Monetary Policy Committee: RBI

For Prelims: RBI, Monetary Policy Committee (MPC), Instruments of Monetary Policy, Various Policy Stances of RBI

For Mains: Banking Sector & NBFCs, Statutory Bodies, Monetary Policy, Growth & Development, Monetary policy and its instruments

Why in News?

Recently the **Monetary Policy Committee (MPC)** of the **Reserve Bank of India's (RBI)** noted that the central bank's **accommodative policy** stance may fail to comply with the Inflation target (upper limit of 6%).

- An **accommodative stance** indicates a willingness on the part of the **central bank to expand money supply and cut interest rates.**
- The MPC fixes the **benchmark interest rate** — or the base or reference rate that is used to set other interest rates — in India.

What is Monetary policy?

- Monetary policy **refers to the policy of the central bank with regard to the use of monetary instruments** under its control to achieve the goals specified in the Act.
- The primary objective of the RBI's monetary policy is to **maintain price stability while keeping in mind the objective of growth.**
  - Price stability is a necessary precondition to sustainable growth.
- The amended **RBI Act, 1934** also provides for the **inflation target (4% +-2%)** to be set by the Government of India, in consultation with the Reserve Bank, **once in every five years.**

Various Instruments of Monetary Policy	
Repo Rate:	▪ The interest rate at which the Reserve Bank **provides overnight liquidity** to banks **government and other approved securities** under the **liquidity adjustment fa**
Reverse Repo Rate:	▪ The interest rate at which the **Reserve Bank absorbs liquidity,** on an overnight ba **of eligible government securities under the LAF.**
Liquidity Adjustment Facility (LAF):	▪ The LAF **consists of overnight as well as term repo auctions.** ▪ The aim of term repo is to help develop the **interbank term money market,** which benchmarks for pricing of loans and deposits, and hence improve transmission of mo ▪ The RBI also conducts variable interest rate reverse repo auctions, as necessitated u
Marginal Standing Facility (MSF):	▪ A facility under which scheduled commercial banks can borrow additional amount of Bank by dipping into their Statutory **Liquidity Ratio (SLR)** portfolio up to a limit at a ▪ This provides a safety valve against unanticipated liquidity shocks to the banking sys
Corridor:	▪ The MSF rate and reverse repo rate determine the **corridor for the daily movemer**

	money rate.
Bank Rate:	▪ It is the rate at which the RBI is ready to buy or rediscount bills of exchange or other published under **Section 49 of the RBI Act, 1934.** ▪ This rate has been aligned to the MSF rate and, therefore, changes automatically as a alongside policy repo rate changes.
Cash Reserve Ratio (CRR):	▪ The average daily balance that a bank is required to maintain with the Reserve Bank **demand and time liabilities (NDTL)** that the Reserve Bank may notify from time t
Statutory Liquidity Ratio (SLR):	▪ The share of NDTL that a bank is required to maintain in safe and liquid assets, such a **securities, cash and gold.** ▪ Changes in SLR often influence the availability of resources in the banking system for
Open Market Operations (OMOs):	• These include both, outright purchase and sale of government securities, for injection respectively.
Market Stabilisation Scheme (MSS):	▪ This instrument for monetary management **was introduced in 2004.** ▪ Surplus liquidity of a more enduring nature arising from large capital inflows is absorb government securities and treasury bills. ▪ The cash so mobilised is **held in a separate government account with the RBI.**

PYQ

With reference to Indian economy, consider the following: (2015)

1. Bank rate
2. Open market operations
3. Public debt
4. Public revenue

Which of the above is/are component/ components of Monetary Policy?

(a) 1 only
(b) 2, 3 and 4
(c) 1 and 2
(d) 1, 3 and 4

Ans: (c)

What is the Monetary Policy Committee (MPC)?

- **Origin:** Under **Section 45ZB of the amended (in 2016) RBI Act, 1934,** the central government is empowered to constitute a six-member Monetary Policy Committee (MPC).
- **Objective:** Further, Section 45ZB lays down that “the **Monetary Policy Committee** shall determine the Policy Rate **required to achieve the inflation target”.**
    - The decision of the Monetary Policy Committee shall be binding on the Bank.
- **Composition:** Section 45ZB says the MPC shall consist of **6 members:**
    - **RBI Governor** as its **ex officio chairperson,**
    - Deputy Governor in charge of monetary policy,

- ◦ An officer of the Bank to be nominated by the Central Board,
- ◦ **Three persons** to be **appointed by the central government.**
    - This category of appointments must be from “persons of ability, integrity and standing, having knowledge and experience in the field of economics or banking or finance or monetary policy”.

PYQ

Which of the following statements is/are correct regarding the Monetary Policy Committee (MPC)? (2017)

1. It decides the RBI’s benchmark interest rates.
2. It is a 12-member body including the Governor of RBI and is reconstituted every year.
3. It functions under the chairmanship of the Union Finance Minister.

Select the correct answer using the code given below:

(a) 1 only
(b) 1 and 2 only
(c) 3 only
(d) 2 and 3 only

Ans: (a)

What is Monetary Policy Framework?

- **Origin:** In May 2016, the RBI Act was amended to provide a legislative mandate to the central bank to operate the country’s monetary policy framework.
- **Objective:** The framework aims at setting the policy (repo) rate based on an assessment of the current and evolving macroeconomic situation; and modulation of liquidity conditions to anchor money market rates at or around the repo rate.
- **Reason for Repo Rate as Policy Rate:** Repo rate changes transmit through the money market to the entire financial system, which, in turn, influences aggregate demand.
    - Thus, it is a key determinant of inflation and growth

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	Various Policy Stances of RBI
Accommodative :	▪ An accommodative stance means **the central bank is prepared to expand the m growth.** ▪ The central bank, during an accommodative policy period, is willing to cut the interes ▪ The central bank typically **adopts an accommodative policy when growth needs the immediate concern.**
Neutral:	▪ A ‘neutral stance’ suggests that the central bank can **either cut rate or increase ra** ▪ This stance is typically **adopted when the policy priority is equal on both inflat** ▪ The guidance indicates that the market can expect a rate action on either way at any
Hawkish Stance	▪ A hawkish stance **indicates that the central bank’s top priority is to keep the i** ▪ During such a phase, the **central bank is willing to hike interest rates to curb m demand.** ▪ A hawkish policy also indicates tight monetary policy. ▪ When the central bank increases rates or 'tightens' the monetary policy, banks too in end borrowers which, in turn, curbs demand in the financial system.
Calibrated Tightening:	▪ Calibrated tightening means **during the current rate cycle, a cut in the repo rat** ▪ However, the **rate hike will happen in a calibrated manner.** ▪ This means the central bank may not go for a rate increase in every policy meeting b towards a rate hike. ▪ This can happen outside the policy meetings as well if the situation warrants.

PYQ

Q. If the RBI decides to adopt an expansionist monetary policy, which of the following would it not do? (2020)

1. Cut and optimise the Statutory Liquidity Ratio
2. Increase the Marginal Standing Facility Rate
3. Cut the Bank Rate and Repo Rate

Select the correct answer using the code given below:

(a) 1 and 2 only
(b) 2 only
(c) 1 and 3 only
(d) 1, 2 and 3

Ans: (b)

Source: IE