Subject: Macroeconomics

Semester/Year: Semester IV (4th Semester)

Name of the Teacher: Dr. Sudip Kumar Ghosh

Name of the Topic: Instruments of Monetary control (Unit 3: Money)

Instruments of Monetary Control

Appointments

Following instruments are used in India for the purpose of monetary control:

(1) Open Market Operations

Open market operations means selling and purchasing of government securities by the RBI in the open market. This is an important instrument of credit control. According to some monetarist and bankers open market operations is a complementary instrument of bank rate policy. In Indian economy ~~the technique~~, the technique of open market operation was developed much later. The need of open market operation was felt when weakness of the interest rate policy was observed. However, the technique of open market operation is not enough for controlling credit creation in the Indian underdeveloped money market.

In order to reduce supply of money in the money market the RBI sells government securities or bond in the open market. In this view bank rate is increased, so that demand for bonds increases, obviously the problems that may be created due to excess supply of money be solved. In opposite, the RBI purchases bonds from market so that supply of money will be increased to meet the demand for money as well as price stability.

(II) Cash Reserve Ratio (CRR)
(III) Statutory Liquidity Ratio (SLR)
(IV) Bank Rate Policy

Bank rate, also known as discount rate, is the rate of interest which a central bank charges on its loans and advances to a commercial bank. Whenever a bank has a shortage of funds, they can typically borrow from the central bank based on the monetary policy of the country.

v) Credit ceiling

In basic terms (since there are a large number of factors depending on the situation) a credit ceiling is the maximum amount ~~of~~ that a person, company or entity can borrow. The term ceiling is typically applied to corporations or governments where a person can't just call their bank to ask for more credit.

When RBI imposes a credit limit, the banks will get tight in advancing loans to public. Further, RBI may also direct the banks to provide certain fraction of their loans to certain sectors such as farm sector or priority sector.

vi) Credit Authorisation Scheme (CAS)

The Credit Authorisation Scheme (CAS) for bank advances was introduced by the RBI in 1965. Under the scheme, all scheduled commercial

banks have to obtain prior authorisation of the

RBI before granting any fresh credit limit of Rs 1 crore or more to any single borrower. The limit was however, raised to Rs 2 crores in 1975. According to CAS, the banks first scrutinise the proposals of the borrowers and then send them to the RBI for approval.

Appointments

(vii) Moral Suasion

Work to do

This is an important qualitative credit control method. This method will be successful only if the central bank is strong enough to influence over other banks like schedule commercial banks and even some cooperative banks.

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This is an informal/psychological means of qualitative credit control method. This has been implementing by the RBI since 1949.

This method is also known as moral persuasion.

Since, the RBI persuades the commercial banks to

follow its orders/directions on the flow of credit. The RBI pressurises the other banks to put a ceiling on credit flows during inflation and it also pressurises the other banks to be liberal in lending during deflationary situation.

Appointments

(VIII) Repo Rate and Reverse Repo Rate

Work to do

(Repo Rate & Reverse Repo Rate ~~discussed~~ have been explained earlier)

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