

## **RESERVE BANK OF INDIA**

The Reserve Bank of India (RBI) began its operations as the India's Central bank in April, 1935. Originally, it was a private shareholders' bank, but since January 1949 it has been functioning as the nationalized Central Bank.

RBI plays an important role in Indian economy. The RBI as the leader of the Indian money market and as the India's Central Bank performs the following useful functions:

### **1. Acting as Note-issuing Authority**

The authority for the issuance of currency (other than one rupee coins/notes and subsidiary coins) in India is Reserve Bank of India. For the purpose of note issue, at present it has to keep a minimum reserve in foreign securities and in gold. It can however, dispense entirely with the holding of foreign securities if circumstances so require.

### **2. Acting as a Banker to the Government**

The RBI transacts the banking business of both the Central and the State Governments. It is entrusted with the management of the public debt and the issue of new loans of Governments. It also holds the cash balances of the government free of interest. Besides, it sells Treasury Bills whenever necessary on behalf of the Government. It also gives advice to both the Central and the State Governments for raising finance for development plans. The RBI acts as adviser to Government on various banking and financial matters. It also helps the Government to remit the funds from one place to another.

### **3. Acting as a Banker to the Other Banks**

The RBI acts as a banker to other banks. It keeps a certain percentage of their deposits as reserve and gives them rediscounting facilities against some specified bills and furnishes advances against government securities. It also gives them free remittance facilities. Against these facilities the scheduled banks are required by law to keep a certain percentage of their deposit liabilities as reserve.

### **4. Monetary Regulations**

The RBI controls the volume of bank advances to implement its monetary and credit policy. It possesses various methods of credit control such as the Bank Rate Policy, Open Market Operations, Variable Reserve Ratio, Selective Credit Controls, etc. At present, it has been implementing the policy of controlled expansions of bank credit.

### **5. Supervision and Control of Commercial Banks**

The Banking Regulations Act 1949, has empowered the RBI to supervise and control the operations of the commercial banks regarding their, paid up capital and

reserves, licensing, branch expansion, cash balance, liquid assets, submission of periodical reports to the RBI, suspension of business etc.

#### 6. Maintenance of Exchange Value of the Rupee

The RBI has also an important role to play in the maintenance of the exchange value of the rupee. For this purpose, it is entrusted with the custody and management of the country's international reserves. It acts also as the agent of the government in respect of India's membership control in accordance with the Government's trade policy.

#### 7. Development and Promotional Functions

With the progress of the economy, the RBI has been undertaking various development functions relating to mobilization of savings, extensions of banking facilities in the un-banked centers, finance for agriculture and industries, protection of depositor's interest through deposit insurance., etc.

#### 8. Control of the Activities of Non-banking Companies and Other Institutions

Recently, the RBI has been empowered to lay down the regulations regarding the acceptance of deposits from the public by non-banking companies and institutions. It can also demand the statement regarding such deposits from these institutions.

#### 9. Implementation of the Plans

The RBI also gives its opinion to the Governments on economic and financial matters relating to the implementation of the Plans. It assists the government in undertaking deficit financing, maintaining price stability and providing credit for the priority sectors.

#### 10. Other Functions

The other functions relate to the regular publication of reports on banking and currency, conducting the clearing houses, developing bill markets, appointing committees and commissions on various economic aspects of the country, etc.

### **Monetary Policy of RBI (Or How RBI controls inflation)**

The Monetary Policy of RBI is not merely one of inflation control through credit restriction, but it has also the duty to see that legitimate credit requirements are met and at the same time credit is not used for unproductive and speculative purposes. RBI has various weapons of monetary control and by using them it hopes to achieve its monetary policy.

#### A. Quantitative Credit Control Methods

In India, the legal framework of RBI's control over the credit structure has been provided under the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949. Quantitative credit controls are used to maintain proper quantity of credit or money supply in market. Some of the important general credit control methods are:

1. **Bank Rate Policy** Bank rate is the rate at which the Central bank lends money to the commercial banks for their liquidity requirements. Funds are provided either through lending directly or discounting or buying money market instruments like commercial bills and treasury bills. Increase in Bank Rate increases the cost of borrowing by commercial banks which results in the reduction in credit volume to the banks and hence declines the supply of money. Increase in the bank rate is the symbol of tightening of RBI monetary policy. As of April 05, 2016, the Bank Rate stands at 7%.

2. **Cash Reserve Ratio (CRR)** The Cash Reserve Ratio (CRR) is an effective instrument of credit control. Under the RBI Act, 1934 every commercial bank has to keep certain minimum cash reserves with RBI. The RBI is empowered to vary the CRR between 3% and 15%. A high CRR reduces the cash for lending and a low CRR increases the cash for lending. The present CRR is 4% on and from 05.04.2016.

3. **Statutory Liquidity Ratio (SLR)** SLR is used by bankers and indicates the minimum percentage of deposits that the bank has to maintain in form of gold, cash or other approved securities. Thus, it can be said that it is ratio of cash and some other approved liability (deposits). At present it is 21.25%.

Both Cash Reserve Ratio (CRR) and SLR are instruments in the hands of RBI to regulate money supply in the hands of banks that they can pump in economy. SLR restricts the bank's leverage in pumping more money into the economy. On the other hand, CRR, or cash reserve ratio, is the portion of deposits that the banks have to maintain with the Central Bank to reduce liquidity in banking system. Thus CRR controls liquidity in banking system while SLR regulates credit growth in the country. The other difference is that to meet SLR, banks can use cash, gold or approved securities whereas with CRR it has to be only cash. CRR is maintained in cash form with central bank, whereas SLR is money deposited in government securities.

4. **Repo And Reverse Repo Rates** Repo means Sale and Repurchase Agreement. Repo rate is the rate at which the Reserve Bank of India lends money to commercial banks in the event of any shortfall of funds. Repo rate helps commercial banks to

acquire funds from RBI by selling securities and also agreeing to repurchase at a later date. Repo rate is used by monetary authorities to control inflation. In the event of inflation, RBI increases repo rate as this acts as a disincentive for banks to borrow from the central bank. This ultimately reduces the money supply in the economy and thus helps in arresting inflation. RBI takes the contrary position in the event of a fall in inflationary pressures. Repo and reverse repo rates form a part of the liquidity adjustment facility. Reverse repo rate is the rate that banks get from RBI for parking their short term excess funds with RBI. Repo and reverse repo operations are used by RBI in its Liquidity Adjustment Facility. RBI contracts credit by increasing the repo and reverse repo rates and by decreasing them it expands credit. Current Repo rate is 6.5% and Reverse repo rate is 6%

Bank rate usually deals with loans, whereas, repo or repurchase rate deals with the securities. The bank rate is charged to commercial banks against the loan issued to them by RBI, whereas, the repo rate is charged for repurchasing the securities.

5. Open market operations It refers to buying and selling of government securities in open market in order to expand or contract the amount of money in the banking system. This technique is superior to bank rate policy. Purchases inject money into the banking system while sale of securities do the opposite. During last two decades the RBI has been undertaking switch operations. This policy aims at preventing unrestricted increase in liquidity.

B. Selective / Qualitative Credit Control Methods Under Selective Credit Control, credit is provided to selected borrowers for selected purpose, depending upon the use to which the control try to regulate the quality of credit - the direction towards the credit flows. The Selective Controls are:

1. Ceiling On Credit The Ceiling on level of credit restricts the lending capacity of a bank to grant advances against certain controlled securities.

2. Margin Requirements A loan is sanctioned against collateral security. Margin means that proportion of the value of security against which loan is not given. Margin against a particular security is reduced or increased in order to encourage or to discourage the flow of credit to a particular sector. It varies from 20% to 80%. For agricultural commodities it is as high as 75%. Higher the margin lesser will be the loan sanctioned.

3. Discriminatory Interest Rate (DIR) Through DIR, RBI makes credit flow to certain priority or weaker sectors by charging concessional rates of interest. RBI issues

supplementary instructions regarding granting of additional credit against sensitive commodities, issue of guarantees, making advances etc.

#### 4. Directives:-

The RBI issues directives to banks regarding advances. Directives are regarding the purpose for which loans may or may not be given.

5. Direct Action It is too severe and is therefore rarely followed. It may involve refusal by RBI to rediscount bills or cancellation of license, if the bank has failed to comply with the directives of RBI. 6. Moral Suasion Under Moral Suasion, RBI issues periodical letters to bank to exercise control over credit in general or advances against particular commodities. Periodic discussions are held with authorities of commercial banks in this respect.

As on and from 5th April 2016: Bank Rate 7%; CRR is 4%; SLR is 21.25%; Repo Rate is 6.50%; Reverse Repo Rate 6%

As on and from 2nd August 2017: Bank Rate 6.25%; CRR is 4%; SLR is 19.5%; Repo Rate is 6%; Reverse Repo Rate 5.75%