Monetary Policy In India: - Reforms And It’s Evaluation

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Abstract—In a developing economy, monetary policy has a special role to play. The aim of Monetary Policy is to control the supply of money, often targeting a rate of interest for the purpose of promoting economic growth and stability. The official goals usually include relatively stable prices and low unemployment.

Monetary Policy is related to the availability and cost of money supply in the economy in order to attain certain broad objectives. The Reserve Bank of India keeps control on the supply of money to attain the objectives of its Monetary Policy.

Keywords—About four key words or phrases in alphabetical order, separated by commas.

I. INTRODUCTION

Established on April 1, 1935, the Reserve Bank of India is the central bank in India. As the country’s Central bank, it is the apex monetary and financial institution responsible for the efficient working of the monetary mechanism which is indispensable for a rapid development of the economy.

Monetary Policy in India is an adjunct of economic policy. It is the management of money supply and interest rates by Central banks to influence prices and employment. It works through expansion or contraction of investment and consumption expenditure.

The three major objectives of economic policy in India have been Growth, social justice and price stability. Government of India tries to manipulate it’s Monetary Policy, the Reserve Bank of India which is the Monetary authority in the country. The Monetary Policy of the Reserve Bank has been characterized as of controlled monetary expansion. It aims at controlling inflation by restraining the secondary expansion of credit and regulating the supply of money in order to meet the requirements of different sectors of the economy to accelerate the pace of economic growth.

A central Bank has at its disposal various instruments of Monetary Policy, briefly they are-

a. Bank Rate Policy
b. Open Market Operation
c. Variable Reserve System
d. Selective Credit Controls
e. Credit Rationing
f. Moral Suasion
g. Direct Action

II. MONETARY MEASURES

Latest important banking sector-2011 current repo rate 2011, current repo rate, current MSF rate.

RBI has hiked and Reserve Repo rate by 25 bps w.e.f. 16.09.2011.(Repo increased from 8% to 8.25%, Reserve Repo adjusted to 7.25% and MSF 9.25%).

<table>
<thead>
<tr>
<th>Bank Rate</th>
<th>6% (w.e.f.)</th>
<th>24.04.2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Reserve Ratio</td>
<td>6%</td>
<td>24.04.2010</td>
</tr>
<tr>
<td>Statutory Liquidity Ratio (SLR)</td>
<td>24%</td>
<td>w.e.f.18.12.2010</td>
</tr>
<tr>
<td>Repo Rate under (LAF)</td>
<td>8.25%</td>
<td>w.e.f.16.09.2011</td>
</tr>
<tr>
<td>Reverse Repo Rate Under (LAF)</td>
<td>7.25%</td>
<td>w.e.f.16.09.2011</td>
</tr>
<tr>
<td>Marginal Standing Facility (MSF)</td>
<td>9.25%</td>
<td>w.e.f.16.09.2011</td>
</tr>
<tr>
<td>Saving Deposits-Interests Rate of RBI</td>
<td>4%</td>
<td>w.e.f. 03.05.2011</td>
</tr>
</tbody>
</table>

Increased from % to 5.50% (w.e.f) 13.02.2011 and then again to 5.75% w.e.f 27.02.2011 and now to 6% w.e.f 24.04.2011

Decreased from 25% which was continuing since 07.11.2009

Increased from 8% which was continuing since 26.07.2011

Increased from 7% which was continuing since 26.07.2011

Increased from 9% which was continuing since 26.07.2011

Increased from 3.50% which was continuing since 18th March 2003

SOURCES—www.allbankingsolutions.com/data.htm

III. DOMESTIC ECONOMY

A. Growth

Gross Domestic product (GDP) decelerated to 7.7% in quarter -1 of 2011-2012 from 7.8% in the previous quarter and 8.8% in the corresponding quarter a year ago.

Agricultural growth has accelerated but industry and services have decelerated. The index of industrial productions slowed from 8.8% year on year in June to 3.3% in July. However, excluding capital goods, the growth of 11p was higher at 6.7% in July as compared with 4.4% in June. The 11p increased by 5.8% during April-July 2011, compared with...
an increase of 9.7% in the corresponding period of the previous year. The HSBC purchasing managers index of the manufacturing sector also suggested moderation corporate margins in Q1 of to 2011-2012 moderated across several sectors compared to there level in Q4 of 2010-2011. However barring a few sectors significant pass through of rising input cost is still visible.

B. Inflation

Headline year-on-year whole sale price index(WPI) inflation rose from 9.2% in August 2011. Inflation in respect of primary articles and fuel groups edged of in August. Year-on-year non-food manufacturing products inflation rose from 7.5% in July to 7.7% in august 2011. Suggesting as yet persistent demand pressures. The oil marketing companies raised the price of petrol by 3.14 per litre with effect from 6 September 2011. This will have a direct impact of 7 basis points to WPI inflation.

C. Monetary, Credit and liquidity conditions

The money supply growth was 16.7% in August 2011 which was higher than the projection of 15.5% for the year which reflects higher growth in term deposits and moderation in currency growth. Similarly non food credit growth at 20.1% in August 2011 was higher than the indicative projection of 18% set out in the July review.

Liquidity has remained in deficit. The daily average borrowings under the liquidity adjustment facility (LAF) where around 40,000 crore in September 2011 in as a result of global risk aversion, the rupee has depreciated which many have adverse implication for inflation.

D. Fiscal Conditions

The Govt. of India fiscal imbalances widened during April to July of 2011 which reflects the impact of decline in revenue receives coupled with pressures from non plan revenue expenditures on account of higher petroleum and fertilizer subsidies.

Fiscal deficit at 55.4% of the budget estimates in the first four months of the current fiscal was higher than of 42.5% during the corresponding period last year.

IV. REFORMS IN THE INDIAN MONETARY POLICY

The Monetary Policy of RBI has major changes during the economic reforms. Monetary Policy is separated from Fiscal Policy after 1991.

*The major changes in the Indian Monetary Policy are as follows:-

1. REDUCED CRR and SLR

The Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio(SLR) are gradually reduced during the economic reforms period in India. It is reduced from the earlier high level of 15% plus incremental CRR of 10.5% to current 6% level. The SLR is also reduced from early 30.5% to current minimum of 24% level. This has left more loan able funds with commercial banks.

2. INCREASED MICRO FINANCE

The RBI has focused more on the SHG (self help group) to strengthen the Rural Finance. Micro Finance Institutions (MFIs) are kept under priority sector lending e.g- Urban Co-operative banks. It comprises small and marginal farmers, Agriculture and Non- Agriculture Labor, Artisans and Rural sections of the society. Now, still only 30% of the target population has been benefited.

3. FIXING PRUDENTIAL NORMS

In order to induce professionalism in its operations, the RBI fixed prudential norms for commercial banks. It includes recognition of income sources, classification of assets, provisions for bad-debts, maintaining international standards in accounting practices etc. It helped banks in reducing and re-structuring non-performing assets (NPAS).

4. INTRODUCTION OF CRAR

Capital to risk weighted assets ratio (CRAR) was started in 1992. Almost all the banks in India has reached the capital adequacy ratio (CAR) above the statutory level of 9%.

5. DIVERSIFICATION OF BANKING

The Indian Banking sector was well-diversified during the economic reforms period. Many of the banks have started new services and new products. Some bank have established subsidiaries in Merchant Banking, mutual funds, insurance, venture capital etc.

6. NEW GENERATION BANKS

During the reforms many new generations banks have successfully emerged on the financial horizon. Bank such as ICICI Bank, UTI Bank have given a big challenge to the Public Sector Banks leading to a greater degree of competition.

7. OPERATIONAL AUTONOMY

During the reforms period commercial banks enjoyed the operational freedom. If a bank satisfies the CAR then it gets freedom in opening new branches.

8. IMPROVED PROFITABILITY AND EFFICIENCY

During the reform period, the productivity and efficiency of many commercial banks has improved. It has happened due to reduced, non-performing loans, use of technology, use of computers and some other relevant measures adopted by the govt.

9. CHANGES IN ACCORDANCE TO THE EXTERNAL REFORMS

During the 1990, the external sector has undergone major changes. It comprises various controls on imports, reduce tariffs, etc. The Monetary Policy has shown the impact of liberal inflow of the foreign capital and its implication on domestic money supply.

V. EVALUATION OF MONETARY POLICY IN INDIA

During the reforms though Monetary Policy has achieved higher success. It is not free from limitation or demerits. It
needs to be evaluated on a proper scale.

1. Monetary Policy fails to tackle Budgetary Deficit - The higher level of budget deficit has made Monetary Policy ineffective. The automatic monetization of deficit has let to high Monetary expansion.

2. The coverage area of Monetary Policy is limited - Monetary Policy covers only commercial banking sector. Other non banking institutions remains untouchable. It limits the effectiveness of the Monetary Policy in India.

3. Money market is not organized - There is a huge size of money market in our country. It does not come under the control of the RBI. Thus any tools of the Monetary Policy does not affect the unorganized money market making Monetary Policy less affective.

4. Predominance of cash transaction - In India still there is huge dominance of the cash in total money supply. It is one of the main obstacles in the effective implementation of the Monetary Policy. Because Monetary policy operates on the bank credit rather on cash.

5. Increase volatility – As the Monetary has adopted changes in accordance to the changes in the external sector in India, It could lead to high amount of the volatility.

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