

# **MONETARY POLICY**

Monetary policy refers to the use of instruments under the control of the central bank (RBI) to regulate the availability, cost and use of money and credit.

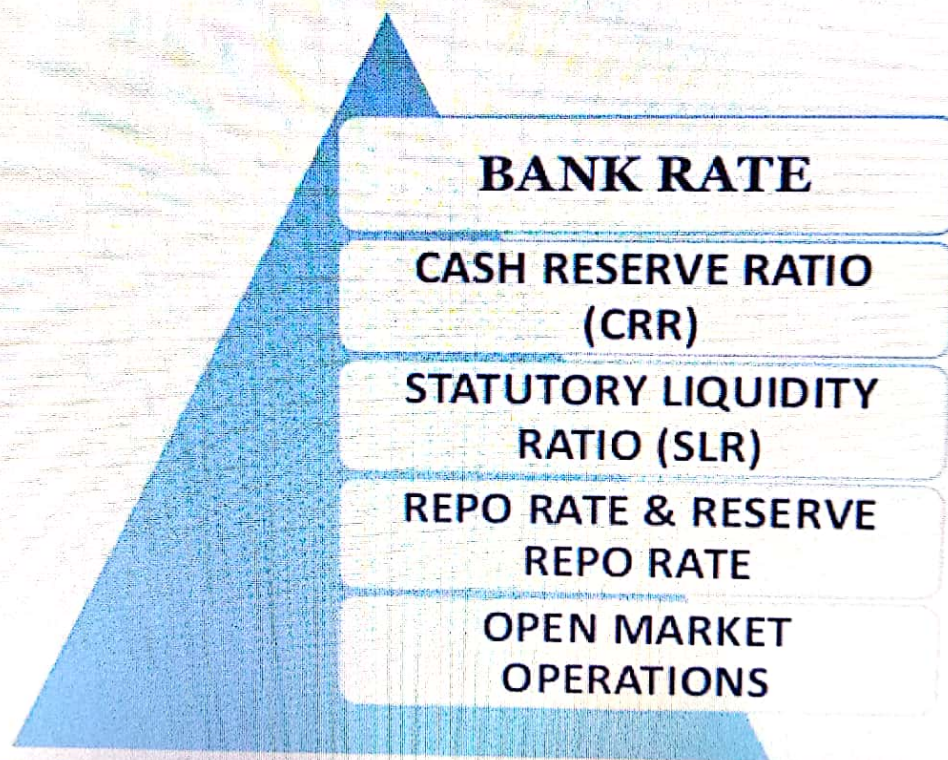
According to **Johnson**, "Monetary policy is defined as policy employing central bank's control of the supply of money as an instrument for achieving the objectives of general economic policy."

# **OBJECTIVES OF MONETARY POLICY**

- ✓ Full Employment
- ✓ Price Stability
- ✓ Economic Growth
- ✓ Balance of Payments



# **INSTRUMENTS OF MONETARY POLICY**



# Monetary Policy vs. Fiscal Policy: An Overview

Monetary policy and fiscal policy refer to the two most widely recognized tools used to influence a nation's economic activity. Monetary policy is primarily concerned with the management of interest rates and the total supply of money in circulation and is generally carried out by [central banks](#), such as the U.S. [Federal Reserve](#).<sup>[1]</sup> Fiscal policy is a collective term for the taxing and spending actions of governments. In the United States, the national fiscal policy is determined by the executive and legislative branches of the government.

## KEY TAKEAWAYS

- Both monetary and fiscal policy are tools a government can access to support and stimulate the economy.
- Monetary policy addresses interest rates and the supply of money in circulation, and it is generally managed by a central bank.
- Fiscal policy addresses taxation and government spending, and it is generally determined by legislation.
- Monetary policy and fiscal policy together have great influence over a nation's economy, its businesses, and its consumers.



# **BANK RATE**

- Bank Rate is also known as discount rate.
- It is the rate at which RBI lends to the commercial banks or rediscounts their bills.
- If bank rate is increased ,then commercial banks also charge higher rate of interest on loans given by banks to public because now commercial banks get funds from RBI at higher rate of interest.
- Higher rate of interest will contract credit in the economy i.e. public will take lesser loans because of higher rate of interest.
- The current bank rate is 6.75%

## **CASH RESERVE RATIO (CRR)**

- Cash Reserve Ratio is a certain percentage of bank deposits which banks are required to keep with RBI in the form of reserves or balances .
- Higher the CRR with the RBI lower will be the liquidity in the system and vice-versa.
- RBI is empowered to vary CRR between 15 percent and 3 percent.
- But as per the suggestion by the Narshimam committee Report the CRR was reduced from 15% in the 1990 to 5 percent in 2002.
- The current CRR is 4.00 %.

## **Statutory Liquidity Ratio (SLR)**

- It means a certain percentage of deposits is to be kept by banks in form of liquid assets.
- This is kept by bank itself the liquid assets here include government securities, treasury bills and other securities notified by RBI.
- If SLR is more then banks have to keep more part of deposits in specified securities and banks will have less surplus funds for granting loans. It will contract credit.
- SLR is fixed by RBI and usually it has been ranging between 25% to 40%. By an amendment of the Banking regulation Act(1949) in January 2007, the floor rate of 25% for SLR was removed.
- The current SLR is 20.75 %.



## **REPO RATE & RESERVE REPO RATE**

- Repo rate is the rate at which RBI lends to commercial banks generally against government securities. Reverse Repo rate is the rate at which RBI borrows money from the commercial banks.
- Reduction in Repo rate helps the commercial banks to get money at a cheaper rate and increase in Repo rate discourages the commercial banks to get money as the rate increases and becomes expensive.
- As the rates are high the availability of credit and demand decreases resulting to decrease in inflation.
- This increase in Repo Rate and Reverse Repo Rate is a symbol of tightening of the policy.
- The current repo rate is 6.25 % and reserve repo rate is 5.75 %.



# **OPEN MARKET OPERATIONS**

- It means that the bank controls the flow of credit through the sale and purchase of securities in the open market.
- When securities are purchased by central bank, then RBI makes payment to commercial banks and public. So, the public and commercial banks now have more money with them.
- It increases money supply with commercial banks and public. This will expand credit in the economy.
- In year 2012-13 RBI Purchases securities 8,000 crore

# **FISCAL POLICY**

- “It refers to a policy concerning the use of state treasury or the government finances to achieve the macro-economic goals”

**OR**

- “Government policy of changing its taxation and public expenditure programs intended to achieve its objective”.

**OR**

- “Government uses its expenditure and revenue program to produce desirable effects on National Income , production and employment”.



# **OBJECTIVES OF FISCAL POLICY**

- ✓ To Achieve Equal Distribution of Wealth
- ✓ Increase in Savings
- ✓ Degree of inflation
- ✓ To Achieve Economic Stability
- ✓ Price stability

# **INSTRUMENTS OF FISCAL POLICY**



**DEFICIT  
POLICY**

**PUBLIC  
EXPENDITURE**

**TAXATION  
POLICY**

**PUBLIC  
DEBT**



# **DEFICIT POLICY**

- Deficit Financing refers to financing the budgetary deficit.
- Budgetary deficit here means excess of government expenditure over government income. It means "Taking loans from reserve bank of India by the government to meet the budgetary deficit" .
- Reserve bank gives loans by issuing new currency notes. Increase in money supply leads to fall in value of money. Fall in value of money in turn leads to increase in price level. So deficit financing should be kept low as it leads to price rise in economy.
- Thus due to deficit financing necessary funds are made available for economic Growth and on the other inflation of country increases

# **PUBLIC EXPENDITURE**

- Public expenditure influences the economic activities of country very much.
- Public expenditure may be of two kinds i.e. developmental and non developmental.
- Expenditure on developmental activities requires huge amount of capital. So much capital cannot be made available by private sector alone. It requires substantial increase in public expenditure.
- Public expenditure may be made in many ways:- (1) Development of state enterprises, (2) Support to private sector, (3) Development of infrastructure & (4) Social Welfare.



# **TAXATION POLICY**

- Taxes are the main source of revenue of government.
- Government levies both direct and indirect taxes in India.
- Direct taxes are those which are directly paid by the assesses to the government i.e. income tax, wealth tax etc. Indirect tax are paid indirectly by the public to the government i.e. excise duty, custom duty, VAT etc.
- Direct tax are progressive in nature. Indirect tax are not progressive.
- These change from all the segments of society at same rate.
- The main objectives of taxation policy are: (1) Mobilization of resources, (2) To promote saving, (3) To promote saving & (4) To bring Equality of income and wealth

# PUBLIC DEBT

- Government needs lot of funds for economic development of the country. No government can mobilize so much funds by way of tax alone.
- It is therefore , becomes inevitable for the government to mobilize resources for economic development by resorting the public debt.
- Public debt is obtained from two kinds:- (1) Internal Debt (2) External Debt
- Public Debt of Year (In crores of Rupees)

	<i>31st March 2013</i>	<i>31st March 2014</i>
Internal debt	48,66,829.00	54,68,622.11
External debt	1,72,302.01	1,82,862.11
<b>Total</b>	<b>50,39,131.01</b>	<b>56,51,484.22</b>