**MONETARY POLICY**

Definition:

Monetary Policy refers to the credit control measures adopted by the central bank of a country.

Monetary policy “as policy employing central bank’s control of the supply of money as an instrument for achieving achieves of general economic policy.”

OBJECTIVES OF MONETARY POLICY

The following are the principal objectives of monetary policy:

• Full Employment

• Price Stability

• Economic Growth

• Balance of Payments

• Exchange Rate Stability

• Neutrality of Money

• Equal Income Distribution

**Full Employment:**

Full Employment has been ranked among the foremost objectives of monetary policy. It is an important goal not only because unemployment leads to wastage of potential

output, but also because of the loss of social standing and self-respect.

**Price Stability**

• One of the policy objectives of monetary policy is to stabilize the price level.

• Both economics and favour this policy because fluctuations in price bring uncertainty and instability

to the economy.

**Economic Growth**

– One of the most important objectives of monetary policy in in recent years has been the rapid economic growth of an economy.

– Economic growth is defined as “the process where by the real per capita income of a country increases over a long period of time.”

**Balance of Payments**

Another objectives of monetary policy since the 1950s has been to maintain equilibrium in the balance of

payments.

**Exchange Rate Stability:**

• Exchange rate is the price of a home currency expressed in terms of any foreign currency.

• If the exchange rate is very volatile leading to frequent ups and downs in the exchange rate, the international community might lose confidence in our economy.

• The monetary policy aims at maintaining the

relative stability in the exchange rate. **Neutrality of Money:**

Economist such as Wicksted, Robertson has always considered money as a passive factor.

According to them, money should play only a role of medium of exchange and not more than that.

Therefore, the monetary policy should regulate the supply of money.

Equal Income Distribution:Many economists used to justify the role of the fiscal policy is maintaining economic equality. However in recent years economists have given the

opinion that the monetary policy can help and play a supplementary role in attaining an economic equality.

**Expansionary Monetary Policy**

Expansionary or easy monetary policy aims at encouraging spending on goods and services by expanding the supply of credit and money by lowering the policy rates (bank rate or repo rate), lowering the reserve requirements and purchasing the

government securities from the market.

**Contractionary Monetary Policy**

Contractionary or tight monetary policy aims at preventing inflation by contracting the money supply.

• Contraction in money supply is achieved by increasing the policy rates, increasing the reserve requirements and purchasing the government securities from the market.

**Countercyclical Monetary Policy**

Countercyclical policy aims at moderating the cyclical fluctuations in the economy and stabilizing the economy around

its trend path by following countercyclical

measures.

**Rule Based Monetary Policy**

• Under rule based policy money supply and related variables are controlled by predetermined rules, norms and standards.

• The central bank authorities cannot use

their discretion to change the values of these

variables.

**Discretionary Monetary Policy**

Discretionary Monetary Policy allows the central bank greater autonomy in the conduct of monetary policy.

Under such a policy rather than getting constrained by the pre-set rule, the central banks, after assessing the emerging economic scenario and using its own judgment, can change the values of money supply and the related variables.

INSTRUMENTS OF MONETARY POLICY

• Credit control is an important tool used by Reserve Bank of India, a major weapon of the monetary policy used to control the demand and supply of money in the economy.

**Qualitative Instruments:**

• **Bank Rate**:

The bank rate, also known as the Discount Rate, is the oldest instrument of monetary policy. Bank rate is the rate at which

the RBI discounts – or, more accurately.. Current Bank Rate is 5.65%

• **Open market Operations**:

open market operations are the means of implementing monetary policy by which a central bank controls its national money supply by buying and selling government

securities or other financial instrument.

**Variations in the Reserve Requirement**

The reserve bank also uses the method of variable reserve requirements to control credit in India. By changing the ratio, The reserve bank seeks to influence the credit creation power of the commercial banks.

**Repo Rate and Reserve Repo Rate**

• whenever the banks have any shortage of funds they can borrow it from RBI.

• Repo rate is the rate at which banks borrow rupees from RBI.

• Current repo rate is 5.40% and reverse repo rate is 5.15%

Note : In India, **repo rate** is the **rate** at which Reserve Bank of India lends money to commercial banks in India if they face a scarcity of funds. ... **Reverse Repo rate** is the **rate** at which the Reserve Bank of India borrows funds from the commercial banks in the country

**Liquidity Adjustments Facility:**

It is a cool, used in monetary policy that allows banks to borrow money through repurchase agreements. This arrangement allows banks to respond to liquidity pressures and is used by governments to assure basic stability in the financial markets.

**Qualitative Instruments**

• **Rationing of credit:** Credit rationing is a method of controlling andregulating the purpose for which credit is grantedby commercial bank.

• It aims to limit the total amount of loans and advances granted by commercial banks.

• **Margin Requirements:**

Margin is the difference b/w the market value of a security and its maximum loan value.

Marginal requirement of loan can be increased or decreased to control the flow of chart.

**Publicity:**

RBI uses media for the publicity of its views on the current market condition and its directions that will be required to be

implemented by the commercial banks to control the unrest.

**Regulation of Consumer Credit:**

If there is excess demand for certain consumer durable leading to their high prices, central bank can reduce consumer credit by

increasing down payment, and reducing the number of instalments of repayment of such credit.

• **Moral Suasion:**

Moral Suasion means persuasion and request. To arrest inflationary situation central bank persuades and request the

commercial banks to refrain from giving loans for speculative and non-essential purposes

• **Direct Action:**

Under the banking Regulation Act, the Central Bank has the authority to take strict action against any of the commercial bank that refuses to obey the directions given by Reserve

Bank of India.

**SIGNIFICANCE OF MONETARY POLICY**

• Control Inflation or Deflation

• Availability of the Supply of money and Credit

• Integrated Interest Rate Structure

• Effective Central Banking

• Long-Term Loans for Industrial Development

• Creation of Financial Institutions

**Control Inflation or Deflation:**

Monetary policy is the policy used by the government of a country to control inflation or deflation in an economy, and this policies been implemented by the central bank through the

ministry of finance.

**Availability of the Supply of money and Credit :**

Monetary policy is concerned with the charges in the supply of the money and credit. It refers to the policy measures under

taken by the government or central bank to influence the availability, cost and use of money and credit with the help of monetary techniques to achieve specific objectives.

**Integrated Interest Rate Structure:**

In an underdeveloped economy, there is absence of an integrated interest rate structure. There is wide disparity of interest rates prevailing in the different sectors of the economy and these rates

do not respond to the changes in the bank rate, thus making the monetary policy ineffective.

**Effective Central Banking:**

To meet the developmental needs the central bank of an underdeveloped country must function effectively to control and regulate the volume of credit through various monetary instruments, like bank rate, open market operations, cash-reserve ratioetc.

**Long-Term Loans for Industrial Development:**

Monetary policy can promote industrial development in the underdevelopment countries by promoting facilities of medium-term and long-term loan to the manufacturing units.

**Creation of Financial Institutions:**

The Monetary policy in a developing economy must aim to improve its currency and credit system. More banks and

financial institutions should be set up, particularly

in both areas which lack these facilities.