❖ **CONTROL OF MONEY SUPPLY BY THE CENTRAL BANK (RBI IN INDIA)**: - The central bank adopts various measures to control the supply of money in the economy Which is why monetary policy of the central bank is often known as credit control policy.

Various instruments of monetary policy (credit control policy) are:

A. Quantitative instruments, and
B. Qualitative instruments.

❖ **QUANTITATIVE INSTRUMENTS OF MONETARY POLICY** :-

1. **RFPO RATE**:- Repo rate refers to the rate of interest at Which RBI lends money to the commercial banks. The commercial banks take loan from RB1 basically to correct their liquidity status.

a. Rise in repo rate would discourage the commercial banks to build their cash reserves to borrow from the RBI. This reduces the supply of money by the commercial banks.

On the other hand. a fall in repo rate induces commercial banks to build their cash reserves by way of borrow from the RB1. This increases the supply of money by the commercial banks. Thus, during inflation. repo rate is increased., when the supply of money needs to he curbed. During deflation, repo rate is decreased, when the supply of money- needs to be increased.

**Rise in Repo Rate** → Discourages the commercial banks to build cash reserves for the purpose of credit creation
→ Reduces the supply of money by the commercial banks Inflation is curbed
**Fall in Repo Rate** → Encourages the commercial banks to build cash reserves for the purpose of credit creation
→ Increases the supply of money by the commercial banks
→ Deflation is curbed.

b. When repo rate is increased market rate of interest (interest rate charged by the commercial banks from their borrowers) is also increased. This lowers demand for credit from the commercial banks by the investors and the households. This leads to a fall in investment expenditure consumption expenditure. Implying a fall in demand for goods and services in the economy. When demand falls, demand for credit is reduced Accordingly, inflation is corrected.
On the other hand, when repo rate is decreased, market rate of interest is also decreased. This increases demand for credit from the commercial banks by the investors and the households. This leads to a rise in investment expenditure and consumption expenditure. Implying a rise in demand for goods and services in the economy. When demand for credit tends to rise. Accordingly, deflation is corrected.

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2. **BANK RATE**,:- Bank rate refers to the rate at which the res makes available credit facilities to the commercial banks.

- An increase in the bank rate means that the reserve hank will charge higher interest from the borrowers banks. As a result, the banks will begin to charge higher interest rates from their borrowers. Money will have a contractionary effect on the economy, as the investors will not like to borrow at higher rates of interest.
- A decrease in the bank rate would result in a fall in the market rates of interest. This will have expansionary effect on the economy.




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3. **OPEN MARKET OPERATIONS**:- It refers to the sale and purchase of government securities by the Reserve bank. •

- When the reserve bank sells these securities to commercial banks, it receives payment in cash from them. To w4itit, extent, the commercial banks' ability to create credit is restricted which will have a contractionary effect on the economy.
- A purchase of securities by the reserve bank will result in a flow of cash to commercial banks. This will have an expansionary effect on the economy.

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4. **VARIABLE RESERVE RATIOS**:- Variable reserve ratios are, of two types, (0 Cash Reserve Ratio and (ii) Statutory Liquidity Ratio

a. Cash reserve ratio refers to that proportion of their time and demand deposits that commercial banks are required to keep in cash with the reserve bank of India.

b. Statutory liquidity ratio refers to that proportion of their time and demand deposits that commercial banks are required to keep with themselves as liquid assets.

An increase in either of these rates reduces the availability of credit in economy. It thus, has a contractionary effect on the economy. A decrease in either of these ratios increases the availability of credit, and this has an expansionary effect.

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5. **REPO RATE AND REVERSE REPO RATE**:- Repo rate is the rate of interest charged by RBI when it leads money to commercial bank for a very short period.

A rise in repo e results in an increase in the cost of funds for commercial banks. The banks pass on this burden to the borrowers. All interest rates go up in the economy. Repo rates are raised to check inflation in the economy. A fall in repo rate makes the loans cheaper, and hence it is an instrument to stimulate investment and growth in the economy.

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