

UPSC PRELIMS

Economy



Sample topic · Monetary Policy

Money

Q. The money multiplier in an economy increases with which one of the following?

- a) Increase in the cash reserve ratio
- b) Increase in the banking habit of the population
- c) Increase in the statutory liquidity ratio
- d) Increase in the population of the country

Monetary Policy Of RBI

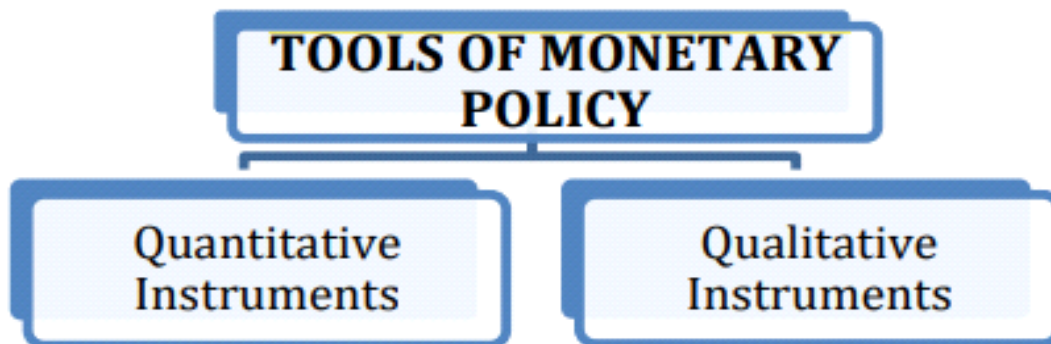
- Monetary policy refers to all those operations, which are used to control the money supply in the economy.
- The RBI implements the monetary policy through instruments like open market operations, bank rate policy, CRR, SLR, reserve system, credit control policy, moral suasion etc.

Objective of Monetary Policy

- To maintain economic and financial stability - by targeting healthy inflation range.
- To ensure adequate financial resources for the purpose of development
- Ensuring price stability in market by maintaining optimum inflation level.
- Adequate flow of credit to productive sectors.

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- Promotion of productive investments & trade by ensuring conducive monetary policy, E.g. by credit rationing tool.
- Promotion of exports and economic growth - by providing timely credit and favourable monetary stimulus through various monetary policy tools.



Quantitative Instruments	Basis	Qualitative Instruments
These are the instruments of monetary policy that affect overall supply of money/credit in the economy.	Meaning	These instruments are used to regulate the direction of credit.
Traditional methods of control	Alternative Name	Selective methods of control
(i) Bank rate (ii) Repo Rate (iii) Reverse Repo Rate (iv) Open market operation (v) Cash reserve ratio (vi) Statutory liquidity ratio	Instruments	(i) Marginal requirement (ii) Moral suasion (iii) Selective credit control

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Monetary Policy Committee (MPC)

- Monetary policy refers to the credit control measures adopted by the central bank of a country. RBI is the sole monetary authority which decides the supply of money in the economy.
- MPC is a statutory body created under Monetary Policy Framework Agreement 2015 between the RBI and Government in 2016.
- MPC is entrusted with the responsibility of fixing the benchmark repo rate (policy rate) required to contain inflation as defined in the Monetary Policy Framework Agreement.
- The meetings of the MPC are held at least 4 times a year and it publishes its decisions after each such meeting.
- MPC is 6-member body including 3 members from RBI and 3 members to be nominated by the Central Government.
- Chairperson of MPC - RBI Governor
- Quorum for meeting - 4 members
- Decisions are taken by majority with the Governor having the casting vote in case of a tie.
- To ensure transparency - Govt can send message only in writing.

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Inflation Targeting

- It is a monetary policy where a central bank follows an explicit target for the inflation rate for the medium-term and announces this inflation target to the public.
- The Government of India has notified a medium term inflation target of 4 %, with a band of $\pm 2\%$.
- If Target fail: If inflation not kept in 4% $\pm 2\%$ zone for 3 consecutive quarters then the Committee must send report to Govt. with reasons and remedies.

Objective of MPC

- **Price Stability** for promoting economic development through ensuring optimum inflation level which will drive economic growth in long run.
- **Controlled Expansion of Bank Credit** with special attention to seasonal requirement (E.g. for agricultural purposes) for credit without affecting the output.
- **Promotion of Fixed Investment** to increase the productivity of investment by restraining nonessential fixed investment.

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- **Promotion of Exports and Food Procurement Operations** by paying special attention in order to boost exports and facilitate the trade. It is an independent objective of monetary policy.
- **Desired Distribution of Credit:** Monetary policy decides over the specified percentage of credit that is to be allocated to priority sector and small borrowers.
- **Equitable Distribution of Credit** to all sectors of the economy and all social and economic class of people.
- **To promote economic efficiency** in the financial system and tries to incorporate structural changes such as deregulating interest rates, ease operational constraints in the credit delivery system, to introduce new money market instruments etc.
- **Reducing the Rigidity** and encouraging more competitive environment and diversification.