



Injecting Liquidity in Economy

Source: TOI

Why in News?

The [Reserve Bank of India \(RBI\)](#) has announced measures to inject over **Rs 1.5 lakh crore** to increase **money liquidity** in the economy.

What are Key Points About RBI's Liquidity Measures?

- **Money Liquidity:** It refers to the **availability of cash and easily accessible funds** in the economy, influencing **spending and investment**.
 - **Liquidity** refers to how **quickly and easily** an asset can be converted into **cash** without impacting its price much.
- **Reason for Liquidity Shortfall:** The RBI's **forex sale** to stabilize the rupee amid [foreign institutional investors \(FIIs\)](#) **outflows** led to a liquidity deficit.
 - RBI sells US dollars in exchange for rupees, reducing the **supply of rupees** in the banking system.
 - It led to **tighter short-term interest rates** and increased borrowing costs.
- **Measures Taken by RBI:** RBI's liquidity infusion plan comprises **three measures**:
 - **Government Bond Buyback:** It means the central bank or the government **repurchases bonds** from the market **before maturity**.
 - It **injects liquidity by paying bondholders** (banks, financial institutions, or investors), increasing fund availability in the banking system.
 - **Repo Auction:** Repo auction is a **liquidity adjustment tool** used by the RBI where banks **bid for funds** at desired borrowing rates, and the **RBI accepts the lowest bids** until the required amount is allotted.
 - **US Dollar-Rupee Swap Auction:** A [swap auction](#) increases liquidity in the market by facilitating the **temporary exchange** of currencies or financial instruments.
 - **Borrowing dollars** stabilizes the domestic currency and prevents a liquidity drain by **avoiding rupee sales** in the forex market.
- **Potential Repo Rate Cut:** Addressing the **liquidity deficit** may be a **precursor to a possible repo rate cut** in the upcoming monetary policy review.
 - **Sufficient liquidity** will ensure that any future **repo rate cuts are effectively transmitted** to borrowers through lower interest rates.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Prelims

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)

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
3. RBI and is reconstituted every year.
4. 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)