Significance of Monetary Policies for Control of Inflation

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ABSTRACT

The development of the country depends on their economy, which needs money circulation time to time for striking equilibrium points between excess or scarcity. The monetary policies helpful in adjusting the problem of the economy's situation over a period of time. The problem of inflation arises due to the inflows and outflows of the money in excess quantity, which overall reduces the purchasing power of the money. So, inflation is said to be main the indicator of the development of the country. The objective of the study is to study the framework of Monetary Policies declared by RBI Governor and measures to control the inflation. The researcher has done descriptive research which is focusing on the monetary policies as well as impact on inflation. The purposive sample is used in the study and the data was collected through the secondary sources like from the various official websites. The findings of the study are that the inflation is seen from the monetary policy's angle and controlling aspects of the monetary policies is also seen through the implementation and changing in monetary policies time to time. Both term monetary policies and inflation inter dependent to each other and this paper attempts to analyse the relationship between monetary policies and inflations. At the end, it is concluded that monetary policies play a very significant role in controlling monetary supplies, if it is maintained in a good manner then equilibrium point is achieved at good inflation which should be operated to achieve overall high rate of development for the country.

Key Words: Monetary Policies, Inflation and Economy situation

I INTRODUCTION

Monetary Policies are said to be the monetary control system for any country. In monetary policies, various techniques are being adopt to control the monetary flow in a country.

Monetary Policies are governed by the monetary authority like RBI. It is a process by which monetary authority of a country controls the supply of money by increasing rates or decreasing rates of Monet which could be monetary flow from bank, financial institutions etc. or money revolving around the economy. This could result in expansionary or contractionary, so there are mainly two policies of monetary, i.e. expansionary policies, and contractionary policies. When RBI expands the supply in the economy then expansionary decisions have to be taken in regard to monetary flow, and when there is already extra circulation then RBI takes contractionary decision for minimizing it.

Central bank uses the expansionary policy under monetary policies framework, for solving the issue of unemployment in the period of recession: by lowering the interest rate, the ease of credit provides the loan facility to the people and this make encouragement in people to start their business. Contractionary policy is just opposite to the expansionay policy when Monetary policies involve the management of money supply through changing interest rates RBI influence the Monetary supply through operating monetary policies and keep change as it requires for the economy, and all these actions are directly or indirectly attaches with the inflation. inflation not to be too high for a country and too low for a country. the ideal rate of inflation is to 2 to 3% means money supply not to be too large or too low for making development in the country. While Monetary Policies tend to be maintained for money circulates in the economy of the country, there are some ways or actions which are to be taken in controlling the monetary system by the monetary authority like RBI, these actions such as modifying interest rates, selling or buying Government Bonds, and changing the rates of banks loans and commercial loans.RBI uses number of tools to shape monetary one of is open market operations, through buying short term government bonds when expansion needed, or sells them when need of contraction, arise. Monetary Policies refer to the controlling tools or say techniques adopted by the central bank of the country. Monetary policies are helpful in stabilizing the price level according to the Prof.Harry Johnson " A policy using by RBI to control the supply of money are treated as an instrument for accomplishing the purpose of modern economic policy is known as monetary policy"

To increase in Economic Growth Monetary Policy, boost the economic growth by controlling interest rates and its effect on the investment, if RBI cuts down the interest rates on Credit and avails the easy credit for all ten-investment level in the economy can be encouraged and this increased investment ultimately helps in increasing in economic growth of the country.

Price stability is main motive behind the monetary policy is also the main component of the economy which decides the economy is going well or not, the country have the strong or a weak economy? All economies in the world suffer from inflation and deflation and this is the price instability both inflation and deflation are harmful to the economy, therefore it is necessary to use monetary policy as a tool for minimizing the differences between inflation and deflation, in other words monetary policy have an objective of price stability that tries to keep the value of money stable.

Exchange rate stability it is the rate or say price at which the home currency is valued in terms of any foreign currency, if the rate is very volatile in nature and frequently goes ups and downs in the market, then at international level our rupees does not have the value of money, it may lose confidence in our economy. RBI tries to alter the rates of Foreign Exchange Reserves and influence the demand for foreign Exchange and maintain the stability.

(a) Objectives of Monetary Policies set by RBI

(i) The primary objective of monetary policy with the view of sustainable growth is to maintain stable price keeping growth rate increased.

(ii) In May 2016, the Reserve Bank of India (RBI) Act, 1934 provide a statutory basis for the implementation of the flexible inflation targeting framework.

(iii) The amended RBI Act also provides for the inflation target to be set by the Government of India, in consultation with the Reserve Bank, once in every five years. Accordingly, the Central Government has notified in the Official Gazette 4 per cent Consumer Price Index (CPI) inflation as the target for the period from August 5, 2016 to March 31, 2021 with the upper tolerance limit of 6 per cent and the lower tolerance limit of 2 per cent.

(b) How Monetary Policies Instruments Controls Inflation

The steps generally taken by the RBI to tackle inflation include a rise in repo rates (the rates at which banks borrow from the RBI), increased or decreased , interest rate also altered time to time for controlling inflation. The signals are intended to spur banks to raise lending rates and to reduce the amount of credit disbursed. The RBI take necessary steps for protecting the commercial banks working capital needed for monetary transactions. In effect, while the economy is booming and the credit needs grow, the central bank is tightening the availability of credit.

The RBI also buys dollars from banks and exporters, partly to prevent the dollars from flooding the market and depressing the dollar — indirectly raising the rupee. In other words, the central bank's interactions have a desirable objective — to keep the rupee devalued — which will make India's exports more competitive, but they increase liquidity.

To combat this, the RBI does what it calls "sterilisation" — it sucks out the rupees it pays out for dollars through sale of sterilisation bonds. It then sells these bonds to banks. Economists point out that there has not been much success in such sterilisation attempts in India. The central bank's attempt to offload Government bonds on banks has not been too successful inasmuch as the banks sell the bonds and get rupees instead.

Economists also contrast this with the successful experience of China, where the state-owned banks strictly abide by the central bank's dictates and absorb the sterilisation bonds. That discipline is lacking in India. The net effect is that the RBI has to resort to indirect methods of sterilisation, such as raising interest rates and raising CRR to contract liquidity. This makes India more attractive for foreign capital flows that seek better returns and a vicious cycle follows. RBI has to buy more foreign currency and sterilize. The cycle becomes worse. Credit control is a tool used by RBI, which is act as a major weapon for regulating the monetary policies, which ultimately used to control the demand and supply of money (liquidity) in the economy. Central bank RBI controls over the commercial banks for giving grant to them and monitors the credit value. This method is used by RBI to bring Economic Development with stability, thus it can be said that banks will not only control the liquidity and inflation trends in the economy but boosting the economic growth of the country also, which ultimately brings rise in real national income.

(c) Need of credit control in Monetary Policies

This is the most important aspect of the monetary policies which is adopted by RBI to adjust the liquidity in the economy that's why there is a great need of the credit control. it is done through two basic methods, qualitative method & quantitative method

Some of the objectives have to be secured by RBI through Credit Control.

(i) It is possible through credit control to specify the particular developed sector means it helps to encourage the development for priority sector which is

predetermined by Government.

(ii) To monitoring over the channelization of credit so that credit is not delivered for undesirable purpose.

(iii) To maintain adequate flow of money in the economy.

(iv) To strike a balance between inflation and deflation.

(d) Objective of credit control in Monetary Policies

If we talk about the objectives of credit control then need itself tells about its goals the main objective of the credit control to achieve high growth rate, and stability is also considered neither there is condition of higher, inflation or deflation in the country.

(e) Qualitative method

Controls the way of cash channel through by restricting or allowing it for expansion it is used in absolute value.

(f) Tools of Qualitative methods

(i) **Marginal requirement:** - in case of loan means, the current value offered for loan and the value which is offered for loan and the value which is granted for loan marginal requirement increased means the more amount of granted loan has been kept by the bank and less grant amount of loan provided by the bank.

(ii) **Rationing of the credit:** -it is a measure undertaken by central bank to limit or deny the supply of credit based on the credit worthiness and increased loan demand in other words it is a situation where the RBI denies credit to the borrower who want fund and are willing to pay at higher interest rate is called a credit rationing.

(iii) **Publicity:** - sometimes RBI uses media to look over the current market condition and its direction that is to be followed by the all commercial banks to control the unrest.

(iv) **Direct Action:** - Under the banking regulation act RBI have the right to take action against any commercial bank that refuses to obey the directions given by the RBI

(g) Quantitative method

Quantitative controls means controlling the quantity of credit and this is possible by using different techniques like BR, CRR, SLR, MSF at which monetary flow is circulated by specified rates at which RBI want.

There are several direct and indirect instruments that are used for implementing monetary policy.

(i) **Repo Rate:** is that interest rate at which central bank i.e. RBI in India gives overnight liquidity to banks in against of collateral securities of government and other kinds of securities under the head of liquidity adjustment facility.

(ii) **Reverse Repo Rate:** The (fixed) interest rate – currently 50 bps below the repo rate – at which the Reserve Bank absorbs liquidity, on an overnight basis, from banks against the collateral of eligible government securities under the LAF.

(iii) The LAF consists of overnight as well as term repo auctions. Progressively, the Reserve Bank has increased the proportion of liquidity injected under fine-tuning variable rate repo auctions of tenors ranging between overnight and 56 days.

(iv) **Marginal Standing Facility (MSF):** in case of Indian commercial bank required money at short period of time or in emergency condition then this gives an option to Indian commercial bank can grabbed the money by sinking into statutory liquidity margin i.e. 2% of net demand and term liabilities.

(v) The MSF rate and reverse repo rate determine the corridor for the daily movement in the weighted average call money rate.

(vi) **Bank Rate:** the rate at which RBI, buys: the rediscounted bills of exchange, it can be commercial paper section 49 of RBI Act, 1934, provides the explanation about the bank rate.

(vii) **Cash Reserve Ratio (CRR):** All commercial bank have to maintain the cash reserve of their total net demand and total liabilities of their capital with the RBI.

(viii) **Statutory Liquidity Ratio (SLR):** The share of NDTL that banks shall maintain in safe and liquid assets, such as, unencumbered government securities, cash and gold. Changes in SLR often influence the availability of resources in the banking system for lending to the private sector.

(ix) **Open Market Operations (OMOs):** These include both outright purchase and sale of government securities for injection and absorption of durable liquidity, respectively.

(h) Market Stabilisation Scheme (MSS)

This scheme was introduced in the year 2004 for the purpose of management of monetary variable. Short term government securities and treasury bills are helpful in raising large capital flows because of surplus liquidity. Cash is also utilised in government account with RBI.

II OBJECTIVE OF THE STUDY

To study the framework of Monetary Policies declared by RBI.

To review and analyse Monetary Policies and measures to control the inflation.

III RESEARCH METHODOLOGY

This Study is exclusively based on Secondary data which are collected from RBI Occasional Papers, RBI Annual Report, Report on Currency & Finance, Economic Survey, Economic & Political Weekly, Asia Economic Review, Indian Economic Journal, World Bank Report, Internet etc.

(a) **Scope of the Study-** The study covers for a period of 11 years' financial years 2005 to 2016. Thus, the study examines the impact of monetary policy for controlling inflation in economy of the country, in India.

IV REVIEW OF MONETARY POLICY SINCE 2005 TO 2016

Movements in cash reserve ratio during 2005 -2016

Table 1

Year	CRR	Remark
2005	5%	---
2006	5.25%	---
2007	5.50%	---
2008	8.25%	Banks needs more liquidity at the time of Financial fall down and inflation is too high that it downs the purchasing power of money then it is decided bank have to kept more amount of money in comparison to the previous year.
2009	5%	
2010	5.75%	To control inflation.
2011	6%	To absorb excess liquidity for prevention of speculative measures.
2012	4.25%	---
2013	4%	---
2014	4%	---
2015	4%	---
2016	4%	---

source www.rbi.gov.in

Movements in Statutory Liquidity Ratio during 2005 -2016
Table 2

Year	SLR	Remrk
2005	25%	---
2006	25%	---
2007	25%	---
2008	24%	---
2009	25%	---
2010	24%	---
2011	24%	---

2012	23%	To increase money flow
2013	23%	,,
2014	22.5%	---
2015	21.5%	In order to create space for banks to expand credit, and the more amount of money is now used by lending to productive sectors on competitive terms, so as to support investment and growth.
2016	21.25%	Boosting growth for the industrial sector.

source www.rbi.gov.in

Movements in Reverse Repo rate during 2005 -2016

Year	Reverse repo rate	Remark
2005	5%	---
2006	6%	---
2007	6%	---
2008	6%	To deal with the liquidity crunch &adverse foreign exchange.
2009	4%	For absorption of liquidity
2010	3.75%	,,
2011	5.75%	---
2012	7.50%	To increase money flow in the economy.
2013	6.75%	---
2014	7%	---
2015	6.75%	---
2016	6%	It is reduced to increase flow of money in the market in comparison to the previous year.

source www.rbi.gov.in

Movements in Reverse Repo rate Ratio during 2005 -2016

Year	Repo rate	Remark
2005	5%	---
2006	5%	---
2007	7.5%	---
2008	5.5%	For meeting, economic slowdown
2009	4.75%	To deal with the decelerated growth
2010	6.25%	---
2011	8.50%	To maintain economic stability
2012	8%	---
2013	7.75%	---
2014	8%	---
2015	7.75%	---
2016	6.5%	It is reduced for lowering cost of short term money loans, and encouraging banking transaction with low cost.

source www.rbi.gov.in

V CONCLUSION

The study analyzes the monetary policies framework given by RBI for controlling Inflation, since, Inflation is very important indicator of growth of the country but it should not be too much high for the country that ultimately lowers the purchasing power of the money. It is seen the importance of Monetary Policy has been increasing year after year, its role is very relevant in attaining monetary objectives especially in managing price stability. Monetary Policy adopts various methods such as BR, (bank rate), CRR, (cash reserve ratio) SLR, (Statutory Liquidity Ratio) RR,(Repo Rate) which to have increase as well as maintained for continues economic growth. RBI is able to strike a balance between Inflation and Deflation through monetary policies. It is also seen that inflation could be managed with change in qualitative methods as well as in quantitative methods. There was great economic depression in year 2008 downfall when quantitative methods proved helpful in maintaining the inflation and brought the inflation to its previous situation.

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