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TO ANALYZE THE RBI MONETARY AND TOOLS USED BY RBI IN CURBING INFLATION

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Abstract:

This paper describes about the RBI monetary policy and how RBI functions in order to control the inflation and the cash flow in the market. The main objective of the paper is to give an insight on RBI monetary policies tools used by RBI in curbing inflation. It have seen that RBI uses various methods in curbing inflation and maintain liquidity in the market as CRR, SLR, OMO and guidance and forward guidance.

Keywords: OMO (open market operations), Repo rate, liquidity, cash flow, MPC (monetary policy committee)

Introduction:

The Reserve Bank of India was established on April 1 1935 in accordance with the Reserve Bank of India act 1934. earlier it was established in Kolkata later moved to Mumbai in 1937.The establishment of RBI was recommended by Hilton Young Commission in the year 1926 which is also known Royal commission for finance and banking in India. RBI plays an important role in controlling regulating and supervising the functions of Indian commercial banks.

RBI (Reserve Bank of India) plays a crucial role in function in the finance and banking ecosystem of the Indian economy. Its major role is managing the credit policy formulating the monetary policy it acts as the banks for the government it provides with banks with fund and reserves and frame work to work in an ethical and proper system under an umbrella of RBI where RBI takes all the important decisions for the banks which prepare banks in case of crisis and for the credit defaults. Regulation of money market which is regulating the liquid flow of the money in the market. Regulating the foreign exchange managing the foreign exchange reserves and the formulating the policies for the same.

Literature Review:

Dr. S. Kanthimathinathan

Asia Pacific Journal of Research

Topic - A **Study On Role Of Credit Control Policy Of RBI In The Growth Of Indian Financial System**

Bank rate or the discount rate are set by the central bank for the commercial banks at which they rediscount the first-class bills and government securities that are hold by the commercial bank. Economy and credits are controlled by the central banks by implying bank rates on commercial bank. If the central bank wants to increase the economy the central starts to increase the bank rates and the opposite happens if the central banks want to contract the economy the increase the bank rates so the credit becomes expensive. This function is used by the RBI to control the liquidity in the market.in 2000 the government introduced LAF (liquidity adjustment facility) and repo rates and reserve repo rate under the OMO (open market operation) keeping CRR (cash reserve ratio) as the additional instrument. Earlier reserve cash was used as operating target and CRR was used as the principal operating target. This caused the RBI to be market based.

Dr. T. Helan & Dr. Marimuthu.K. N

Primax International Journal of Commerce and Management Research

Topic – Role of Open Market Operations In Indian Financial Sector

OMO (open market operations) is the instrument used by the RBI in order to maintain the inflation. Central banks like RBI buys and sells the government securities. This trade is usually with the commercial banks. The main objective of RBI is to maintain the liquid conditions of rupees in the market. When the RBI want the increase liquid flow to market is buys the government securities from the commercial and whereas when they want to reduce liquidity RBI starts selling government securities. OMO is the one of the most flexible tools in monetary policy.

The Hindu

Business line

The MPC i.e. monetary policy committee which consist of 6 six members that includes RBI governor, 2 RBI members and 3 members that are elected by government of India. Have decided to keep the repo rate same for this financial quarter at 6.5% in order to maintain the targeted inflation below 4% which is currently running at 5.74%. government has planned to undertake OMO (open market operations) and G-SEC via auction mode. Government allows NBFC to utilize the credit risk instrument in reducing the credit risk.

Objectives:

1. To Understand The Concept Of Monetary Policy In Curbing Inflation.
2. To Know The Instruments Of RBI Monetary Policy.
3. To Know The Recent Trend In Monetary Policy.

Scope of Study:

The scope of this study is to give an insight on the recent trends that are seen in the monetary policy of RBI and understanding the different tools used by the RBI in regulating the inflation. The findings of this study can give a valuable information on RBI policies and how RBI is curbing the inflation using the OMO also different types of interest rates.

Methodologies:

This research is basically based on the theories that are been taken from the journals magazines newsletters and peers reviews and some research paper that have been done in the past on the monetary policy of RBI and the federal banks.

Explanation:

Historical Evolution of the RBI Monetary Policy:

In the earlier phase of RBI i.e. pre-independence (1935-1947) the RBI monetary policy was very simple having major focus was on regulating and issuance of currency and maintain the stability in the money market.

After India got independence in 1947 RBI focused on economic growth and credit policies, regulation of liquidity of money and issuing money and also focused on industrialization for independent India.

The time period from 1950 to 1960 is known as the planning period for the RBI and banking industry. In this era government implemented five-year plan to cater the economic development of country. Rbi played an important role in aligning its monetary policies with the objectives of the government. It emphasises more on giving credit to growing sectors of industries.

RBI amended an act known as RBI act 2016 which focussed on providing the technical frame work for the increasing inflation a setting up the monetary policy committee. MPC (monetary policy committee) was formed in 2016 which included total of 6 members 3 from the GOVERNMENT of India and rest from the RBI itself. Central bank introduced its interest rates called repo rate in order to control the inflation and liquidity of cash flow in the market.

In 2018 MPC continued to use repo rate as the primary function for inflation control.

Hence in 2008-2009 crisis RBI implemented the counterpart of policy, it lowered the interest rates in order to maintain stability let the growth continue also mitigating the risk to Indian economy. In recent years RBI has moved forward to digitisation of the market taking the help of fintech. RBI and Indian government have been supporting the UPI.

The major functions of the RBI are to formulating and administrating monetary authority, supervising financial system, managing foreign exchange, issues currency and all the bank related functions are controlled by the RBI. Monetary policy is function of

RBI that helps in supply and controlling the flow of money into the market. RBI act amended the finance act 2016 under which the institutional framework for the monetary policy committee was formed with an objective of growing economy and regulating the liquid flow of rupees in the market. As per the RBI finance act MPC (monetary policy committee) is 6-member committee comprising of 3 members from RBI one of them including RBI governor and 2 of them are RBI officials and other 3 members are selected by the Government of India. The benchmark of the committee was repo rate.

Focusing on the RBI monetary policy this paper has also explained the concepts of RBI policies OMO (open market operations), the functioning of RBI and impact of monetary policy on the market and banks.

Tools Used By MPC:

To understand the concept of monetary policy first it's needed to understand the different types of interest rates and ratio that are used as instruments by RBI in monetary policy. CRR (cash reserve ratio) is the ratio set up by the central bank. Every bank is said to keep 4% as reserve to central banks of the deposit. Banks love the lower CRR rate and banks earn maximum profit by lending depositor's money to borrower at the rate more than interest given to their depositors from which they take out their profits but in the case of withdrawal of amount by the depositor's bank has to repay the money back to their depositors. This is where the CRR comes to the picture if the creditors defaults from paying the money is to be returned to the depositors and if banks fail to repay the money RBI provides the bank with the money.

The other important ratio mentioned by RBI act 1934 was SLR (statutory liquidity ration). It is ratio that is told by the central banks to keep aside as reserve in the form of cash, gold, government securities in liquid form. This rate is usually near 20% the current rate is 18%. The SLR is important to the banks to know the minimum rate at which the banks can lend to its creditors. If the banks fail to keep the SLR they are charged with the 3% penalty. SLR also serves as source of income to banks as banks prefer keeping gold and G-SEC for reserve taking them from the government on which they receive an interest which act as source of income for the banks.

In the case if the banks are needing the cash in case of liquidity crunch, they take a short term from loan from the RBI at an interest rate known as the repo rate. This rate is usually near to 5-6% the current repo rate is set to 6.5% which is set unchanged i.e. same as the last time. The other concept is of reverse repo rate that is exactly opposite of the repo rate the reverse repo rate is charged when the RBI takes the loan from the commercial banks in order to decrease the liquidity of cash in the market. to understand the functioning of the RBI monetary policies it is necessary to know about the inflation.

OMO stands for open market operations are tools used by all central banks including Federal Reserve and reserve bank of India. It regulates the cash flow of money and credit policies by buying and selling of government securities in order to control inflation.

How OMO Works:

Buying of Government Securities:

In order to increase the cash or increase the liquidity to market RBI creates open market operation and starts to buys government securities from the commercial banks and financial institutions so there by increasing liquidity in the market.

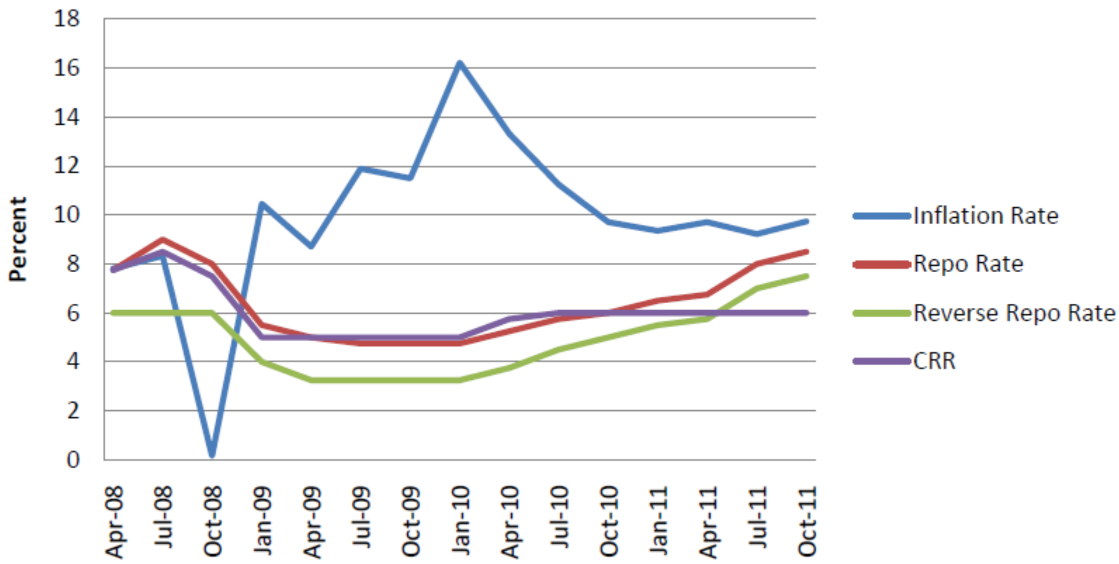
Selling of Government Securities:

When there is increased cash flow or liquidity in the market RBI tries to buy the government securities. This action leads to a crunch of cash in market and the financial systems. Hence it controls the inflationary pressure.

Interest Rates:

When RBI wants to decrease the cash flow it starts to increase the short-term interest rates hence the conversely commercial offer the credits at higher interest rates hence sucking the money from the market. This is the other method of RBI monetary policy.

According to the reports of THE HINDU, RBI has planned to keep the interest rate same for this quarter at 6.5% in order to bring inflation below 5%.



Trends in Monetary Policy:

Effective From	Bank Rate	Cash Reserve Ratio	Statutory Liquidity Ratio	Repo Rate (RR %)	Reverse Repo Rate (%)
03-11-2008	6.00	6.00	25	7.50	6.00
21-04-2009	---	5.00	---	4.75	3.25
19-03-2010	---	5.75	---	5.00	3.50
02-11-2010	---	6.00	24.00	6.25	5.25
26-07-2011	---	---	---	8.00	7.00
25-10-2011	---	---	---	8.50	7.50
17-04-2012	9.00	4.75	---	8.00	7.00
29-01-2013	8.75	4.25	23.00	7.75	6.75
19-03-2013	8.50	4.00	---	7.50	6.50
03-05-2013	8.25	---	---	7.25	6.25
20-09-2013	9.50	---	---	7.50	6.50
29-10-2013	8.75	---	22.50	7.75	6.75
28-01-2014	9.00	---	22.00	8.00	7.00
15-01-2015	8.75	---	21.50	7.75	6.75
04-03-2015	8.50	---	---	7.50	6.50
02-06-2015	8.25	---	21.25	7.25	6.25
29-09-2015	7.75	---	---	6.75	5.75
05-04-2016	7.00	---	19.25	6.50	6.00
04-10-2016	6.75	---	---	6.25	5.75
06-04-2017	6.50	---	---	--	6.00
02-08-2017	6.25	---	19.00	6.00	5.75
06-06-2018	6.50	---	---	6.25	6.00
01-08-2018	6.75	---	---	6.50	6.25
07-02-2019	6.50	---	18.75	6.25	6.00
04-04-2019	6.25	---	---	6.00	5.75
06-06-2019	6.00	---	---	5.75	5.50
07-08-2019	5.65	---	18.50	5.40	5.15
04-10-2019	5.40	---	18.25	5.15	4.90
27-3-2020	4.65	---	---	4.40	4.00
22-5-2020	4.25	3.00	18.00	4.00	3.35

Note -> ----- indicates no change

Source – www.rbi.org

RBI on April 8, 2022 introduced a new tool known as the SDF called as standing deposit facility it is a tool used by RBI to suck the extra liquidity from the market without keeping the capital. This is a time saving process as it does not involve sale of collateral i.e. G-SECS.

It seems to be bit expensive than the FRRR (fixed rate reverse repo) which is at 3.35% and SDF being at 3.75%. it allows the banks to adjust their cash according their discretion.

Conclusion:

After the 1990 there seemed to be liberalisation thus the need for monetary policy seemed to be increasing to control the cash flow and credits. So, in 2016 RBI amended a finance act in 2016 which led to the formation of 6-member committee known as MPC which decided monetary policy every 2 months. There are many tools that are used by RBI that include CRR Repo rate SLR and SDF include these tools by increasing the rates in these tools RBI controls the liquidity or cash flow in the market this rate change is based on the change of percentage of inflation.

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