Monetary Policy Review: RBI

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

For Mains: Inflation Targeting by RBI, Monetary Policy,Standing Deposit Facility and its Significance

Why in News?

Recently, for the eleventh time in a row, the **Reserve Bank of India (RBI)** in its latest **Monetary Policy** review has decided to keep the main policy rate – Repo rate **– unchanged at 4%.**

- It has also retained its **accommodative stance,** but indicated it will engage in a gradual and calibrated withdrawal of surplus liquidity to rein in inflation.

What is the Significance of this Monetary Policy Review?

- **Acknowledging the Impact of Russia-Ukraine War:** In the wake of the **rise in crude oil and commodity prices** and the impact of the **Russian invasion of Ukraine**, RBI has **slashed the growth forecast to 7.2%** for fiscal 2022-23 from 7.8% projected earlier.
    - The Russia-Ukraine war could potentially **impede the economic recovery** through elevated commodity prices and global spill-over channels.
- **Standing Deposit Facility:** The RBI also introduced a new measure, the **Standing Deposit Facility** — an additional tool for absorbing liquidity — to suck out surplus liquidity of Rs **8.5 lakh crore from the financial system which is fuelling inflation.**
- **Signalling Shift in Policy Stance**: This **Monetary Policy Review** signals that the RBI has finally shifted its priorities to tackle **inflation**.
    - Thus, there is a possibility of a hike in its key **policy rate (Repo Rate)** in the coming months.
    - Further, RBI has hiked its inflation forecast from **4.5% projected earlier to 5.7%** still below the **upper band of 6% of the RBI's target** – in 2022-23.
- **Resorting to Pre-pandemic Levels:** RBI policy panel took a concrete step by restoring the policy rate corridor under **Liquidity Adjustment Facility**(LAF) to pre-**pandemic** width of 50 basis points.
    - This is aimed at bringing down the inflationary pressures.
    - **LAF** is a tool used in the monetary policy that allows banks to borrow money from the RBI through repurchase agreements (Repo) or to lend funds to the RBI through reverse repo agreement.

What is Standing Deposit Facility & Its Role?

- **About**: The RBI has introduced the **Standing Deposit Facility (SDF),** an additional tool for absorbing liquidity, at an interest rate of 3.75%.
    - It is an additional tool for **absorbing liquidity without any collateral.**
- **Background**: In 2018, the amended **Section 17 of the RBI Act** empowered the RBI to introduce

the SDF.

- **Modus Operandi**: By removing the **binding collateral constraint on the RBI,** the SDF strengthens the **operating framework of monetary policy.**
  - The SDF is also a financial stability tool in addition to its role in liquidity management.
  - The SDF rate will be **25 bps below the policy rate (Repo rate),** and it will be applicable to **overnight deposits at this stage.**
  - It would, however, retain the flexibility to absorb liquidity of longer tenors as and when the need arises, with appropriate pricing.
- **Need:** The **"extraordinary" liquidity measures** undertaken in the wake of the pandemic, combined with the liquidity injected through various other operations of the RBI, have left a liquidity overhang of the order of **Rs 8.5 lakh crore in the system.**
  - The main purpose of SDF is to **reduce the excess liquidity in the system, and control inflation.**
- **Implementation:** The RBI will engage in a gradual and calibrated withdrawal of this liquidity over a **multi-year time frame** in a non-disruptive manner beginning this year.

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.**
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 ▪ 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 movemen money rate.**
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
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 ur
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.**

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.
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.

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 n**

	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.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

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)

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