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MONETARY POLICY INSTRUMENTS BY RBI: INSTRUMENTS AND POLICIES TO COMBAT COVID-19 PANDEMIC

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ABSTRACT

The given research discusses the monetary policy instruments of the Reserve Bank of India and how these instruments and policy rates have been changed during the COVID-19 Pandemic to keep the economy of India under control. Monetary policies are taken by Central Bank of India, Reserve Bank of India (RBI) aims at changing the policy rates with respect to the given situations. The outbreak of Coronavirus affected the Indian economy massively and to control the situation, RBI has provided some significant changes in policy rates that can help to stabilize the economic activities until the pandemic gets over. Changes in these policies rates and how these changes are helping the economy and banking system of India are the main concern of this research.

Keywords: COVID-19 Pandemic, Monetary Policy, Monetary Policy Instruments, RBI

Introduction

A virus of size 0.12 microns, Covid-19, has severely damaged the global economy and the pandemic is spreading at an alarming speed and infecting the people all over the world. As a consequence of this condition, governments of all the affected countries are imposing strict restrictions to control the spread of the virus leading to a slow down of world economic activities. It is predicted that most of the countries are going to face a recession in the later months of 2020 and per capita income will contract in the large fraction that the countries have ever witnessed since 1870. In such a situation, although advanced countries can easily finance the unexpected increase in the expenditure when the overall revenues are dropping; however challenges remain for the emerging economies. Low-income countries face capital flight and require financing and grants from the global economy (World Bank, 2020). This crisis needs urgent action to combat these economic consequences and it becomes the responsibility of the Central Banks and governments to take necessary decisions in order to defend the economy. Major economic policies in this respect include fiscal and monetary policies that can help the economies to overcome from such disruptions.

Monetary Policy of Reserve Bank of India (RBI)

Monetary policy is referred to the usage of monetary instruments undertaken by the central bank in order to control and regulate the money supply, interest rates, and availability of the credit to achieving the ultimate objectives of the economic policy. In India, the responsibility to conduct the monetary policy is on the central bank that is Reserve Bank of India (RBI). The objective of monetary policy taken by RBI lies in maintaining the stability of prices in the economy along with economic growth as it is observed that stability in prices plays a crucial role in sustainable economic growth. The aim of the monetary policy framework is to set the policy rate which is also known as repo rate on the basis of an assessment of the current as well as evolving macroeconomic situations. This framework also looks after the modulation of liquidity conditions to anchor the money market rates at the repo rate. Change in repo rate through the money market to the financial system influences the aggregate demand which is considered to be the key determinant of inflation and growth.

Monetary Policy Instruments of RBI

There are some important direct and indirect instruments taken by the RBI that are used to implement the monetary policy. Repo rate is the fixed interest rate at which RBI gives liquidity to the banks against some collateral of the government and other securities approved by the government under the LAF (liquidity adjustment facility). In order to absorb liquidity based on overnight terms, RBI uses a fixed interest rate which is known as reverse repo rate. Here RBI absorbs such liquidity from banks in return of collateral of the eligible government securities under liquidity adjustment facility. The LAF is consisting of two significant aspects such as overnight repo auctions and term repo auctions. Marginal standing facility (MSF) is another important instrument of monetary policy and this is the facility under which RBI lends money to all the commercial banks of the country against particular interest rates by considering the statutory liquidity ratio (SLR) portfolio. When the banks face unanticipated liquidity shocks, MSF at that point provides a safety valve against the shock. Bank rate is the rate at which RBI buys commercial papers and it is published under section 49 of the RBI Act 1934. Bank rate is associated with the MSF rate which indicates that change in the MSF rate leads to a change in bank rate along with policy repo rate. Cash Reserve Ratio (CRR) is a significant instrument that is considered an average daily balance. Every commercial bank is required to keep a particular amount as a share of the Net Demand and Time Liabilities (NDTL) and this is nothing but the CRR (Rbi.org.in. 2020). Commercial banks are required to maintain government securities, cash, and gold as safe and liquid assets and these are also the shares of NDTL. This share of NDTL is known as the statutory liquidity ratio (SLR).

Data and Sources

All the relevant data have been collected from the RBI website which has the updated information regarding policy changes after the spread of Coronavirus.

Monetary Policy Measures taken by RBI for COVID-19 Pandemic

The COVID-19 Pandemic has adversely impacted the economy of India along with the GDP growth rate of the economy. According to the reports of the Ministry of Statistics, the growth of the Indian economy has fallen to 3.1% due to this pandemic which is an add-on to the pre-pandemic slowdown. Effects of this pandemic are considered to be more severe than it was expected to be. Monetary Policy Committee (MPC) of Central Bank is making continuous plans for easing the financial conditions of the economy by conducting several meetings. The committee is opting for unconventional monetary policy and the tools are designed to ease the underlying pressures of financing the state governments. After the meeting held in April 2020, RBI planned to cut the interest rates under LAF by 40 basis points and took the repo rate at the lowest level from 4.40% to 4%. The members of this committee announced that macroeconomic impact as a consequence of this pandemic turned out to be more brutal than it was anticipated given the depth of the crisis and they predicted that the economy will contract in this current fiscal year. In the meeting held in May 2020 provided some other changes in policy instruments of

RBI based on the given evolving macroeconomic condition. The MPC reduced MSF rate and Bank Rate from 4.65% to 4.25% and the reverse repo rate under LAF also reduced from 3.75% to 3.35% (Reserve Bank of India - Database, 2020). This committee decided to continue with these new stances till the time it is required for the economy to revive its growth again in pre-pandemic conditions. As a result of immediate lockdown in the country, consumption of the individuals has also reduced and excess liquidity occurs in the Indian banking system. In March 2020, RBI announced that to overcome this excess liquidity situation, the central bank has decided to widen the existing policy rate corridor to 65 basis points from 50 basis points. These modifications made by the RBI in policy instrument rates will compel the banks to deploy surplus funds to the productive sectors of the Indian economy as loans and investments instead of the RBI.

Inflation in this situation was considered to remain within the targeted rate and this decision was made by considering the objective to achieve the medium-term target in Consumer Price Index (CPI) inflation of 4% within the band of more or less 2% to support the growth (Reserve Bank of India, 2020). It is predicted that inflation remains at the targeted level until the period of July-September and it will remain stable in the second half of the current financial year as well. RBI has also ensured certain liquidity for the small non-banking financial companies (NBFCs) and it instructed the commercial banks to lend at least half money allocated to be borrowed from liquidity window. RBI released some new windows for financial institutions of India involving micro and small companies along with housing finance companies. It also asked the banks not to care about the payments related to dividends until the month of September and lower the liquidity coverage ratio (LCR).

In recent policy highlights, it has been mentioned that the current repo rate will remain unchanged and the MPC has voted unanimously for maintaining the status quo on the given policy rates. Current inflation dynamics will again remain watchful and it will be monitored continuously to maintain stability on the monetary side. Some significant stimulus measures have also been updated that includes additional liquidity of amount Rs. 10,000 crore at the current repo rate to the NHB and NABARD. RBI has also allowed the MSME borrowers for restructuring the current debt if the loans had been classified as standard until March 2020. The uncertain outbreak of Coronavirus disrupted the working of MSMEs and this sector needs additional support from both RBI and government. To ease the impacts of this pandemic on households, RBI decided to increase the permissible loan to value ratio (LTV) for such loans that have been sanctioned against the pledge of the jewelry and gold ornaments for the non-agricultural purposes from 75% to 90% until March 2021.

Conclusion

It can be concluded from the above analysis that due to the breakdown of economic activities during the COVID-19 Pandemic, the Indian economy is suffering from the chronic downturn of GDP and investment slowdown. Several stimulus packages have been taken in the form of policies to fight against this situation and monetary policy instruments are of them. These relief packages provide temporary assistance to kickstart the economy again towards economic progress. RBI provides liquidity support and transfers in order to keep businesses from becoming bankrupt. Several developmental and regulatory measures have been announced by RBI to complement the reduction of policy rates that have been decided by MPC to control this current situation. Decisions taken by MPC in the reduction of policy repo rate along with maintaining other accommodative stances related to monetary policy gives the opportunity to announce some corrective measures against the severe outlook for the activities of the economy. All these policy measures strengthen and complement each other and these measures are made to improve market functioning, to support the exports and imports of the economy, to ease the financial stress that occurred due to COVID-19 disruptions, and also to ease the financial constraints faced by the state governments. RBI will continue to use these new policy instruments to address the given dynamics of the unknown future and these stances will contribute to a better tomorrow.

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