Q.1. what is monetary policy?/Define monetary policy.

Monetary policy is a set of tools used by a nation's central bank to control the overall money supply and promote economic growth and employ strategies such as revising interest rates and changing bank reserve requirements.

R.P. Kent has defined the monetary policy as "The management of the expansion and contraction of the volume of money in circulation for the explicit purpose of attaining a specific objective such as full employment."

Q.2. what are the different types of monetary policy?

There are two types of monetary policy in an economy depending upon the level of growth within the economy.

Contractionary Monetary policy:

A contractionary policy increases interest rates and limits the outstanding money supply to slow growth and decrease inflation, where the prices of goods and services in an economy rise and reduce the purchasing power of money.

Expansionary Monetary Policy:

During times of slowdown or a recession, an expansionary policy grows economic activity. By lowering interest rates, saving becomes less attractive, and consumer spending and borrowing increase.

Q.3. Explain the different tools of monetary policy.

Some of the following instruments are used by RBI as a part of their monetary policies.

- **Open Market Operations:** An open market operation is an instrument which involves buying/selling of securities like government bond from or to the public and banks. The RBI sells government securities to control the flow of credit and buys government securities to increase credit flow.
- **Cash Reserve Ratio (CRR):** Cash Reserve Ratio is a specified amount of bank deposits which banks are required to keep with the RBI in the form of reserves or balances. The higher the CRR with the RBI, the lower will be the liquidity in the system and vice versa. The CRR was reduced from 15% in 1990 to 5 % in 2002. As of 31st December 2019, the CRR is at 4%.
- **Statutory Liquidity Ratio (SLR):** All financial institutions have to maintain a certain quantity of liquid assets with themselves at any point in time of their total time and demand liabilities. This is known as the Statutory Liquidity Ratio. The assets are kept in non-cash forms such as precious metals, bonds, etc. As of December 2019, SLR stands at 18.25%.
- **Bank Rate Policy:** Also known as the discount rate, bank rates are interest charged by the RBI for providing funds and loans to the banking system. An increase in bank rate increases the cost of borrowing by commercial banks which results in the reduction in credit volume to the banks and hence the supply of money declines. An increase in the bank rate is the symbol of the tightening of the RBI monetary policy. As of 31 December 2019, the bank rate is 5.40%.
- **Credit Ceiling:** With this instrument, RBI issues prior information or direction that loans to the commercial bank will be given up to a certain

limit. In this case, a commercial bank will be tight in advancing loans to the public. They will allocate loans to limited sectors. A few examples of credit ceiling are agriculture sector advances and priority sector lending.

Q.4.What are the objectives of Monetary Policy?

As the objective of monetary policy varies from country to country and from time to time, a brief description of the same has been as following:

1. Neutrality of Money:

Under this system, money is kept stable by the monetary authority. Thus the main aim of the monetary authority is not to deviate from the neutrality of money. It means that quantity of money should be perfectly stable. It is not expected to influence or discourage consumption and production in the economy.

Economists like Wicksteed, Hayek and Robertson are the chief exponents of this objective. They hold the view that monetary authority should aim at neutrality of money in the economy.

2. Exchange Stability:

Exchange stability was the traditional objective of monetary authority. This was the main objective under Gold Standard among different countries. When there was disequilibrium in the balance of payments of the country, it was automatically corrected by movements. It must be noted that if there is instability in the exchange rates, it would result in outflow or inflow of gold resulting in unfavorable balance of payments. Therefore, stable exchange rates play a key role in international trade. Thus, it is clear from this fact that: the main objective of monetary policy is to maintain stability in the external equilibrium of the country.

3. Price Stability:

The objective of price stability has been highlighted during the twenties and thirties of the present century. In fact, economists like Crustar Cassels and Keynes suggested price stabilization as a main objective of monetary policy. Price stability is considered the most genuine objective of monetary policy. Stable prices repose public confidence because cyclical fluctuations are totally eliminated.

It promotes business activity and ensures equitable distribution of income and wealth. As a consequence, there is general wave of prosperity and welfare in the community.

4. Full Employment:

Classical economists believed in the existence of full employment which is the normal feature of an economy. Full employment, thus, exists when all those who are ready to work at the existing wage rate get work. Voluntary, frictional and seasonal unemployed are also called employed.

However, with the publication of Keynes' General Theory of Employment, Interest and Money in 1936, the objective of full employment gained full support as the chief objective of monetary policy.

After achieving the objective of full-employment, monetary policy should aim at exchange and price stability. In short, the policy of full employment has the far-reaching beneficial effects.

5. Economic Growth:

Monetary authority should follow an easy or tight monetary policy to suit the requirements of growth. Again, monetary policy in a growing economy, has to

satisfy the growing demand for money. Thus, it is the responsibility of the monetary authority to circulate the proper quantity and quality of money.

6. Equilibrium in the Balance of Payments:

Equilibrium in the balance of payments is another objective of monetary policy which emerged significant in the post war years. This is simply due to the problem of international liquidity on account of the growth of world trade at a faster speed than the world liquidity.