RBI’s Monetary Policy Review

Why in news?

The Reserve Bank of India recently issued its monetary policy report and kept key lending rates (repo rate and reverse repo) unchanged.

What is the monetary policy?

- The monetary policy is a collection of financial tools and measures available with the RBI to safeguard and promote economic growth.
- Monetary policies basically control the overall supply of money available to commercial banks and, indirectly, to individual users and companies.
- The primary objective of a monetary policy is to maintain price stability while keeping in mind objective of growth.

What is the big picture emerging from the monetary policy review?

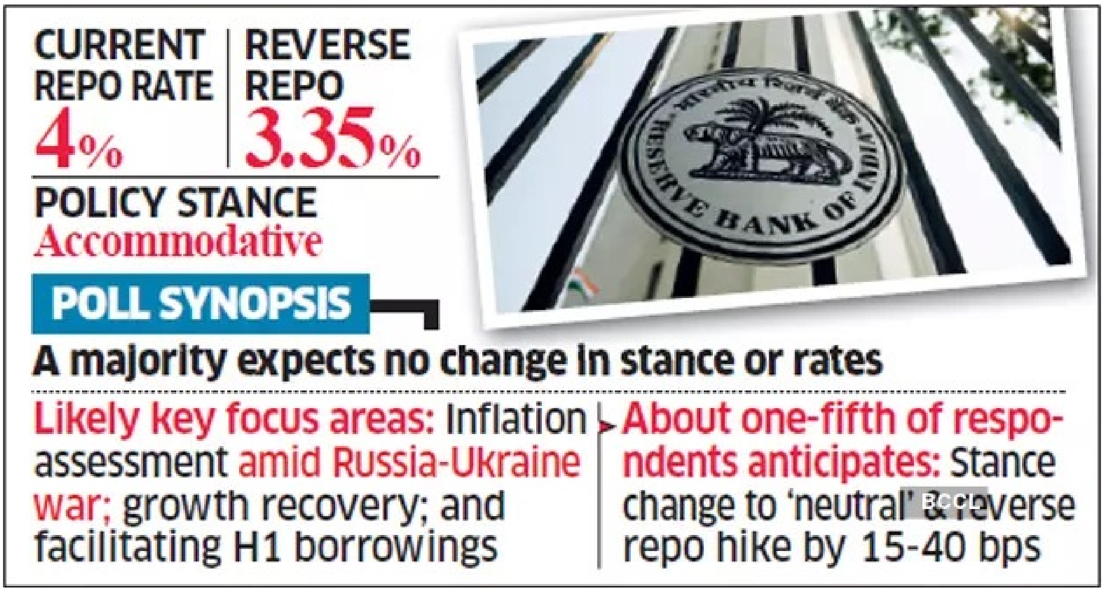
- **Accommodative stance**- The committee voted to keep the central bank's stance 'accommodative' so that it remains conducive for easier borrowing between the RBI and other banks.
- **Repo rate and reverse repo**- The repo and reverse repo rate were kept unchanged at 4 % and 3.35 % respectively.
- **Growth forecast**- RBI has slashed the growth forecast to 7.2% for fiscal 2022-23 from 7.8% projected earlier.
- **Retail inflation projection**- RBI has also increased the retail inflation projection from 4.5% to 5.7% in 2022-23.

> *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 is the interest rate the RBI pays to commercial banks when they store excess cash reserves with the central bank.*

How has inflation moved of late?

- The RBI’s objective is to achieve the medium-term target for consumer price index (CPI) inflation of 4% within a band of ±2%, while supporting growth.
- Provisional CPI data released by the NSO showed that headline CPI inflation for February 2022 edged up to 6.1%.
- Retail inflation rose to 5.59% cent in December 2021 from 4.35% in September.
- Reasons for rising inflation

  - The rise in oil and commodity prices
  - supply disruptions due to the war



What policy instruments has the RBI proposed to tackle this situation?

- The RBI's liquidity management is characterised by two-way operations
  - Variable rate reverse repo (VRRR) auctions of varying maturities- to absorb liquidity
  - Variable rate repo (VRR) auctions - to meet temporary liquidity shortages and offset mismatches
- **SDF**- In this review, the RBI has introduced the Standing Deposit Facility (SDF) for absorbing liquidity at an interest rate of 3.75%.
- Both the standing facilities - the MSF and SDF, will be available on all days of the week, throughout the year.
- The FRRR rate, retained at 3.35%, will remain part of the RBI's toolkit, and its operation will be at the discretion of the RBI for purposes specified from time to time.
- The FRRR along with the SDF will impart flexibility to the RBI's liquidity management framework.

What is SDF and how will it operate?

- The idea of an SDF was first mooted in the Urjit Patel Monetary Policy Committee report in 2014.
- In 2018, the amended Section 17 of the RBI Act empowered the Reserve Bank to introduce the SDF.
- The SDF will help the central bank in absorbing liquidity (deposits) from commercial banks without giving government securities in return to the banks (collateral).
- The main purpose of SDF is to reduce the excess liquidity and control inflation.
- The SDF is also a financial stability tool in addition to its role in liquidity management.
- The SDF will replace the fixed rate reverse repo (FRRR) as the floor of the liquidity adjustment facility corridor.
- The SDF rate will be 25 bps below the policy rate (Repo rate), and 50bps lower than the marginal standing facility (MSF).
- It would retain the flexibility to absorb liquidity of longer tenors as and when the need arises,

with appropriate pricing.

Is a long-term tightening of money supply indicated?

- The RBI has now decided to focus on inflation over growth as inflation remains above the RBI's upper band of 6%.
- The RBI has said it will engage in a calibrated withdrawal of the accommodative stance over a multi-year time frame in a non-disruptive manner beginning this year.
- The gradual tightening of money supply is expected to push up interest rates.

References

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