Indian Economy: Some Contemporary Perspectives
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Indian Economy - Monetary Policy 1

So, welcome back. We are talking about the financial inclusion. And in financial inclusion certain recent developments I thought I should be discussing and I should spend at least 1 to 2 minutes time on that. So, that it should look complete, because we have discussed the C. Rangarajan committee, we also discussed the Micro Finance Institution. So, I thought, it is good that I should share some light on the financial inclusion process that we have undertaken.

And then, we will go for the monetary policy formulation. So, the financial sector is now over. I think, I have covered almost all segments and it is quite comprehensive. So, I think it took more than 10 sessions to finish this financial sector of India, because we have so much diversity in the financial sector that it is very difficult to cover with few sessions. I think, if I have time then I can take one more any NPTEL course on the financial side of the India's economy because that will cover everything. But keeping in mind that time limitations let us move to the monetary part.

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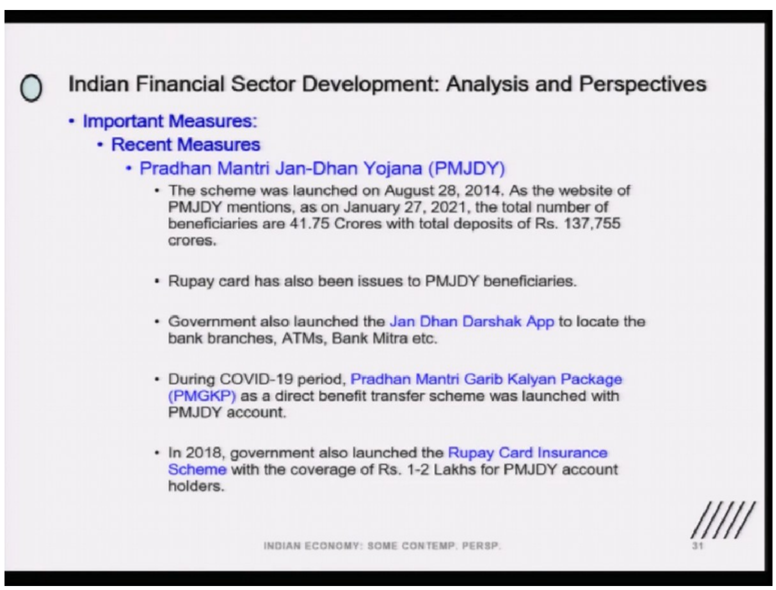

So, whatever I am going to discuss about the financial inclusion process. So, let us first finish this then we will start the monetary policy. Soon August 28, 2014, we had a very important program launch, it is called Pradhan Mantri Jan-Dhan Yojana. And this Yojana was launched on

August 28, as I mentioned. And the idea was that there should be some kind of financial inclusion process with the incentive of the account holders that there should be having extra incentive.

So, as I mentioned, we started with the no frills account, then we had gone for opening up the passbook, then we had gone for the issuing of the general credit card. But after that, it was also found that there should be some kind of social coverage for the account holders, those who are going to have the account. And since we are into the information business, so once if somebody is going to give you information about the personal detail, because nowadays data is the most important resource and costliest and not the oil.

So, keeping that in mind that some incentive must be given to the household if they are going to reveal some information and that is why it became one of the flagship programs of the government. So, at the website of the PMJDY, so it is called Pradhan Mantri Jan-Dhan Yojana, so PMJDY mentions, January 27, 2021, the total number of beneficiaries are around 41.75 cores with the total deposits of 1,37,755 crores.

The Rupay card has also been issued under the PMJDY. So, this is the card which also has is has the rupee operations plus the maintenance by rupee and plus some insurance coverage. Government also launched the Jan Dhan Darshak App that also helps the rural masses to locate bank branches, post offices. And in the rural segment it becomes really difficult to locate. So, I hope it is quite useful and it is being used.

So, there was a scheme of transfer of money and it was called Pradhan Mantri Garib Kalyan Package, PMGKP as a direct benefit transfer scheme. And it was also launched through the PMJDY. So, the money was transferred or whatever was in terms of 500 or I think it was about 500. In 2018, government also launched the Repay card insurance scheme with the coverage of 1 to 2 lakh for PMJDY account holder. So, these are the recent outlooks of the PMJDY. But PMJDY scheme has also been in controversy, because of the non-operational accounts.

So, the paper that I mentioned of the Dipa, Rohit, can Jan Dhan Yojana achieve financial inclusion? It talks about those issues that how Jan Dhan Yojana is not the only scheme that will be enforced through the PMJDY. Because there are there are concerns that once the account is open so non-operational accounts are one of the important issues to be discussed. And that is why it is important that that one should be analyzing the data. So, the website of PMJDY gives the data at the state level, even at the district.

So, if some of you are interested to analyze this particular scheme then it will be interesting. I find some kind of simple write up on PMJDY, but there is a need to analyze the data in detail and find it out that what is going on with this particular scheme.

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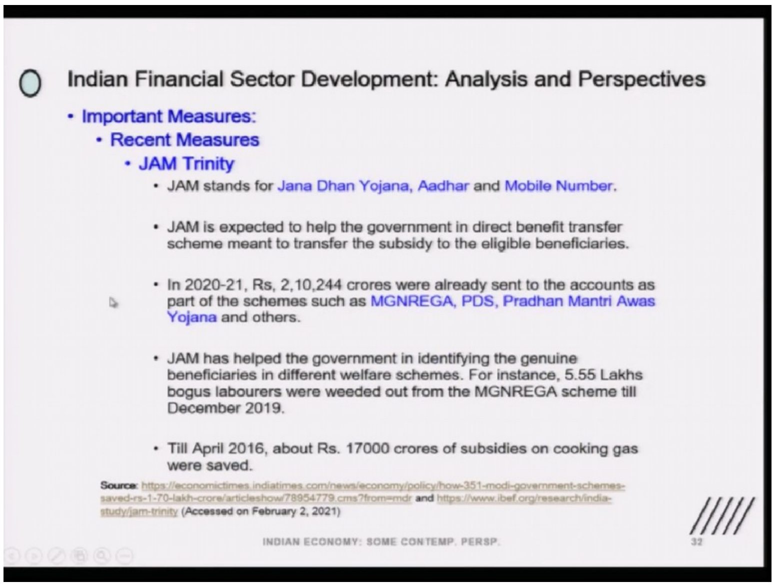

Then there is an important scheme, keeping in mind that mobile phone is going to be one important instrument and it can help generate or for the government it has it has become one of the convenient tools to provide services direct services. So, in case of Kenya and all other countries it has been successful.

So, in India there is JAM trinity. So, for the first time I read in the economic survey of 2017-18 or so. In that survey it was mentioned that about the JAM trinity, which means that a person who has a Jan Dhan Yojana account, a person who has Aadhaar and a person who has mobile number, these three will be helpful.

Because in India in especially in case of subsidies, it has been found that there are incidences of leakage, high leakage and which means that the policies which are designed for the required set of people there is some kind of mismatch happening and because of that the beneficiaries or the benefits are not reaching to the true or genuine beneficiary especially in terms of subsidies that we give on the cooking gas and some other others. So, in India right now, the subsidy on cooking gas is the only major subsidy that we see.

So, JAM is expected to help the government in direct benefit transfer scheme mean to transfer the subsidy to the eligible beneficiaries that we have. In 2020-2021; 2,10,244 crores sent to the accounts as part of the schemes and now because of this JAM that we have the Jan Dhan account plus the Aadhaar plus mobile number now it has helped in terms of facilitating the MGNREGA schemes plus the identification of some bogus accounts, bogus workers, those who are not a part of this. But they were getting the benefit.

So, JAM has helped the government in identifying the genuine beneficiary in different welfare schemes. For instance, 5.5 lakhs bogus laborers were weeded out from the MGNREGA scheme till December 2019. But this also needs verification that whether those workers which are weeded out, they also had alternative livelihoods option or not? If they did not have then at least there should be some kind of benefit given.

Till April 2016, about 17,000 crores of subsidies on cooking gas were saved because it was it was not transferred based on this JAM trinity. So, JAM trinity is going to be one of the important topics to be discussed in future. So, I thought this is also helping the financial inclusion process because it is facilitating. So, once we have Jan Dhan Yojana account, you have Aadhaar card and the mobile number, so this also help. So, if somebody will ask what is JAM trinity, then you should be at least able to answer. So, this completes the financial inclusion chapter.

Now I will be moving to the new topic. So, the financial sector is over now. In case if I am left with any topic then I will be covering towards the end of this course. But now we will be moving to the monetary policy. Then after that, I have to cover the fiscal policy, the recent changes in the fiscal policy and then we will have the WTO issues and then we will conclude this particular course.

So, the monetary policy objectives that if you see, so it is important that since we are dealing with India’s economy and we have covered the historical aspect of each and every policy, so it is important that we should be covering the monetary policy also.

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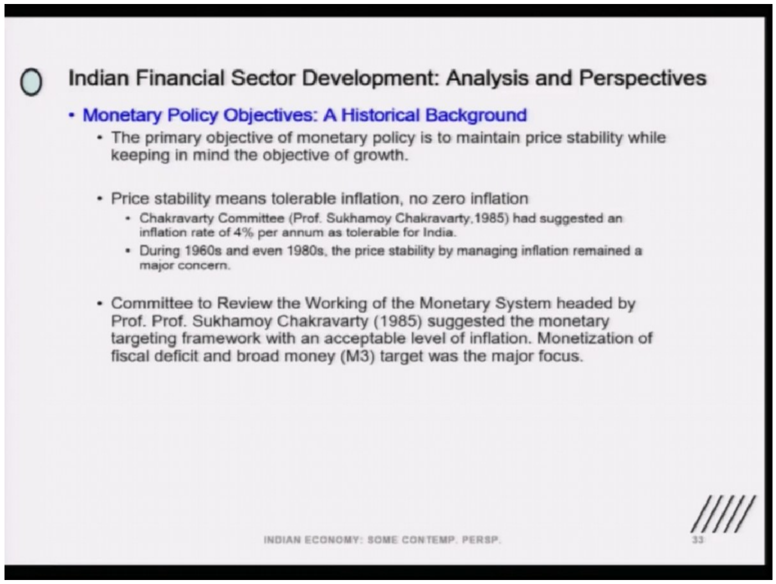

And we should at least provide some background of this that, what is at this policy is all about? So, monetary policy is in the hand of the Central Bank. So, Central Bank takes care of the monetary policy. And one of the major objectives of the monetary policy is that it has to work on the price stability process, which means that it has to ensure that inflation does not arise so high that it becomes unbearable for the large section of the people.

So, just to make sure that the inflation does not arise high, so Central Banks regulates. Now after the Sri Krishna committee report that we just discussed. Now, we have a certain inclusion coming from the government. So, the finance ministry has also become one of the partners in managing.

But if you trace the history that what were the objectives of the monetary policy in India since independence. So, if you look back from the word historical perspective that I have given in terms of the planning process, then you will find that in the beginning, the major concern was the infrastructure bottlenecks and then the food supply. So, during 1960s inflation was majorly a phenomenon linked to the either a bad monsoon or it was also linked to the availability of limited food grains in the country, till we introduced the Green Revolution process and then we had sufficient food grains in the 1970s and then we were looking beyond that.

And in 1960s, we also experienced a very unusual trends, so in 1960s, we had to go for external or for geopolitical issues. So, we had geopolitical issues in the mid of or in the beginning of

1960s. Because of that, we had to go for extra borrowing and we had to finance those geopolitical issues and that also resulted in the scarcity of resources and as a result, the inflation became one of the important issues to be discussed. So, in the beginning of the monetary policy formulation price stability and inflation targeting was the sole purpose of implementing the monetary policy, nothing else.

Till we entered into the phase of a stabilization where we were in the era of ’80. So ‘80s was the era where we started looking after the well being of the people. We started looking for the expansion of certain sectors though we were not doing very good in terms of the industrial sector, because of certain domestic regulations. But still the monetary policy was more or less focused on the inflation part.

Then there was a committee set it is called Professor Sukhamoy Chakravarty committee. Sukhamoy Chakravarty committee in 1985 it was set up, had suggested that so price stability means that it does not mean that zero inflation, it means that there should be some kind of tolerable level of inflation, because inflation is also an incentive for the seller. But we have to think that sellers also have the incentive to sell the product, if the inflation will be low then of course, sellers would not be interested and we may have to go for heavy import.

So, those kinds of things. So, at that time, this committee, Sukhamoy Chakravarty committee had recommended the inflation rate of 4 percent tolerable in case of India, because at that time we had sufficient resources. So, I am talking about the mid-1980s. So mid-1980s we had sufficient. During 1960s and even 1980s the prices stability by managing inflation remain a major concern. Committee to review the working of the monetary system headed by the professor Sukhamoy Chakravarty suggested that the monetary targeting with an acceptable level of inflation that 4 percent.

He had also recommended for monetization of a fiscal deficit that is called the deficit financing, which means that the government should go for borrowing from RBI. And it has also recommended for the targeting of the money supply through the broad money that we have M3. So, M3 will be discussed, what are the components of M3? So, you can see that since the beginning, we were focusing on the inflation. But in 1980s, we started targeting some other indicators also. The domestic expenditure which is the fiscal deficit and in terms of money supply that we have.

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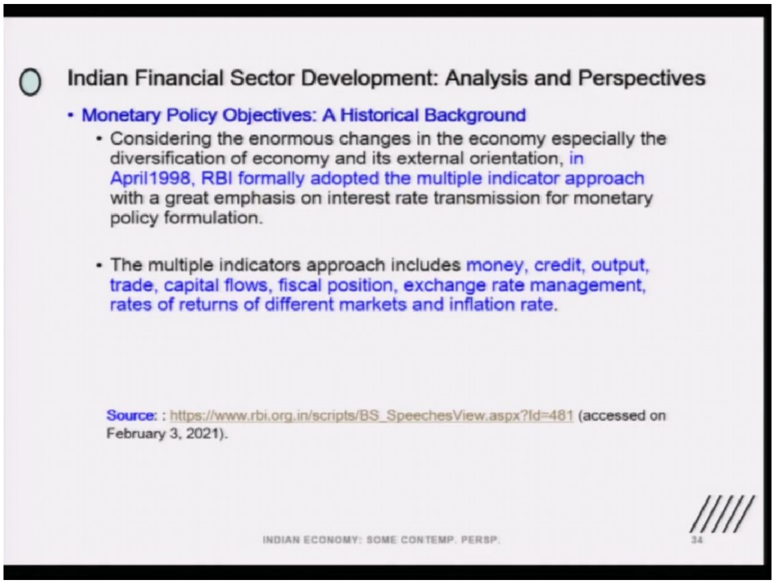

Then in April 1998, RBI had formally adopted what is called the multiple indicator approach. And this multiple indicator approach is important to examine because in 1998, when we had liberalized our economy, we were also quite vulnerable to external shock, exchange rate was also one of the important issues to be analyzed. Then we had the capital inflow, capital outflow issue and then we also looking for some kind of adjustment in terms of the trade. So overall, it was realized that now our economy is not a completely closed economy. We are open economy now.

So, we have the open economy issues. So, it is better that we should not look for the internal issues. We should also focus the variables or parameters of external economy. So, at that time, money, credit output trade, capital flows, fiscal policy and exchange rate management rates of whatever activities that we have returns of different securities, different in markets for example, money market here the here you have and then also you have the different types of government securities traded and the inflation rate.

So apart from inflation, we have the host of indicators to be monitored by the Central Bank and based on that, they decide about the interest rate. So, they have the money, then they have the credit, then they have the output then you have the trade output, GDP growth. Then trade means whatever current account in terms of we have the current account deficits. Then capital flows whatever we have in terms of high liquidity or higher inflow of either foreign portfolio investment or any kind of investment that we see even the forest reserves.

Fiscal position, exchange rate management all these things are part of the multiple indicator approach. Now, if you try and understand from the perspective of the management, so then you have the different instruments to control, the money supply or the to implement the monetary policy in the country.

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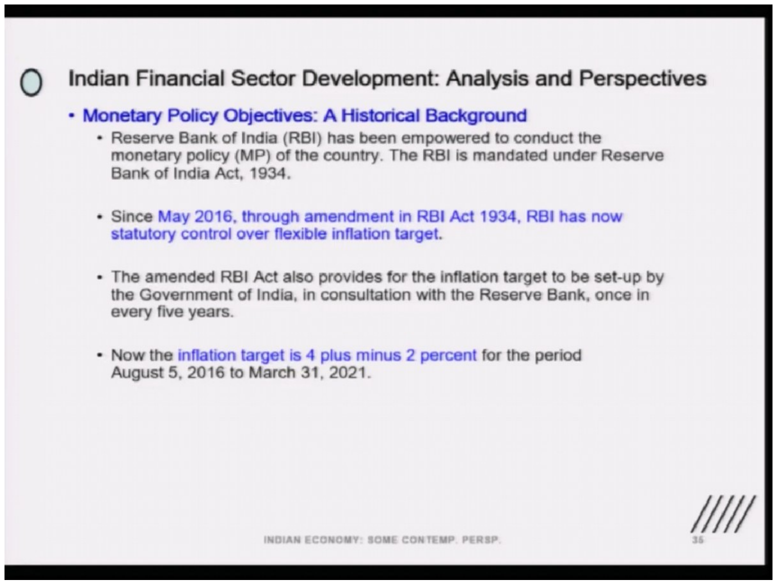

But before that, I should be giving you some idea about how we can go for. So, the Reserve Bank of India has been empowering to conduct the monetary policy and it has been mandated under the RBI Act of 1934. Since May 2016, through amendment of RBI Act, RBI has now complete control on the inflation target. So, flexible inflation target that we have. Right now, the target is 4 plus minus 2 and the amended RBA Act that we have it provides the inflation target to be set by the government in consultation with the Reserve Bank of India, once in every 5 years.

So, this inflation target that we have 4 plus minus 2, it is for the period from 2016 to 2021. But in economics, there is always a controversy that what should be the scope of functioning of the Central Ban? How much a government should have the interference in the daily affairs or the primary affairs of the Central Bank? And for the first time, we have seen that the Central Bank autonomy is being encroached by the government and now government is also having say in terms of inflation targeting.

And that that is coming from if you remember, the Sri Krishna committee, financial sector legislative reforms commission, Indian financial code, it was also mentioned that the finance ministry will take a role in terms of finding out which all infusions will play a role in. So now, we have the monetary policy committee.

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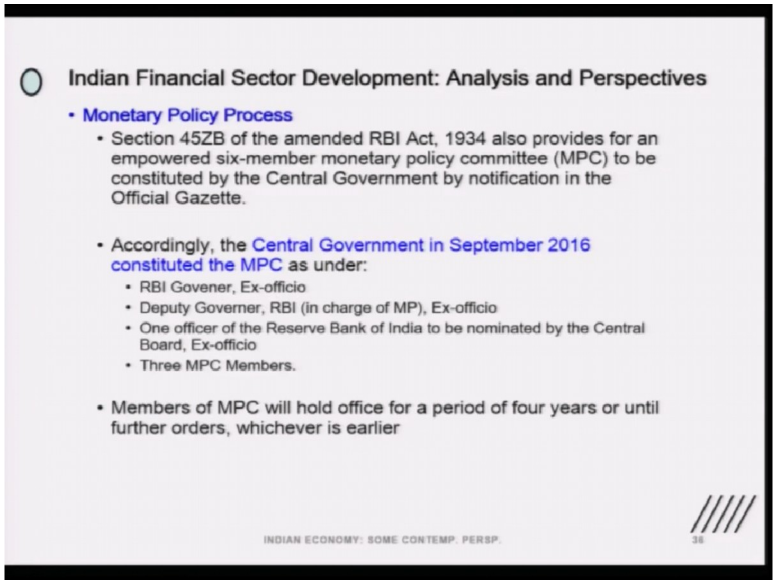

Let us work on the implementation. So, section 45ZB of the amended RBI Act, 1934 also provides for an empowered six-member monetary policy committee. Who all will the members of this committee? The Central government in September 2016 constituted the MPC, the Monetary Policy Committee, it will have the RBI governor by default Ex-officio, Deputy Governor RBI In-charge Ex-officio, one officers of the Reserve Bank of India to be nominated by the Central Board Ex-officio and three MPC members.

So, right now we have Professor Ashima Goyal from IGIDR. Then we have Jayant Verma from, Ahmedabad. Then we have Shashanka Bhide from NCAER. So, these three are the government nominated and these all three are academicians. Earlier, first committee had a professor Pami Dua, then we had Professor Chetan Kate and one more name we had it was also from the Ahmedabad. I am forgetting the name.

But first committee completed the term. In 2020 the name was announced. The members of the MPC will hold office for a period of four years until further orders, whichever is earlier. So, this is what it is recommended.

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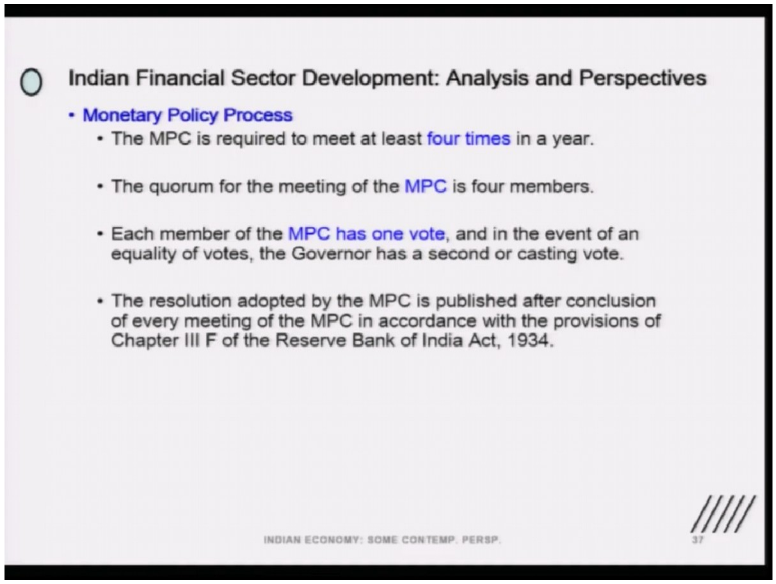

Monetary policy, if you think how it is being implemented when we think about the rate of interest cut or whenever we read a News Paper that how this rate of interest cut is going to be decided. So, MPC is required to meet at least 4 times in a year. The quorum for the meeting of the MPC is 4 members. Each member of the MPC has one vote. And in the event of an equality of award the governor has a second or the casting vote.

So, which means that each MPC members will have the one vote. In case of tie, the governor has the second or the casting vote. The resolution adopted by MPC published after conclusion every meeting emphasis on the website you will find that it is being mentioned. And it comes under the RBI Act 1934.

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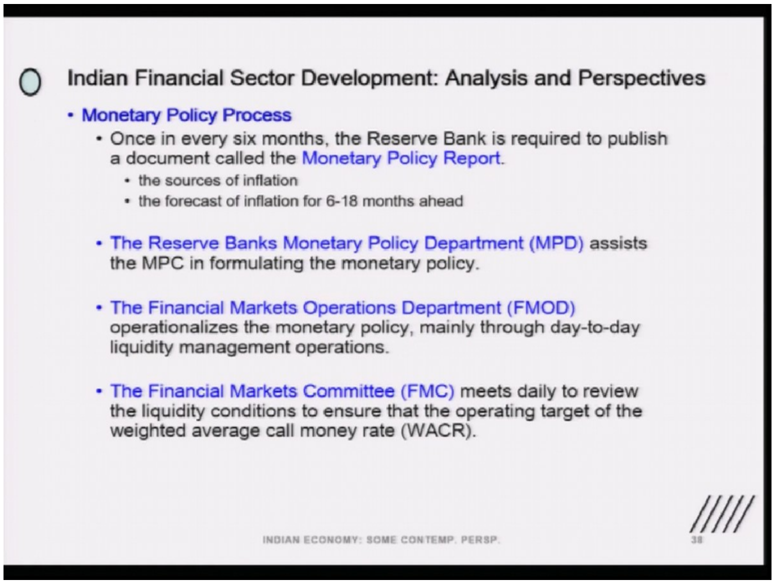

One important document, which I always recommend even to my students and even those who are from economics or those who are going to prepare for examinations, apart from economic survey of the government, there is also a very important document published at the RBI website. So, if you go on the RBI website, you will find this something called monetary policy report.

This is 6 monthly report and it has all the topics, chapters discussed. And it is very important document because it is a quite forward looking. So, if you read between the lines of this particular document monetary policy report then you will find that it is really important in terms of finding out what will be the future of the interest rate in India and how the inflation will be adjusted. So, this becomes one of the important documents to read.

The Reserve Bank's monetary policy department assist the MPC in formulating the monetary policy. The Financial Market Operations Department, FMOD operationalizes the monetary policy and mainly through day-to-day liquidity management operations. Financial Markets Committee, FMC meets daily to review the liquidity conditions to ensure that operating target of the weighted average call money rate.

So, these are the organizations within RBI offices, within RBI which are having a certain responsibility to look after the monetary policy formulations and day-to-day-operations also in terms of liquidity management. And also, the weighted average call money rate that we have.

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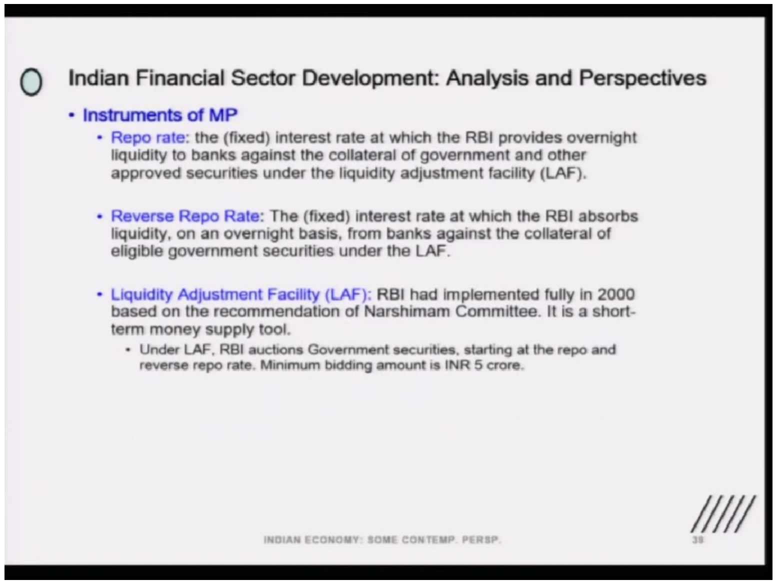

Then, if you look from the perspective of instruments, then instruments are really important. So, as I have discussed here that the central bank is now going under different So I hope, it is clear for everyone that how we have understood. So, let us now think about the important rates that you will be reading in News Paper.

So, in News Paper you might be reading that whenever we have an RBI MPC meeting coming then there will be a lot of speculation in the News Paper, in the digital media, in print media that how RBI is going to react to given the inflation and given the macroeconomic conditions? How they are going to take decision? Whether the interest rate will be up or down?

Once we have that kind of speculation or that kind of scenarios being discussed everywhere then we have an understanding that which rate it is going to be decided. So, it is about the repurchase agreement rate which is that the repo rate and then we have the reverse repo rate. So, reverse repurchase agreement, which means that repo rate when the Central Bank lends money overnight to the to the banks against the collateral of the government and other approved securities under the liquidity adjustment facility, which means that they will be surrendering some government securities in return of the loan.

So, in case of liquidity adjustment facility, why it is being mentioned? Because these are repurchasing so they will have to purchase those assets whatever they have kept under collateral. Reverse repo. So, repo rate is the lending rate at which RBI lends money to the Bank. Reverse repo rate is just opposing. So, reverse repo rate, if the banks are finding that they have the excess liquidity and they have excess cash and they want to keep money with the RBI then in terms of purchase whatever they have given in terms of collateral.

So, I would say return of those securities these banks will be parking money with the RBI. So, that is called reverse repo. So, repo means, RBI’s lending and reverse repo means just opposite, banks are lending. And liquidity adjustment facility based on the Narasimham Committee-II that we discussed, Narasimham Committee-I we discussed. And then we had a Narasimham Committee-II it was in 1998.

So, post that, government has gone for a short-term money supply tool. So, in case if banks are not finding it easier and if they have some trouble, so there is one more window open and this Liquidity Adjustment Facility, it is in turn of the repo and reverse report. And it also goes by the same collateral that they have to keep. So, Liquidity Adjustment Facility it is about the adjustment in the liquidity by either go for borrowing or go for lending depending on that.

Now normally repo rate will be higher than the reverse repo rate because RBI lends at a higher rate. But when it borrows or when it has to take money from anywhere, then it gives the lower rate of interest on that. So, in the same way, with the bank when you go to borrow from the bank and if you take the loan then of course, you will have to pay high rate of interest.

But if you are going to keep money with the bank then bank will offer you a very low rate of interest. So, in the same way, the same mechanism works here that if the banks have to borrow from RBI, they have to pay a higher rate of interest. But when they keep their money with the Bank, RBI, then RBI will offer them are lower rate of interest. So, this is how it works.

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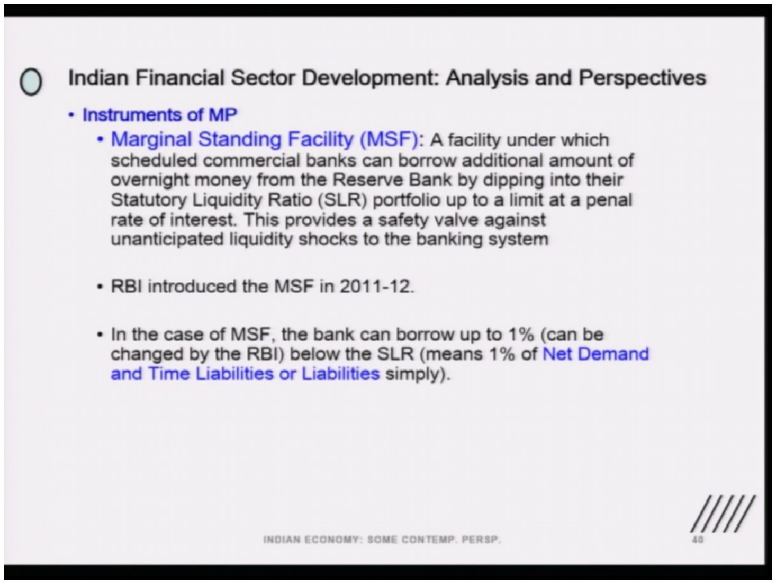

Then we have the Marginal Standing Facility, MSF. It is also one of the important instruments to provide the liquidity in case the banks are feeling shortage of liquidity then this particular, this standing facility becomes operational and through that banks can borrow. But there is a limit on SLR that 1 percent or so whatever is the limit 1 percent of that whatever is the net deposit, net demand and time liabilities of the bank. So, NDTL that we say that whatever is the size of the deposit adjusted for liabilities, then 1 percent of that amount can be borrowed to the marginal standing facility.

This was a special window created for the banks because there is a limit on the borrowing from the RBI. But here, RBI through repo channel and here, in this case in Marginal Standing Facility, they can also go for extra. The only thing is that they will have to pay extra interest on that. So, this is what 1 percent of the repo it has being normally assumed that 1 percent the repo that they pay. So here, we have so under LAF, Liquidity Adjustment Facility repo, this liquidity adjustment that we have it goes like borrowing and lending. So, whether you are working with repo or reverse repo that is the important thing that we should be knowing.

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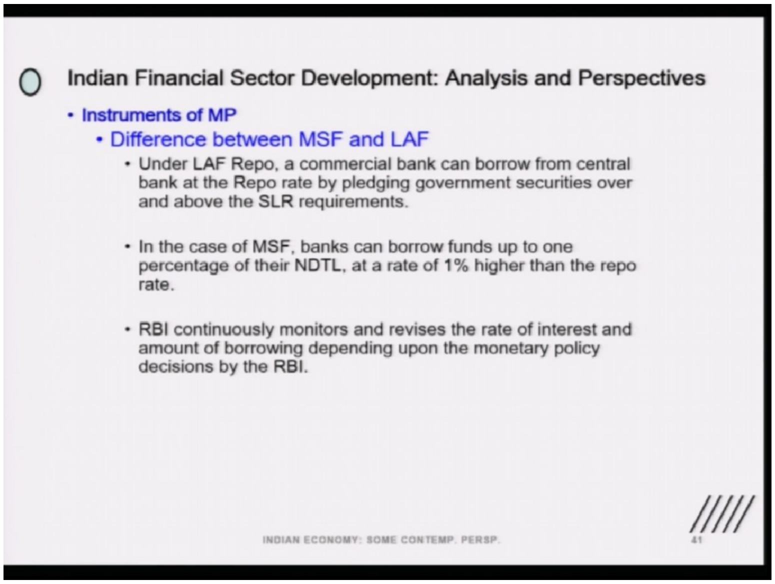

So, a commercial bank can borrow from the Central Bank at the repo rate by pledging government securities over and above the SLR requirements. So, this is what we have. In the case of MSF banks can borrow funds up to 1 percent at a rate higher than 1 percent rate of interest that you have. So, you will be paying 1 percent higher rate of interest and the repo rate. So, it means that now, if you think then if you are bank you have two options, you can go through the repo rate borrow money and it is overnight. So, you can borrow money because it is repurchasing agreement, so you have to surrender some kind of securities.

In case of Marginal Standing Facility, you will be paying 1 percent higher rate of interest on the repo. But you will be given one more opportunity that whatever SLR requirement that you have or what whatever is your deposit NDTL based on that 1 percent of that amount you can borrow through MSF, Marginal Standing Facility. RBI continuously monitors and revises the rate of interest and the amount of orient dependent upon the monetary policy decision by the RBI.

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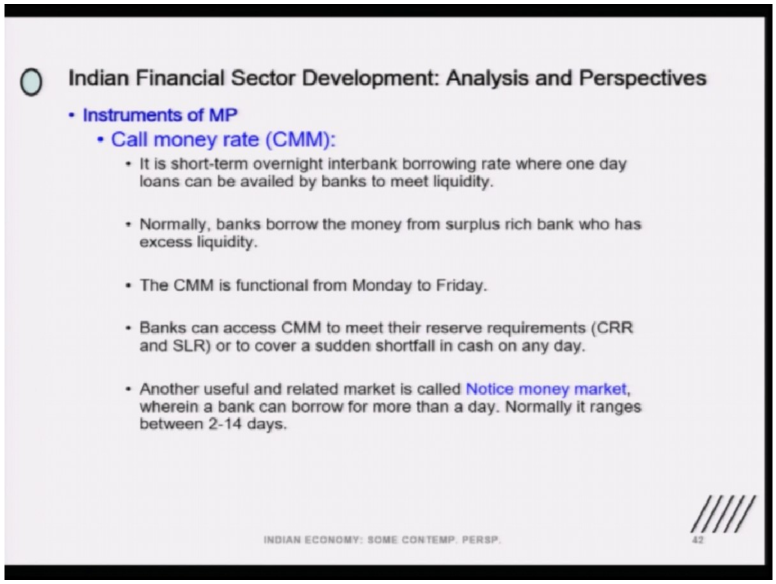

So, this is the borrowing and lending happening between the Central Bank and the bank. So, here we have the repo rate, reverse repo rate, under the Liquidity Adjustment Facility and the Marginal Standing Facility that we have. So, this is between Central bank and the Bank. What happens if the SBI suppose, it is having some kind of liquidity crunch and then, it is asking money from the Bank of Baroda or other bank that you give me.

So, they will also have overnight borrowing and lending that is called call money market. When we have interbank borrowing and lending happening, then that is called the call money market. And this call money market is again an overnight interbank borrowing and lending. Overnight means just for a few hours or so. So, this is what, where one day loans can be availed by banks to meet liquidity.

Banks borrow money from surplus reach banks who has excess liquidity and call money market is function from Monday to Friday. So, on RBI website, if you go on the first page it will mention that, what is the auction amount that is being there. So, banks can access CMM to meet the reserve requirement. CRR, SLR to cover certain shortfall in cash on any day, so anytime they can. So, there is a requirement of SLR, CRR, if there is any kind of variation then they can they can meet by participating in the call money market. Other useful and related market is called notice money market, where a bank and borrow for more than a day, normally it ranges between 2 to 14 days. So far, I have covered this.

In the next session, I will be continuing this again and I will be discussing the recent chapter on the financial markets and the intermediation in the economic survey. And I will be giving you some more insights about the recent policy majors. Those who are from non-economics for them it is useful because you should be aware. Those who are from economics you may find it quite easy and quite as simple. But these tools are important to understand the root of monetary policy and how it should be analyzed. Thank you. Thank you so much.