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RBI MONETARY POLICY AND ITS IMPACT ON THE INDIAN ECONOMY

- Priya Khandelwal[1]

ABSTRACT

The central theme of this Research Paper is the current monetary stance taken by the RBI in the Indian Financial System with special reference to the Monetary Policy Statements issued by the Monetary Policy Committee (MPC) during the six months period starting from September 2023 till February 2024. This time frame is of great importance since it highlights how RBI's interventions have consolidated the Indian financial and banking system against a tricky backdrop characterized by brewing global uncertainties like rising geo-political tensions, US Federal Bank spiking interest rates, surging domestic inflation, 2019 pandemic spillovers etc. The central bank's recent efforts to regulate, supervise and act as a watchdog for the financial market have been a strong contributor to India's robust GDP growth in the FY 2023-24. The paper commences with a general discussion on the RBI's role and various monetary and credit tools it relies upon to ensure financial stability. The research paper then analyses the overall impact of the Monetary Policy on the Indian economy which is currently emerging as a global growth engine.

Keywords- Monetary policy, GDP, regulation, repo rate, CRR, SLR, inflation, price stability

INTRODUCTION

Monetary Policy formulated by the Monetary Policy Committee has a huge bearing on the economic and financial system of a country. Interest/ policy rate is a key instrument in the hands of the Central Bank to influence the overall inflation in an economy. Since the year 2014, inflation levels in India have witnessed a decline and a major factor for the same is the

[1] Student at Amity Law School, Noida

Monetary Policy stance taken by the RBI. RBI is mainly tasked with monitoring the money supply in the economy in order to maintain stability in the prices. Amount of money freely circulating in the system is effectively controlled by the RBI by using tools such as bank rate, repo rate, cash reserve ratio (CSR), statutory liquidity ratio (SLR), open market operations (OMO) etc. The overall objective of a Monetary Policy is to achieve the optimum levels of inflation. More than required demand in the market is deterred by the RBI by hiking the interest rates. The policy rate also impacts the exchange rate for the Indian rupee and a higher interest rate provides a conducive environment for foreign investors. On the other hand, reducing interest rates reduces borrowing costs, attracts investment and promotes growth in the domestic economy. RBI thus has to strike a balance and adjust the monetary policy rates accordingly. Policy repo rate is definitely not a solution to all the problems in an economy but it definitely sets the course and direction and forms the basis of other policy decisions. How well this policy rate ripples its effects through the system in form of economic growth and price stability, is a real question and dependent on several factors and the overall macroeconomic and policy background.

CENTRAL BANK'SMONETARY POLICY AND ITS TOOLS

Most important function of RBI is to formulate and execute monetary policy. As the saying goes 'with great power comes great responsibility', RBI has immense responsibility to shoulder since implementation of Monetary policy is the sole domain of the RBI. Primary objective of monetary policy is to control inflation, money supply and credit availability. Increase in credit availability further increases the money supply in the economy. This leads to surge in consumer demand which ultimately causes inflation (rise in prices). RBI therefore intervenes to keep the inflation at the target levels. This is done through introducing changes in the market determined interest rate. The objective is to ensure economic stability, minimum unemployment, secure value of currency and boost GDP. Central Bank mainly engages in adjusting interest rates, participating in open market operations setting requirements for reserves. The traditional approach uses Bank Rate, Reverse Repo Rate, Repo Rate, CRR, SLR, Marginal Standing Facility (MSF) and liquidity Adjustment Facility (LAF). The modern or qualitative instruments include Credit Rationing, Consumer Credit Regulation, Moral Persuasion and Margin Requirements.

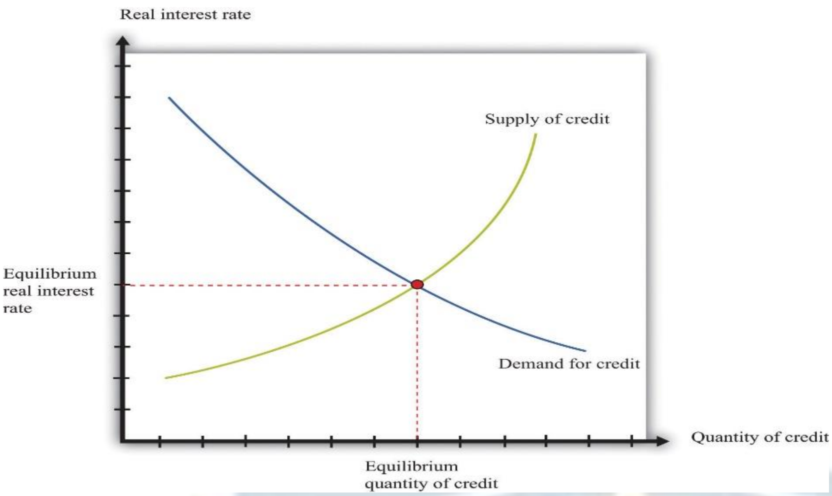

Fig. 1

Quantitative Measures

Repo Rate & Bank Rate

Bank rate and repo rate is the rate of interest charged by the RBI on loans granted to the commercial banks. The difference between the two is that no collateral is not required in case of loans on bank rate. In case on repo rate or repurchase rate, RBI requires collateral from the banks in form of government securities.

Cash Reserve Ratio (CRR)

Every commercial bank is under obligation to keep a proportion of its cash with the RBI as a reserve. CRR helps in moderating the loan giving capacity of commercial banks.

Statutory Liquidity Ratio (SLR)

SLR is another obligation on commercial banks which mandates it to maintain a percentage of its total liquid assets as a reserve with itself at all times and puts a bar on it to shell out these liquid funds are loans. This also ensures sufficient liquid funds with the banks.

Open Market Operations (OMO)

Buying and selling of securities (e.g. government bonds) by RBI to commercial banks is another tool deployed by the RBI to control money supply.

Qualitative Measures

Marginal Requirement

The difference between value of collateral and amount of loan is called marginal requirement. Increase in marginal requirement discourages people from borrowing money from commercial banks.

Moral Suasion (Appeal)

RBI appeals to the commercial banks to control credit supply. This is termed as moral suasion and can be in form of letters.

Direct Control

In case of failure by commercial banks to adhere to the moral suasion given earlier, RBI takes strict action by giving directions and establishing a direct control on these banks.

Selective Credit Rationing

This means loans for selective purposes only such as home loan, education loans. Medical loans. Restrictions are placed by RBI on lending in non-essential loan segments such as personal loans, car loans, higher education loans etc. Distributing money in all loan segments by reducing overall percentage of loan to a particular segment is termed as credit rationing.

Modern tools of Monetary Policy

Market Stabilization Scheme

This scheme came in existence in the year 2004 following MoU between RBI & Government of India. Similar to open market operations where the RBI issues government securities to the commercial banks, under market stabilization scheme government bonds are sold to the public directly. It is a monetary policy intervention by RBI to withdraw excess liquidity.

Interest-rate Corridor

RBI has stipulated maximum and minimum interest payable by commercial banks to the public on deposits. Between this floor rate and ceiling rate for interest, commercial banks can exercise discretion while deciding amount of interest to be payable on the bank deposits and which is receivable on loans. In other words, this is the range within which short-term interest rate moves around the policy rate as announced by the RBI.

Liquidity Adjustment Facility (LAF)

LAF tools in monetary policy allows banks to borrow money through re-purchase agreements in case of liquidity deficit. In case of excess liquidity, reverse repo rate is used to drain excess money standing with banks. LAF aids bank by adjusting day to day mismatches in the banking system. We can infer LAF comprises of both repo rate and reverse repo rate.

Marginal Standing Facility (MSF)

This scheme was announced in the FY 2011-12. MSF is the rate at which banks can borrow money from Central Bank over & above (threshold limit) what is available to them through LAF corridor. MSF is always more than the repo rate since it is the penal rate.

Reverse Repo Rate

Interest rate at which RBI absorbs liquidity by borrowing money from commercial banks on overnight basis against government securities. Reverse repo rate is always lower than the repo rate.

RECENT MONETARY POLICY STATEMENTS & REGULATORY POLICIES

Monetary Policy Committee, its Meetings and Report

Section 45 ZB of the RBI Act, 1935 dictates the composition of MPC. MPC consists of the Governor, Deputy Governor, RBI officer and 3 members appointed by the central government.As per the provisions of section 45 ZI of RBI act, 1935, 4 meetings are to be held in a year. Meeting schedule of full year is published by RBI at least 1 week before the first meeting. Change in the meeting schedule are made if it is in the opinion of the governor. Alternatively, such a decision is taken in the meeting prior to the meeting in which such a change is to be affected. Quorum of Meeting comprise of 4 members, out of which, one is mandatorily required to be the governor or the deputy governor. Resolution of meeting is passed based on majority votes and in can of a tie, casting vote of governor prevails. Every member has to state reasons for his vote and proceedings of MPC are kept confidential. As per section 45 ZM of RBI Act, 1935, a monetary policy report is to be published by the RBI every six months which reflects the Sources of Inflation and the Inflation Forecast of 6-18 months from publications.

RBI's Modern Monetary Policy Framework

In 2015, Monetary Policy Framework Agreement (MPFA) was executed between the RBI and the Government of India and a Flexible Inflation Targeting (FIT) framework by adopted for the monetary policy framework. FIT was formally recognized by amendment of 2016 in RBI Act, 1934. Inflation target (CPI) was back then set as 4 % with deviation of 2% above and below the target level. The amended act also states that this figure for inflation target is to be set every 5 years by the Central Government in consultation with the Bank. The Monetary Policy Committee is responsible for adjusting the benchmark policy rate or the repo rate which will lead the economy to the required levels of inflation. The interest rates are set keeping in mind the prevailing macroeconomic conditions in the economy.

Modus Operandi- A standard scheme of Monetary Policy consists of a pre-defined goal and to achieve the same specific instruments are defined along with operating and intermediate targets. Tools include policy rate, OMO etc. as discussed above and operational targets include short-term money market rates and reserve money. Tools are used to directly influence the operational targets. Intermediate goals are more closely related to the overall objective set and include targets such as long-term interest rate. The ultimate goal chalked out by the RBI usually are as follows- financial stability, exchange rate stability, economic growth, and exchange rate growth. After the repo rate is set, target shifts to liquidity management by anchoring weighted average call rate (WACR) to the desired levels. Along with the policy rate, a Statement on Development and Regulatory policy is also announced to further ensure that the overall objective is met. India follows a committee-based approach to set the monetary policy. First meeting of the MPC was held in the year 2016 and many meetings have been conducted from then onwards. Let us now briefly study the 3 most recent Monetary Policy Statements released by the committee in the year 2023 and 2024.

A. Monetary Policy Statement, 4-6 October, 2023

Resolution Taken

Policy repo rate is unchanged at 6.5 %. As a result, marginal standing facility (MSF) and bank rate is also unchanged at 6.25 % and 6.75 % respectively. The MPC has also not moved away from earlier taken 'withdrawal of accommodation' stance to make sure inflation (CPI) reaches the target level of 4 % with deviation permissible in the range of +/- 2 %.

Considerations for the above decision

As per RBI, global growth has been slowing down. There are visible signs of declining inflation but it was still much out of the acceptable range in most global economies. The global markets have turned volatile due to speculations around persistent high interest rates. The developing economies have been facing fall in currency values and fluctuating capital influx.Supported by investment demand and private consumption, domestic Real GDP has registered a growth rate of 7.8 % y-o-y in April-June quarter of 2023-24. Industrial Production Index rose by 5.7 per cent in July and industries output of core industries rose by 12.1% in august. Services sector indicators had also registered good growth in august-September.

Healthy urban consumption and rural demand are present on demand side. Other strong factors in the economy included capital expenditure, steel consumption, cement production, imports. CPI headline inflation surged in July due to spike in vegetable prices however the core inflation eased in the July-august period of 2023. Money supply increased by 10.8% year-on-year as on September 2023 and bank advances spiked by 15.3 %. Forex reserves were shown to hold US dollars 586 billion dollars as on September 2023.

Inflation in near term has been estimated to ease owing to number of factors. CPI inflation is expected to be 5.4 % for 2023-24.Positive outlook is also expected for domestic demand due to performance in services sector, rural demand, business optimism and government thrust on capital expenditure. On the grey side, uncertainties are present due to looming geopolitical tensions, fluctuating financial markets, energy prices and climate shocks. Considering all the above factors, real GDP growth is projected at 6.5 %.

It is seen by MPC that consistent food price shocks can cause persistent inflation without the levels falling within the tolerance levels of inflationary. Consequently, the monetary policy remained disinflationary. Domestic economic activity is also poised to show good performance underpinned by consumption demand, investment prospects and positive business outlook. Since the policy repo rate hike of 250 basis points is still transmitting its effects through economy, MPC has paused the repo rate and kept it the same at 6.50 %.

Statement on Development and Regulatory Policies

Regulation-In order to strengthen the extant guidelines on Project Finance, the prudential norms for Projects under Implementation have been revised. This will also ensure harmony with respect to the same amongst all the regulatory entities. For Urban Cooperative Banks that have achieved their priority sector lending targets as on March 31, 2023, the RBI has raised the maximum limit for gold loans that can be granted under the Bullet Repayment Scheme to Rs. 4 lakhs which is double the earlier limit.

Payments-The Payments Infrastructure Development Fund (PIDF) Scheme has been extended till 2025 and the number of beneficiaries under the same are also enlarged. PIDF aims to encourage digital transactions through Point of Sale (PoS) transactions and QR codes.

Protection of Consumers-A consolidated framework on Internal Ombudsman (IO) for redressal of consumer grievances has been rolled out to ensure an IO mechanism across the regulated entities ensuring Internal Grievance Redress (IGR).

B. Monetary Policy Statement, 6-8 December, 2023

Resolution Taken

Stance of 'Withdrawal of Accommodation' and Interest Rates has remained same for Monetary Policy Statement (Dec 8) [2].RBI's Repo Rate is announced to stay at 6.50 % (same as Feb 2023, MPC Statement[3]) and the regulator has pointed towards resuming its stance of withdrawal of accommodation. This shows RBI's intention to maintain tight liquidity amidst speculations over plausible rise in food prices and forecasted weather disruptions. Due to likelihood of future rise in food inflation (tomato, onion prices) and more-than-expected overall GDP in July-Sept quarter among other factors, the regulator has felt the need to keep its stance and repo rate status quo despite decrease in core inflation

Considerations for the above decision

The regulator has kept apause on the interest rates and its monetary policy stance in a bid to direct consumer inflation to the set target levels of 4 % (with tolerance band of 2 % points on either side). Inflation forecast is also unchanged despite speculations in the market of an

[2]RBI likely to stay with interest rate pause - Times of India (indiatimes.com)
[3]Reserve Bank of India - Press Releases (rbi.org.in)

increase in food prices. CPI inflation is projected to be near 5.4 % for this financial year. It has also increased its projection of economic growth for FY 2023-24 to 7.0%due to favorable market demand.

Statement on Development and Regulatory Policies

Framework for connected lending [4]-RBI has announced one of its decisions to formulate a unified framework for connected lending/ related party loans. Connected lending refers to lending activity to a person capable of influencing the decision making of the lender. This is seen among related parties. RBI had flagged this as an issue involving moral hazard and can lead to lender compromising with its pricing and credit management. The already existing guidelines on related parties does not cover all the regulated entities in its ambit. Thus, the need for a new draft framework. Objective of RBI's move-RBI's decision came following several lenders expressing their concerns in cases where bank boards are a part of renewing loan proposals where related party is involved. Lenders had in the past also expressed their problems in tracking these related parties. The upcoming draft directions would plug the loopholes in connected lending. Such a robust and uniform framework would prevent lending decisions involving hefty amounts being swayed by influential people/ related parties.

Regulation for WALPs (Web Aggregation of Loan Products)-After mulling over recommendations of Digital Lender Working Group, RBI has decided to come up with guidelines for Web Aggregators of for the Loan Products. WALPs provide an electronic platform displaying several loan options across various lenders so as to help make the customer the best choice by comparing the alternatives. Objective of RBI's Move- By bringing WALP activity of the Lending Service Providers within a framework of regulation would promise greater transparency in LSP operations. This would ultimately be helping the customers make an informed choice.

Proposal for Fintech Repository-RBI has proposed that since in the economic landscape, several Fintech businesses have popped up, a repository for these fintech’s would be instrumental in keeping a credible database record. The repository would include information relating to their activities, products, financial records which would serve the timely needs of

[4] Reserve Bank of India - Press Releases (rbi.org.in)

the various stakeholders. A Fintech Repository would further add to the Digital India movement and support a cash less economy.

Financial Sector focused Cloud Facility-Bank and other financial institutions are currently deploying different private and public cloud facilities for storage of vast amounts of data these entities generate. The regulator is currently working on establishing a common cloud facility for our financial sector entities. Objective of RBI's move- A central financial cloud facility regulated by the RBI will ensure more financial integrity, safety and stability. Such a cloud facility will boost in the Digital India Movement.

Increased cap for UPI transactions -The upper limit for UPI (Unified Payments Interface) transactions pertaining to medical and educational purposes has been lifted to Rupees 5 Lakhs for a single transaction. This will enable customers to make higher amount payments in a single go. Earlier in 2021, limits for UPI payments involving IPO subscriptions and Retail Direct Scheme were also raised to Rupees 5 lakhs. Similarly, cap for e-mandates to make recurring payments such as paying insurance, credit card bill payments, subscription to mutual funds has been proposed to be raised to rupees 1 lakh from the existing rupees 15,000 without the requirement of AFA (Additional Factor of Authentication). Objective of RBI's Move and Impact- The above regulatory steps will ensure both safety and convenience for customers, and provide more impetus to the Digital India movement. The above measure offers a part of gamut of steps taken by RBI to boost the digital drive in India. RBI is including more areas wherein payments can be made by UPI and also raising the threshold limit for such transactions.Value of UPI transactions have grown aggressively in November 2023, overtaking NEFT (National Electronic Fund Transfer) and debit card transactions. UPI usage is not only prevalent in the urban areas but has risen exponentially in the rural and semi-rural areas both in volume and value. UPI is increasingly become the preferred choice for B2C, C2C and ecom transactions apart from the retail transactions

C.Monetary Policy Statement, 6-8 February 2024

Resolution Taken

Policy repo rate is yet again unchanged at 6.5 %. As a result, marginal standing facility (MSF) and bank rate is also unchanged at 6.25 % and 6.75 % respectively. The MPC has also not moved away from withdrawal of accommodation stance to make sure inflation (CPI) reaches the target level of 4 % with deviation permissible in the range of +/- 2 %.

Considerations for the above decisions

MPC is expecting a consistent global growth in the current year of 2024 due to a good performance last year despite global headwinds. Participants in the financial markets have mixed opinions over early interest rate cuts by central banks of developed economies due to uncertainty in timings. Optimism surrounding rate ruts has led to bullish equity markets. Fluctuations in domestic currency rates are being faced by developing countries.Owing to strong influx of foreign capital, GDP is expected to display growth rate of 7.3 % y-o-y in 2023-24. Manufacturing and services segment has caused surge in gross value added (GVA) by 6.9% in 2023-24.

Major drivers of economy in 2024-25 are expected to be manufacturing and services sector, capital expenditure, improved household consumption, profitable balance sheets of businesses and improved global trade. On the other side, geopolitical uncertainties and other global uncertainties are also expected to add to the risks. Considering all the above elements, real GDP growth for year 2024-25 is estimated to be 7.0 %.Food inflation has caused increase in headline inflation even though core inflation had fallen. This fall can be attributed to transmission of monetary policy stance. Inflation levels were declared to be governed by how the food inflation turns out to be. Domestic economic activity has performed well on the back of positive business sentiments and an increased consumer confidence. The only hurdles which are believed to remain were food price shocks and geopolitical tensions which disrupt the supply chains. Since the economy is believed to yet to realise the full effects of tight monetary policy, the policy repo yet is still disinflationary. This stance is ruled to remain unchanged till the inflation targets are realized.

Statement on Development and Regulatory Policies

Financial Markets-A regulatory framework for ETP was established by RBI in 2018. The system sought to ensure transparency, safety and efficiency in trading processes. Due to recent developments in the forex markets, a revised regulatory framework for Electronic Trading Platforms would be brought. To ensure more flexibility and access to resident entities, it has been decided by RBI to allow hedging of gold price risk in OTC market in IFSC.

Regulations-RBI has mandated provision of Key Fact Statement (KFS) by the borrowers to the lenders to encourage more disclosure and good practices. A KFS would include all the data pertaining to the loan agreement and this would be required to be adhered by all the regulated entities granting retail and MSME loans.

Fintech-An important tool for financial inclusion has been Adhaar Enabled Payment System (AePS). Further improvements would be done in the AePS system to enhance its security and streamline its processes. RBI has time and again pressed for the safety of digital payments through additional factor authentication (AFA). Several mechanisms have emerged serving as AFA mechanisms. Keeping these technological advancements in mind, the central bank has resolved to propose adoption of a principle-based "Framework for authentication of digital payment transactions". New features are set to be introduced in the currently ongoing CBDC-retail pilot. CBDC would be now programmed for pre-defined benefits, specified expenditures, limited time period and set geographical areas. Offline functionality of CBDC-R would also be added to improve access.

Objective of RBI's Monetary Policy Stance

Unchanged repo rate will keep inflation within the Monetary Policy Committee's selected inflation band (2%-6%) [5]amidst inflation risks in the economy. Withdrawal of accommodation stance means central bank's contractor monetary policy to reduce money supply in the economy. What is seen is an Unwavering Resolve to bring inflation down to 4 %. RBI Guv Shantikanta Das in the Monetary Policy Press Conference [6] had also cleared the air and stated the fact to not interpret its stance to moving anywhere towards neutral. This was to discourage the already building hype in the market of an easing monetary policy. The hopes in the market for this shift was due to lack of solid measures such securities sales or a higher requirement for CRR, among other reasons.Despite easing core inflation, decrease in US bond yields, softer crude oil prices and a pause on rising interest rates, the RBI guv did not want to give any forward guidance to the market of easing interest rate hikes. As per the

[5] Reserve Bank of India - Press Releases (rbi.org.in)
[6] Reserve Bank of India - Speeches (rbi.org.in)

central bank, one is seeing financial risks unfolding globally. In order to protect the economy and currency from fluctuations, the central bank will only give nod for rate cuts next year when the geopolitical conditions ease and India has won the battle against domestic inflation by having reached its target of durable 4 % inflation. Interest rates is domestic economies are also influenced by stance taken by central banks in developed economies. This is reflected in the fact that due to US Federal Open Market Committee Policy Statement (December, 2023), the common man is optimistic and expecting an easing cycle to begin around next year due around second or third quarter of FY 24. This also due to strong economic conditions such as robust GDP growth, high foreign reserves and crude prices softening. The recent December 13 policy statement [7]by the US Federal bank puts forth clearly that the Fed is done with hiking interest rates and also signals to three rate cuts next year. This dovish outlook came after a long period of quantitative tightening by the US Federal Bank. The RBI would still be shy of any easing policy too soon and would maintain its vigilant tone since domestic inflation is still high. Vegetable price inflation which jumped in November and December is a cause of concern according to the authorities. One can however expect it to change its stance to 'neutral' from 'withdrawal of accommodation' next year FY 2024.

REGULATORY POLICIES AND INTERVENTIONS BY THE RBI

Apart from deciding upon the monetary policy rates, RBI is also responsible for responsible formulations of guidelines, norms, policies for its regulated entities. These policies ultimately form part of the monetary policy and complement the overall economic objectives set by the RBI. Following are the most recent interventions by the RBI during the span of September 2023 to February 2024. These are aimed to meet intermediate goals set by the RBI which eventually contribute to its broader objectives of growth. We study each one of these in brief along with the objective of the RBI in introducing the same

A. Master Direction - Classification, Valuation and Operation Of Investment Portfolio Of Commercial Banks (Directions)[8]

The RBI had issued a discussion paper on January 14, 2022 proposing revisions to the current norms for the classification, valuation, and operation of investment portfolios of commercial

[7]Federal Reserve Board - Implementation Note issued December 13, 2023
[8]Reserve Bank of India - Master Directions (rbi.org.in)

banks. After considering the feedback, RBI had revised norms for classification, valuation and operation of investment portfolios of commercial banks (excluding Regional Rural Banks) and these were made applicable from April 1, 2024. Central Bank is hopeful that these directions would elevate the financial reporting standards of banks, encourage disclosures, give impetus to the corporate bond market, encourage use of derivatives for hedging and improve the larger risk management framework.

Classification of Portfolio-Under the new guidelines, banks are required to formulate board-approved investment policy and classify their investment portfolio into three categories-

- Available for sale (AFS)- This includes securities that a bank may retain for long durations but may also sell.
- Held to maturity (HTM**)-** HTM is a security instrument that is purchased and owned until its maturity period.
- Fair value through Profit and Loss (FVTPL)- This new category includes all securities that do not qualify for inclusion in AFS or HTM category. Their value is regularly updated to match their current market prices. Any gains or losses on these securities are directly included in the bank's profit and loss statement.

B. **Higher Risk Weights Assigned By RBI To Personal Lending**

The Regulator has prescribed increased risk weights for the consumer credit exposure of commercial banks to 125 percent against an earlier weight of 25 percent. The increase would apply to personal loans but would exclude housing loans, vehicle loans and loans secured against gold. (RBI circular dating November 16, 2023). Risk weightsrefer to the capital which is reserved by the banks to provide for the credit risks associated with a particular loan category. Risk weights are reflective of the risk of loss in case of default by the borrower. Low credit rating leads to higher risk weights being assigned and also higher interest rates. This means banks would have to set aside 11.25 rupees for every 100 rupees of credit they give out as compared to earlier risk weight of 9 rupees. Risk weight for retail loan category of NBFCs has also been hiked to 125 percent against an earlier weight of 100 percent. This hike in risk weight for NBFC's consumer credit exposure excludes housing loans, vehicle loans, loans against gold and Microfinanace/ SHG (Self-Help Group) loans. For credit card receivables, risk weights have been increased from 125 percent to 150 percent for scheduled commercial banks. NBFCs are required to increase risk weights with respect to the same from 25 percent to 125 percent.

C. New Stringent Guidelines Rolled Out Pertaining To Investment By Banks In AIF

RBI directed banks and NBFCs via circular dated 19 December 2023 to deter from making investments in Alternate Investment Funds (AIFs) that directly or indirectly has downstream investments in the debtors of these lenders. Debtors here refers to any company to which the RE currently has or previously had a loan/investment exposure anytime during the preceding 12 months. RBI in its circular has explained that banks invest in these AIFs as part of their normal investment activities, however some transactions have caught the attention of the central banks due to concerns over their regulation.These investments encourage evergreening of loans by the RE who, due to inability to provide direct loan exposure to these debtors, opt for the AIF units route to provide indirect loan exposure to their debtors struggling to repay their earlier loan.

Mandatory Liquidation/ 100 % Provision -The advisory given by RBIs further mandates that in case a RE already holds units of any AIF scheme, it must take active steps toliquidate the above investment within a span of 30 days from AIF corpus making any downstream investment in the bank's borrower ORLiquidate investment within 30 days of issue of circular, in case REs have already invested into such schemes having downstream investment in their debtor companies.In case of inability to liquidate the above investments in the market, the bank/NBFC is required to maintain a 100% provision on such investment [9].

D. Rbi's Guidelines On Penal Charges In Loan Account[10]

The RBI reviewed the existing guidelines on the levy of penal interest and decided that in case of default in non-payment of loans or any other material violation of the conditions imposed by the loan contract, banks should impose penal charges as penalty and not penal interest.Via its circular dated 18 August 2023. RBI had made it mandatory for the Regulated Entities (RE) to only impose a charge and not penal interest by adding additional components to the interest rate. The effective dates are 1st April, 2024 (New loans) and 1st June, 2024

[9] RBI tightens norms for lenders investing in AIFs - BusinessToday
[10] Reserve Bank of India - Index To RBI Circulars

(Existing Loans). Central Bank is of the view that Penal charges should be levied in a transparent and reasonable manner and not as penal interest which are in addition to the interest rates already being levied on the loan advanced thus creating a compounding effect. RBI released its draft circular on fair lending practices on April 12, 2023.Penal Chargesare fixed payment charges imposed by banks on borrowers for defaults or non-compliance events. Previously, lenders would levy penal interest (often at a higher rate) on customers for delays in payment of EMIs. Under the new guidelines, penal interest is no longer allowed.The guidelines prohibit financial institutions from using penal charges as a revenue enhancement tool. The intent is to instil credit discipline rather than generate additional income. Under the new norms, banks and finance companies cannot capitalize penal charges. This means that they must be levied separately and not added to the principal outstanding amount.

E. **Draft Omnibus Framework for Recognizing SROs for Regulated Entities (REs) of RBI[11]**

The RBI has come up with draft guidelines for Self-Regulatory Organizations (SRO). These guidelines list down the standard characteristics, objectives, governance standards and eligibility criteria for SROs representing various sectors. RBI has highlighted the role played by SROs in promising better compliance, safeguarding interests of the interested parties, development of the sector, fostering innovation and not just lobbying for their members. These SROs complement the existing regulatory framework made by the RBI for its REs by providing nuanced and technical inputs, and further refining the extant policies.

F. **RBI Draft Framework For Fintech SROs**

The regulator has come out with fresh set of draft norms for Self- Regulatory organizations involved with the financial technology sector, i.e. SRO-FT. This move is to make sure that the SROs can flexibly and openly work without any water-tight norms but at the same time innovate and experiment in a responsible fashion. This will strike the necessary balance between innovation and regulations. SRO-FT as per the regulator must work towards capacity building, resolving any dispute, conflict of interests among its member organizations. These SRO-FT would add to compliances by the fintech's while under the

[11]Reserve Bank of India - Reports (rbi.org.in)

guidance of the RBI. SROs will mainly be accountable for regulating unregulated entities. These include third-part apps on UPI, loan service platforms etc. RE such as payment aggregators and digital lending startups would be out of its purview of control.

G. RBI's Formulation Of Tighter Rules For HFC [12]

The central bank has resolved to tighten the norms for accepting of deposits by the HFC (Housing Finance Companies). This will add HFCs to the gamut of other heavily regulated entities like NBFCs. The RBI also looks forward to broaden the scope of services offered by the HFCs by adding specific fee-income based and credit card services to its list. As per the RBI's draft, only those set of HFCs shall be allowed to accept deposits from the public which have an investment grade credit rating. Further the upper limit for the number of PDs for eligible HFCs has been pared to 1.5 times of its net owned funds. These rules have been effective from 15 January 2024. Apart from the above mandate, these HFCs must also at all times maintain liquid assets to the extent of 15 % of PDs with them. This is an increase from the earlier mandate of 13 5. HFCs must also make sure asset cover to a full extent is also present fort these accepted deposits.

H. New Guidelines for G-Sec Forwards [13]

RBI has come up with draft norms to launch bond forwards in the government securities market. Such form of securities is ideal for long term investors avoiding interest rate and cash flow risks. A bond forward comes under the ambit a of a derivative contract. Here one of the parties to the transaction undertakes to buy a given debt instrument on a pre-decided date in future, at a pre-defined price. The above RBI norms pertain to OTC transactions in bond forwards. As per the norms one of the parties in such a transaction should be a CCP (central counterparty)/ market maker. Lenders barring SFBs (Small Finance Banks), RRBs (Regional Rural Banks), local area banks and payment banks are eligible to be market makers. The above excluded banks are however authorized to be the users in such transactions. Other users include urban co-op banks, NBFCs, AIFI (All India Financial Institutions), Insurance companies, pension funds, mutual funds, alternative investment funds, FPIs etc.

[12] Reserve Bank of India - Database (rbi.org.in)
[13] Reserve Bank of India - Press Releases (rbi.org.in)

I. RBI's Draft Circular On Dividend Pay-Out By Banks [14]

In the revised norms, the central bank has stated that eligibility norm for banks to declare dividends. This entails lenders with Net NPA ratio below 6 % mark and sufficient capital buffer (capital adequacy) above the mandatory threshold level for the three preceding FYs. [15]Earlier the eligibility limit for dividend declaration was Net NPA ratio below 7%. The new stringent norms however would not have adverse effect on dividend payouts by the lenders since the quality of bank assets have improved over time. These guidelines have raised the higher limit for dividend payout ratio from 40% to 50%. This means a bank's ratio of dividend payout can be upto 50% in a FY if there is nil net NPA in the said FY. Maximum dividend payout ratio can be 15% if NPA ratio is more than 4 %. Dividend payout ratio is the quantum of dividend payable in a FY divided by the Net profit in that FY as per the financial statements. Lesser the NPA ratio of banks, more dividend they would be able to declare. However extraordinary items ballooning up profits must be subtracted first before calculating profits available for dividend payout. Government will benefit the most from these rules since they hold substantial portions of stake in Public sector banks (PSBs). Further, the draft circular also stated that branches of foreign banks in India which qualify to transfer profits to its head office abroad is allowed the same without taking any approval from the central banks given it meets certain conditions. These conditions include audited financials and in case of excess transfer of profits, it must be forthwith corrected by the head office.

J. RBI’s Easing Of NBFCs Credit Concentration Rules [16]

Credit concentration risk guidelines for Middle Layer (ML) and BL (Base layer) NBFCs have been relaxed to align the same with the Upper-layer (UL) NBFCs. As per the revised norms, for the purpose of calculation of concentration risks the following are not to be added- NBFC exposures to SG/ CG which quality for 0 percent risk weight and such exposures wherein the government wholly guarantees principal and interest repayment, security deposits of debtors held as collateral against loans disbursed, Certain central government and state government guaranteed claims, Guarantees issued under several government provided guarantee schemes- CGTMSE, CRGFTLIH, NCGTC and NBFC exposures wherein the prudential limit has been

[14]Reserve Bank of India - Press Releases (rbi.org.in)
[15]RBI issues draft norms on dividend declaration by banks | Mint (livemint.com)
[16]CIRCULARNBFCCRM4CF8A1691D204F28A307FD70C51C48B7.PDF (rbi.org.in)

bypassed must be exposed under notes to accounts in the financial statements for added transparency.

IMPACT OF RECENT MONETARY POLICY STATEMENT

There has been a sustained Bullish Stock Market. RBI's stance and US fed's dovish stance is a green signal to easing interest rates. The overall market optimism has spurred rally in stocks, banking and IT stocks in particular.Local Bonds Yields have overall eased. Since interest rates have been kept unchanged by the RBI and nosedive in US bond yields, domestic sovereign yields have eased.This results in cheaper cost of raising finance through corporate bonds as they are benchmarked against the rate government pays to raise debt.Yield on 10-year benchmark Indian govt. bond has dropped by 10 basis points bps to 7.16% around December 14.Further, more Corporates are tapping into the debt securities market. Several lenders including HDFC, BoI, Canara Bank etc. have opted for the issue of infrastructure bonds. The added advantage for infrastructure bonds is that the central banks allow exemptions on SLR and CRR on the money lent which is raised through this route of infra bonds[17].Marking one of the biggest developments in the corporate bond market, NABARD (National Bank for Agricultural and Rural Development) is set to carry out bond sales on December 20 of infra bonds worth rupees 5000 crore with LIC as the anchor investor. [18]Investors now believe that this interest rate pause is a green flag to look for returns from debt funds like long term bonds. This development is due to domestic fixed-income assets appearing more lucrative[19]. Expected government spending in the fourth quarter of FY 24 will hopefully inject liquidity and result in rate cuts in Q4. This will further lower down the overnight money market/ call rates which is currently hovering around the MSF (Marginal Standing Facility) rates. On several occasions this year it touched 6.75%-7.80% as against the repo rate of 6.50%. Lastly there has been a recent Overseas Investment Influx. Both the factors, unchanged interest rates in India and lower US bond yields have paved the floor for more foreign funds taking up interest in the Indian bonds.

Regulator to use fund injections amidst excessive liquidity deficit and high Money Market

[17]HDFC Bank: HDFC Bank plans Rs 10,000 crore infra bond - The Economic Times (indiatimes.com)
[18]LIC: In a first, LIC plays anchor for Nabard's infra bond sale - The Economic Times (indiatimes.com)
[19]RBI's prolonged pause hint may be a good time for long duration debt funds - The Economic Times (indiatimes.com)

rates for banks [20]-The regulator is planning short-term fund injections in the banking system since the financial institutions are struggling with increased borrowing costs and liquidity deficit. The liquidity gap has especially increased in December last year. It has now become very expensive for these lenders to raise money through debt instruments in the money market. Money markets help banks in financing their short-term fund requirements. A surge in cost of raising funds in the money market makes in turn raising funds expensive in the overall economy. Thus, some banks are also choosing to raise funds via repo (repurchase) agreements by using government securities. This however has a downside as repo operations reduce the High-quality liquid assets (HQLA) available with the banks. And HQLA is pertinent to maintaining the mandatory LCR (liquid coverage ratio). RBI after considering the above situation deems it fit to allow the money market rates to come down towards the repo rate from the upper limit of the interest rate corridor.In the past few months, call/money market rates in form of WACR (Weighted Average Call Rate) had touched the MSF (Marginal Standing Facility) rates. MSF represents the upper band of the interest rate corridor. It is the rate at which commercial banks borrow money from the central bank above the rates of LAF (Liquidity Adjustment Facility). WACR has been hovering around the MSF rates of 6.75% lately and even higher than the MSF since September 2023. RBI's objective is to sync the WACR with the repo rate of 6.5 % to reduce the call market borrowing costs for the banks. Owing to RBI's efficient liquidity management and several rounds of VRRR auctions since December 15, WACR in the first week of January lowered down to 6.73 %.As per Crisil Economists' Views, Over the course of next few months, 10-year Gsecs are projected to soften more. The system is expected to witness cooling inflation, fiscal strengthening and more foreign capital inflows in the domestic bond markets.

Monetary Policy Transmission [21]

Monetary Policy Transmission is a procedure through which effects of the set policy rate influence the economic system. Firstly, the policy rate is transmitted to the short-term money market rate (weighted average call money rate- WACR) and then it eventually impacts the interest rate, financial market rate, bank deposit and lending rates. Financial market rates include certificates of deposit (CD) rates, commercial paper (CP) markets, Treasury Bill (T-

[20] RBI: RBI seen using fund injections to lower money market rates - The Economic Times (indiatimes.com)
[21] Reserve Bank of India - Publications (rbi.org.in)

Bill) market, Government Securities market and the bond market. Policy rate effect is further passed on to three prominent areas- Investment, exports and consumption. The above changes have the final impact on the overall objective of price stability and economic growth. Such ready transmission can be attributed to the External Benchmark Lending Rate System. Monetary Policy Transmission has been fastest in the past interest-hike cycles on account of EBLR. Lenders have transmitted the hiked interest rates the fastest in the interest rate-increase cycles between April 2022 to September 2023 as mentioned in the RBI Financial Stability Report. This increase in pace of monetary policy transmission can be attributed to the regulator making linkage of lending rates to external benchmark indices compulsory for the banks and financial institutions. As a result, policy transmission to bank's lending and deposit rates has been robust in the past three cycles in contrast to other tightening cycles prior to these.Majority of the banks have linked pricing of their loans to the repo rate. Therefore, the moment RBI hikes up the repo rate, banks are supposed to adjust their lending rates accordingly in a short span of time.

Current Position of Indian Economy

Revelations from RBI Monetary Policy Report 2024

As per National Statistical Office (NSO), GDP growth for FY 2023-34 is estimated to be 7.6 percent on the back of a strong investment activity. For the third quarter of FY 2023-24, GDP is expected to touch 8.4 %. Inflation (CPI) has also dropped down to 5.3 % between these past six months between September 2023- February 2024. Continued flood price shocks however has kept the inflation sticky and therefore interest rate cuts still are awaited as the RBI has paused at its current policy rate of 6.5%. Fastest Growing Economy Tag is now Registered by India. India has emerged as a role model for stability in FY 2023 for other economies during a time of strong global headwinds, monetary tightening in advanced economies and domestic inflation is persistent. The country has emerged as the fifth largest economy and is set to become the third largest economy by 2047 as part of PM Modi's Vikshit Bharat mission. The esteemed PM in his speech at the Vibrant Gujrat Global Summit 2024 credited the government's structural reforms including RBIs, for this pick-up in momentum. As of 10th April 2024, India holds the title of 5th largest economy with a GDP estimate of whooping 3.7 trillion dollars. The commendable revitalization of the Indian banking system is a major pillar of the country's success tale. This global growth engine which India is now more frequently addressed as has become so on the back of a robust banking system and financial sector among other factors. The RBI forms the backbone of the same. The regulator's intervention has really pulled out the system from a dark place in the past when balance sheets were overflowing with NPAs. The NPAs have dropped to a low of 3% from an early soaring figure of 11 % NPAs with several banks under PCA (Prompt Corrective Action). RBI's well thought prudential norms and vigilance helped tackle the covid induced crisis in the system. RBI's efforts have fostered a sense of trust on the banking and financial sector. This trust is here to stay due to the regulator's continuous steps towards supervision and regulation.

As per the World Bank, despite a global slowdown, World Bank has projected Indian Economy to be in the pink of its health in the coming years. Growth rates for FY25 and FY26 is estimated to be 6.4 % and 6.5 % respectively. This is on the back of robust investment, services and healthy corporate balance sheets, including banking segment[22]. Throwing light on the Statistics,India is on its way to meet its Fiscal Consolidation target with its general government debt contracted to 81% in FY 23 from 88% in FY21as reported by the finance ministry. Fiscal deficit target for FY 26 is also set to be 4.5%[23].What we see is a Resilient Indian Rupee and Economy [24].RBI currently maintains forex reserves of more than 600 billion dollars. RBI's resolution to keep forex buffers has guarded the Indian rupee against runaway depreciation in case of external spillovers. Its forex intervention has contributed to increased exports and narrowed down the current account deficit.This is despite global inflationary pressures and increased commodity prices (crude oil, natural gas, fertilizers etc.).RBI's foreign policy and tight monetary policy over the past months has lent macroeconomic stability to India amid volatile conditions brewing globally. In 2023 rupee has been less volatile against the US greenback and domestic currency's effective exchange rate has stayed majorly stable.

Revelations from RBI's Financial Stability Report

[22] World Bank keeps India's FY25 GDP growth estimate unchanged at 6.4% | Economy & Policy News - Business Standard (business-standard.com)
[23] India committed to bring economy on path of fiscal consolidation: FM | Economy & Policy News - Business Standard (business-standard.com)
[2424] global financial markets: Budget 2024: India's no longer 'fragile', can weather global market volatility - The Economic Times (indiatimes.com)

Indian Financial System to be propelled by steady growth momentum [25]-India is expected to carry forward the consistency in growth from 2023 to 2024. The financial institutions need to further improve their asset quality and financial statements to keep up with the pace of growth. Deploying the required technology would also ensure for an inclusive growth. The better-than-expected performance for the previous year is also largely due to state's thrust on capital expenditure. For delivering 7 % GDP growth in FY 25, achieving the inflationary target below 4 % is a pre-requisite for growth across all sector. Bringing down inflation would further help with revival of rural economy and private consumption.12.2 % Growth logged by lender for FY 2023[26]-The given growth rate for the banks is on the back of expansion in retail consumer loans and customer services sector. The performance of banks is attributed to be their best in over a decade. Some of the characteristics of the banking sector include-Efficient asset-liability management**,** capital adequacy**,** fast increasing retail loans,compliance with regulator's prudential norms, Improvement in asset quality. Macro-prudential norms introduced in November 2023 with respect to certain categories of loans including those to NBFCs have also contributed to the above by de-risking the traditional and non-bank lenders.

Statistics also reveal a decadal low GNPA ratio, The banking system currently boasts of capital adequacy, high asset quality and strong profitability. The NPAs have improved manifolds. The GNPA ratio which is a metric to measure the improvement is asset quality, tamed down to 3.2% nearing the end of September 2023.This clearing of gross bad loans is consistent for the fifth consecutive year. Reduction in NPAs has had a positive influence on NIMs. Less number of slippages have helped banks generate a low gross NPAs to total advances ratio. Increased lending rates reduced provisions were instrumental in ramping up capital structure for these banks. Indian Banks HTM Book also show a rosy picture [27].

Results

Indian economy has shown great resilience in the past year. India has truly emerged as the fasted growing economy, underpinned by robust demand, macroeconomic framework,

[25] Indian economy poised to sustain growth momentum: RBI report - The Economic Times (indiatimes.com)
[26] Banks log 12.2% growth in FY23, gross bad loans down for 5th year: RBI report - The Economic Times (indiatimes.com)
[27] Indian banks: Indian banks shrug off multiple headwinds - The Economic Times (indiatimes.com)

investment, well performing services and manufacturing sector and a strong monetary policy framework. Volatility in food prices have still kept the prices high and therefore RBI has still not started the process of rate cuts and is maintaining its status quo of repo rate at 6.5 %. The findings therefore reveal that RBI's monetary policy has a strong impact on the Economic growth. Interest rates and other tools of the RBI are however not the only contributors to the economic growth. Several other macroeconomic factors effect this growth and also control how the effects of monetary policy rates are reverberated through the system. We can therefore infer thatMonetary Policy does have a significant impact on the Economic Growth

Inference

I have studied RBI's activities in the past few months which were characterised by looming geopolitical tensions (war in Ukraine and Gaza), uncertainty over Federal Bank spiking its interest rates, climate crisis, global economy still recovering post pandemic etc. A perusal of RBI's monetary policy and other regulatory interventions clearly reflects how RBI has kept together the Indian economy notwithstanding the regulatory headwinds. RBI's policy mainly eyed controlling the inflation in order to bring it within the targeted levels. For achieving the same, apart from maintaining an unchanged repo rate of 6.50% percent, several regulatory measures were introduced. These included introducing higher weights on personal loans, tighter norms for Alternative Investment Funds, revised wilful defaulter norms, more scrutiny on fintech companies, promotion of ease of doing business through mediating BoE- CCIL issue and promoting Central Banks Digital Currency. In order to contain the effects of liquidity drainage, RBI also actively engaged in redemption of SGBs and Variable Repo Rate Auctions. Financial stability was also ensured by active foreign exchange intervention. Apart from the above several other regulatory interventions was introduced by the RBI for the benefit of the banking system that aimed at reducing the overall NPAs in the system. All the above measures have beautifully transmitted through the economy in form of speedy growth. No doubt growth is dependent on several others reforms in the economy such as robust digital public infrastructure, tax reforms, government schemes and other macroeconomic factors and regulations introduced by other sectoral regulators. How well a monetary policy is received is also dependent on the macroeconomic background. However, one can not shy away from the fact that the RBI and its policy forms a backbone of the system. Its policy is formulated keeping in mind several factors as we observed above. The MPC statement reveals the policy rate, inflation target and growth prospects and thus forms foundation of all other directions and reforms. The current robust position of the financial and banking system can be verified by the fact that during this period, India became the 5th country to the trillion GDP mark. RBI is an important pillar and contributory to India entering its golden era of development. Other parameters of growth include surging stock indices, FPI investing in India in large number, an overall positive market sentiment, reduced core inflation, sustained GDP growth of 6-7% and rising per capita incomes. A major chunk of the credit must be given to the accountable and transparent workings of the MPC which ultimately set the policy interest rates and set the sail going. By following the rule of price stability, RBI has controlled the level of money supply in the market which has kept an eye on the inflation levels in the economy. This has positively influenced the consumption, investment and other factors, ultimately contributing to the economic growth.

APPENDICES

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