RBI’s Monetary Policy

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Why in News?

In the June 2025 **Monetary Policy Committee (MPC)** meeting, the **Reserve Bank of India (RBI) Governor** highlighted the fragility of the **global economy**, noting that despite 100 bps rate cuts since February 2025, monetary policy has **limited space to support growth**. Given the slow pace of inflation reduction and external uncertainties, a **shift from an accommodative to a neutral stance** was deemed appropriate.

Note: An **accommodative stance** means the RBI **lowers or maintains low policy rates** to **boost growth, increase liquidity, and encourage investment** during slow growth or low inflation.

- A **neutral stance** gives the RBI flexibility to **raise or cut rates depending on evolving inflation or growth risks,** aiming for a balanced policy approach.

What is the Monetary Policy Committee (MPC)?

Monetary Policy Committee

Monetary Policy

- It is formed and managed by **Reserve Bank of India** to control a nation's overall money supply and achieve economic growth
- It is **different from Fiscal Policy** which is managed by the **Ministry of Finance** that measures the spending and taxation in Indian Economy

Monetary Policy Committee (MPC):

- **Ex-officio Chairperson:** RBI Governor
- **Objective:** To determine the policy rate required to achieve the inflation target (4+/- 2%, Urjit Patel Committee)

- **Legal Framework:** Under Section 45ZB of the amended RBI Act, 1934, the Central Government is empowered to constitute a six-member Monetary Policy Committee (MPC)
  - The MPC is required to meet at least four times in a year. Each member of the MPC has one vote, and in the event of an equality of votes, the Governor has a second or casting vote.
- **Monetary Policy Report:** RBI once in every six months, releases Monetary Policy Report to explain the sources of inflation and the forecast of inflation for 6-18 months ahead

What is Monetary Policy?

- **About: Monetary policy** is the process through which the **RBI regulates the money supply** in the economy by using various **monetary instruments** under its control to achieve the objectives outlined in the **RBI Act, 1934**.
- **Objectives:** The **primary objective** is **price stability**, with **inflation targeting** as the primary focus. The target is **CPI (Combined)** inflation within the **2-6% range**, set by the **Government in consultation with the RBI**.
  - Other objectives include **promoting growth**, **generating employment**, and ensuring **exchange rate stability**.

Tools of Monetary Policy:

- Quantitative Tools
  - **Reserve Ratios:**
    - **Cash Reserve Ratio:** The **percentage of a bank's Net Demand and Time Liabilities (NDTL)** that must be maintained as **cash reserves with the RBI.**
    - **Statutory Liquidity Ratio:** Banks are required to hold a fixed portion of their **NDTL** as **liquid assets** such as **cash**, **gold**, and **unencumbered securities.**
  - **Open Market Operations (OMO): Purchase and sale of government securities.**
  - Repo & Reverse Repo Rate:
    - **Repo Rate:** It is the rate at which the **RBI offers overnight liquidity** to banks in exchange for **government and other approved securities as collateral.**
    - **Reverse Repo Rate:** It is the rate at which the **RBI absorbs overnight liquidity** from banks in exchange for **eligible government securities as collateral.**
  - **Bank Rate: It is the rate at which the Reserve Bank is willing to purchase or rediscount bills of exchange or other commercial papers.**
    - The **bank rate** is the interest rate at which the **RBI lends long-term, unsecured funds** to commercial banks, without collateral. The **repo rate** is the rate at which the **RBI lends short-term funds** to banks against **collateral** to manage **liquidity**.
  - **Marginal Standing Facility (MSF):** It is the **amount of overnight funds** that **scheduled commercial banks** can borrow by utilizing their **SLR portfolio up to a specified limit**, at a **penal interest rate.**
  - **Liquidity Adjustment Facility (LAF): It consists of overnight as well as term repo auctions.**
  - **Market Stabilisation Scheme (MSS): MSS bonds** are special bonds issued by the **RBI on behalf of the government** to **absorb excess liquidity** when regular government bonds are insufficient.
    - These bonds generally have a **short tenure of less than six months**, though the maturity period may vary as per requirements.
- Qualitative Tools
  - **Margin Requirement:** It is the **difference** between the market value of the assets and its maximum loan value.
    - It helps control **speculative lending** and is adjusted under **selective credit control**.
  - **Consumer Credit Control:** Setting rules on **down payments** and **maximum repayment periods** for **installment credit** used to purchase goods.
  - **Rationing: Regulation of credit** by commercial banks, e.g., RBI may limit loans to sectors like real estate to **check excessive lending.**
  - **Moral Suasion:** A **request by the RBI** urging **commercial banks** to adopt specific measures in line with **economic trends**.
  - **Direct Action:** Steps taken by the **RBI** against banks that **fail to meet specified conditions or requirements.**

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Q.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)

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

1. Cut and optimize 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)