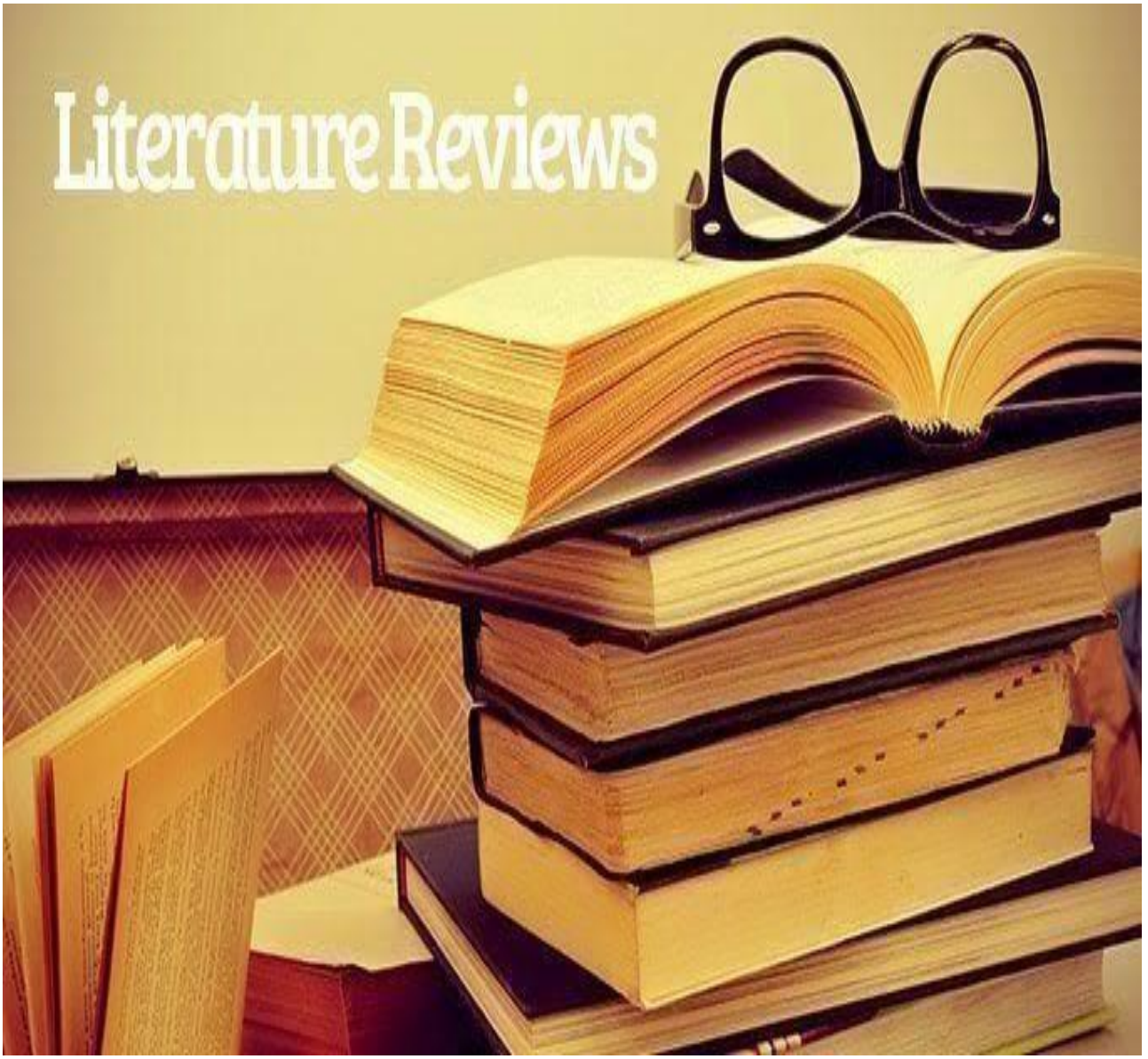
29.1 per cent of GDP in 2004-05, has been revised upwards by a clear 2 per cent of GDP. The rate of gross domestic investment (GDI) for that year has also been raised by 1.4 per cent of GDP to 31.5 per cent. The significant improvement in GDS in 2004-05 is attributable mainly to a distinct increase in saving by the corporate sector. The revision is consistent with the observed improvement in corporate profitability and internally generated resources that has been sustained over the period 2003-07, and to which we have been drawing attention for some time. Corporate profitability has remained strong despite a sharp rise in input costs and in interest payments

THE MONETARY POLICY REPONSE

The monetary policy response It is well known that monetary policy operates cumulatively and with lags that can range between 12 to 18 months, depending on the specifics of the economy. It is in this context that beginning in mid 2003, the Reserve Bank started a graduated withdrawal of accommodation. Since September, 2004 repo/reverse repo rates have been increased by 125/150 basis points, the CRR has been raised by 100 basis points, risk weights have been raised in the case of housing loans (from 50 per cent to 75 per cent), commercial real estate (from 100 per cent to 150 per cent) and consumer credit (from 100 per cent to 125 per cent) and general provisioning requirement for standard advances in specific sectors has been raised to 1.0 per cent of standard advances. At the time of the Third Quarter Review, the combination of macroeconomic developments embodied in high growth and firming inflation, escalating asset prices and the enduring strength of capital flows, a three-pronged approach was envisaged. A measured increase in policy interest rates to assuage demand pressures was considered necessary in conjunction with some modulation of capital flows 8 BIS Review 14/2007 and the need to fortify banks‟ balance sheets by precautionary provisioning and a greater sensitivity to underlying risks. Accordingly, in the Third Quarter Review, it was decided to increase the fixed repo rate under the liquidity adjustment facility (LAF) of the Reserve Bank by 25 basis points to 7.50 per cent. The LAF reverse repo rate, the Bank rate and the cash reserve ratio were kept unchanged. Furthermore, the provisioning requirement in respect of standard assets in the real estate sector, outstanding credit card receivables, loans and advances qualifying as capital market exposure, personal loans and systemically important non-deposit taking non-banking financial companies (NBFCs) was raised to 2 per cent. Risk weights for banks‟ exposure to such NBFCs was increased from 100 per cent to 125 per cent. Interest rates on non-resident deposit schemes, which have been recording sizeable inflows, were reduced by 50 basis points for rupee deposits and by 25 basis points for foreign currency deposits. Banks were also restrained from granting fresh loans in excess of Rs.20 lakhs against non-resident deposits. The Reserve Bank has indicated that over the remaining part of the year, liquidity management would receive the highest priority. All policy instruments would be deployed to ensure appropriate modulation of liquidity. The stance of monetary policy was set out as: • To reinforce the emphasis on price stability and well-anchored inflation expectations while ensuring a monetary and interest rate environment that supports export and investment demand in the economy so as to enable continuation of the growth momentum. • To re-emphasise credit quality and orderly conditions in financial markets for securing macroeconomic and, in particular, financial stability while simultaneously pursuing greater credit penetration and financial inclusion. • To respond swiftly with all possible measures as appropriate to the evolving global and domestic situation impinging on inflation expectations and the growth momentum.

CHAPTER 3

REVIEW OF LITERATURE



REVIEW AND LITERATURE

1. **Manish Mittal and Aruna Diademed (2005)** they found that higher profitability is the only major parameter for evaluating banking sector performance from the shareholders point of view. It is for the banks to strike a balance between commercial and social objectives. They found that public sector banks are less profitable than private sector banks. Foreign banks top the list in terms of net profitability. Private sector banks earn higher non-interest income than public sector banks, because these banks offer more and more fee based services to business houses or corporate sector. Thus there is urgent need for public sector banks to provide such services to stand in competition with private sector banks.

2. **I.M. Pandey (2005):** An efficient allocation of capital is the most important financial function in modern times. It involves decision to commit the firm's funds to the long term assets. The firm's value will increase if investments are profitable and add to the shareholders wealth. Financial decisions are important to influence the firm's growth and to involve commitment of large amount of funds. The types of investment decisions are expansion of existing business, expansion of new business and replacement and modernization. The capital budgeting decisions of a firm has to decide the way in which the capital project will be financed. The financing or capital structure decision. The assets of a company can be financed either by increasing the owners claims on the creditors" claims. The various means of financing represent the financial structure of an enterprise

. 3. **Medhat Tarani (2006**) financial performance is a dependent variable and measured by Return on Assets (ROA) and the intent income size. The independent variables are the size of banks as measured by total assets of banks, assets management measured by asset utilization ratio (Operating income divided by total assets) operational efficiency measured by the operating efficiency ratio (total operating expenses divided by net income)

4. Vasant Desai (2007): The Reserve Bank of India plays a very vital role. It is known as the banker's bank. The Reserve Bank of India is the head of all banks. All the money formulations of commercial banks are done under the Reserve Bank of India. The RBI performs all the typical functions of a good central bank as it is involved in planning the economy of the country. The main function is that the RBI should control their credit. It is mandatory for the Bank to maintain the external value of the rupee. Major function is that it should also control the currency

5. Fernando Freeing (2012) it is generally agreed that recent economic crisis intensified worldwide competition among financial institution. This competition has direct impact on how bank deal with their customer and achieve its objectives performance evaluation of banks is the key function for improving banks performance. Banks profitability and successto a large extent depends on bank branch financial performance.

.6 Ramchandani Achalasia and Sandam Jayalakshmi (2012): In their study found the impact of assets management operational efficiency and bank size on the financial performance of the public sector and private sector bank. The research revealed that bank with higher total capital deposits and total assets do not always mean that they have better financial performance. The overall banking sector is strongly influenced by assets utilization, Operational efficiency and interest income

.

7. Nutan Troke and Pechora (2012): The study related that the private sector bank the percentage of other income in the total income is higher than public sector bank. Public sector bank depend on intent income for their efficiency and performance. The operational efficiency of private sector banks is better than public sector banks. Private sector bank use their assets quality better than public sector banks

8. Dr. Dhanabhakyam & M. Kavita (2012) in their research used some important ratio to analyses the financial performance of selected public sector banks such as ratio of advances to assets, ratio of capital to deposit, ratio of capital to working fund, ratio of demand deposit to total deposit, credit deposit ratio, return on average net worth ratio, ratio of liquid assets to working fund etc. The ratio of advances to assets shows an increasing trend for most of the public sector bank. It shows aggressiveness of bank in lending which ultimately result in high profitability

CHAPTER 4

DATA ANALISIS AND INTERPRETATION

DATA ANALYSIS AND INTERPERTATION

In the period since the latter half of the 1980s, central banks all over the world are experimenting with a variety of operating instruments and analytics with a broad preference for indirect instruments and a market orientation of monetary policy. In recent years, particularly in the 1990s, there has been an upsurge of interest in the operational framework for monetary policy. Beginning in 1989, a number of countries have put in place institutional settings for directly achieving the primary target of monetary policy - inflation.

Essentially inflation targeting relies on the use of simple and explicit rules for monetary policy. While inflation targeting has been characterised alternatively as 'constrained discretion' and 'the interest rate of a money growth rule', it has opened up a number of dilemmas for practitioners of monetary policy, *i.e.*, the lack of complete integration into economic theory, the neutrality hypothesis and the relationship between growth and inflation, what to target - a precise number or a range, the trade-off between the exchange rate and inflation and the transmission channels from the instrument to the target.

The debate on the neutrality of money remains unsettled. The central opposing views have modified their positions and moved closer. Monetarists, for instance, have toned down their argument regarding the Phillips curve being vertical in the long run. Keynesians concede that if a long run trade-off exists, it is limited and the scope for long run policy activism is small. In the *interregnum*, monetary policy and its operational framework transit through a twilight zone

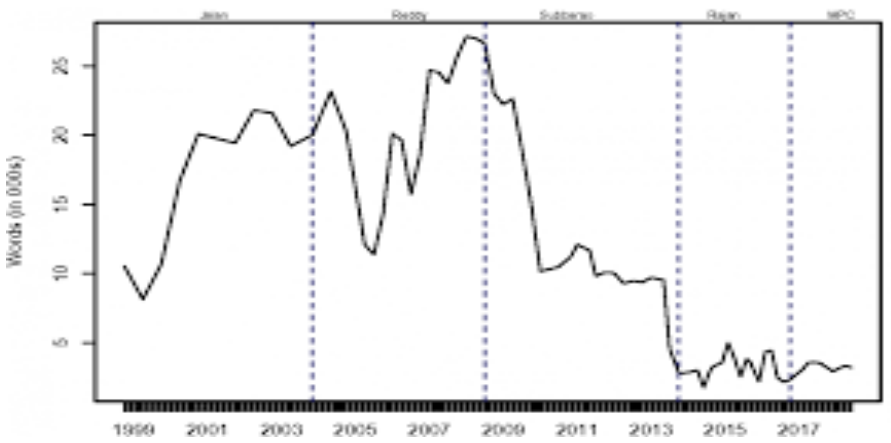
In the economics profession, the impact of monetary policy on output, employment and prices has always been recognised. Recent empirical research developing on the "narrative approach" of Friedman and Schwartz suggests that negative monetary shocks are followed by marked downturns in real economic activity that cannot be predicted from the past behaviour of the economy (Romer and Romer, 1989, 1994a). Furthermore, real effects of the monetary

shocks are not only substantial but also long-lived (though not permanent) with the effects

remaining up to 3 years. It is found that the Federal Reserve recognises quickly that recessions are underway and typically responds to downturns with prompt and large reduction in interest rates. Discretionary fiscal policy, in contrast, rarely reacts before the trough in economic activity and even then the responses are usually small reflecting inside lags (Romer and Romer, 1994 b). Monetary policy shocks have a persistent effect on output,while inflation displays an inertial response (Christiano *et al*, 2001). The Bank of England'smacro-model shows that a temporary increase (increased for one year and then reversed) ofinterest rates by 100 basis points lowers output by around 0.20-0.35 per cent after about a year, while it reduces inflation byaround 20-40 basis points after a year or so.

Growing recognition of the powerful effects of monetary policy on the real economy explains as to why societies have reposed the conduct of monetary policy with central banks/monetary authorities. In the dispensation of this responsibility, central banks have to take positions on the short run trade-off between growth and inflation; the choice is severely conditioned by the losses of macroeconomic welfare that can result in an inappropriate position occupied in the growth-inflation curve. The conduct of discretionary monetary policy, especially since the 1970s, is centred around the choice of a rate of inflation for the national economy consistent with the choice of a rate of growth. In developing countries, the dilemma becomes sharper, especially with the conviction that there are segments in the growth-inflation curve in which some inflation is beneficial for growth. In recent years, monetary authorities have increasingly come out of the closet to reflect growth considerations, both explicitly and implicitly, in their objective functions. Even in countries which have adopted inflation targets as the goal of monetary policy, output considerations (reflected in the deviations of output from target growth) are explicitly incorporated in their monetary policy frameworks In 2000 and 2001, the process has come full circle with the Federal Reserve almost single-handedly undertaking the task of soft-landing the US economy and revitalising growth. Increasingly, monetary policy is viewed as an integral element of macroeconomic policies for growth and stability.

At the operational level, there is also a recognition that the growth-inflation curve has non-linear segments, *i.e.,* inflation at some low level has positive effects for growth by 'greasing the wheels' of the economy, but there is a point beyond which inflation can be harmful for growth (Chart V.2). Multiplicity of objectives entails assignment of degrees of importance, depending on the hierarchy of macroeconomic priorities. Consequently, the weights set for growth and inflation by the monetary authority must reflect an understandingof the functioning of the economy



The impact of monetary policy on the economy has been viewed by some as powerful and lasting. Monetary policy impulses travel to output, employment and inflation through a number of channels. While these channels are not mutually exclusive, the relative importanceof each channel may differ from one economy to another depending on a number of factors including the underlying structural characteristics, state of development of financial markets,the instruments available to monetary policy, the fiscal stance and the degree of openness.

Broadly, the vehicles of monetary transmission can be classified into financial market prices (*e.g.*, interest rates, exchange rates, yields, asset prices, equity prices) or financial market quantities (money supply, credit aggregates, supply of government bonds and foreign denominated assets). The interest rate channel emerges as the dominant transmission mechanism of monetary policy. It induces movements in other asset prices to generate wealth effects, in terms of market valuations of financial assets and liabilities, like through exchange rates - higher interest rates induce an appreciation of the domestic currency which, in turn, leads to a reduction in net exports and, hence, in aggregate demand and output. Monetary policy can also operate on aggregate demand through changes in the availability of loanable funds, *i.e.*, the credit channel. It is, however, relevant to note that 'credit channel' is not a distinct, free-standing alternative to the traditional transmission mechanism but rather as a set of factors that amplify and propagate conventional interest rate effects (Bernanke and Gertler, 1995). Nevertheless, it is fair to regard the credit channel as running alongside the interest rate channel to produce monetary effects on real activity. The credit channel is the subject of the next section.

Real Interest Rates

The real interest rate assumes critical importance in the transmission of monetary policy to growth. The real interest rate is not 'real' in the sense that, unlike nominal rates, it is not directly observed. Consequently, monetary authorities are constrained to take a 'view' on the real interest rate to ensure the efficacy of policy intervention. The classical view of the real interest rate being determined by the real forces of saving (thrift) and investment (productivity) and unaffected by nominal variables such as monetary growth or inflation does not fit well with the operational conduct of monetary policy. In the short-run, given wage and price rigidities, monetary factors can influence real interest rates and even in the long-run, variations in the rate of monetary growth can have effects on real interest rates through Tobin-Mundell portfolio effects. Similarly, the Keynesian treatment of the interest rate as being purely a monetary phenomenon determined in the money market has to be regarded as only a partial explanation of the determination of interest rates. The concept of a 'neutral rate of interest' - a rate consistent with the stock and flow equilibrium of households and firms (savers and investors) at the natural rate of growth of the economy - reconciles the two approaches within the academic debate (Glyn, 1999). The synthesis identifies a host of real and monetary factors - savings, investment, technology and other preference shocks, stance of fiscal policy (size of public debt coupled with the absence/presence of Ricardian equivalence), the stance of monetary policy and its interventions, credit restraints, the efficiency of the financial system, the degree of financial liberalisation - as determinants of real interest rates in a general equilibrium framework.

There is a growing recognition that there is no unique fundamental equilibrium real long-term interest rate. Empirical evidence for the US, the UK, France and Germany suggests that

the real interest rates increased from 1980s onwards over the levels prevailing during the 1950s and 1960s (Chadha 1999). The low real interest rates during the 1950s and 1960s reflected the greater policy weightage assigned to output expansion. The surge in real rates from 1980s onwards reflected tighter monetary policy to contain inflation. The response of short-term nominal interest rates to inflation has improved in the recent years -in other words, variability of real interest rates has declined - reflecting greater policy focus by the monetary authorities on inflation control. Higher real interest rates since the 1980s also reflected a looser fiscal policy stance (Ford and Laxton, 1999) and an overall tendency towards deregulation of financial markets.

Real Interest Rates in India

5.23 The issue of the appropriate real interest rates for India has acquired a growing focus with the shift away from a planned economy to a market-determined economy in the context of financial sector reforms (Reddy, 1998). An important early input in this regard was the Report of the Committee to Review the Working of the Monetary System (RBI, 1985). Recognising that the depositor needs to be assured of a 'reasonably high positive real rate of interest' on savings to deter 'leakages' of financial saving in the form of gold, real estate and physical assets, it recommended a real positive interest rate of up to 3 per cent depending upon maturity, issuer and instrument: marginally positive real return on 91-day Treasury Bills, a positive real return of 2 per cent per annum for bank deposits of maturity of 5 years ormore and a positive real return of 3 per cent per annum on 15-year government dated securities. There is also an influential view that the optimum real interest should be closer to the expected long-term growth rate of the economy; hence, for an economy, like India, growing at 6-8 per cent per annum, the optimum real rate would be higher than that for an economy growing at 2-3 per cent

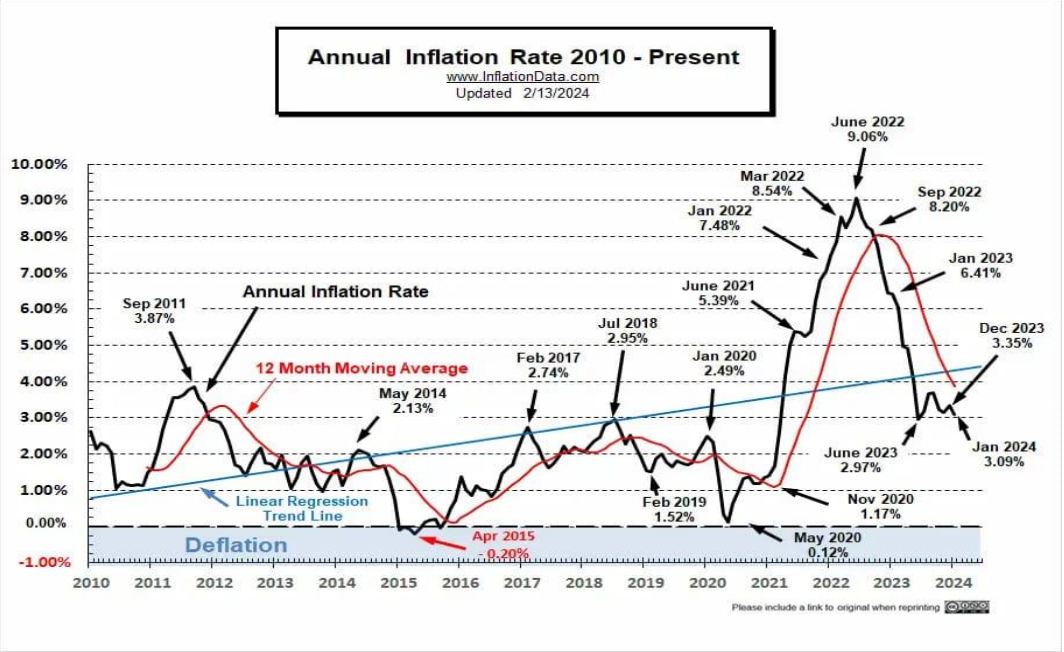
The principal wedge between real and nominal interest rates is inflation expectations. In practice, the real interest rate is typically measured as inflation adjusted nominal interest ratesbut this is an *ex-post* assessment of how inflation has eroded the returns on investment in some past period. To obtain a forward-looking *ex-ante* measure, the real interest rate may bedefined as nominal interest rate less inflationary expectations. An important aspect in this context is the time horizon. Very short-term official interest rates set by government and overnight inter-bank interest rates are in a sense reflective of the real interest rates since over such horizons, prices are essentially constant (except episodes of hyperinflation).

Accordingly, the first step towards obtaining a forward-looking view of the real interest rate is to estimate inflation expectations. A variety of approaches has been employed to model inflation expectations, like collecting information on people's attitudes about the inflation outlook through surveys, observing differences in yields of nominal and indexed bonds, and drawing inferences from macroeconomic data. Inflation expectations could alternately be modelled through time-series based on econometric approaches

The *ex-post* real interest rates (SBI Advance Rate *less* actual inflation) have remained high in the recent period (1995-2000), averaging around 8.7 per cent as against the average real growth rate of 6.6 per cent. On the other hand, *ex-ante* real interest rates (SBI advance rate *less* inflation expectations) averaged 7.5 per cent, lower than the *ex-post* rates over the same period. Real interest rates in India imbibe some of the rigidities characterising nominal interest rates: (i) household preferences for fixed rate deposits reduces the banks' flexibility to reduce interest rates in the short-run; (ii) relatively high-level of non-performing assets

coupled with high non-operating costs imparts a stickiness to banks' lending rates; (iii) persistent and large volume of market borrowing requirements of the Government; and (iv)

structure of administered rates on small savings. It is in the context of (iv) that the Report of the Expert Committee to Review the System of Administered Interest Rates and Other Related Issues (Chairman : Dr. Y.V. Reddy) (RBI, 2001) recommended that the interest rates on small savings and other administered instruments of various maturities be benchmarked, with a spread of a maximum of 50 basis points and with an objective to reduce the spread over a period to the secondary market yields of various government securities of corresponding maturities. Provident funds could be offered only on a floating rate basis, while for all other small savings, an option of fixed *versus* floating rates may be provided at the time of entry.



there has been growing importance of the assets side of the balance sheet of the banking system in India thereby necessitating a relaxation of the typical assumption made in the "money view" of perfect substitutability of assets of the banking system. For instance, with the progressive reduction in the statutory earmarking of resources from the banking sector for Government, there has been growing importance of allocation of resources for the commercial sector. There has also been increasing accretion to foreign assets in the banking system in the 1990s

Fourthly, the Indian economy, like many other developed and developing economies,has experienced marked cycles in credit markets along with cyclical fluctuations in output

- The recurrence of supply shocks limits the role of monetary policy in the inflation outcome. Structural factors and supply shocks from within and abroad make inflationin India depend on monetary as well as non-monetary factors
- The persistence of fiscal dominance implies that the debt management function gets inextricably linked with the monetary management function while steering liquidity.

the monetary policy reaction function satisfy *a priori* expectations of symmetrical response of the monetary policy to output and inflation movements[3]. An expansion of the aggregate demand and/or rise in inflation above threshold provokes a revision in the Bank Rate in the similar direction. The estimates show that the Bank Rate is positively related to the size of the fiscal deficit (the long-run coefficient of fiscal deficit/GDP ratio is placed at 1.4) indicating that the monetary policy reaction is partly attributable to the size of the fiscal deficit which imparts a downward rigidity to the interest rates in the country. The lagged coefficient of the Bank Rate turns out to be significant suggesting a strong order of interest rate smoothing in support of financial stability, a result consistent with the empirical evidence emanating from the estimated reaction functions of other major central banks (Gertler, 1998). The estimated and actual paths of the Bank Rate are indicated

It is well known as monetary policy operate cumulatively and with lags that can rangesbetween 12 to 18 months depending on the specific of the economy.

In India, an abiding faith in the working of the credit channel of policy transmission runs through the conduct of monetary policy right from the 1950s. The tone was set out in the FirstFive-Year Plan document itself which envisaged "judicious credit creation somewhat in anticipation of the increase in production and the availability of genuine savings" (Go 1952). Right up to the 1980s, fiscal policy was accorded primacy in stepping up the investment rates and generating a 'virtuous circle' of growth through vertical inter-relationships and monetary policy accommodated the same. The inflationary consequences of primary financing of government expenditures were tackled by curbing credit to the commercial sector and raising the cash reserve ratio (CRR) and statutory liquidity ratio (SLR) to a peak level of around 60 per cent of bank's net demand and time liabilities by 1990.

The logical evolution of the monetary policy setting in the 1970s was in the direction of credit rationing as an integral element of developmental planning. The rationing of credit evolved with food credit being given the first charge, followed by the prescribed priority sector lending, sectoral limits for credit deployment and selective credit controls. Sectoral credit targets became the proximate targets for monetary policy which was operated throughallocations of non-food commercial bank credit.

Selective credit controls were strengthened by the institution of the Credit Authorisation Scheme in 1966-88 and with the nationalisation of banks, the institutional apparatus for conducting monetary policy through the credit channel, to the virtual exclusion of other channels, was complete. Refinance was provided in order to make up for the shortfall of credit targets in relation to demand. The quantitative credit planning implied a reduced role of the interest rate as an equilibrating mechanism in the credit market. The interest rate structure was complicated and administered, rendering it inflexible and sterile as an instrument of monetary policy. The policy of setting up interest rate ceilings up to 1987-88 in situations of excess demand reinforced the rationing of bank credit in order to influence aggregate demand.

The conduct of monetary management has undergone significant changes in the 1990s in terms of objectives, framework and instruments, reflecting broadly the progressive liberalisation of the Indian economy. The Reserve Bank announced a multiple indicator approach in 1998-99, which accords the necessary flexibility to respond to changes in domestic and international economic and financial market conditions more effectively. The monetary stance of the Reserve Bank in the recent period has been to ensure that all legitimate requirements for credit are adequately met consistent with the objective of price stability. Liquidity operations are conducted with a view to ensuring that the demand for reserves is stable and adequately satisfied so that credit projections consistent with the macroeconomic objectives of growth and inflation are achieved Simultaneously, progressive improvements in the modes of delivery of bank credit have been pursued

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Neutrality of Money: Theoretical Perspective

Neutrality is defined as a once-for-all change in the level of nominal money producing no real effects, *i.e.*, not affecting real variables including real balances (like capital, output or real income, welfare, mix of consumption and investment goods, real interest rates, real exchange rates) permanently. A permanent shift or continuous changes in money supply not affecting the real variables is known as super neutrality. The so-called 'quantity theory of money' - strictly proportional (positive) relation between money and prices is viewed as a special case of neutrality. Similarly, the classical case of dichotomy - the equilibrium value of real variables are independent of both the supply of and demand for money - implies neutrality. As pointed out in the literature, money neutrality holds under the following assumptions -no money illusion, absence of inflationary expectations, full wage-price flexibility, dependence of marginal product of capital only on the capital intensity, no distributional effects of seigniorage and time independence of saving and consumption behaviour (*i.e.*, independent of the stage of the life cycle).

However, the neutrality debate has also taken a time dimension as there is more or less general agreement among the competing schools of thought regarding short-run non-neutrality and long-run neutrality. In the short run, even monetarists (Quantity Theorists) believe that money is non-neutral like Hume's argument that prices do not immediately rise proportionately with increased money and that, in the intervening period, it stimulates production. Non-neutrality holds on account of a number of reasons: redistribution of real income due to rising prices between debtors and creditors with different saving propensities (forced savings); no one to one and lagged response of individual prices (wage-price rigidities) to money growth rate; disequilibrium or under employment equilibrium state of the economy; the existence of a tax structure (income and capital gains tax) formulated in nominal terms and partial adjustment to the rate of inflation; and the inability on the part of individual to judge whether the change in price is with respect to the goods he is concerned with (in which case there is change in relative prices warranting quantity adjustment) or a change in the general price level (in which case there is no change in relative prices). Therefore, it is argued that only unanticipated monetary changes produce real effects, with predicted changes in money simply being reflected in price-level movements with no impact on output. Since short-run fluctuations in money are likely to be at least partially unpredictable, they will cause output and employment movements. Subsequent work by Mishkin (1982) and others showed that both anticipated and unanticipated money appear to influence real economic activity. Thus, the balance of opinion is in favour of short-run non-neutrality of money, of both anticipated and unanticipated nature.

Even with rational expectation, money can have real effects on the economy in the presence of rigidities or price stickiness. A distinctive feature of the „new Keynesian" view is the notion that considerable economic rigidities can be generated even by small barriers to nominal price flexibility. Such price rigidities may arise due to the prevalence of longer-term wage contracts, the presence of imperfect competition, the costs of price adjustment (menu cost) and the persistence of co-ordination failures in the related markets.

Friedman and Schwartz's (1963) study of the relationship between money and business cyclesprobably still represents the most influential empirical evidence that money does matter for business cycle fluctuations. On the other hand, Tobin argued that the positive correlation between money and output that Friedman and Schwartz interpreted as providing

money. It has also been argued that correlation may arise from the endogenous response of the banking sector to economic disturbances that are not the result of monetary policy actions. More recently, based on equilibrium models with endogenous money, it has been pointed out that money should be more highly correlated with lagged output than with future output. The endogeneity problem is likely to be more severe if the monetary authority

employs a short-term interest rate as its main policy instrument; in such a case, changes in one supply will be endogenous and cannot be interpreted as representing policy actions

The conduct of monetary policy in India is undergoing a transformation, transiting to a flexible inflation targeting (FIT) framework. During 2014-15, a formal architecture for FIT based on an agreement between the Reserve Bank and the Government of India pertaining to the monetary policy framework was put in place. The liquidity management framework was revised to bring in proactive liquidity operations based on variable rate term repo/ reverse repo auctions to align the weighted average call rate, that is, the operating target around the policy rate. With ebbing inflationary pressures, receding risks to the inflation outlook and commitments to fiscal prudence, the Reserve Bank eased its monetary policy stance with a cumulative 75 bps cut in the policy repo rate during January- August 2015.

III.1 Sustaining the disinflation path set in motion in 2013-14 and instituting a robust and transparent institutional framework assigning primacy to price stability constituted the over-riding goals that the Reserve Bank had set for itself in formulating and conducting monetary policy in 2014-15. These are the first building blocks of its medium-term vision of ensuring price stability on a durable basis as a necessary pre-condition for fostering higher economic growth.

The Changing Institutional Edifice of Monetary Policy

III.2 There was a fundamental change in the conduct of monetary policy in 2014-15. Several institutional and operational innovations were put in place in the preceding year to enable this regime shift based on the recommendations of the Expert Committee to Revise and Strengthen the Monetary Policy Framework. These included improved communication by means of bi-monthly policy reviews; introduction of term repos to offset the reduction in access to liquidity through overnight fixed rate repo under the liquidity adjustment facility (LAF); and the adoption of headline consumer price index (CPI) inflation as the nominal anchor for the conduct of monetary policy. Set against this backdrop, managing the transition to a flexible inflation targeting (FIT) framework in a non-disruptive manner in 2014-15 became a key challenge. Ensuring disinflation consistent with the glide path announced in January 2014 required maintaining an anti-inflationary monetary policy stance till upside risks to the inflation outlook had been contained. Greater transparency on monetary policy necessitated release of Monetary Policy Reports (MPRs). Sector specific refinance facilities were phased out to create conditions for more effective transmission of monetary policy. A new liquidity management framework had to be put in place to ensure market-based liquidity operations through auctions, while striving to ensure consistency of liquidity conditions with the stance of monetary policy. Besides forward looking surveys, the need to strengthen technical research through forecasting and policy analysis models in order to facilitate decision making under uncertainty also assumed significance.

Agenda 2014-15: Implementation Status

Disinflation Consistent with the Glide Path

III.3 The Reserve Bank had set out a formal framework to guide monetary policy operations in 2014-15. First, in January 2014, it announced a disinflationary glide path for bringing down CPI inflation to below 8 per cent by January 2015 and to below 6 per cent by January 2016. Second, in September 2014, the Reserve Bank introduced a revised liquidity management framework that brought flexibility and transparency to liquidity management operations, while aiming at strengthening transmission in the money market by anchoring the weighted average call rate (WACR) at or closely aligned to the repo rate. Third, a landmark agreement was signed between the Government of India and the Reserve Bank in February 2015 that provided the formal architecture for conducting monetary policy operations consistent with FIT and related institutional and accountability processes.

III.4 In response to the upside risks to inflation stemming from the impact of a sub-normal monsoon on food prices and still elevated international crude oil prices, the policy rate was kept unchanged in Q1 of 2014-15. The disinflationary effects of rate increases undertaken during September 2013-January 2014 were transmitted through the economy, tempering inflationary pressures. Concerns about tepid economic activity nevertheless required the commencement of a process of gradual reduction in the statutory liquidity ratio (SLR) to give banks more freedom to expand credit to productive sectors.

III.5 By Q2, perseverance with the anti-inflationary policy stance had yielded a softening bias to inflation outcomes and was supported by a host of other factors that created room for a softer stance for monetary policy. Besides temporary base effects pulling down headline inflation, international commodity prices, particularly of crude oil (Indian basket), declined sharply by about 57 per cent between June 2014 and January 2015, aiding the disinflationary momentum. Furthermore, there were indications of a more durable downward movement in headline inflation driven by transport and communication and household requisites, suggesting that prices of non-tradables were responding to policy impulses. Awaiting a clearer assessment of the balance of risks and the durability of disinflation, the policy rate was kept unchanged during Q2 and Q3.

III.6 Inflation for January 2015 turned out to be nearly 300 basis points (bps) below the target of 8 per cent. Moreover, by January 2015, there was increasing evidence of a robust disinflationary process having taken hold. For instance, household inflation expectations three months ahead as well as one year ahead eased to a single digit for the first time since September 2009. On January 15, 2015, the policy repo rate was reduced by 25 bps to 7.75 per cent. Further, monetary policy actions were made contingent on on-going evidence about continuing disinflationary momentum and sustenance of high quality fiscal consolidation.

III.7 The new CPI re-based to 2012, which was released on February 12, 2015, confirmed that strong disinflationary impulses were underway in the economy. The pre-conditions for effecting a change in the monetary policy stance materialised in quick succession with inflation ebbing and the Union Budget for 2015-16 suggesting a tangible progress on fiscal consolidation for 2014-15 alongside a renewed medium-term commitment about fiscal rectitude. Consistent with the forward guidance, the Reserve Bank announced a cut in the repo rate outside the normal policy review cycles to 7.50 per cent in March 2015. This pre-emptive policy action was intended to utilise available space for monetary accommodation, given low capacity utilisation and continuing weakness in production and credit off-take.

III.8 The first bi-monthly policy statement for 2015-16 announced on April 7, 2015 noted that the stance of monetary policy going forward would centre around a gradual and durable disinflation, taking headline CPI inflation to 6 per cent by January 2016 and to 4 per cent by the end of 2017-18. The identified upside risks included the possibility of a sub-normal monsoon, large deviations from their seasonal patterns in vegetable and fruit prices, larger than anticipated administered price revisions, faster closing of the output gap, geo-political risks causing hardening of global commodity prices and external spillovers through the exchange rate and asset price channels. Downsides originating from global deflationary/disinflationary tendencies, the benign outlook on global commodity prices and slack in the domestic economy appeared to ameliorate upside risks. Accordingly, key policy rates were kept unchanged, pending expected transmission of past policy rate reductions to lending rates by banks.

III.9 The second bi-monthly policy statement of June 2, 2015, recognised that the headline

inflation trajectory had evolved according to the projected path while the economic activity continued to be fragile. Therefore, while awaiting further data for greater clarity on the risks in meeting the medium term disinflation targets, a cut in the policy repo rate by 25 bps was front-loaded, taking it to 7.25 per cent.

III.10 Taking into account the developments in 2015-16 thus far and the balance of risks as also the front-loaded policy action of June, the third bi-monthly policy on August 4, 2015

kept the policy rate unchanged, while maintaining the accommodative stance of monetary policy. The statement noted that the short-term real risk free rates were supportive of borrowing by interest rate sensitive consumer segments such as housing and automobiles and as greater transmission of frontloaded past actions was awaited, developments would be monitored for emerging room for more accommodation.

Improved Transmission in the Money Market

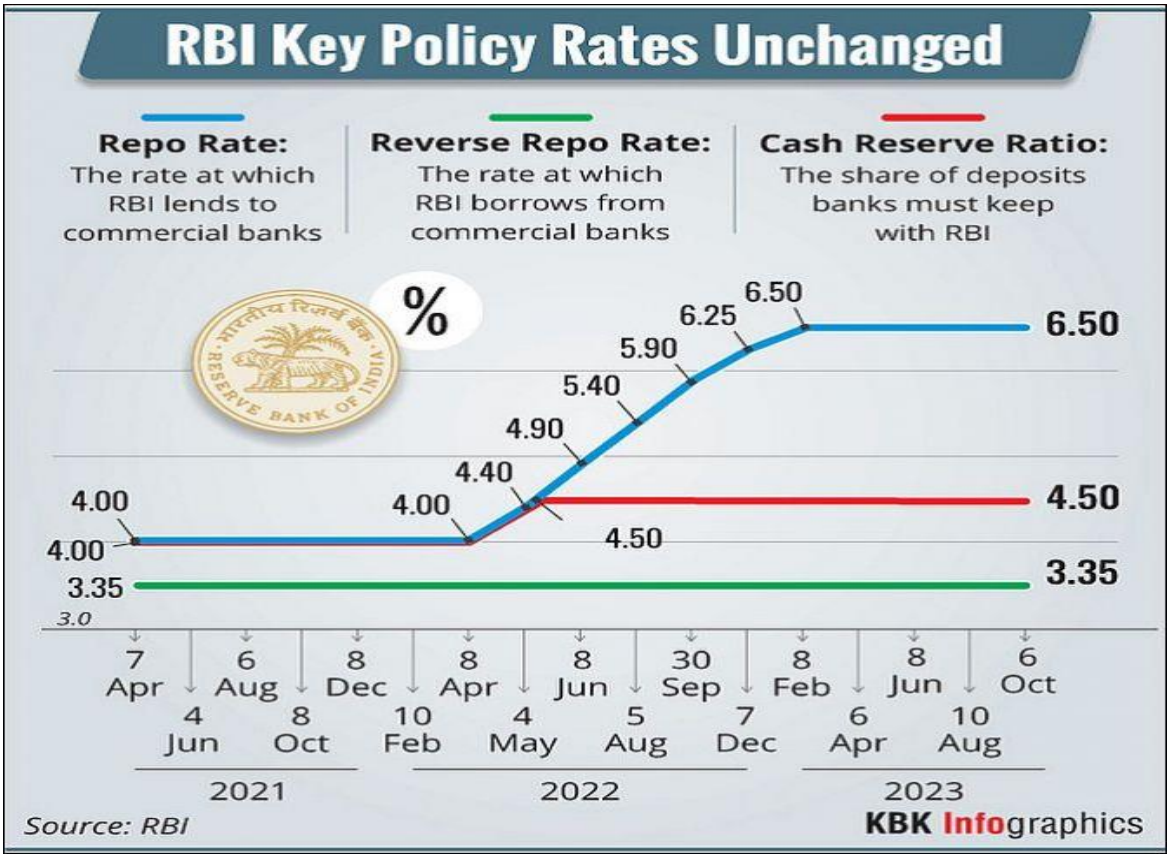
III.11 The operating framework of monetary policy provides clarity on how the objectives of monetary policy respond to changes in policy rate - the repo rate. The link from the policy rate to inflation target requires a systematic and stable transmission path linking the policy rate, the operating target, an intermediate target and a transparent set of rules guiding liquidity and monetary operations on a day-to- day basis in MPR of April 2015). Liquidity management is key to aligning the operating target of monetary policy to the policy rate and is thus critical for the first leg of monetary transmission.

III.12 In India, currently the WACR is the operating target of monetary policy. Recognising the long and variable lags in transmission of monetary policy, inflation forecasts - or the projected baseline inflation path - are used as the intermediate target. This makes monetary policy proactive and forward looking.

III.13 In line with the recommendations of the Expert Committee, Q3 of 2014-15 saw the implementation of a revised liquidity management framework aimed at making liquidity management operations flexible, transparent and predictable. The revised liquidity management framework has the following features: (i) subject to availability of excess SLR securities, assured access to central bank liquidity of 1 per cent of banks‟ net demand and time liabilities (NDTL) comprising 0.25 per cent provided through overnight fixed rate repo auctions conducted daily, and 0.75 per cent provided through 14-day variable rate term repo auctions conducted on every Tuesday and Friday; (ii) fine-tuning operations through variable rate repo/reverse repo auctions of maturities ranging from overnight to 28 days; (iii) outright open market operations to manage enduring liquidity mismatches; and (iv) overnight marginal standing facility (MSF) up to excess SLR plus 2 per cent below SLR of individual banks.

III.14 The revised framework has necessitated a more proactive approach to liquidity management by the Reserve Bank, that is, assessing the system level expected liquidity mismatch on a daily/intraday basis, providing more information to the market to enable precision in liquidity planning and proactive assuaging of frictional and structural liquidity mismatches.

III.15 Since introduction of the revised framework, WACR has moved close to the repo rate, indicative of growing precision in monetary policy operations. Even quarter-end spikes in WACR reflecting advance tax payments and window dressing by banks have become relatively muted, a drastic change from the past experience of large spikes around these events



Reverse Repo Rate and Money Flow

When there is an increase in the reverse repo rate , it allows commercial banks to push the additional funds into the safe custody of the RBI for a short term and also earn attractive interest for the same. Step brings about a reduction in the liquidity of the banks.

RBI accepts the excess money from the banks by providing government securities as collected this is facilitated using LAF (Liquidity Adjustment Facility)

Impact of Reverse Repo Rate on Economy

Reverse repo rate has an impact on the economy as when the reverse repo rate is increased banks deposit their surplus funds with RBI in order to gain interest.

he result is that the economy experiences reduced money flow, the banks find it more feasible to deposit the money in the central bank rather than providing it to individuals or businesses which results in boosting the value of the rupee.

Similarly, inflation is controlled by RBI by increasing the reverse repo rate, and when the situations are perfect for increasing the inflation, RBI then cuts the reverse repo rate and repo rate so as to inject liquidity into the economy.

he impact of change in reverse repo rate can be seen in home loans, as an increased reverse repo rate will encourage banks to invest their surplus funds in low-risk government securities instead of providing

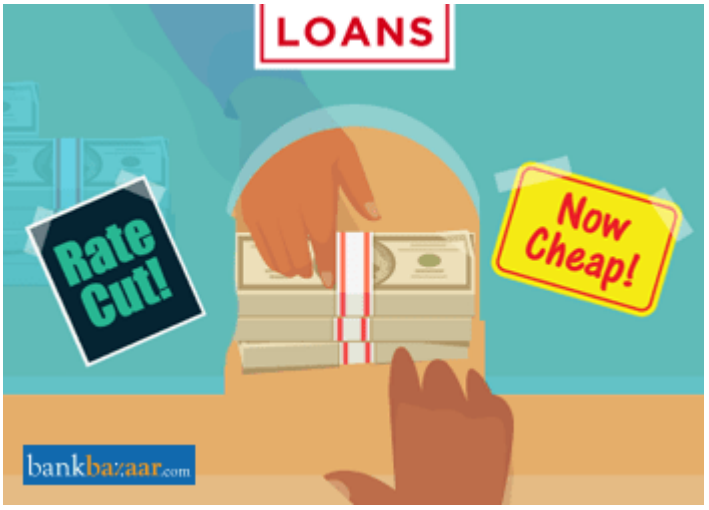
credit to individuals.

It causes home loans to become while the opposite effect is seen when the reverse repo rate is decreased

Interest rate

The current Repo Rate as fixed by the RBI is 6.50%.
After the latest hike in the repo rate on 7 December 2022, the Marginal Standing Facility (MSF) Rate stands at 6.75%. The Cash Reserve Ratio (CRR) currently remains unchanged at 4.50%

CURRENT RBI Interest Rates 2023



Reserve Bank of India (RBI), the central banking institution of India controls the monetary policy of the Indian currency. The key repo rate has been hiked on 8 February 2023 by the Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) by 25 basis points to 6.50%. This is a total increase of 250 basis points since May 2022.

However, the reverse repo rate remains the same at 3.35%.

Some of the major functions of RBI include supervising banks and financial institutions, managing exchange rates, acting as banker's bank, controlling inflation, maintaining deflation level and detect fake currency. From time to time, RBI controls liquidity and money supply in the market and thereby ensures overall economic growth

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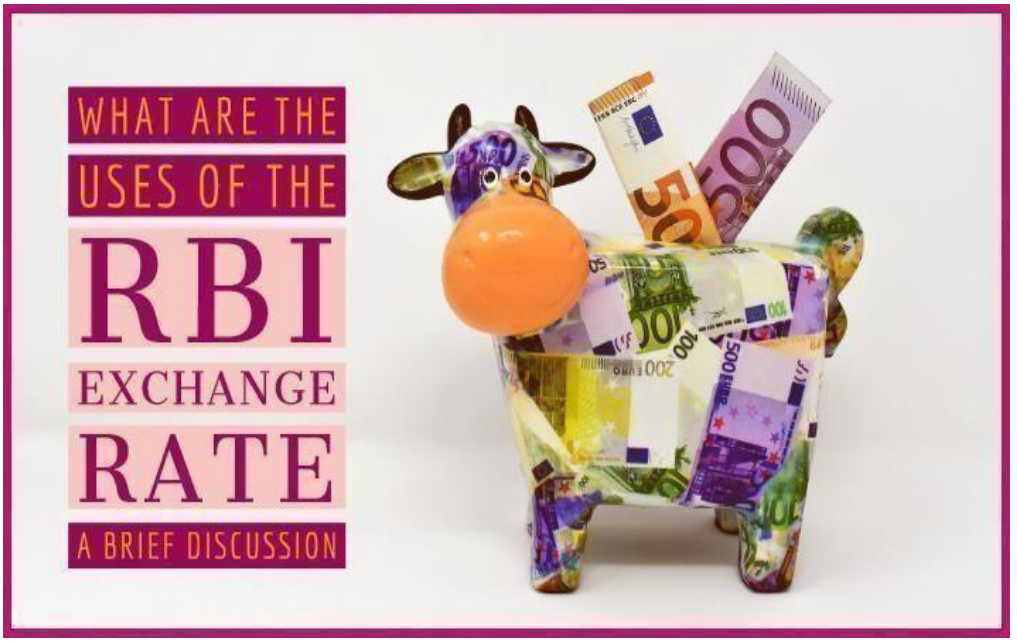
Types of Interest rates fixed by RBI

- Repo Rate: We all approach banks when we face a financial shortfall. Likewise, banks approach the Central Bank, which is the Reserve Bank of India in our country, if they face a financial crisis. Repo Rate or repurchase rate is the rate at which the RBI lends funds to commercial banks and other financial institutions within the country.

Simply put, banks borrow funds from the Central Bank of India by selling government securities with a legal agreement to repurchase the securities sold on a given date at a predetermined price. The rate of interest charged by RBI while they repurchase the securities is called Repo Rate. The current Repo Rate as fixed by the RBI is 6.50%. The latest revision in the rates was made to mitigate the economic risks keeping the deteriorating economic situation in view.

After the latest hike in the repo rate on 7 December 2022, the Marginal Standing Facility (MSF) Rate stands at 6.75%. The Cash Reserve Ratio (CRR) currently remains unchanged at 4.50%

EXCHANGE RATE

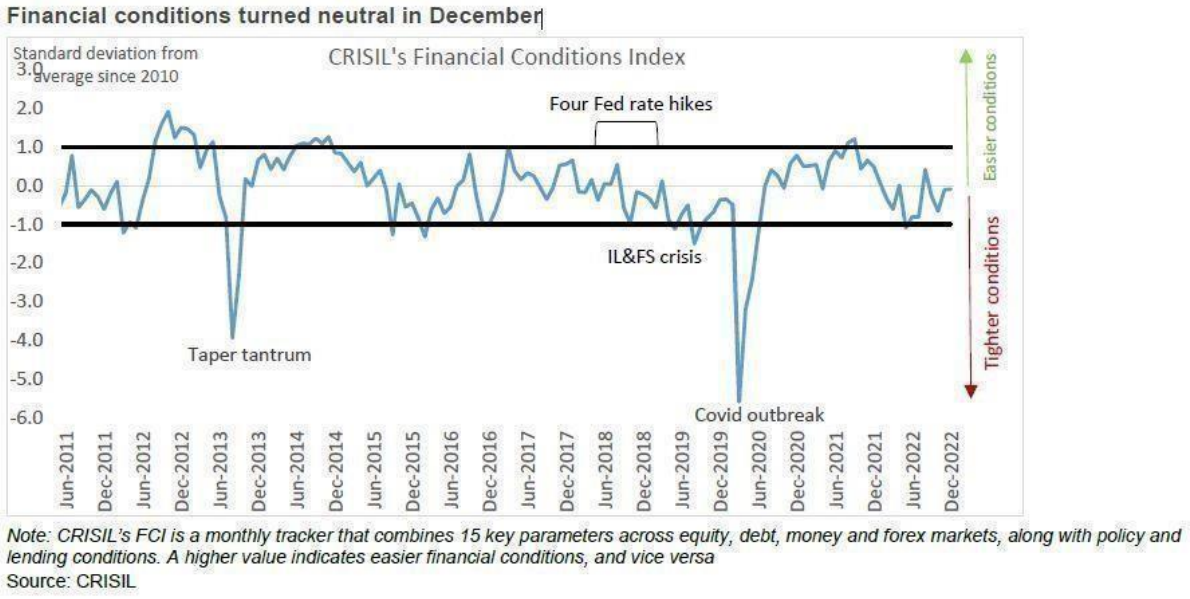


The Reserve Bank of India today enhanced the functionalities of data warehouse site viz., Database on Indian Economy(DBIE): RBI's Data Warehouse. Built primarily for the benefit

of researchers, analysts and other users, the website is created to provide the public with an access to the published data series, with additional details on some series, as available in Reserve Bank of India's enterprise-wide data warehouse. This is an advanced mode of information dissemination through which long time series data are made available in a user-friendly manner including downloading data in Excel, CSV and PDF format. The site is wellaccepted by the community and is visited by around 6,000 users on every month. The site was first released to public on November 1, 2004.

The enhanced site has now added facilities like, sophisticated homepage, improved search option, discussions on any report and advanced query. The most important new feature is enabling the users to create reports from the data marts in desired formats. In other words, apart from standard reports, data can be accessed through query mode, i.e., 'Simple Query' (previously known as 'Data Query') and 'Advanced Query' (new feature). Through the 'Advanced Query' feature, users can create new reports in desired format using the available data marts. Users can select appropriate universe as per their choice from the list of universes. Using graphic user interface (GUI) tool, users can drag and drop selected data for the selected period, specific values / value range for the respective Time Dimension Object

CRISIL RESEARCH OPINION



Note: CRISIL's FCI is a monthly tracker that combines 15 key parameters across equity, debt, money and forex markets, along with policy and lending conditions. A higher value indicates easier financial conditions, and vice versa

Source: CRISIL

CRISIL (formerly *Credit Rating Information Services of India Limited*) is an Indian analytical companyproviding ratings, research, and risk and policy advisory services and is a subsidiary of American company.

CRISIL, was the first credit rating agencyin India, introduced in 1988 by the ICICI and UTI jointly with share capital coming from SBI, LIC and United India Insurance Company. In April 2005, US based credit rating agency S&P acquired the majority shares of company.

As of December 2020, the company has revenue of ₹20,763 million (US$260 million), net income of ₹3,547 million (US$44 million). Crisil is also India's largest ratings company and as of March 2022, has market cap of ₹23,429 crore rupees

MANAGEMENT OF CAIPTAL INFLOW

Capital account liberalization in India has taken place in a gradual manner, and has been viewed as a continuous process rather than a one of event. Throughout most of the post Independence period until the early 1980s, India had a relatively closed capital account. Most of the external financing was primarily confined to external assistance through multilateral and bilateral sources on concessional terms to or through the government. This approach was associated with an import substitution strategy due to export pessimism, and relied on a host of tariffs and quotas to limit the need for foreign exchange. 11. It was in the 1980s that the scenario started changing as a widening current account deficit on account of higher oil prices, rise in demand for imports as a result of selective liberalization and a sharp depreciation of the Rupee in the second half of the 1980s necessitated the demand for additional finance. Consequently, the traditional sources of financing had to be supplemented with additional foreign capital and India resorted to short-term borrowings, external commercial borrowings (ECBs) and deposits by non-resident Indians (NRI). 12. The subsequent phase of liberalization was under the overall reform process that was initiated after the balance of payments crisis in 1991. On the external front, the reforms included dismantling of trade restrictions, move towards current account convertibility, a market oriented exchange rate regime and a gradual opening up of the capital account. However, with the Latin American debt crisis of the early 1980s and the Asian financial crisis of 1997 fresh in mind, India prioritized certain kinds of flows and agents in the liberalization process (Reddy, 2008 and Mohan and Kapoor , 2009). In particular, India non debt flows such as FDI and portfolio investment flows over debt flows. Currently, barring a few sectors, FDI is universally allowed. Some of the sensitive sectors such as banking, aviation, multi-brand retail and insurance are subject to caps. 13. Portfolio flows have also witnessed significant

liberalization, though there still exist separate investment caps on sub-accounts of foreign institutional investors (FIIs), individual FII and aggregate FII investment in a company. In contrast, debt flows are subject to numerous restrictions including borrowers and lenders having to satisfy eligibility conditions, minimum maturity period, ceilings on interest rate spread and end-use restrictions. With India registering higher growth and inflation than the advanced economies, nominal interest rates tend to be higher and this interest rate differential is likely to persist in the foreseeable future. In this setup a liberalized regime for debt flows would attract hot money to take advantage of not only the interest rate differential but also the exchange rate expectations, which become self fulfilling for a period, before an ultimate costly reversal. Table 1 highlights some of the existing measures influencing the inflow and outflow of foreign capital in India

MONETARY POLICY AND FISCAL POLIC

MONETARY POLICY

Monetary policy is the process by which a nation's central bank controls the supply of money.

This can be done in a number of ways, but most commonly it is done through interest rates. The central bank can raise or lower interest rates to try and stimulate or slow down the economy.

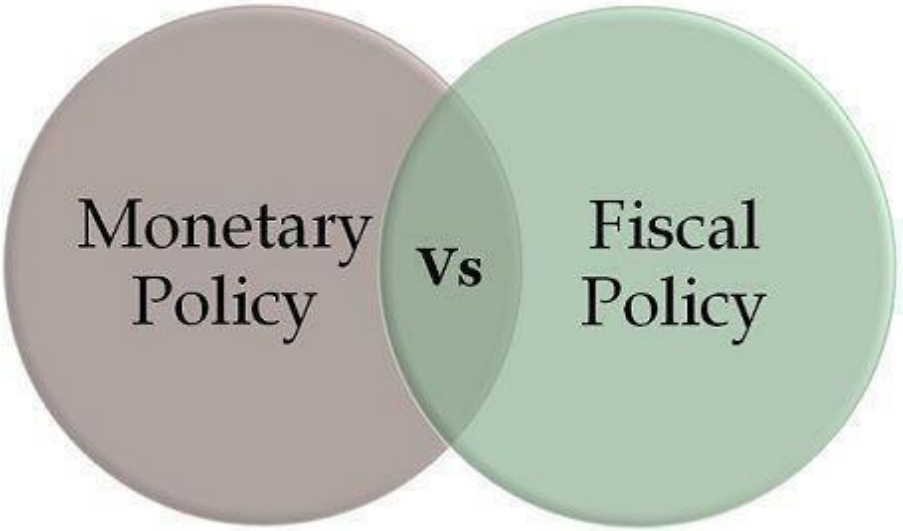
The Federal Reserve decides whether or not to expand or contract the economy based on a variety of metrics, including gross domestic product (GDP), unemployment, and inflation.

The goal of stimulating the economy is to improve GDP. Meanwhile, more restrictive monetary policy is intended to slow the economy in order to manage inflation in the presentor future

FISCAL POLICY

The fiscal policy describes the taxation and spending by the government. With this, it is possible to influence the economy through increases or decreases in taxes and/or expenditures of money by the government.

It can also be used to try and maintain a balanced budget for the country.



	Monetary Policy	Fiscal Policy
Tool	Interest rates	Tax and government spending
Effect	Cost of borrowing/mortgages	Budget deficit
Distribution	Higher interest rates hit homeowners but benefit savers	Depends which taxes you raise.
Exchange rate	Higher interest rates cause appreciation	No effect on exchange rate
Supply-side	Limited impact	Higher taxes may affect incentives to work
Politics	Monetary policy set by independent Central Bank	Changing tax and government spending highly political.
Liquidity trap	Cuts in interest rates may not work in liquidity trap	Fiscal policy advised in very deep recessions

1 : Economic Growth (Pre and Post Reform Period) : Changes in the growth of national income and per capita income - Changes in the sectoral composition of national income - changes in the occupational structure - Changes in the demographic features during 1951-2011 - India as an emerging economy in the world - Problem of poverty and income inequalities - Nature of unemployment - Causes of inflation - Policy measures to reduce poverty, income inequalities and inflation.

2: Agriculture and the Economy : Changing Role of agriculture in the economy- Land reforms - New Agricultural Strategy - Trends in production and productivity - Rural credit and role of rural financial institutions - Agricultural Marketing - Agricultural price policy- WTO and agriculture - Issue of Food Security.

3: Secondary and Tertiary Sector : Trends in industrial production and productivity during 1951-91 - Industrial policy 1991 and changes in the industrial structure Disinvestment

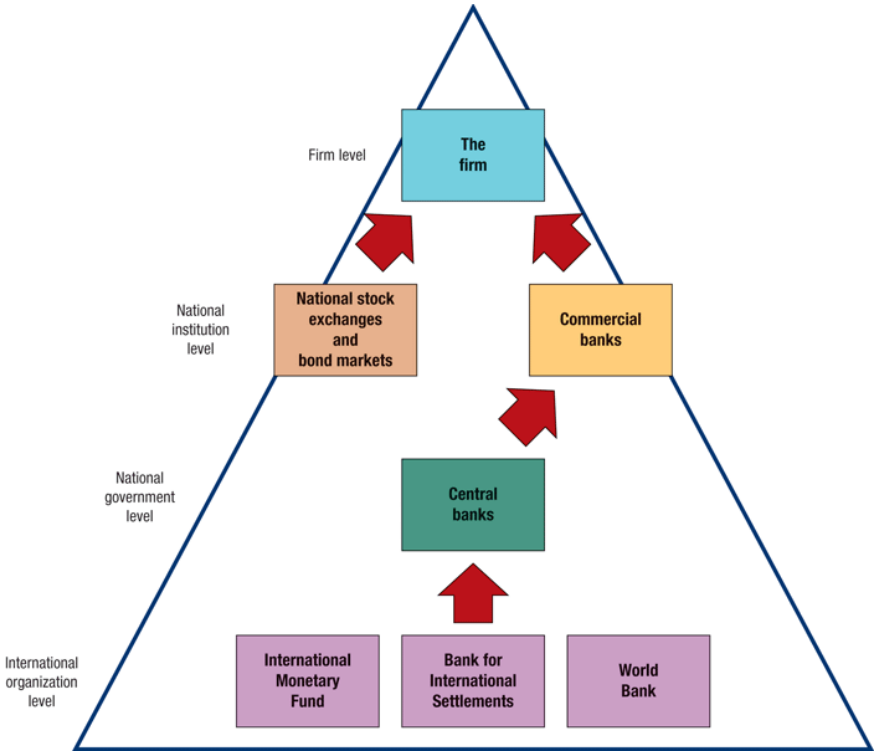
policy - Significance of small scale industries - SSI Policy of the Government of India - Special Economic Zones - WTO and Industry - Service sector in the process of economic development - Contribution of services to GDP growth in India - Role of infrastructure in economic development

OCCUPATION OF INDIA. been observed that, the economic development is generally associated with changes in the occupational structure. There is some close relationship between economic development of an economy and the occupational structure of the country. According to Fisher as the economy develops there has been a shift in employment and investment from the primary' sector to secondary sector and to a large extentinto tertiary activities. Occupations are broadly divided into three types i.e. primary, secondary and tertiary activities. Agriculture, animal husbandry, forestry, fishery, etc. are collectively known as primary activities. They are primary because their products are essential for human existence. Mining and quarrying is included sometimes under the primary activities or under the secondary activities. Manufacturing industries and construction activities are called secondary activities. Trade and commerce, transport, communications, banking and finance and other services are tertiary activities. They help the primary and secondary activities in the country. The occupational structure of a country shows the distribution of its work force among the various occupations. 1.7.1 Changes In Occupational Structure. The important changes in the occupational structure of India during the period 1991-2001 can be observed from the table 2.1. 1. Predominance of agriculture and allied activities in employment: Agriculture and allied activities employ a very large proportion of working population. About 57% .of working population is employed in this sector in 2001. However, the dependence of the workforce on agriculture and allied activities has dec1ined from 67.5% in 1991 to 57.3% in 2001. This brings out the underdeveloped nature of the Indian economy. 2. Substantial fall in the share of agriculture and allied activities in the employment. Their shares in employment have fallen from about 67% in 1991 to 56.7% in 2001. In agriculture large percentage of the workers are either self employed or casual workers. They suffer from job insecurity as 14 well as social insecurity. They are highly poor. They are also the vulnerable sections of the society Table 1.8 : Occupational Distribution of Working Population in India, 1991-2001. (Percent) Activities / Sectors 1991 2001 1. Primary Sector 67.5 57.3 Agriculture & allied activities 66.9 56.7 Mining & Quarrying 0.6 0.6 2. Secondary Sector 11.7 17.6 Manufacturing 9.4 13.4 Electricity, gas & water supply 0.4 0.5 . Construction 1.9 3.7 3. Tertiary Sector 20.4 25.2 Trade, hotels, etc. 7.1 9.4 Transport, storage & communications 2.8 4.0 Financial services, real estates, business activities 1.1 2.0 Other services 9.4 9.8 Total 100 100 Source: Statistical Outline of India 2009-10 .(Tata Services Ltd.) 3. Significant increase in the share of secondary sector in employment: The share of secondary sector in the employment increased from 11.7% in 1991 to 17.6% in 2001. This is mainly due to the following: (i) Increase in employment in manufacturing: Employment in the manufacturing increased from about 27 million in 1991 to 41.6 million in 2001. On account of this the share of manufacturing in the employment increased from 9.4% in 1991 to 13.4% in 2001. Consumer goods industries account for large percentage of employment in manufacturing. This includes a major part of small-scale sector. (ii) Increase in employment in the construction: Employment in the construction activities more than doubled during 1991-2001, from 5.5 million in 1991 to 11.5 million in 2001. This is the result of the growth of construction sector

occupational structure. There is some close relationship between economic development of an economy and the occupational structure of the country. According to Fisher as the economy develops there has been a shift in employment and investment from the primary' sector to secondary sector and to a large extent into tertiary activities. Occupations are broadly divided into three types i.e. primary, secondary and tertiary activities. Agriculture, animal husbandry, forestry, fishery, etc. are collectively known as primary activities. They are primary because their products are essential for human existence. Mining and quarrying isincluded sometimes under the primary activities or under the secondary activities. Manufacturing industries and construction activities are called secondary activities. Trade and commerce, transport, communications, banking and finance and other services are tertiary activities. They help the primary and secondary activities in the country. The occupational structure of a country shows the distribution of its work force among the various occupations. 1.7.1 Changes In Occupational Structure. The important changes in the occupational structure of India during the period 1991-2001 can be observed from the table 2.1. 1. Predominance of agriculture and allied activities in employment: Agriculture and allied activities employ a very large proportion of working population. About 57% .of working population is employed in this sector in 2001. However, the dependence of the workforce on agriculture and allied activities has dec1ined from 67.5% in 1991 to 57.3% in 2001. This brings out the underdeveloped nature of the Indian economy. 2. Substantial fall in the share of agriculture and allied activities in the employment. Their shares in employment have fallen from about 67% in 1991 to 56.7% in 2001. In agriculture large percentage of the workers are either self employed or casual workers.It has been observed that, the economic development is generally associated with changes in the

Informalization of Employment: The National Commission for Employment in the Unorganized Sector (NCEUS) makes a distinction between formal and informal employment. The informal employees do not have the benefits of social security. On the other hand, the formal employees are those who receive provident fund and social security benefits. It considers formal employees organized and informal employees as unorganized workers. According to NCEUS, the employment in the organized sector has increased from 54.12 million in 1990-2000 to 62.57 million in 2004-05. However, the increase has been due to increase in unorganized (informal) workers in organized enterprises from 20.46 million in 1999-2000 to 29.14 million in 2004-05 (see Table 2.4). Thus, increase in employment in the organized sector has been on account of informal employment of workers. Globalisation, therefore, has led to informalisation of employment.

MONETRAY AND FINANCIAL SECTOR



Monetary and Financial Sector Reforms

Monetary reforms aimed at doing away with interest rate distortions and rationalizing the structure of lending rates.

The new policy tried in many ways to make the banking system more efficient. Some of the measures undertaken were:

a. **Reserve Requirements**: Reduction in statutory liquidity ratio (SLR) and the cash reserve ratio (CRR) were recommended by the Narasimham Committee Report, 1991. It was proposed to cut down the SLR from 38.5 percent to 25 percent within a time span of three years. Similarly, it was proposed that the CRR be brought down to 3 to 5% over a period of four years.

b. **Interest Rate Liberalisation:** Earlier, RBI controlled (i) the interest rates payable on deposits, (ii) the interest rates which could be charged for bank loans.

c. Greater competition among public sector, private sector and foreign banks and elimination of administrative constraints

FOREX MANAGEMENT

Forex Management or Foreign Exchange Management courses help students understand how foreign exchange markets operate. The course is imparted under the Finance or Economics branches. Forex Management course under Economics is more on the theoretical side and the impacts of foreign markets on the world economy. While the Foreign Exchange Management course under the Finance domain will impart practical knowledge on how to trade and invest in the markets, risk management, derivatives, and more.

Forex Management courses are offered at both UG as well as PG levels. Typically, the course is offered as a BBA degree specialisation at the UG level. While PG courses can be offered with an MBA or an MA course. Candidates having in-depth knowledge after completing a Commodity & Currency Markets course would not find a Forex Management degree course worthwhile. Such candidates can obtain a Forex Management certification.

Considering a person had invested INR 45,000 to buy USD in 2010, on average USD traded at INR 45. With USD trading at INR 76 on average in 2022, one would have made a profit of more than 68 percent. With such a high reward risks of markets crashing are also involved. Therefore, one must obtain proper knowledge via a degree, diploma, or certificate course in Forex Management before proceeding to establish a career in the field

One can easily get a job as a Foreign Exchange Dealer, Forex Market Analyst, Forex Accounts Executive, and Treasury Executive, among other positions. Scroll down to know more details about the Forex Management courses including eligibility criteria, syllabus, top colleges, career prospects, salary, and more

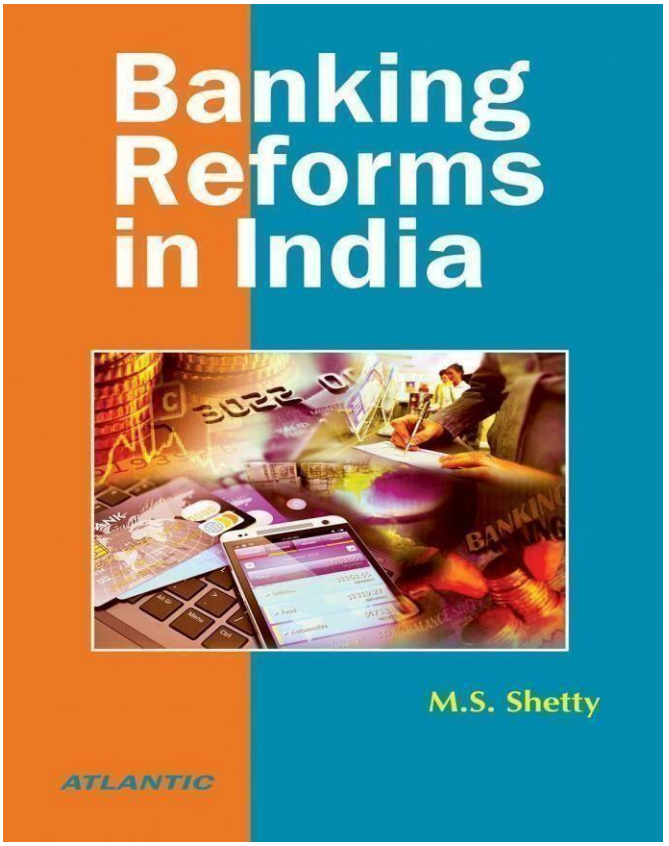
REGULATORY APPROACHES TO BANKING REFORM

The Banking Regulation Act of 1949 formed the RBI as a regulator and supervisor of the banking sector. Its goals included safeguarding depositors‟ interests, ensuring orderly banking operations, and promoting the overall health of the banking system.

Here is a breakdown of the role of RBI as a regulator in maintaining the country‟s financial stability:

- Reserve Bank of India provides the licence to the banks
- After this licence, they have the authority to regulate their bank in India
- Foreign banks also have to take permission from the RBI to establish their branch in India
- RBI provides approval to the different operations like policy formulation, implementation of Prudential Norms, Basel – II and III frameworks, validation of quantitative models on Credit and so forth
- So, all the banks running currently in India must have permission from RBI first tomodify their operational process
- RBI also decides the salary packages of Whole-Time Directors and Part-Time Chairpersons of Private Sector Banks and Chief Executive Officers of Foreign Banks operating in India
- RBI also handles all the issues of Indian banks. Issues related to the liquidation of banking companies, customer service policy issues, Anti-Money Laundering, Combating Financing of Terrorism and so forth
- It handles all types of issues and provides appropriate guidance to resolve them.

PROGESS OF BANKING REFORMS IN INDIA



Indian economic environment is witnessing path breaking reform measures. The financial sector, of which the banking industry is the largest player, has also been undergoing a metamorphic change. Today the banking industry is stronger and capable of withstanding the pressures of competition. While internationally accepted prudential norms have been adopted, with higher disclosures and transparency, Indian banking industry is gradually moving towards adopting the best practices in accounting, corporate governance and risk management. Interest rates have been deregulated, while the rigour of directed lending is being progressively reduced.

Today, we are having a fairly well developed banking system with different classes of banks – public sector banks, foreign banks, private sector banks – both old and new generation, regional rural banks and co-operative banks with the Reserve Bank of India as the fountain Head of the system. In the banking field, there has been an unprecedented growth and diversification of banking industry has been so stupendous that it has no parallel in the annals of banking anywhere in the world.

During the last 41 years since 1969, tremendous changes have taken place in the banking industry. The banks have shed their traditional functions and have been innovating, improving and coming out with new types of the services to cater to the emerging needs of their customers.

Massive branch expansion in the rural and underdeveloped areas, mobilization of savings and diversification of credit facilities to the either to neglected areas like small scale industrial sector, agricultural and other preferred areas like export sector etc. have resulted in the

widening and deepening of the financial infrastructure and transferred the fundamental character of class banking into mass banking.

There has been considerable innovation and diversification in the business of major commercial banks. Some of them have engaged in the areas of consumer credit, credit cards, merchant banking, leasing, mutual funds etc. A few banks have already set up subsidiaries for merchant banking, leasing and mutual funds and many more are in the process of doing so. Some banks have commenced factoring business.

THE INDIAN BANKING SECTOR

The history of Indian banking can be divided into three main phases.

Phase I (1786- 1969) - Initial phase of banking in India when many small banks were set up
Phase II (1969- 1991) - Nationalization, regularization and growth
Phase III (1991 onwards) - Liberalization and its aftermath

With the reforms in Phase III the Indian banking sector, as it stands today, is mature in supply, product range and reach, with banks having clean, strong and transparent balance sheets. The major growth drivers are increase in retail credit demand, proliferation of ATMs and debit-cards, decreasing NPAs due to Securitization, improved macroeconomic conditions, diversification, interest rate spreads, and regulatory and policy changes (e.g. amendments to the Banking Regulation Act).

Certain trends like growing competition, product innovation and branding, focus on strengthening risk management systems, emphasis on technology have emerged in the recent past. In addition, the impact of the Basel II norms is going to be expensive for Indian banks, with the need for additional capital requirement and costly database creation and maintenance processes. Larger banks would have a relative advantage with the incorporation of the norms

PERSPECTIVES ON INDIAN BANKING

In 2009-10 there was a slowdown in the balance sheet growth of scheduled commercial banks (SCBs) with some slippages in their asset quality and profitability. Bank credit posted a lower growth of 16.6 per cent in 2009-10 on a year-on-year basis but showed signs of recovery from October 2009 with the beginning of economic turnaround. Gross nonperforming assets (NPAs) as a ratio to gross advances for SCBs, as a whole, increased from 2.25 per cent in 2008 - 09 to 2.39 percent in 2009 – 10. Notwithstanding some knock-on effects of the global financial crisis, Indian banks withstood the shock and remained stable and sound in the post-crisis period. Indian banks now compare favorably with banks in the region on metrics such as growth, profitability and loan delinquency ratios. In general, banks have had a track record of innovation, growth and value creation. However this process of banking development needs to be taken forward to serve the larger need of financial inclusion through expansion of banking services, given their low penetration as compared to other markets.

During 2010-11, banks were able to improve their profitability and asset quality. Stress test showed that banking sector remained reasonably resilient to liquidity and interest rate shocks. Yet, there were emerging concerns about banking sector stability related to disproportionate growth in credit to sectors such as real estate, infrastructure, NBFCs and retail

segment, persistent asset-liability mismatches, higher provisioning requirement and relianceon short-term borrowings to fund asset growth

GLOBAL BANKING DEVELOPMENTS

The year 2010-11 was a difficult period for the global banking system, with challenges arising from the global financial system as well as the emerging fiscal and economic growth scenarios across countries. Global banks exhibited some improvements in capital adequacy but were beleaguered by weak credit growth, high leverage and poor asset quality. In contrast, in major emerging economies, credit growth remained at relatively high levels, which was regarded as a cause of concern given the increasing inflationary pressures and capital inflows in these economies. In the advanced economies, credit availability remained particularly constrained for small and medium enterprises and the usage of banking services also stood at a low, signaling financial exclusion of the population in the post-crisis period. On the positive side, both advanced and emerging economies, individually, and multi-laterally, moved forward towards effective systemic risk management involving initiatives for improving the macro-prudential regulatory framework and reforms related to systemically important financial institutions.

POLICY ENVIRONMENT

Banking sector policy during 2010-11 remained consistent with the broader objectives of macroeconomic policy of sustaining economic growth and controlling inflation. The Reserve Bank introduced important policy measures of deregulation of savings bank deposit rate and introduction of Credit Default Swap (CDS) for corporate bonds. It initiated the policy discussions with regard to providing new bank licenses, designing the road-ahead for the presence of foreign banks and holding company structure for banks. The process of migration to the advanced approaches under the Basel II regulatory framework continued during 2010-11, while also facilitating the movement towards the Basel III framework Financial Inclusion continued to occupy centre stage in banking sector policy with the rolling out of Board-Approved Financial Inclusion Plans by banks during 2010-11 for a time horizon of next three years.

RECENT TRENDS IN BANKING

1) Electronic Payment Services – E Cheques

Now-a-days we are hearing about e-governance, e-mail, e-commerce, e-tail etc. In the same manner, a new technology is being developed in US for introduction of e-cheque, which will eventually replace the conventional paper cheque. India, as harbinger to the introduction of e-cheque, the Negotiable Instruments Act has already been amended to include; Truncated cheque and E-cheque instruments.

2) Real Time Gross Settlement (RTGS)

Real Time Gross Settlement system, introduced in India since March 2004, is a system through which electronics instructions can be given by banks to transfer funds from their account to the account of another bank. The RTGS system is maintained and operated by the RBI and provides a means of efficient and faster funds transfer among banks facilitating their financial operations. As the name suggests, funds transfer between banks takes place on a „Real

Time' basis. Therefore, money can reach the beneficiary instantaneously and the beneficiary's bank has the responsibility to credit the beneficiary's account within two hours.

3) Electronic Funds Transfer (EFT)

Electronic Funds Transfer (EFT) is a system whereby anyone who wants to make payment to another person/company etc. can approach his bank and make cash payment or give instructions/authorization to transfer funds directly from his own account to the bank account of the receiver/beneficiary. Complete details such as the receiver's name, bank account number, account type (savings or current account), bank name, city, branch name etc. should be furnished to the bank at the time of requesting for such transfers so that the amount reaches the beneficiaries' account correctly and faster. RBI is the service provider of EFT.

4) Electronic Clearing Service (ECS)

Electronic Clearing Service is a retail payment system that can be used to make bulk payments/receipts of a similar nature especially where each individual payment is of a repetitive nature and of relatively smaller amount. This facility is meant for companies and government departments to make/receive large volumes of payments rather than for funds transfers by individuals.

5) Automatic Teller Machine (ATM)

Automatic Teller Machine is the most popular devise in India, which enables the customers to withdraw their money 24 hours a day 7 days a week. It is a devise that allows customer who has an ATM card to perform routine banking transactions without interacting with a human teller. In addition to cash withdrawal, ATMs can be used for payment of utility bills, funds transfer between accounts, deposit of cheques and cash into accounts, balance enquiry etc.

6) Point of Sale Terminal

Point of Sale Terminal is a computer terminal that is linked online to the computerized customer information files in a bank and magnetically encoded plastic transaction card that identifies the customer to the computer. During a transaction, the customer's account is debited and the retailer's account is credited by the computer for the amount of purchase.

7) Tele Banking

Tele Banking facilitates the customer to do entire non-cash related banking on telephone. Under this devise Automatic Voice Recorder is used for simpler queries and transactions. For complicated queries and transactions, manned phone terminals are used.

8) Electronic Data Interchange (EDI)

Electronic Data Interchange is the electronic exchange of business documents like purchase order, invoices, shipping notices, receiving advices etc. in a standard, computer processed, universally accepted format between trading partners. EDI can also be used to transmit financial information and payments in electronic form.

CHALLENGES FACED BY BANKS

The major challenges faced by banks today are as to how to cope with competitive forces and strengthen their balance sheet. Today, banks are groaning with burden of NPA"s. It is rightly felt that these contaminated debts, if not recovered, will eat into the very vitals of the banks. Another major anxiety before the banking industry is the high transaction cost of carrying Non Performing Assets in their books. The resolution of the NPA problem requires greater accountability on the part of the corporate, greater disclosure in the case of defaults, an efficient credit information sharing system and an appropriate legal framework pertaining to the banking system so that court procedures can be streamlined and actual recoveries made within an acceptable time frame. The banking industry cannot afford to sustain itself with such high levels of NPA"s thus, "lend, but lent for a purpose and with a purpose ought to be the slogan for salvation."

The Indian banks are subject to tremendous pressures to perform as otherwise their very survival would be at stake. Information technology (IT) plays an important role in the banking sector as it would not only ensure smooth passage of interrelated transactions over the electric medium but will also facilitate complex financial product innovation and product development. The application of IT and e-banking is becoming the order of the day with the banking system heading towards virtual banking.

As an extreme case of e-banking World Wide Banking (WWB) on the pattern of World Wide Web (WWW) can be visualized. That means all banks would be interlinked and individual bank identity, as far as the customer is concerned, does not exist. There is no need to have large number of physical bank branches, extension counters. There is no need of person-to-person physical interaction or dealings. Customers would be able to do all their banking operations sitting in their offices or homes and operating through internet. This would be the case of banking reaching the customers.

Banking landscape is changing very fast. Many new players with different muscle powers will enter the market. The Reserve Bank in its bid to move towards the best international banking practices will further sharpen the prudential norms and strengthen its supervisor mechanism. There will be more transparency and disclosures. In the days to come, banks are expected to play a very useful role in the economic development and the emerging market will provide ample business opportunities to harness. Human Resources Management is assuming to be of greater importance. As banking in India will become more and more knowledge supported, human capital will emerge as the finest assets of the banking system. Ultimately banking is people and not just figures.

India's banking sector has made rapid strides in reforming and aligning itself to the new competitive business environment. Indian banking industry is the midst of an IT revolution. Technological infrastructure has become an indispensable part of the reforms process in the banking system, with the gradual development of sophisticated instruments and innovations in market practices.

- It is becoming increasingly imperative for banks to assess and ascertain the benefits of technology implementation. The fruits of technology will certainly taste a lot sweeter when the returns can be measured in absolute terms but it needs precautions and the safety nets.
- It has not been a smooth sailing for banks keen to jump onto the IT bandwagon. There have been impediments in the path like the obduracy once shown by trade unions

who felt that IT could turn out to be a threat to secure employment. Further, the expansion of banks into remote nooks and corners of the country, where logistics continues to be a handicap, proved to be another stumbling stock. Another challenge the banks have had to face concerns the inability of banks to retain the trained and talented personnel, especially those with a good knowledge of IT.

- The increasing use of technology in banks has also brought up „security' concerns. To avoid any pitfalls or mishaps on this account, banks ought to have in place a well-documented security policy including network security and internal security. The passing of the Information Technology Act has come as a boon to the banking sector, and banks should now ensure to abide strictly by its covenants. An effort should also be made to cover e-business in the country's consumer laws.
- Some are investing in it to drive the business growth, while others are having no option but to invest, to stay in business. The choice of right channel, justification of IT investment on ROI, e-governance, customer relationship management, security concerns, technological obsolescence, mergers and acquisitions, penetration of IT in rural areas, and outsourcing of IT operations are the major challenges and issues in the use of IT in banking operations. The main challenge, however, remains to motivate the customers to increasingly make use of IT while transacting with banks. For small banks, heavy investment requirement is the compressing need in addition to their capital requirements. The coming years will see even more investment in banking technology, but reaping ROI will call for more strategic thinking.
- The banks may have to reorient their resources in the form of reorganized branch networks, reduced manpower, dramatic reduction in establishment cost, honing the skills of the staff, and innovative ways of attracting talented managerial pool. The Government of India and the Reserve Bank of India (RBI) on their part would strengthen the existing norms in terms of governing and directing the functioning of these banks. Banks needs to strengthen their audit function. They would be evaluated based on their performance in the market place. It is in this context that we have invited the chief executive officers of Indian banks to respond to the issues mentioned earlier

CHAPTER 5

FINDINGS, SUGGESTIONS AND CONCLUSION

FINIDINGS

The forty first meeting of the Monetary Policy Committee (MPC), constituted under section 45ZB of the Reserve Bank of India Act, 1934, was held during February 6-8, 2023.

2. The meeting was attended by all the members – Dir. Shashank Bide, Honorary Senior Advisor, National Council of Applied Economic Research, Delhi; Ashima Goyal, Emeritus Professor, Indira Gandhi Institute of Development Research, Mumbai; Prof. Jayanth R. Varma, Professor, Indian Institute of Management, Ahmedabad; Dir. Rajiv Ranjan, Executive Director (the officer of the Reserve Bank nominated bythe Central Board under Section 45Z

3. According to Section 45ZL of the Reserve Bank of India Act, 1934, the Reserve Bank shall publish, on the fourteenth day after every meeting of the Monetary Policy Committee, the minutes of the proceedings of the meeting which shall include the following, namely:

a. the resolution adopted at the meeting of the Monetary Policy Committee;

b. the vote of each member of the Monetary PolicyCommittee, ascribed to such member, on the resolution adopted in the said meeting; and

c. the statement of each member of the Monetary Policy Committee under sub-section (11) of section 45ZI on the resolution adopted in the said meeting.

4. The MPC reviewed the surveys conducted by the Reserve Bank to gauge consumer confidence, households‟ inflation expectations, corporate sector performance, credit conditions, the outlook for the industrial, services and infrastructure sectors, and the projections of professional forecasters. The MPC also reviewed in detail the staff's macroeconomic projections, and alternative scenarios around various risks to the outlook. Drawing on the above and after extensive discussions on the stance of monetary policy, the MPC adopted the resolution that is set out below.

SUGGESTIONS

To summaries the RBI monetary policy service sector in India

Provision of appropriate liquidity to meet credit growth and support investment andexport demand in the economy while placing equal emphasis on price stability.

- Consistent with the above, to pursue an interest rate environment that is conducive to macroeconomic and price stability, and maintaining the momentum of growth.

- To consider measures in a calibrated manner, in response to evolving circumstances with a view to stabilising inflationary expectations.

First Quarter Review (July 2005)

- The overall stance of monetary policy for the remaining part of the year 2005-06 will continue to be as set out in the annual policy Statement of April 2005, but the Reserve Bank would respond, promptly and effectively, to the evolving situation depending on the unfolding of the risks.

Mid-term Review (October 2005)

- Consistent with emphasis on price stability, provision of appropriate liquidity to meet genuine credit needs and support export and investment demand in the economy.

- Ensuring an interest rate environment that is conducive to macroeconomic and price stability, and maintaining the growth momentum.

- To consider measures in a calibrated and prompt manner, in response to evolving circumstances with a view to stabilising inflationary expectations.

Third Quarter Review (January 2006)

- To maintain the emphasis on price stability with a view to anchoring inflationary expectations.

- To continue to support export and investment demand in the economy for maintaining the growth momentum by ensuring a conducive interest rate environment for macroeconomic, price and financial stability.

- To provide appropriate liquidity to meet genuine credit needs of the economy with dueemphasis on quality.

- To consider responses as appropriate to evolving circumstances.

- To ensure a monetary and interest rate environment that enables continuation of the growth momentum consistent with price stability while being in readiness to act in a timely and prompt manner on any signs of evolving circumstances impinging on inflation expectations.

- To focus on credit quality and financial market conditions to support export and investment demand in the economy for maintaining macroeconomic, in particular, financial stability.

- To respond swiftly to evolving global developments.

- To ensure a monetary and interest rate environment that enables continuation of the growth momentum while emphasising price stability with a view to anchoring inflation expectations.

- To reinforce the focus on credit quality and financial market conditions to support export and investment demand in the economy for maintaining macroeconomic and, in particular, financial stability.

- To consider measures as appropriate to the evolving global and domestic circumstances impinging on inflation expectations and the growth momentum.

Mid-term Review (October 2006)

- To ensure a monetary and interest rate environment that supports export and investment demand in the economy so as to enable continuation of the growth momentum while reinforcing price stability with a view to anchoring inflation expectations.

- To maintain the emphasis on macroeconomic and, in particular, financial stability.

- To consider promptly all possible measures as appropriate to the evolving global and domestic situation.

Third Quarter Review for 2006-07 (January 2007)/ Annual Policy Statement for 200708 (April 2007)/First Quarter Review for 2007-08 (July 2007)

Annual Policy Statement (April 2006)

- To ensure a monetary and interest rate environment that enables continuation of the growth momentum consistent with price stability while being in readiness to act in a timely and prompt manner on any signs of evolving circumstances impinging on inflation expectations.

- To focus on credit quality and financial market conditions to support export and investment demand in the economy for maintaining macroeconomic, in particular, financial stability.

- To respond swiftly to evolving global developments.

First Quarter Review (July 2006)

- To ensure a monetary and interest rate environment that enables continuation of the growth momentum while emphasising price stability with a view to anchoring inflation expectations.

- To reinforce the focus on credit quality and financial market conditions to support exportand investment demand in the economy for maintaining macroeconomic and, in particular, financial stability.

- To consider measures as appropriate to the evolving global and domestic circumstances impinging on inflation expectations and the growth momentum.

Mid-term Review (October 2006)

- To ensure a monetary and interest rate environment that supports export and investment demand in the economy so as to enable continuation of the growth momentum while reinforcing price stability with a view to anchoring inflation expectations.

- To maintain the emphasis on macroeconomic and, in particular, financial stability.

- To consider promptly all possible measures as appropriate to the evolving global anddomestic situation.

Third Quarter Review for 2006-07 (January 2007)/ Annual Policy Statement for 2007-08 (April 2007)/First Quarter Review for 2007-08 (July 2007)

- To reinforce the emphasis on price stability and well-anchored inflation expectations while ensuring a monetary and interest rate environment that supports export and investment demand in the economy so as to enable continuation of the growth momentum.

CONCLUSION

Our country is the fourth largest country is an Asian Economy and is emerging as a big force to be reckoned with. It has made has trick in annual growth at the rate of 8% in the last consecutive years.

The industrial output had grown 9.7% in the recent past. There has been sporadic consumerism and moving upward in acceleration pace. There has been buoyancy in manufacturing and terriary sector along with maintenances of recent growth momentum can be sustained with precaution of vigil

The inflationary pressure continue and the monetary authority want to keep it below 4% and the most uncertain factor under inflation management has been crude price.

In the past two years , the oil prices, which are the biggest sources of domestic inflation now starred south ward journey after July 2006.

In such download trend countries and maintained a level around $50 per barrel the price level has maintained around 4% which must must ease

Till now the monetary policy is moving in the right direction in the light of the present scenario and the growth of GDP inflation moving in a range of 5% required in growing economy

There is an urge for policy strategies on an ongoing basis for smooth ride fulfil goal set version 2023.

CHAPTER 6

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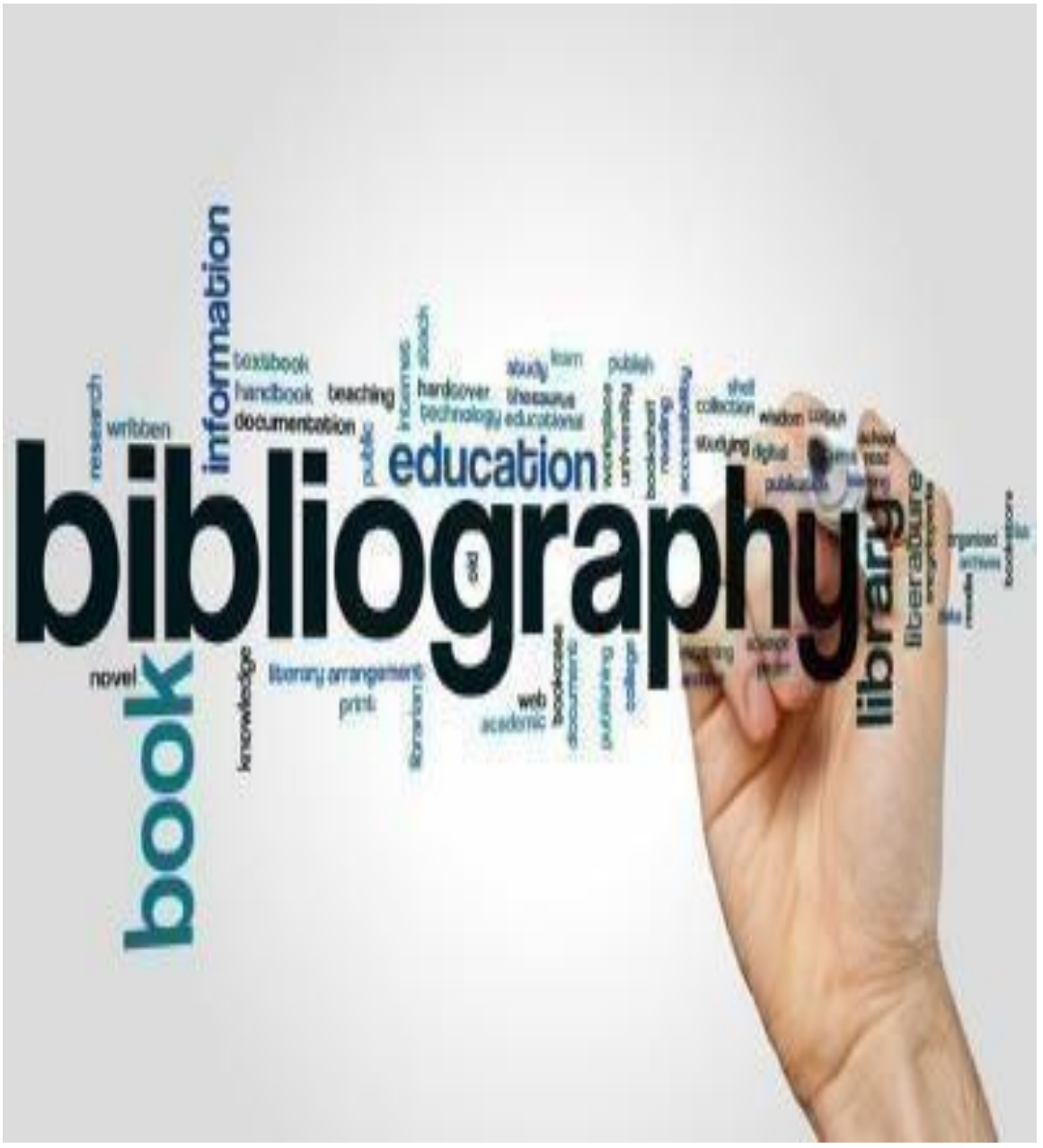

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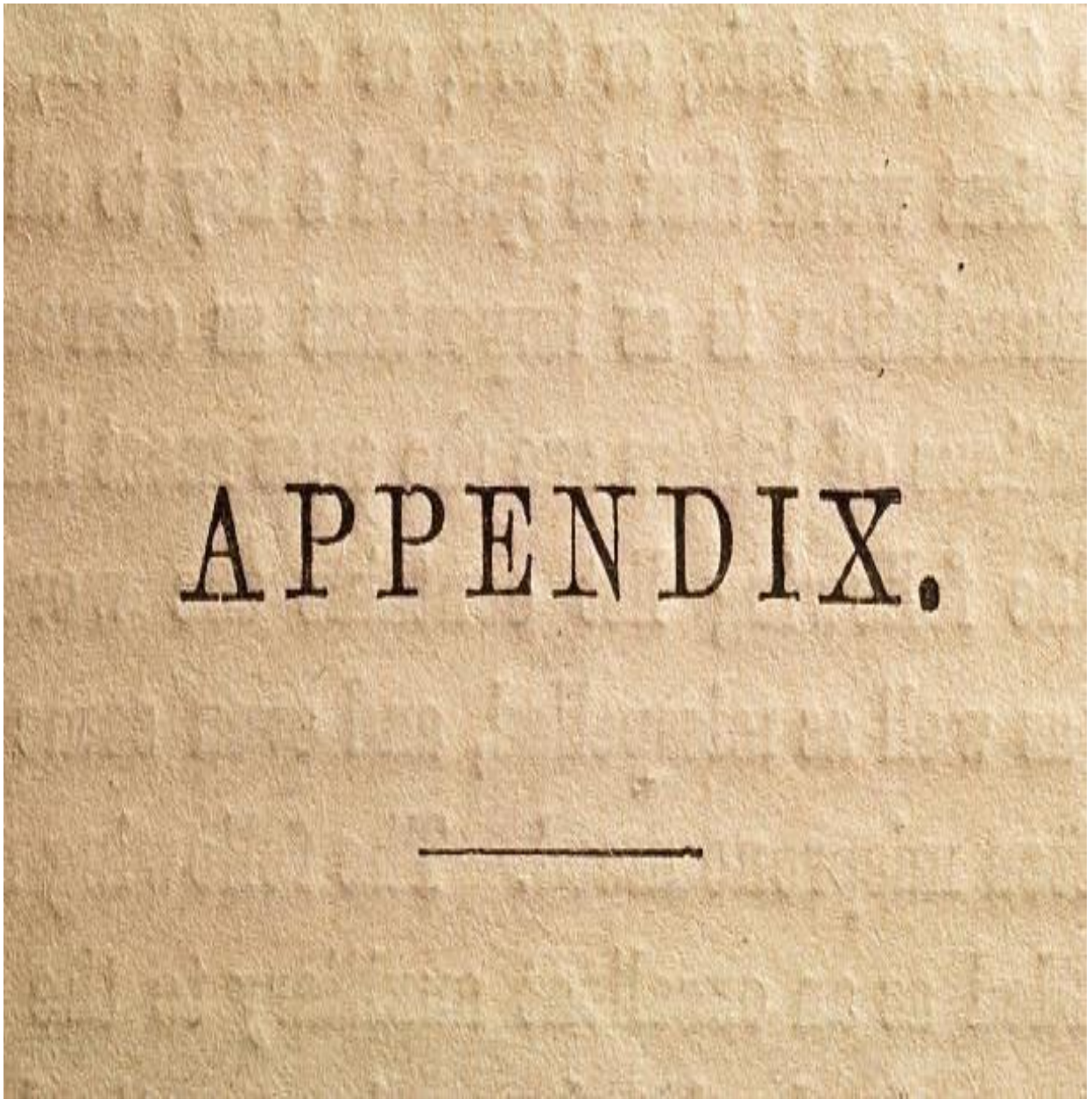
CHAPTER 7

APPENDIX



APPENDIX

This questionnaire is designed to gather insights into public perceptions and understanding of the monetary policy framework of the Central Bank of India. Your responses will aid in evaluating the effectiveness of the central bank's communication strategies and the public's awareness of monetary policy measures**.**

Instructions:

Please read each question carefully and select the option that best represents your opinion or knowledge. If a question does not apply to you or you are unsure, feel free to skip it.

Questionnaire:

1) Which of the following do you believe is the primary goal of the Central Bank of India's monetary policy?

A) Promoting economic growth
B) Maintaining price stability
C) Controlling unemployment
D) Managing exchange rates

2) How often do you follow news or updates related to the monetary policy decisions of the Central Bank of India?

A) Daily
B) Weekly
C) Occasionally
D) Rarely or never

3) In your opinion, how effective is the communication of monetary policy decisions by the Central Bank of India to the general public?

A) Very effective
B) Somewhat effective
C) Not very effective
D) Not effective at all

4) How would you describe your level of trust in the Central Bank of India's ability to manage monetary policy effectively?

A) Complete trust
B) High trust
C) Moderate trust
D) Low trust
E) No trust at all

5)Do you believe that changes in the central bank's interest rates directly impact economic activities in India?

A) Strongly agree
B) Agree
C) Neutral
D) Disagree
E) Strongly disagree

6)Have you ever taken any financial decisions (e.g., investments, loans) based on your understanding of the central bank's monetary policy stance?

A) Yes, frequently
B) Yes, occasionally
C) No, never
D) Not applicable

7)How do you think the Central Bank of India should prioritize its monetary policy objectives during times of economic uncertainty?

A) Focus on inflation control
B) Support economic growth
C) Stabilize financial markets
D) Mitigate unemployment
E) Other (please specify)

8)To what extent do you believe the central bank should consider global economic conditions when formulating monetary policy for India?

A) Very much
B) Somewhat
C) Not much
D) Not at all

9) Do you think the general public in India understands the goals and functions of the Central Bank of India adequately?

A) Yes, very well
B) Yes, to some extent
C) No, not very well
D) No, not at all

10) How transparent do you believe the Central Bank of India is in communicating its monetary policy decisions and rationale to the public?

A) Very transparent
B) Moderately transparent
C) Somewhat transparent
D) Not very transparent
E) Not transparent at all

Thank you for your participation. Your feedback is valuable for our research on monetary policy perceptions and public engagement.