Monetary Policy

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- Monetary policy is a set of tools used by a country's central bank, like the RBI, to control interest rates and the money supply. Its aim is to achieve macroeconomic goals such as inflation control, economic growth, and liquidity management.

Objectives of Monetary Policy

Inflation
- Low inflation is healthy
- Contractionary policy for high inflation

Unemployment
- Expansionary policy reduces unemployment

Currency Exchange Rates
- Central bank regulates exchange rates
- Influence through money supply

Types of Monetary Policy

Expansionary
- Increase money supply
- Lower interest rates
- Boosts economic growth
- May lead to inflation

Contractionary
- Decrease money supply
- Raise interest rates
- Controls inflation

Monetary Policy Tools

Reserve Ratio:
- Mandates banks to maintain a percentage of their deposits as cash reserves (CRR) or in liquid assets (SLR).

Open Market Operations (OMO)
- Central bank buys/sells government securities to regulate liquidity in the market.

Market Stabilization Scheme (MSS)
- Used to manage excessive liquidity by issuing government securities.

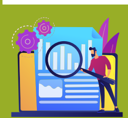
Policy Rates:
- Interest rates set by the central bank to influence borrowing and lending activities:

1. ***Bank Rate:*** Rate at which central bank lends to commercial banks.
2. ***Repo Rate:*** Rate at which banks borrow from the central bank.
3. ***Reverse Repo Rate:*** Rate paid by central bank to banks for excess funds.
4. ***Marginal Standing Facility (MSF) Rate:*** Penal rate for banks borrowing beyond repo limits.

Qualitative Tools:

Margin Requirements:
- Prescribes a collateral margin that affects borrowing capacity.

Moral Suasion:
- Persuasion by central bank to guide bank investments.



Selective Credit Control:
- Central bank's restriction on lending to specific sectors or industries.

Monetary Policy Committee (MPC)

- Government-constituted body within RBI.
- Shapes monetary policy using tools like repo rate, reverse repo rate, and bank rates.
- Proposed by the Urjit Patel Committee.
- Empowered by the RBI Act, 1934.
- Conducts a minimum of 4 meetings annually.
- Comprises 6 members: 3 RBI officials and 3 government-nominated external members.
- Chaired by the RBI Governor.
- Decisions require a simple majority (4 out of 6).
- Inflation target: 4% with upper and lower tolerance limits.
- Target period: April 1, 2021, to March 31, 2026.