[Academic Script]

Role of RBI in India

Subject:	Business Economics
Course:	B. A., 4th Semester, Undergraduate
Paper No. & Title:	Paper – 404 Indian Financial System
Unit No. & Title:	Unit – 5 Banking and Housing Finance
Lecture No. & Title:	Lecture – 1 Role of RBI in India

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1. Introduction

The units are divided into three lectures first the concept of the Role of RBI, second various development in banking sector and third the housing finance.

(1) Reserve bank of India

- The reserve bank of India was established on April 1, 1935 in accordance with the provision of the reserve bank of India Act, 1934. Though originally owned privately, it was nationalized in 1949 and Reserve Bank is fully owned by the government of India.
- On the recommendation of Hilton young commission RBI was established.
- The central office of the Reserve Bank was initially established in Calcutta but in 1937 it was moved to Mumbai where the Governor presently sits and policies are formulated.
- RBI total capital of rupees 5 crores was divided in 5 lacs share of rupees 100 each.

1. Functions

➢ Functions of the reserve bank may be classified into two parts:

❖ Traditional functions and

❖ Development functions

Traditional functions of the reserve bank may be classified as under:

Central banking functions	General banking functions	Prohibitory functions
1.note issuing	1. To accept deposits	1.neither to participate in business nor to provide economic assistance
2. Regulation credit	2. to deal in bills	2.neither to purchase share nor to give loans against it
3. Banks of banks	3. lending of money	3.neither to purchase immovable wealth nor to lend loans against it
4. Banker of the government	4.to deal in foreign securities	4.not to deal in time bill
5. Regulation of exchange	5.to deal in costly metals	5.not to give interest on private savings
6. Other functions (a) Clearing house functions (b) Transfer of currency (c) Publication of information (d) Control over nationalized banks	6.to deal with the banks of the other countries	6.not to advance loans without securities
	7.miscellaneous functions	

2. Development functions of the reserve bank

1. Promotion of agricultural finance: contribution of the reserve bank to the field of agricultural credit may

be describes as under. Short-term agriculture credit, medium term agriculture credit and purchase of share of the co-operative sugar mills.

2. Promotion of industrial finance: establishment of specialized institutions, national industrial credit (long term operations) fund, credit guarantee scheme for small scale industries , help to sick industrial units, export assistance.
3. Promotion of export finance: Several measures have been taken for export finance like special schemes, export-import bank of India.
4. Promotion of banking: The reserve bank has undertaken several measures to promote the banking structure of the country. The main steps undertaken in this direction are, strengthening of banking structure, extension of banking facilities, extension of functional coverage, deposit insurance, development of bill market and training in banking.

Role of RBI in India

The role of RBI is very vast in the Indian economy. It performs certain functions which are important to be done for a better economy conditions which other financial institution are not allowed to perform in India:

- It is the central bank of India.
- RBI is the regulator in banking sector in India.
- It regulator of money flow in India.
- RBI has the monopoly to issue note in India.
- It is the mentor who performs certain functions to regulate and boost up each and every sector in India.

3. Monetary policy instrument

- ❖ The policy is frame by the RBI to regulate the flow of money in India.
- ❖ Monetary policy refers to the instrument under the control of central bank to regulate the availability, cost and use of money and credit.(RBI website)

Various objective of monetary policy is listed here:
The primary objective of monetary policy should be domestic price stability.
The stated objective of monetary policy in India is “To promote sufficient credit for growth while ensuring that there is no emergence of inflationary pressures on this account”.
There are several instruments of monetary policy, which is also known as weapon of RBI they are:

- ❖ **Cash Reserve Ratio (CRR):** The share of net demand and time liabilities (deposits) that banks must maintain as cash balance with the Reserve Bank.
- ❖ **Statutory Liquidity Ratio (SLR):** The share of net demand and time liabilities (deposits) that banks must maintain in safe and liquid assets, such as, government securities, cash and gold. Changes in SLR often influence the availability of resources in the banking system for lending to the private sector.
- ❖ **Refinance facilities:** Sector-specific refinance facilities aim at achieving sector specific objectives through provision of liquidity at a cost linked to the policy repo rate. The Reserve Bank has, however,

been progressively de-emphasising sector specific policies as they interfere with the transmission mechanism.

- **Liquidity Adjustment Facility (LAF):** Consists of overnight and term repo/reverse repo auctions. Progressively, the Reserve Bank has increased the proportion of liquidity injected in the LAF through term-repos.
- **Term Repos:** Since October 2013, the Reserve Bank has introduced term repos (of different tenors, such as, 7/14/28 days), to inject liquidity over a period that is longer than overnight. The aim of term repo is to help develop inter-bank money market, which in turn can set market based benchmarks for pricing of loans and deposits, and through that improve transmission of monetary policy.
- **Marginal Standing Facility (MSF):** A facility under which scheduled commercial banks can borrow additional amount of overnight money from the Reserve Bank by dipping into their SLR portfolio up to a limit (currently two per cent of their net demand and time liabilities deposits) at a penal rate of interest (currently 100 basis points above the repo rate). This provides a safety valve against unanticipated liquidity shocks to the banking system. MSF rate and reverse repo rate determine the corridor for the daily movement in short term money market interest rates.

- **Open Market Operations (OMOs):** These include both, outright purchase/sale of government securities (for injection/absorption of liquidity)
- **Bank Rate:** It is the rate at which the Reserve Bank is ready to buy or rediscount bills of exchange or other commercial papers. This rate has been aligned to the MSF rate and, therefore, changes automatically as and when the MSF rate changes alongside policy repo rate changes.
- **Market Stabilisation Scheme (MSS):** This instrument for monetary management was introduced in 2004. Surplus liquidity of a more enduring nature arising from large capital inflows is absorbed through sale of short-dated government securities and treasury bills. The mobilised cash is held in a separate government account with the Reserve Bank. The instrument thus has features of both, SLR and CRR.

Current rates:

- policy repo rate: 7.25%
- Reverse repo rate: 6.25%
- Marginal standing facility rate: 8.25%
- Bank rate: 8.25%
- Reserve ratio: CRR: 4%, SLR: 21.5%
- Lending/ deposit rates: base rate: 9.70% - 10.00%,Savings deposit rate: 4.00,Term deposit rate > 1 year: 8.00-8.50%

4. Summary

1. The reserve bank of India was established on April 1, 1935 in accordance with the provision of the reserve bank of India Act, 1934. It was nationalized in 1949.
2. The main functions of RBI are the monetary authority and regulator and supervisor of the financial system.
3. The role of RBI is very vast in India it regulate the monetary cycle and regulate the Indian economy.
4. Monetary policy refers to the instrument under the control of central bank to regulate the availability, cost and use of money and credit.(RBI website)
5. There are several weapons of monetary policy in India like CRR, SLR, LAF, MSF, OMOs and MSS.
6. Following are the current rate structure:

- policy repo rate: 7.25%
- Reverse repo rate: 6.25%
- Marginal standing facility rate: 8.25%
- Bank rate: 8.25%
- Reserve ratio: CRR: 4%, SLR: 21.5%
- Lending/ deposit rates: base rate: 9.70% - 10.00%,Savings deposit rate: 4.00,Term deposit rate > 1 year: 8.00-8.50%