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## 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.

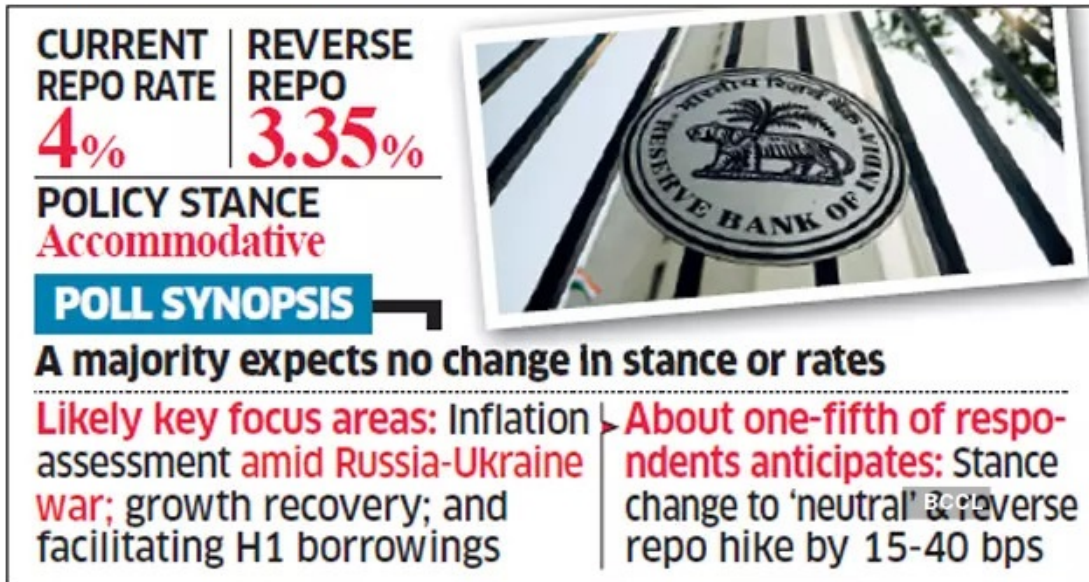
*Repo rate is the interest charged by the RBI when commercial banks borrow from them by selling their securities to the central bank.*

*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  $\pm 2\%$ , 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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