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ROLE AND IMPORTANCE OF MONETARY POLICY IN INDIA

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Abstract

Our economy is composed of monetary and non-monetary sectors. With the passage of time area of monetary sector is increasing. Due to this importance of monetary policy is increasing in our country. Monetary policy plays very important role in the economic development of a country. Modern economists also laid more stress on this policy for economic development of an economy. It is made by central Bank of a country. In this paper it is my utmost desire to explain monetary policy in India and its importance. In this paper I also want to describe role of monetary policy in economic development of our economy.

INTRODUCTION:-

Monetary policy means a policy which is made to control money supply in the country. It is announced by the governor of RBI after each quarter. Its main aim is to regulate rate of interest to control money supply in order to achieve the objective of economic growth and development. It involves the management of money supply and interest rate and it is the demand side economic policy. Its main objectives are controlling inflation, increase in consumption, increase in growth and increase in liquidity. In India we know that monetary policy is made by RBI because it is central monetary authority in our country. Main objectives of this policy are given below

STABILITY OF PRICES:-

It is the main objective of this policy. When there is the condition of inflation the policy of credit control is adopted on the other hand if there is the condition of depression the policy of credit creation is adopted. In this way this policy helps to maintain price stability in the economy.

CONTROL OF BANK CREDIT:-

Monetary policy is directly related to banking sector of the economy. To control bank credit is also an important objective of it. By adopting quantitative and qualitative methods, it can control bank credit for the sake of maintaining stabilization in the economy.

TO INCREASE INVESTMENT:-

By adopting an efficient monetary policy govt. of a country can increase the level of investment in the economy. Particularly it helps to promote fixed investment in the country.

RESTRICTIONS ON INVENTORIES AND STOCKS IN THE ECONOMY:-

Monetary policy also restricts the overfilling of inventories and stocks because overfilling of inventories and stocks do not add to any productive capacity of the country.

PROMOTION OF EFFICIENCY:-

This policy also leads to the increase in the efficiency in the economy. IT also tries to increase the financial efficiency by maintaining economic stability in the country.

FULL EMPOLYMENT:-

It is also an important objective of this policy. By increasing financial efficiency, by increasing productive capacity, this policy tries to increase level of employment and tries to achieve full employment in the economy.

INSTRUMENTS OF MONETARY POLICY

MONEY SUPPLY:-

It is the main instrument of this policy. By controlling money supply the objectives of price stabilization and economic stabilization can be achieved. If money supply increases in the economy, it can lead to inflation in the economy which can prove very harmful in the long run for the economic development of the economy. By adopting the policy of credit control inflation can be removed from the economy. On the other hand decrease in money supply leads to depression which is again a big threat for an economy. By adopting policy of credit creation depression can be curtailed.

RATE OF INTEREST:-

Monetary control can be implemented by controlling rate of interest in the economy. Rate of interest can be controlled by adopting an appropriate monetary policy in the economy. There are a large number of key rate of interests like Bank rate, Repo rate, Reverse Repo rate, Statutory liquidity Ratio, Cash Reserve Ratio etc. these rates are important rates which can be changed by RBI governor for controlling credit in the economy. For example during inflation these rates (except Reverse Repo Rate) are increased and during depression these are increased.

MONETARY POLICY IN INDIAN CONTEXT

In India monetary policy is announced after each quarter by the governor of RBI. All the key rates of interest are changed during the announcement of the monetary policy to maintain economic and price stabilities. For example during UPA govt. all the rates of interest were very high because of price rise. Like CRR was 6%. But during preset govt. due to fall in prices CRR has come down to 4%. SLR is also has come down to 21.5%. current Bank rate is 7.75%, CRR is 4%, SLR is 21.5%, Repo Rate is 7.25%, Reverse Repo rate is 5.75% and Marginal Standing Facility is 8.25%.Till 03/05/2011 the Reverse Repo rate was an independent rate but now it is linked with Repo Rate and it will always be 100 bps below the Repo Rate. And the concept of Marginal Standing Facility was introduced on 3rd may 2011 and implemented from 9th may 2011. At that time it was decided that MSF will be linked to Repo Rate and will be 100 bps above the Repo Rate. But on 15thjuly 2013 it was decided that MSF will be 300 bps above the Repo Rate. Again on 20th September 2013 it was determined 200 bps above the Repo Rate i.e. 9.50%. So we can say that MSF is linked only to Repo Rate.

ROLE OF MONETARY POLCY IN ECONOMIC DEVELOPMENT OF A DEVELOPING ECONOMY:-

In a country like India monetary policy plays very important role in economic development. It is explained below

TO ACHIEVE PRICE STABILITY:-

Developing countries like India suffer from the problem of instabilities of prices. For example India is suffering from the problem of inflation for last many years. To stabilize prices credit control policy of monetary policy is very effective and rational. In this policy key rates of interests like Bank rate, Repo rate, CRR, SLR are raised. It is a tight monetary policy which makes the credit dear and supply of money becomes low and prices are controlled from rising. Similarly when prices become low and there arises the conditions of depression, this situation can be controlled by increasing the supply of money. Supply of money can be increased by adopting the cheap monetary policy. For this purpose key rates of interest are decreased. It is called credit creation and it can curb the situation of depression.

REMOVING THE ADVERSE BALANCE OF PAYMENT:-

Less develop countries like India suffer from the problem of adverse balance of payments. It is so because that their exports are always less than their imports. It is so because they are technically backward and their industries suffer from the problem of shortage of capital (financial, human and physical). This problem can be removed by increasing foreign capital and by increasing exports.

If monetary authority increases the rate of interest, foreign investment can increase and by increasing production capacity, exports can be increased. By doing these deficits of BOP.

INTEREST RATE POLICY:-

It is the main instrument of monetary policy. By making rational changes in rates of interest savings can be mobilized and capital formation can be done in the economy. If rate of interest on deposits is increased, it will increase savings, it will develop banking habits among the people and it will lead to monetization of the economy. It further leads to capital formation in the economy. If rate of interest are increased, it is also an anti-inflationary policy. It discourages borrowing and lowers the speculative demand for money.

EXPANSION OF BANKING AND FINANCIAL SECTOR:-

Monetary policy is made by the central bank of an economy. An efficient monetary policy not only regulates money supply and rate of interest but also helps in the expansion of banking and financial sector of the economy. It develops the banking habits among the people and helps in the monetization of non-monetized sector of the economy. Only after the approval of Governor of central bank of the country banks and financial institutions are opened in the economy. Same is true with our economy. Due to this there are a large number of nationalized and private banks are in our economy which are playing very important role in our economy.

CONCLUSION:-

To conclude we can say that monetary policy is one the most important policies of an economy which can play very important role in the economic and social development of our economy. Its efficiency depends upon the central bank of the country. Economic stabilization can be maintained with its help. Many modern economists are in the favor of monetary policy for improvement in the economy and to make economy free from the economic fluctuations. This policy proves very helpful in the debt management. RBI issues govt. bonds at right time in order to stabilize their prices and to stop speculative activities in the economy. An appropriate monetary policy increases the trust of foreign investors in our economy. It is the need of hour that our economy should adopt appropriate monetary policy.

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