# 7. MONETARY POLICY

## ANSWERS FOR TEST YOUR KNOWLEDGE QUESTIONS

### QUESTION NO. 1

Fundamentally, the primary objective of monetary policy has been maintenance of a judicious balance between price stability and economic growth.

### QUESTION NO. 2

Monetary policy is intended to influence macro- economic variables such as the aggregate demand, quantity of money and credit , interest rates etc., so as to influence overall economic performance.

### QUESTION NO. 3

Open Market Operations (OMO) is a general term used for market operations conducted by the Reserve Bank of India by way of sale/ purchase of Government securities to/ from the market with an objective to adjust the rupee liquidity conditions in the market on a durable basis.

- **Purchase of securities by the RBI increases the liquidity in the economy.**
- **Sale of securities by the RBI decreases the liquidity in the economy.**

### QUESTION NO. 4

As per 3rd Bimonthly Monetary Policy Statement i.e., as on 07.08.2019.

| Key Indicators | |
|---|---|
| **Indicator** | **Current rate** |
| CRR | 4% |
| SLR | 18.75% |
| Repo rate | 5.40% |
| Reverse repo rate | 5.15% |
| Marginal Standing facility rate | 5.65% |
| Bank Rate | 5.65% |



But there has also been **criticisms** of RBI's role as India's financial sector regulator. Some of the concerns are:

- RBI has not always been able to contain inflationary tendencies, especially around 2012-13.
- RBI has not always been able to maintain a balance between curbing inflation and promoting growth. Mr. Rajan was criticised for not lowering interest rates leading to lower credit uptake in the economy.
- The NPAs have risen with time, especially in public sector banks.
- Commercial banks complain about higher reserve requirements by the RBI, leaving them with lesser amount to lend out.
- The bank has not always seen eye-to-eye with the ruling government's view on economic policy of the country.

Despite all its criticism, the central bank has still been able to navigate India properly, especially now when our foreign exchange is at an all-time high of over 350 billion $ and inflation coming under control. Institutional reforms like the Monetary Policy Committee and greater transparency and objectivity in selection of the bank's governor can improve the central bank further.

### QUESTION NO. 5

**a)** Contractionary monetary policy
**b)** Expansionary monetary policy.
**c)** Expansionary monetary policy.
**d)** Contractionary monetary policy.
**e)** Contractionary monetary policy.
**f)** Contractionary monetary policy.
**g)** Absorbs the liquidity in the system and hence money supply reduces.

**h)** Influence the availability of resources in the banking system for lending.

## QUESTION NO. 6

RBI has not changed CRR but it reduced SLR by 0.5% as to avail more money with the banks and to increase the money supply. SLR of the banks can be utilized to raise their borrowings and even for LAF from RBI. Whereas CRR can't be utilized for the above purpose and doesn't bring any interest to the banks.

## QUESTION NO. 7

**Reasons for holding money as per Liquidity Preference Theory:**

According to Keynes' Liquidity Preference Theory', people hold money (M) in cash for three motives:

**i)** **The transactions motive:** People hold cash for current transactions for personal and business exchanges i.e. to bridge the time gap between receipt of income and planned expenditures.

**ii)** **The precautionary motive:** People hold cash to make unanticipated expenditures that may occur due to unforeseen and unpredictable contingencies.

**iii)** **The speculative motive:** This motive reflects people's desire to hold cash in order to be equipped to exploit any attractive investment opportunity requiring cash expenditure. According to Keynes, people demand to hold money balances to take advantage of the future changes in the rate of interest, which is the same as future changes in bond prices.

## QUESTION NO. 8

**Narrow Money ($M_1$):** It is a measure of money supply

**$M_1$** = Currency and coins with the people + demand deposits of banks (Current and Saving accounts) + other deposits of the RBI.

**Broad Money ($M_3$):** It is a measure of money supply

$M_3$ = $M_1$ + net time deposits with the banking system.

**By comparing $M_1$ and $M_3$:** $M_3$ - $M_1$ = Net time deposits with the banking system.





## THE END