Monetary Policy

Monetary policy refers to the use of instruments under the control of the central bank to regulate the availability cost and use of money and credit. The RBI's Monetary Policy Department formulates monetary policy and the financial markets department handles day-to-day liquidity management operations.

The Main Objectives of Monetary Policy

1. Exchange stability
2. Price stability
3. Full employment
4. Economic growth

Conflicting objectives of monetary policy

1. Exchange Stability and Price Stability
2. Full Employment and Economic Growth
3. Full Employment and Price Stability

Instruments of Monetary Policy:

There are several direct and indirect instruments of that are used in the formulation and implementation of monetary policy.

Direct Instruments:

The followings are the direct instruments of Monetary Policy.

1. **Cash Reserve Ratio:** CRR is the amount of funds that the banks have to keep with RBI. If RBI increases CRR, the available amount with the banks comes down. RBI is using this method (increase of CRR), to drain out the excessive money from the banks.
   Current CRR – 4%

2. **Statutory Liquidity Ratio:** SLR is the amount a commercial banks needs to maintain in the form of cash, or gold or govt. approved securities (Bonds) before providing credit to its customers. SLR rate is determined and maintained by RBI in order to control the expansion of the bank credit.
   Current SLR is 23%

3. **Refinance Facility:** Sector specific refinance facilities provided to banks (e.g. against lending to export sector).

Indirect Instruments:

1. **Liquidity Adjustment Facility (LAF):** It consists daily infusion or absorption of liquidity on a repurchase basis, through repo(liquidity injection) and reverse repo(liquidity absorption) auction process/operations, using govt. security as collateral.
2. **Repo/Reverse Repo Rate:** These rates under the LAF determine the corridor for short term money market interest rates. In turn this is expected to trigger movement in other segments of the financial market and the real economy.
3. **Open Market Operations:** Outright sales/purchases of government securities in addition to LAF, as a tool to determine the level of liquidity over the medium term.
4. **Marginal Standing Facility:** under this facility which scheduled commercial banks can borrow overnight at their discretion up to one percent of their respective NDTL at 100 basis points above the repo rate to provide a safety valve against unanticipated liquidity shocks.
5. **Bank Rate:** it is the rate at which the RBI is ready to buy or rediscount bills of exchange or other commercial Papers (CPs). It also signals the medium term stance of monetary policy.