# Monetary Policy

[UPSC Notes]

## What Is Monetary Policy?

In order to promote economic growth, RBI uses Monetary Policy to control the overall money supply.

- This Monetary Policy was constructed under the RBI Act in 1934.
- This policy is often considered a contractionary or an expansionary and is different from the fiscal policy, which manages the taxes and overall expenses of the country.
- When the total money is increased more suddenly than normal, it is called expansionary policy.
- When a slower increase or decrease in money occurs, it is called contractionary policy.

## Objectives Of The Monetary Policy

Monetary Policy was designed in order to provide reasonable price stability, high employment, and an increase in the growth of economic conditions. There are 6 major objectives of this policy, which are mentioned below.

### The Neutrality of Money:

Many great economists like Wicksteed and Robertson are the chief of the neutral money objective. According to the Monetary Policy, authorities must target to have the nonalignment of money in the country’s economy. Any monetary change can cause economic fluctuations. According to them, changing any Monetary Policy factor will adversely affect the country's overall economic condition. They also believe that if the neutral Monetary Policy is strictly followed, cyclic fluctuations will be minimal; there will be no trade cycle, no inflation, or deflation in the country's economy. Here, the money is kept stable by the Monetary Policy authorities. The main aim of this objective in Monetary Policy is to keep the quantity of money perfectly stable.

## Exchange Stability:

Exchange stability is the traditional objective of Monetary Policy authority. This was one of the main objectives under Gold Standard for different countries. When there was a disturbance in the amount of money or a disbalance, it was automatically corrected by these movements. Uncertainty in the conversation rates will cause the outflows or inflows of gold, creating a disturbance in the undesired payment balance.

Therefore, stable exchange rates are essential to inter-country trade. Therefore, Monetary Policy is primarily concerned with controlling and stabilizing the external changes taking place in a country. It is important to avoid forces that will cause instability in the exchange rate.

I. It can have a violent fluctuation which can result in encouraging speculative activities in the market.
II. More fluctuations can also make a tremendous loss and lower the confidence of the domestic people and cause problems to the foreign capitalists, which will result in a bad impact on the capital outflow, which is responsible for capital formation and growth.
III. More Fluctuations in exchange rates can also make the price greater, and the level of prices will also be increased.

## Price Stability:

This is another major Monetary Policy objective, and it has been highlighted during the present century. Price stability can be called the most trusted and important objective of Monetary Policy.

Stable prices increase common people's confidence, and cyclical fluctuations are eliminated. Thus, it helps people understand the value of business activities and will give equal income and wealth distribution. Due to this, a general wave of welfare and prosperity arrives in the community and benefits everyone.

Price stability also encourages the growth of the economic condition of the country. And the good production also increases which is also benefited to the country as well as the people. It also decreases the exports and increases import takes place. Some small increase in the prices also helps the economy of the country to work well.

## Full Employment:

During the period of the world depression, the unemployment problem increased suddenly, so the people who were employed were thrown out, which caused a lot of unemployment in the society. It has been recognized as socially dangerous and economically wasteful. Thus, it was also listed as the main objective of Monetary Policy. Currently, it is also referred to as if we can achieve full employment; it could directly affect the price and the exchange stability. This will all work better if both these things work together.

The economist says that the main reason to achieve full employment is to have a balance between saving and investment at the full employment level. Classical economist says that full employment is a normal feature of the economy, but in the current situation, it cannot be completely applied; thus, we need to have full employment to better growth of the country's economic situation.

According to them, the people who worked for some time and lost their job after some time are also called employed. After completing the aim of comprehensive employment, Monetary Policy must try to have price balancing. The below mentioned as some of the ways through which the policy can work upon

- Analyzing the current unemployment and disguised unemployment is growing in a country like India; thus, Monetary Policy is more suitable for the countries like ours.
- The policy can solve the real unemployment problem, leading to the country's rapid economic growth.
- It is one of the most useful tools that can provide economic and social welfare to the community.

## Economic Growth:

Economic growth has become a major topic of discussion among economists and statesmen around the world in recent years. We also need to use natural, human, and all other resources to increase the country's per capita income. Most of the time, a country's economy is decided as per the per capita income of the country. If we want to increase the country's economy, the per capita should also be up to the mark.

### Stability in the Balance of Payments:

It is the balance of payment and is another objective of Monetary Policy. It was introduced after the war period. The main aim of this Monetary Policy objective is because of the issue of international liquidity of world trade. It was felt that increase in the deficit in the balance of the payment was reduced. Many less developed countries curtail their imports, which badly affects the country's economy and development. Thus, this objective makes a balance in the payments.

## Instruments Of Monetary Policy

### The instruments of monetary policy are as follows

### Open Market Operations

These are exchanges of the securities like government bonds or banks. The Reserve Bank of India need to sell government securities to have control over the flow of credit, and they also need to buy government securities to increase the credit flow.

### Cash Reserve Ratio

It is also called CRR. A specific amount of the back deposit with the banks is needed to keep with the Reserve Bank of India in the form of a balance or reserve. The CRR was 15 percent in 1990, which was got down to 5 % in the year 2002. And currently, the CRR is 4 percent.

### Statutory Liquidity Ratio (SLR)

All financial institutes need to maintain a certain level of liquid assets within themselves at any time of their total time. It is what is meant by Statutory Liquidity Ratio. These are the assets kept in a non-cash form, just like silver, gold, diamonds, and other precious metals and bonds. The SLR stands at 18.25 percent in December 2019.

## Bank Rate Policy

It also has another name which is the discount rate. It is the interest that the Reserve Bank of India charges for providing the loans and funds to the banks. If the bank rate increases, the credit volume will go down, and the available money will be less. On 31st December 2019, the bank rate was 5.40 percent and is continuing till today.

## Credit Ceiling

This is the type of instrument which make the Reserve Bank of India prior information about the loans to the bank will be made available to a certain limit. Thus, this makes the banks have a certain loan to the sectors.

These are the Monetary Policy instruments used under the Monetary Policy.