Monetary policy of India

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INTRODUCTION

MONETARY POLICY is the process by which monetary authority of a country, generally central bank controls the supply of money in the economy by its control over interest rates in order to maintain price stability and achieve high economic growth.

RBI is the central bank of India.

OBJECTIVES:

IN INDIA THE CENTRAL MONETARY IS THE **RESERVE BANK OF INDIA (RBI).** MONETARY POLICY IS DESIGNED TO MAINTAIN THE FOLLOWING OBJECTIVES.

FULL EMPLOYMENT

PRICE STABILITY

ECONOMIC GROWTH

BALANCE OF PAYMENTS

FULL EMPLOYMENT **:full employment has been ranked among the foremost objectives of monetary policy . It is an important goal not only because unemployment leads to wastage of potential output, but also because of the –loss of social standing –and self respect.**

PRICE STABILITY **:** One of the objectives of monetary policy is stabilise the price level. Both economists and laymen favour this policy because flunctuations in prices bring uncertainty and instability to the economy.

Economic Growth : one of the most important objectives of monetary policy in recent years has been the rapid economic growth of an economy, economic growth is defined as "the process whereby the real per capita income of a country increases over a long period time.

Balance of payments : another objectives of monetary policy since 1950s has been to maintain equilibrium in the balance of payments.

Types of monetary policy

There are two types of monetary policies:

Expansionary monetary policy

Contactionary monetary policy

Expansionary monetary policy

Expansion monetary policy is when a central bank uses its tools to expand the economy by increasing the money supply and lowering interest rates which increase aggregate demand. That boosts economic growth as measured by Gross Domestic Product (GDP).

It is used during recession.

Recession is a temporary period of economic decline during which trade and industrial activity are reduced.

Contractionary monetary policy

Contractionary monetary policy are set of tools that slow down the growth rate of the economy to prevent it from overheating , these tools includes the credit flow in the economy , interest rate and currency exchange.

Here monetary policy are being used during inflation.

Inflation is continuous increase in the price level of goods and services. And increase in supply of money as compared to some benchmark.

Tools of monetary policy

- Cash Reserve Ratio (CRR) :- Cash Reserve Ratio is a certain percentage of bank deposits which banks are required to keep with RBI in the form of reserves or balances. Higher the CRR with the RBI lower will be the liquidity in the system and vice versa.
- Statutory Liquidity Ratio (SLR) :- it is the indian government term for reserve requirement that the commercial banks in india require to maintain in the form of gold, government approved securities before providing credit to the customers.

- Repo Rate :- Repo rate is the rate at which RBI lends to its clients generally against government securities. Reduction in Repo rate helps the commercial banks to get money at a cheaper rate and increase in Repo rate discourage the commercial banks to get money as the increase and becomes expansive.
- Reserve Repo Rate :- Reserve Repo rate is the rate at which RBI borrows money from the commercial banks. The increase in the Repo rate will increase the cost of borrowing and lending of the banks which will discourage the public to borrow money and will encourage them to deposit.

- Bank Rate :- it is the tare at which the reserve Bank is ready to buy or rediscount bills of exchange or other commercial papers. This rate has been aligned to the MSF rate and , therefore , changes automatically as and when the MSF rate changes alongside policy repo rate changes.
- Open Market Operations (OMOs) :- These include both outright purchase/ sale of government securities for injection/absorption of durable liquidity , respectively.

- Marginal Standing Facility Ratio (SLR) :- a facility under which schedule commercial banks can borrow additional amount of overnight money from the reserve bank by dipping into their Statutory Liquidity Ratio (SLR).

Conclusion

Monetary policy is very important for the economic growth of a country , its instruments play a very important role to adjust the economic condition according to the current economic situation.