BHARAT SCHOOL OF BANKING
Monetary Policy of RBI

Monetary Policy

Monetary policy is the process by which **central bank**, the **monetary authority** of a country, controls the **supply** of **money** in the **economy.** In **India, Reserve Bank (RBI)** is the sole authority to frame the **monetary policy.**

As per the recommendations of **Urjit Patel Committee**, RBI adopted the release of **monetary policy** on **bi-monthly** basis, i.e., **bi-monthly** monetary policy.

Operating Target and Operating Procedure of Monetary Policy

To understand the **Monetary Policy** of **RBI**, you have to understand the following terms specified by it -

1. Policy Rate
The **fixed overnight repurchase rate (repo rate)** under the **Liquidity Adjustment Facility (LAF)** is the **single monetary policy rate**.

2. Operating Target
The **Weighted Average Call-money Rate (WACR)** is the **operating target** of **monetary policy**. Note that **Call money** is the **overnight funds** that are lent by one **bank** to another **bank**.

3. Operating Procedure
Once the **policy rate** is announced in the **bank's statements** on **Monetary policy**, the **operating procedure** aims at modulating **liquidity conditions** so as to achieve the **operating target** (meaning - anchor the **call money rate** around the **policy rate / repo rate**). This is the **first leg** of monetary policy transmission to the **financial system** and the **economy**.

4. Liquidity Management
RBI uses the **pro-active liquidity management** mechanism to achieve the **operating target**. The main features of this **framework,** which was announced on **August 22, 2014**, and implemented since **September 5** are as follows -

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a. Assured Liquidity Operations -
Assured access to **central bank liquidity** of **1 %** of bank's **Net Demand and Time Liabilities(NDTL)** (meaning **Demand deposits - Current** and **Savings;** and **Time deposits - Term** and **Recurring**). This 1 % comprises -

- **0.25 %** of **NDTL** provided through **overnight fixed repo auctions**, conducted **daily** at the **policy rate (repo rate)**, and
- **0.75 %** of **NDTL** provided through **14-day variable rate term repo** auctions, conducted on **every Tuesday** and **Friday.**

b. Fine-tuning Operations -
Fine-tuning operations through **variable** rate **repo / reverse repo** auctions of **maturities** ranging from **overnight** to **28 days**, to **even out** frictional **liquiditymismatches** that occur **in spite** of **assured Liquidity Operations**

c. Open Market Operations (OMO) -
Outright OMO through **auctions** and **anonymous** screen-based trading on the **NegotiatedDealing System - Order Matching (NDS-OM)** platform to mange **enduring liquidity mismatches**

d. Special Operations -
Special Operations are also conducted on **holidays** to help **market participants** tide over pressured arising from one-off events such as **tax payments, government spending, balance sheet adjustments** and **payment and settlement requirements**.

5. Standing Facilities

a. Marginal Standing Facility (MSF) -
A **Marginal Standing Facility (MSF)** allows **market participants** to access central bank **liquidity** at the **end of the day** (including **Saturdays**), even after providing **assured** and **fine-tuning operations**.

Under **MSF,** up to **2 %** of their (market participant's) stipulated **Statutory Liquidity Ratio(SLR)** holdings of **government securities** in addition to **excess SLR** as **collateral** at a **rate** set at **100 basis points (bps) above** the **policy rate** (meaning - **MSF rate = Repo rate + 1 %**)

b. **Reverse Repo** -
Fixed rate **daily overnight** - **reverse repo** auctions are conducted at the **end of the day** (including **Saturdays**) to allow **market participants** to place their **surplus liquidity** with the **RBI** at a **rate** set at **100 bps below** the **policy rate** (meaning - **Reverse Repo rate = Repo rate - 1 %**). It operates as a *de facto* **standing facility**.
Note that the **MSF rate** and the fixed overnight **reverse repo rate** define an **informal corridor** for limiting **intra-day variations** in the **call rate**.

1st Monetary Policy - April 7, 2015

RBI governor **ShriRaghuramRajan** has decided to keep the **policy rate** and **cash reserve ratio** unchanged. Followings are the current **rates** -

- **Repo rate** (policy rate) - **7.5 %** (rate charged by RBI to banks)
- **Reverse Repo rate = Repo rate - 1 % = 6.5 %** (rate at which RBI pays interest to banks)
- **MSF rate = Repo rate + 1 % = 8.5 %** (rate charged by RBI to banks)
- **Bank rate = 8.5 %** (rate charged by RBI to banks)
- **Cash Reserve Ratio (CRR) - 4 %** (percent amount to be stored with RBI, in terms of account balance or reserves)
- **Statutory Liquidity Ratio (SLR) - 21.5 %** (percent amount to be stored with itself, in terms of golds or government securities - cannot be lent to public)