Journal of Advances and Scholarly Researches in Allied Education

Vol. IX, Issue No. XVII, Jan-2015, ISSN 2230-7540

# CREDIT POLICY OF RBI IN ENSURING LIQUIDITY

AN INTERNATIONALLY INDEXED PEER REVIEWED & REFEREED JOURNAL

Journal of Advances and Scholarly Researches in Allied Education
Vol. IX, Issue No. XVII, January-2015, ISSN 2230-7540

# Credit Policy of RBI in Ensuring Liquidity

Seema Devi

***Abstract – RBI's proactive stance in the present environment is estimable and the proceeded back to systemic liquidity and more level investment rates is welcome. The credit policy likewise strikes an exceptional equalize between advertising development and financial sector improvement and strength.***

***Keywords: Credit Policy, Liquidity, RBI***

- - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - X - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - -

## INTRODUCTION

Credit policy is the use of the financial system to influence aggregate demand (AD). Monetary policy affects AD through the Central bank controlling interest rates and the money supply. Fiscal policy affects AD through the use of government spending and taxation.

Credit policy looks at factors such as:

- Bank lending rates to firms and households in the economy.
- The supply of credit and availability of loans from banks to firms and households.

In normal economic circumstances, it was felt the Central Bank could adequately control the economy through changing base rates. RBI has underpinned financial development while supporting systemic solidness through its monetary policy structure. The lessening in the repo also reverse repo rates is a welcome move and indicators the continuation of a strong investment rate administration in the economy. RBI has expressed that it will supervise the administration's obtaining program in a non-disruptive way through open market operations and an unwinding of the Mss. It has additionally put the net supply of crisp government securities of Rs. 853.64 bn throughout the first 50% of monetary 2010 in setting of the past years and this will help advertise an adjusted view in the government securities showcase.

## REVIEW OF LITERATURE:

Kannan *et al*. (2003) [1], in an article, "Liquidity Measures as Monetary Policy Instruments" attempts to build a frame work to quantify the developments in the money markets in quantum terms through autonomous and discretionary liquidity measures. Manohar Rao (2003) [2] exposits the problems of monetary policy design within the limits of an empirical framework for the Indian Economy. "Exchange Rate Policy and Management" The Indian Experience'written by Pattnaik *et al*. (2003) [3], is to present the Indian experience of exchange rate management against the backdrop of international developments both at the theoretical and empirical levels. Philip Arestis and Malcolm Sawyer, (2003) [4]articulate that When the level of aggregate demand is stable and only effected by random shocks and the rate of interest, then monetary policy (in the form of varying the rate of interest) may be an effective way of offsetting those shocks. Kannan *et al***.** (2006) [5] attempt to construct a monetary conditions index (MCI) for India in order to take both interest rate and exchange rate channels simultaneously into consideration, while evaluating the stance of monetary policy and evolving monetary conditions. Deepak Mohanty (2010) [6] discusses the global financial crisis and monetary policy response in India. At present, the focus around the world and also in India has shifted from managing the crisis to managing the recovery. To start with, in the improvement economics writing it is inferred that speculation exercises in an immature nation are liable to more terrific level of lack of determination than in a financially advanced nation. Changes in policy rates which are dependably little and incremental may not be paramount enough as determinants of venture. It could be components like accessibility of credit, wanted rates of return which will be dominating as determinants of venture. Our reaction to this concern is that our study is identified with a period in which there have been broad changes in the financial sectors of the Emes, when there is fall in policy rates for instance, market rates of premium likewise fall and thus, rebate rates go down. This expands the present esteem of money spills out of speculation other than decreasing the obtaining cost. Further, the national banks of the Emes have to a vast degree calibrated the utilization of policy devices what's more amount indicators, value signs are additionally adequate. The generally speaking for situation in Emes is more changed in the post change period. Therefore, the provincial financial markets are better combined inside the home economy and additionally with worldwide financial markets. For economies with improved financial markets there are a few studies which look at the effect of monetary policy activities utilizing the credit channel of transmission. Some of these studies are, Bernanke (1993) and Gertler (1995), Kashyap, Stein and Wilcox (1993) [8, 9, 10]. Bank-credit markets show the average characteristics of "client markets". No less than three variables help the building of long haul client relationship between a bank and its customers Berger and Udell (1995) [7].

## MONETARY AND CREDIT POLICY

In India, while the basic objectives of monetary policy, namely, price stability and adequate credit flow to the productive sectors of the economy, have remained the same, the operating environment has changed significantly. As pointed out in the RBI's Report on Currency and Finance 2003-04, there is an increasing focus on the maintenance of financial stability in the context of better linkages between various segments of the financial markets including money, Government securities and forex markets. Managing the capital flows has emerged as an important concern of monetary policy. The phasing out of adhoc treasury bills and their automatic monetization in 1997 imparted a lot of flexibility to the RBI in monetary management. Simultaneously, however, reserve flows through the balance of payments and increase in the prices of crude petroleum in the international markets have posed new challenges for monetary policy. As indicated earlier, in the current year, the two major constraints facing monetary management were carry forward of excess liquidity of over Rs.81, 000 crore from the previous year and rise in inflation following the rising international prices of petroleum crude.

## THE ANNUAL POLICY STATEMENT:

The annual policy statement for 2004- 05 had placed the growth of GDP in 2004-05 in the range of 6.5 to 7.0 per cent, on the assumption of sustained growth in industrial sector, normal monsoon and good performance of exports. On the assumption of no significant supply shocks and appropriate management of liquidity, inflation rate in 2004-05, on a point-to point basis, was placed at around 5.0 percent [11].

## INTEREST RATES

The RBI has been following a policy stance of imparting flexibility to the interest rate structure. Concerned over the downward rigidity of lending rates, even while deposit rates were coming down, RBI advised banks to announce their benchmark prime lending rates (BPLRs) based on their actual cost of funds, operating expenses and a minimum margin to cover regulatory requirement. In response to this policy directive, all banks put in place a system of BPLRs in 2003-04. The BPLRs of five major banks are lower by 25 to 50 basis points in December, 2004 compared to the rates prevailing a year ago[11].

## CONCLUSION:

In general, the policy shows the advancement of a sound financial sector and a stable nature's domain. It distinguishes the need to uphold a monetary policy helpful to development while ensuring dependability and the capability to withstand any stuns that may come in future. It presses on to reconcile Indian policy with the worldwide markets, while sequencing and timing these measures in the setting of residential goals.

## REFERENCES:


1. Kannan, R., Indranil Sen Gupta and Sidharathan Sanyal, 2003. “Liquidity Measures as Monetary Policy Instruments”. Economic and Political Weekly, October 4, p. 4251-4259.

2. Manohar Rao, 2003. “Science of Monetary Policy –Some perspectives on the Indian Economy”. Economic and Political Weekly, February 22, p.809-820.

3. Pattnaik, R.K., Nuneesh Kapur and Dhal, S.C. 2003. “Exchange Rate Policy and Management-The Indian Experience”. Economic and Political Weekly, May 31, p.2139-2153.

4. Philip Arestis and Malcolm Sawyer, 2003. “On the Effectiveness of Monetary Policy and Fiscal Policy”. Working Paper No. 369, Levy Economics Institute of Bard College, New York, January. www.levyinstitute.org

5. Kannan, R., Siddhartha Sanyal and Binod Bihari Bhoi, 2006. “Monetary Conditions Index for India”, Reserve Bank of India Occasional papers, Vol.27(3), Winter, pp.57-86.

6. Deepak Mohanty 2010. “Implementation of Monetary Policy in India”. Speech Delivered at the Banker‘s Club, Bhubaneswar on 15th March, www.rbi.org.in

7. Berger, A. and G.F. Udell (1995) : “ Relationship lending and lines of credit in small firm finance” Journal of Business, 68 : 351-381

8. Gertler, M. and S. Gilchrist (1995): “The role of credit market imperfections in the monetary transmission mechanism: Arguments and evidence” Scandivian Journal of Economics, 95(1):43-64.

9. Bernanke, B. (1993) How Important is the Credit Channel in the Transmission of Monetary Policy, Carnegie Rochester Series on Public Policy, 39: 47-52.

10. Kashyap, A., J.C. Stein and D.W. Wilcox (1993) Monetary Policy and Credit Conditions: Evidence from the Composition of External Finance, American Economic Review, 83: 78-98.

11. http:/indiabudget.nic.in