RBI Monetary Policy Highlights

Why in news?

The Monetary Policy Committee has decided to hike the repo rate by another 50 basis points to 5.9% from a rate of 4.4% earlier this May.

What is monetary policy?

- Monetary policy is a plan under which the central bank takes necessary measures to ensure the economic growth and stability of the country.
- These measures help the RBI to influence the demand and supply of money to stabilise inflation for the time being.
- **Tools of Monetary Policy-** RBI uses several economic tools to control the economic activities, like
  - Changes in repo rates
  - Cash Reserve Ratio (CRR)
  - Statutory Liquidity Ratio (SLR)
  - Engaging in open market operations of selling or buying government securities
- **Types of monetary policy**
  - **Contractionary policy**- It increases interest rates and limits the money supply to slow growth and decrease inflation.
  - **Expansionary policy**- It happens during times of slowdown or a recession
  - It lowers the interest rates, where saving becomes less attractive and consumer spending and borrowing increase.

What are the goals of the monetary policy?

- **Inflation-** Contractionary monetary policy is used to target a high level of inflation and reduce money circulating in the economy.
- **Unemployment-** Higher money supply and attractive interest rates stimulate business activities and expands the job market.
- **Exchange Rates-** With an increase in the money supply, the domestic currency becomes cheaper than its foreign exchange.

What are the key highlights of RBI Monetary Policy?

- **Status of Indian economy**- The world is in midst of third major shock arising from aggressive rate hikes in advanced economies apart from the Covid impact and the Ukraine war.
- **Repo rate**- RBI hikes benchmark lending rate by 50 basis points to 5.90%.
- **Others**- Accordingly, the standing deposit facility (SDF) now stands at 5.65% and marginal standing facility (MSF) and bank rate at 6.15%.

- **Nature of policy**- RBI to remain focused on withdrawal of accommodative monetary policy.
- **Inflation**- Inflation expected to remain elevated at around 6% in second half of FY23.
- Inflation projection for FY23 retained at 6.7% for FY23.
- **Currency**- The rupee orderly depreciated by 7.4% against US dollar this year.
- **Forex Reserve**- Forex Reserve now stands at 537.5 billion dollars.
- **Debt-** External debt to GDP is lowest amongst growing economies.
- **Economic growth**- RBI cuts its economic growth projection for FY23 to 7% from earlier estimate of 7.2%.
- India's import growth is decelerating compared to export growth.

What can be inferred from the report?

- **Rate hike**- The move to hike the repo rate is justified under the extremely stressed global and domestic circumstances.
- The unpredictable rupee was certainly an important factor.
- **Decline in forex reserves-** 67% of the decline in the foreign exchange reserves since April was due to valuation changes arising from strengthening US dollar and higher American bond yields.
- **Growth forecast**- Aggressive tightening of monetary policies globally has led to the cut in growth forecast to 7%.
- **Economic activity**- The Indian economy continues to be resilient and the economic activity in India remains stable.
- **Strengthening the banking sector**- The RBI has taken a few regulatory and developmental measures that will strengthen the balance sheets of the banking sector.
- Similar to the NBFCs, banks will now be subjected to a strong way of "expected loss based approach" for their loan loss provisioning.
- **Securitization of stressed assets**- The RBI is considering the introduction of a framework for the securitisation of stressed assets similar to that of standard assets.
- This will widen the investor base for direct purchases of stressed loans from banks and could lead to better price discovery for banks.

References

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Quick facts

- **Repo rate**- Repo rate is the interest charged by the RBI when commercial banks borrow from them by selling their securities to the central bank.
- **Reverse repo rate-** It is a rate at which RBI borrows money from the commercial banks of the country.
- **Inflation**- Inflation is the economic situation when prices are rising over time and money loses value.
- **Currency depreciation**- Currency depreciation is a fall in the value of a currency in terms of its exchange rate versus other currencies.
- **Cash Reserve Ratio**- It is a percentage of the banks' deposits maintained in cash form with the RBI.
- **Statutory Liquidity Ratio**- It is an obligatory reserve of commercial banks' net demand and time liabilities, maintained as approved securities by the commercial banks themselves.