

# DELIBERATIONS AND RESOLUTIONS OF MONETARY POLICY COMMITTEE – AN ANALYSIS

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## **Abstract**

*Monetary Policy Committee, MPC, and its resolutions/decisions play an important role as they influence Consumer Price Index (CPI) inflation and also the economic growth. In accordance with an understanding between the Government of India (GoI, Government) and the Reserve Bank of India (RBI, apex bank), the Government has set (in consultation with the apex bank) the CPI inflation at 4 per cent for the period from 5 August 2016 to 31 March 2021 with  $\pm 2$ . If it (i.e., CPI inflation) exceeds the upper limit or falls below the lower limit for three quarters continuously, it will be construed as failure to achieve the inflation target. Hence, the MPC has greater responsibility and its decisions impact all walks of life – primary, secondary and tertiary sectors in one way or the other, and both directly and indirectly. This committee had its sixth meeting on August 1 and 2, 2017 and taken a decision to cut down the Repo Rate, with immediate effect, by 25 basis points to 6 per cent – the lowest since November 2010. Consequently, the Reverse Repo Rate has been cut by 0.25 per cent to 5.75 per cent. This decision is based on perusal of recent developments in the economy, both globally and in the domestic economy, and also the outlook for the future. In this background, this paper makes an attempt analyse and present various dimensions of MPC – its composition, deliberations, resolutions, and also the statements by the members as to why they voted in favour of the subject or against it.*

**Key Words:** Repo Rate, Reverse Repo Rate, Money Supply, CPI Inflation, Monetary Policy, Monetary Policy Committee, Bank Rate

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## **Introduction**

Monetary policy is an important macro-economic policy of the apex bank (Reserve Bank of India, RBI) of the country. It (i.e., monetary policy) plays a stupendous role as it primarily aims at maintaining price stability by managing money supply and interest rate. It may be noted here that based on an amendment made to the

Reserve Bank of India Act, 1934 in the month of May 2016,<sup>1</sup> the Government of India (Government, GoI), in consultation with the apex bank, notified 4 per cent Consumer Price Index (CPI) inflation<sup>2</sup> as the target for the period from 5 August 2016 to 31 March 2021 with  $\pm 2$ .<sup>3</sup> Therefore, if the average inflation is higher than the upper tolerance limit (i.e., +6 per cent) or



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lower than the lower tolerance limit of inflation target (i.e., -2 per cent) for any three consecutive quarters, then it constitutes failure to achieve the inflation target.

Simultaneously, the monetary policy also aims at growth by creating conducive economic environment. That means, by ensuring price stability, it (i.e., monetary policy) aims at achieving sustainable growth. Therefore, maintenance of price stability and promotion of economic growth are the two major objectives which both the apex bank and the government are determined to achieve through the monetary policy (of MPC). And this responsibility is now entrusted to a new authority, Monetary Policy Committee (MPC).

### **Objective of the Study**

In the backdrop of the twin objectives set for the MPC, this paper makes an attempt to analyse a few dimensions of MPC such as its composition, deliberations in its meetings, resolutions/decisions, the stand of members on the resolutions, etc., focusing on its sixth meeting held on August 1 and 2, 2017. For obvious reasons, this paper draws the necessary material from the minutes of the meeting of MPC held on August 1 and 2, 2017.

### **Monetary Policy Committee**

As already stated, the MPC is empowered/responsible for fixing/revising the benchmark policy interest rate to contain inflation within the target level. This committee comprises six members – (1) three members are nominated by the GoI for a fixed 4-year term (or until further orders whichever is earlier) and these members are not eligible for re-appointment; (2) other three members are, (i) Governor of RBI, (ii) Deputy Governor (in-charge of Monetary

Policy), and (iii) Executive Director of RBI nominated by the Board of RBI.

The committee is required to meet, under the chairmanship of the Governor of RBI, once in two months (i.e., bi-monthly) and at least four times in a year. The quorum for the meeting is four members. Each member (including the Governor of RBI) has one vote. And the interest rates are decided, in the meeting of MPC, by majority of votes of the Committee. However, there is a provision for a casting vote by the Governor of RBI in case of tie (i.e., a situation where the votes are equally distributed on any subject brought before the meeting of MPC).

The decision of the MPC is binding on the RBI as it is bound to give effect to the decision of MPC. Most importantly, the members are required to write a statement specifying the reasons for their voting – either in favour of the proposal brought before MPC meeting or against it. Further, the vote of each member along with the reasons/justifications behind each member's vote are required to be made public on the 14th day from the date of meeting of MPC.

### **Literature Review**

Plenty of material is available about the role of monetary policy statements. However, only a few works are reviewed here.

Monetary policy strategy of the apex bank is influenced by a number of factors that are very specific to the country's economy. However, the degree of openness in the economy, and the development stage of markets, institutions and technological development are important factors. And this monetary policy has both short- and long-term implications affecting the real sector with long and variable lags, and the

financial markets with short-run implications (Smith T H, 2010).

However, it is observed that the use of monetary policy for the purpose of financial stability is highly contested. It is further observed that the price stability is not sufficient for financial stability. As the financial crises are costly, the policy should be directed towards reducing the likelihood of crises instead of dealing with their repercussions after their occurrence. It is, therefore, suggested that the well-targeted micro and macro-prudential policies and regulations should be used effectively for the purpose of lessening the accumulation of financial risks. It is also observed that though it is possible to keep the interest rates at higher level persistently, it is costlier (International Monetary Fund, September 2015).

Though the Repo Rate intends to contain the CPI inflation, the success also depends upon other developments. However, the fact is that both the Repo Rate and the CPI inflation are strongly correlated (both positively and negatively) depending upon the nature of developments in other determinants of CPI inflation. And the Repo Rate has a direct impact on the CPI inflation (Inchara P M Gowda, November 2016).

Inflation uncertainty is counter-cyclical, and it is correlated with many determinants such as inflation disagreement, volatility and the economic policy uncertainty index. However, it is observed that the inflation uncertainty is lowest among high-income consumers, stock market investors and males. And the uncertain customers are more reluctant to spend on durables such as four-wheelers (Carola C. Binder, 2017).

To examine the effectiveness of monetary policy in controlling inflation, Repo Rate, Cash Reserve Ratio<sup>5</sup> and Bank Rate are used as policy instruments during April 2005 to August 2014. Through the analysis of test results, it is observed that rise in Bank Rate and Cash Reserve Ratio results in a rise in Wholesale Price Index (WPI) which in turn causes a rise in Repo Rate. From the Co-integration analysis among Repo Rate, Cash Reserve Ratio and Bank Rate, it is inferred that whatever little monetary policy has been used has actually been ineffective (Ray Lipsa, December 2015).

After considering the developments in the recent past (both globally and domestically), and also the outlook for the future, the Monetary Policy Committee (MPC) of RBI, in its meeting held on April 5-6, 2017, decided to keep the policy Repo Rate<sup>6</sup> under LAF (Liquidity Adjustment Facility)<sup>8</sup> unchanged at 6.25 per cent but to increase the Reverse Repo Rate<sup>8</sup> by 25 basis point to 6 per cent, and to reduce the Marginal Standing Facility (MSF) rate<sup>9</sup> by 25 bps to 6.5 per cent. In the light of the uncertainty as to the directions of developments, it was felt that the stand of the MPC was balanced as it adopted 'wait and watch policy' before making any revision in the policy Repo Rate (Inchara P M Gowda, May 2017).

Robert H Rasche & Marcela M Williams (July 2005), in their working paper, have addressed four important dimensions viz., (i) the changing views of the role and effectiveness of monetary policy, (ii) inflation targeting as an 'effective monetary policy', (iii) monetary policy and short-run output stabilization, and (iv) problems in implementing a short-run stabilization policy. Based on the factual analysis, it is concluded that the inflation targeting central banks appear to

have hitting the targets on a medium-run horizon. Further, it is observed that there are many dimensions to uncertainty in the environment in the apex banks operate.

Though the country's (India) monetary policy played a positive role in the past, the good track record came to a sudden end in the recent years as the inflation increased sharply. It is observed that both the monetary policy strategy and the framework of the apex bank would benefit from further evolution in the direction of a specifically defined and all-embracing objective instead of the current multiplicity of goals. It is, therefore, suggested that acceptance of a flexible targeting approach would be a possible solution (Riccardo Cristadoro & Giovanni Veronese, 2011).

The recent financial crisis in many countries has forced policy-makers to rethink about the inter-relationship between monetary policy and financial stability. And it is argued that the central banks should assume greater responsibility for preventing financial crises instead of mopping up after the financial crises. As over-borrowing is likely to contribute to financial imbalances, an array of micro and macro-prudential policies is suggested to limit borrowings. However, it is observed that neither the monetary policy nor the new policies are expected to rule out the possibility of a financial crisis (Roberto M. Billi & Anders Vredin, 2014).

From the point of view of RBI, 2008-13 were very crucial years as the financial crisis in the world which started in September 2007 on account of imprudent lending by US banks having spill-over effects in all emerging economies including India. This is because of the reason that in an open economy like India, the country cannot remain unaffected when the world economies are bursting/booming. High

prices of essential goods and services, subsidies which were on higher side leading to higher fiscal deficits, increasing current account deficits, etc., made the apex bank to play a responsible role even with some tough measures. In this situation, the apex bank played a commendable job by taking some strong measures (IshaDhar, April-June 2014).

2007-08 witnessed the ugly side of the monetary system as excess creation (prior to this period) leading to rising inflation worldwide. One of the reasons for this was the bank lending (in the US) to not-so credit-worthy borrowers. This has traumatized the public confidence in the banking system on the one hand and failure of regulators such as apex banks to exercise proper control over the banking network on the other. It was felt that the central banks were ineffective in their supervision, monitoring and regulating the functioning of banks in a few countries (Faure A P, 2013).

#### **Deliberations of MPC**

Before deciding about the interest rates, the MPC, in each meeting, considers various developments during recent past (more specifically, the developments in the economy after the immediately preceding meeting) and also the outlook in the near future. Further, it reviews the surveys conducted by the apex bank to gauge the consumer confidence, households' inflation expectations, performance of corporate sector, the outlook for the different sectors of the economy. The committee also takes into account the macro-economic projections by the staff of the apex bank and the alternative scenarios around different risks to the outlook. Most importantly, it takes into account both the recent developments and also future outlook both globally and domestically (Figure – 1).

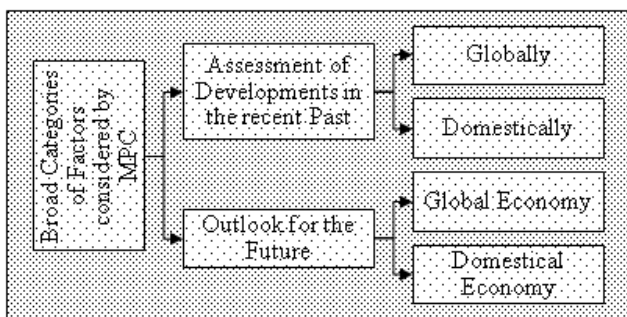


Figure - 1:

*Broad Categories of Factors considered by MPC*

### **Assessment of recent Developments at the Global Level**

The MPC considered various developments at the global level – focusing on the developments in a few major economies in the recent past i.e., since June 2017. Some of the developments considered by the committee in its meeting on August 1 and 2, 2017 are summarized below.

The US economy, among Advanced Economies (AEs), has registered faster rate of growth in Q2, and this is attributed to the steady improvement in labour market conditions, increase in consumer spending and upbeat consumer confidence owing to softer than the expected level of inflation, improved industrial production, etc. In the Euro area, declining unemployment, picking up in the private consumption, substantially receding political uncertainty, etc., have contributed to the broadening of recovery across constituent economies. Strengthening of exports, accelerating industrial production, wage deflation, etc., have enabled Japan to record steady and modest expansion. However, the continued Policy and Political Risks in US are create some problem.

Among Emerging Market Economies (EMEs), owing to rising retail sales and

industrial production, China has regained some lost ground in growth during Q2 thoughttightening of financial situation due to deleveraging financial institutions and the real estate slowdown are expected to weight negatively. Declining unemployment, increasing retail sales, strengthened industrial production, etc., have enabled Russian economy to come out of two years of recession. Consequent to political uncertainty, still depressed labour market, etc., a fragile economy remains vulnerable on Brazil. Similarly, economic activities are continued to be beset by structural and institutional bottlenecks in South Africa which is also in a technical recession.

The developments such as modest firming up of global demand and stable commodity prices in most of key economies have contributed to the global trade volumes as echoed by increasing exports and imports. Though crude prices have registered modest rise (from bearish territory due to inventory drawdown in the US), the supply overhang continues. Besides, the Bullion prices registered to a multi-month low owing to improved risk appetite. In spite of and/or on account of all these developments, the MPC noted that in most of AEs, the inflation is well below the target, and across most of EMEs, it is subdued.

Though equity markets have registered gains in most of AEs, European markets have weighed down owing to Brexit talks and strengthening euro. Bond yields in major AEs have hardened on expectations of normalization of monetary policy. Similarly, in EMEs, the situation is not different as the situation remained diverse. As far as the currency markets are

concerned, except US Dollar, currencies of major AEs and EMEs either remained stable or improved marginally. US Dollar has weakened further to a multi-month low in July owing to weak inflation and uncertainties attributed to the policies of US administration.

### **Assessment of recent Developments at the National Level**

The MPC has taken into consideration many developments in the Indian economy in the recent past. Brightened prospects of agricultural and allied activities on account of normal and well-distributed south-west monsoon, increase in the Kharif showing than the previous year in most of the crops except oilseeds, etc., are expected to enable the country to achieve the targets set by the Ministry of Agriculture, GoI, for 2017-18.

However, the country experienced mixed success in industrial sector. Weakened industrial performance in April-May 2017, excess inventory of coal, almost stagnated production of crude oil and refinery products resulting in slowing down of mining activities, declining number of new investment announcements to a 12-year low in Q1, unsatisfactory attempts to execute the stalled projects, slowing down in the output of infrastructure goods, contraction in electricity, coal and fertilizer production in June (on account of excess inventory and lukewarm demand) dragging down the output of core industries, etc., are some of indicators of weak or not-so-satisfactory performance. This is also indicated by the 78th Round of RBI's Industrial Outlook Survey (IOS) of the fading optimism in Q2 about capacity utilization, employment, profit margins, etc. Owing to decline in new orders and a worsening in business conditions,

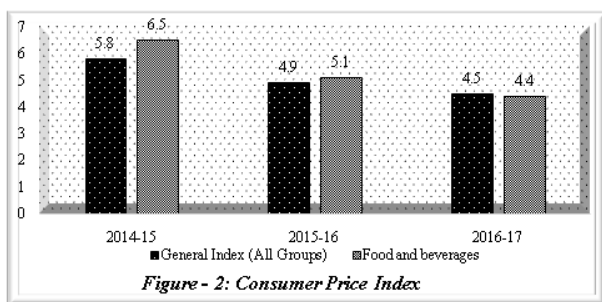
the purchasing managers' index (PMI) declined into the contraction zone. On the other hand, after a persistent decline, the production of natural gas is encouraging along with steel output remaining strong.

Increase in the freight carriage by air, sale of commercial vehicles and motor-cycles, acceleration in activities of communication sector, increase in foreign tourist arrivals and air passenger traffic supporting hospitality sector, etc., ensured the PMI for the services sector continued to remain in expansion mode during May-June.

Though the growth in merchandise export weakened in May-June (from peak in April) as echoed by either slow or decline in the value of shipments across commodity groups, there is an acceleration in the imports of oil, stockpiling of gold imports, increase in the import of coal, electronic goods, machinery, vegetable oils, pearls and precious stones, etc. Consequently, the import growth continued to outpace export growth as reflected by the trade deficit of US \$ 40.1 billion in Q1 registering more than 100 percent increase over the level a year ago. However, net foreign direct investment (FDI) into the areas like manufacturing, retail and wholesale trade and business services, etc., doubled during April-May 2017 (over its level a year ago). Further, the foreign portfolio investors have made net purchases of US \$ 15.2 billion in domestic debt and equity markets. As a result, the level of foreign exchange reserves stood at US \$ 392.9 billion by the end of July 2017.

The prices of food and beverages (which went, for the first time in the new CPI Series) into deflation in the month of May) further dropped in June. This is attributed to the decline in the prices of pulses, vegetables, spices and eggs on the one

hand, and moderate inflation across most of other sub-groups on the other. Even the fuel inflation registered a continuous decline, for the second month in succession, due to decline in the international prices of LPG and moderation of price increases in the cases of coke, firewood, chips, etc. However, administered prices of LPG and kerosene are expected to rise on account of reduction in subsidy. As a result of these developments, the CPI inflation (excluding food and fuel) moderated (for the third month in succession) in June and declined to 4 per cent. Price war in the telecommunication sector was succeeded in depressing the inflation in communication (and transport) services. Even the input costs pertaining to both the farms and industry remain gentle tracking prices at the international level. However, the power prices polled in the RBI's IOS and in manufacturing and services PMIs are still unresponsive. Most importantly and on an average, the consumer price index for almost all categories of goods and services is registering a continuous decline. A few details are presented below (Figure – 2).



Surplus liquidity situation persisted in the system exacerbated further fueled by front-loading of budgetary spending by the Government. And the active liquidity management reflected in the firming up of weighted average call rate (WACR) and traded about 17 bps below the Repo rate, on an average, during June-July. Besides

these, the MPC considered a few more developments on the lines of the above during its recently held meeting.

### Outlook for the near Future

Much of the deliberations of MPC about the outlook for the future focused on the domestic perspective. The committee observed that the evolving momentum of inflation would be influenced by three important factors, among others, viz., (i) impact of giving effect to the house rent allowances (HRA) under the 7th Central Pay Commission (CPC), (ii) implications of price revisions withheld ahead of the goods and services tax (GST), and (iii) the disentangling of the structural and transitory factors that shape food inflation. However, the baseline inflation trajectory will be influenced by the States' implementation of salary and allowances award (similar to the Centre), price pressures building in vegetables and animal proteins, etc. The committee also considered a few positive aspects such as second successive normal monsoon, effective supply management measures, fairly stable international commodity price outlook, etc. These are expected to play the role of moderating forces. Further, excess supply situation pushes down the prices of pulses and that of cereals in check. Therefore, the MPC noted that while the outlook for agriculture appears to be robust, the underlying impulses in secondary and tertiary sectors are weakening on account of corporate deleveraging and the retrenchment of investment demand. Further, the MPC noted that some of the upside risks to inflation have either reduced or not materialized. Though the business sentiment polled in the manufacturing sector is an indication of moderation of activities in Q2 of 2017-18, the twin balance sheet problem of stressed assets is

likely to dissuade new investment. Even the real estate sector is expected to involve extended gestations owing to regulatory umbrella restraining growth and this in turn is expected to spillover construction and ancillary activities. On the positive side, possibility of another good kharif harvest, higher budgetary allocation to rural housing leading to boost in rural demand, substantial increase in the budgetary allocation for road networks and bridges, growth-enhancing implications of GST, reduction in tax cascades, etc., are expected to contribute the economic growth by spurring investment. Besides, though the global political risks remain note-worthy, gradual improvement in the external demand conditions are expected to support the domestic economy. In this background, the projection for real GVA growth for 2017-18 is retained at the June 2017 projection of 7.3 per cent with risks evenly balanced/distributed.

Besides, the committee also noted that (i) the baseline path of headline inflation (excluding the impact of HRA) has declined to little over 4 per cent, (ii) inflation (excluding food and fuel) has declined over the last three months, (ii) smooth and successful roll-out of GST and (iii) normal monsoon. And based on these, the committee (majority) felt that some space has opened up for the monetary policy accommodation. However, the committee was also of the view that there is a pressing need for reinvigorating private investment, removal of bottlenecks in the development of infrastructure and providing a major thrust to the Pradhan Mantri Awas Yojana for housing needs of all. In this background, and after thorough/extensive deliberations on the stance of monetary policy, the MPC has taken the following decisions.

### **Resolutions of MPC**

After comprehensive deliberations on the facts and projections evolving macro-economic situation, the MPC, in its sixth meeting (third in this financial year, 2017-18) held on August 1 and 2, 2017 has decided to reduce the policy Repo Rate under LAF by 25 basis points from 6.25 per cent to 6 per cent with immediate effect. As a result, the Reverse Repo Rate under the LAF stands adjusted to 5.75 per cent, and MSF Rate and the Bank Rate<sup>11</sup> to 6.25 per cent. The MPC stated that this decision is consistent with a neutral stance of monetary policy in consonance with the primary objective of achieving the medium-term target for CPI inflation of 4 per cent within a band of  $\pm 2$  per cent. This is considered to be an important step to ensure sustained economic growth.

For the first time, after the constitution of MPC, the decision was taken by the committee on majority of votes. In the earlier five meetings of MPC, the decisions/resolutions were unanimous. But this time, four members (including the Governor, Dr. Urjit R Patel) were in favour of the decision. Out the remaining two, Dr Ravindra H Dholakiavoted for a policy rate reduction of 50 basis points. And the last member, Dr Michael Debabrata Patra, voted for status quo. As the first four members voted in favour of the decision and the fifth member argued for a policy rate reduction by 50 basis points (instead of 25 basis points), the thinking of these members is, more or less, on the same lines as presented above. But the sixth member (Dr Michael Debabrata Patra) who argued for the maintenance of status quo, it is necessary to look to his line of thinking.



### **Statement by Dr. Michael Debabrata Patra**

He has consistently been maintaining that the inflation targeting framework should be forward looking. This is because of the reason that the monetary policy set by looking over the shoulder at inflation prints of the recent past runs the risk of time inconsistency with regard to the target. He supported his argument by restating the decision of MPC in its first meeting in October 2016 – currently anticipating recent inflation developments back in October 2016, it (i.e., MPC) took monetary policy action that was consistent. But when the inflation is set to rise (in a couple of months), the decision of MPC to lower the policy rate now is not only inconsistent but also undermines the credibility.

Owing to sharpest rise expected in prices of household durable goods and services, 70 per cent of respondents expect prices to increase. And the CPI inflation's historic low has completely been discounted by the households. Even the professional forecasters, considered to be forward-looking people, predict inflation rising over the rest of the year – he said in his statement. The increase of 106 per cent in HRA for the employees of central government will feed into the CPI cumulatively. Adding to this, there is an uncertainty about the inflationary impact of roll-out of GST such as release of pending price revisions, restocking after clearance sales, unwinding of arrangements made to prepare for initial difficulties, etc. He expects, in the near future, the emergence of one-off inflation effects. Further, the base effects, in his opinion/judgment, will reverse and turn unfavourable from the month of August. Already, there are signs of seasonal spikes in inflation-sensitive food prices - however, the issue is, will there be spillovers persuade/induce generalization of inflation momentum?

The financial environment, Dr Michael Debabrata Patra observes, is bubbly/frothy – (i) combination of high valuation in equity and fixed income markets, (ii) an appreciating currency and (iii) persistency of a liquidity overhang in the money market reflect a perfect recipe for a financial imbalance. A rate cut, he fears, can amplify it if the apex bank is seen as encouraging risk-taking. Though it was possible to achieve the inflation targets (8 per cent, 6 per cent, and 5 per cent) adopted by the apex bank in the recent past, much of it was attributed to the collapse of international crude prices, new CPI Index, demonetization, favourable supply shocks, etc. But the situation now is different and as the MPC is in a formal inflation targeting framework, he prefers to achieve the mandated target with good policy.

The above factors could come together in CPI readings (from August) and if this happens, then it is better for the MPC to stay on hold now, observe the shape/slope of the upturn closely, if it is benign, deliver credible monetary policy that supports the economy – he says. In this background, he voted for the maintenance of status quo in the Repo Rate.

### **Conclusion**

To sum up, it may be said that the monetary policies of the apex bank play an important role in lowering CPI inflation and also in ensuring sustainable growth. And therefore, there is greater responsibility on the shoulders of MPC to take appropriate decision about the Repo Rate and other interest rates keeping in mind the overall interest of the country and its economy. Though past is important to learn good lessons and to shape the future, it is much more important to take note of the forecast for the future while

deciding about the monetary policy statements. The MPC should not be influenced much by the weak positive developments. Instead, it should base its decisions on the reliable projections for the future.

### Notes

- (1) The amendment made to the Reserve Bank of India Act, 1934 in May 2016 provides a statutory basis for the implementation of Flexible Inflation Targeting Framework. It also empowers the GoI to set the inflation target, in consultation with the RBI, once in five years.
- (2) Consumer Price Index (CPI) is the change in prices of a basket of consumer goods and services that are typically purchased by specific groups of households. It is estimated by considering both the prices and quantities of a fixed set of consumer goods and services. Therefore, it is the weighted average of prices.
- (3) CPI inflation: upper tolerance limit is 6 per cent (i.e.,  $4 + 2$ ) and lower tolerance limit is 2 per cent (i.e.,  $4 - 2$ ).
- (4) Earlier (i.e., prior to the establishment/constitution of Monetary Policy Committee), the Governor of the apex bank was empowered, assisted by the Technical Advisory Committee (TAC), to take decision pertaining to Repo Rates. The role of TAC was only advisory – no binding on the Governor to take decision pertaining to Repo Rate (and others) as advised by the TAC.
- (5) Cash Reserve Ratio (CRR): Banks in India are required to keep certain percentage, as the apex bank may stipulate from time to time, of their deposits with the RBI. And this

(i.e., the amount kept with the apex bank) is reckoned as equivalent to holding cash with themselves. This minimum ratio is known as CRR. As result, the amount available with the banks for investments, lending, etc., reduces. Therefore, higher the CRR, lower is the amount available with the banks for lending, etc. And the apex bank uses this tool (i.e., CRR) to control liquidity in the banking companies.

- (6) Repo Rate (RR), also called benchmark interest rate, is the rate which the apex bank lends money to the banks for a short term against government securities (with an explicit understanding to buy them back at a pre-determined price and date) under the Liquidity Adjustment Facility (LAF). Therefore, whenever there is an increase in the RR, it becomes comparatively costlier for the banks to borrow from the apex bank and vice-versa. Hence, RR indicates the rate at which the apex bank liquidity is injected into the banking companies. The apex bank uses this instrument as a part of its monetary policy to control the money supply in the economy. At present, it is 6 per cent.
- (7) Liquidity Adjustment Facility (LAF) is a facility provided by the RBI to the banking companies enabling them to adjust their liquidity mis-matches in their day-to-day operations. It allows them to borrow expeditiously from the apex bank in case of emergency and/or for making adjustments in their SLR and/or CRR requirements. It, therefore, consists of both Repo and Reverse Repo Operations.
- (8) Reverse Repo Rate (RRR), the mirror image of Repo Rate, is the short-term borrowing rate at which the apex bank absorbs liquidity

by borrowing money from banking companies under LAF against the collateral of eligible government securities. Whenever the apex bank feels that there is too much money floating in the banking sector, it (i.e., apex bank) increases the RRR and vice-verse. An increase in the RRR encourages the banking companies to lend their money to the apex bank which safer than lending to others. RRR, therefore, indicates the rate at which the apex bank absorbs liquidity from the banks.

- (9) Marginal Standing Facility (MSF) is a special window for banking companies to borrow additional amount of overnight money (in emergency situation like acute cash shortage) from the apex bank (by dipping into their SLR portfolio up to a limit) at a penal/higher rate of interest (than the Repo Rate).
- (10) Liquefied petroleum gas
- (11) Bank Rate is the long-term rate at which the apex bank provides finance to banking companies. It may be noted here that the Repo rate is for short term.

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