For XAT , CMAT , SNAP , MAT , IIFT Exam

RESERVE BANK OF INDIA

- The Reserve Bank of India was established on April 1, 1935, in accordance with the provisions of the Reserve Bank of India Act, 1934.
- The Central Office of the Reserve Bank was initially established in Kolkata but Headquarter moved from Calcutta to Mumbai in 1937
- Osborne Smith was the first Governor of Reserve Bank of India
- RBI was Nationalised on 1 January 1949

Administration

- RBI has four zonal offices: New Delhi for North, Chennai for South, Kolkata for East, and Mumbai for West
- The Central Board consists of:
    - Governor
    - 4 Deputy Governors
    - 2 Finance Ministry representatives
    - 4 directors to represent local boards headquartered at Mumbai, Kolkata, Chennai, and New Delhi
- Governors and 4 Deputy Governors along with the central board of directors are appointed by the Government of India.
- The only Prime Minister who was the Governor of RBI was **Manmohan Singh**.
- The Reserve bank is referred to by the name 'Mint Street'.

Functions of Reserve Bank of India

Monetary Authority

- It controls the supply of money in the economy to stabilize exchange rate, maintain healthy balance of payment, attain financial stability, control inflation, strengthen banking system

The issuer of currency

- The objective is to maintain the currency and credit system of the country. It is the sole authority to issue currency (Except the currency and coins of one rupee or its denominations, which are issued by Ministry of Finance). It also takes action to control the circulation of fake currency

The issuer of Banking License

- As per Section 22 of the Banking Regulation Act, 1949, every bank has to obtain a banking license from RBI to conduct banking business in India.

Banker’s Bank

- RBI is the bank of all banks in India as it provides loan to banks, accept the deposit of banks, and rediscount the bills of banks.

Banker to the Government

- It acts as banker both to the central and the state governments. It provides short-term credit. It manages all new issues of government loans, servicing the government debt outstanding and nurturing the market for government securities.
- It advises the government on banking and financial subjects.

Lender of last resort

- The banks can borrow from the Reserve Bank of India by keeping eligible securities as collateral at the time of need or crisis, when there is no other source.

Act as clearing house

- For the settlement of banking transactions, RBI manages 14 clearing house. It facilitates the exchange of instruments and processing of payment instructions.

Custodian of foreign exchange reserves

- RBI acts as a custodian of FOREX. It administers and enforces the provision of Foreign Exchange Management Act (FEMA), 1999.
- RBI buys and sells foreign currency to maintain the exchange rate of Indian rupee v/s foreign currencies. Keeping the Forex (foreign exchange) reserves of the country
- RBI representing the Government of India in the IMF and World Bank (and other international financial agencies of which India is member).

Regulator of Economy

- It controls the money supply in the system, monitors different key indicators like GDP, Inflation, etc.

Regulator and Supervisor of Payment and Settlement Systems

- The Payment and Settlement Systems Act of 2007 (PSS Act) gives RBI oversight authority for the payment and settlement systems in the country.
- RBI focuses on the development and functioning of safe, secure and efficient payment and settlement mechanisms.
- The objective is maintaining public confidence in payment and settlement system.

Banking Ombudsman Scheme

- RBI introduced the Banking Ombudsman Scheme in 1995. Under this scheme, the complainants can file their complaints in any form, including online and can also appeal to the Ombudsman against the awards and the other decisions of the Banks.

Publisher of monetary data and other data

- RBI maintains and provides all essential banking and other economic data, formulating and critically evaluating the economic policies in India. RBI collects, collates and publishes data regularly

Developmental Functions

- This role includes the development of the quality banking system in India and ensuring that credit is available to the productive sectors of the economy .It provides a wide range of promotional functions to support national objectives..
- It also includes establishing institutions designed to build the country's financial infrastructure. Playing this role, RBI did set up developmental banks like—IDBI, SIDBI, NABARD, NEDB (North Eastern Development Bank), Exim Bank, NHB.

Monetary Policy

- Monetary policy refers to the use of monetary instruments under the control of the central bank to regulate magnitudes such as interest rates, money supply and availability of credit with a view to achieving the ultimate objective of economic policy.
- Monetary Policy is the macroeconomic policy being laid down by the Central Bank towards the management of money supply and interest rate.
- It is the demand side economic policy used by the government of a country to achieve macroeconomic objectives like inflation, consumption, growth and liquidity.
- There are several direct and indirect instruments that are used for implementing monetary policy. These are Cash Reserve Ratio, Statutory Liquidity Ratio, Bank Rate, Repo Rate, Reverse Repo Rate, and Open Market Operations.
- The Monetary Policy Committee (MPC) constituted by the Central Government under Section 45ZB determines the policy interest rate required to achieve the inflation target.
- The objectives of monetary policy are
  1. Neutrality of Money
  2. Stability of Exchange Rates
  3. Price Stability
  4. Full Employment
  5. Economic Growth
  6. Equilibrium in the Balance of Payments

Credit Control Measures

- Credit control is the primary mechanism available to the Central banks to realize the objectives of monetary management
- The statutory basis for the control of the credit system by the Reserve Bank is embodied in the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949.

Methods of Credit Control

- General or Quantitative Methods
  1. Bank Rate 2. Open Market Operations 3. Variable Cash Reserve Ratio
- Selective or Qualitative Methods
  1. Rationing of Credit 2. Direct Action 3. Moral suasion 4. Publicity 5. Regulation of Consumer' Credit 6. Marginal Requirements

Quantitative or General Methods

1. Bank Rate Policy

- The interest rate which the RBI charges on its long-term lendings is known as the Bank Rate.
- The rate has direct impact on long-term lending activities of the concerned lending bodies operating in the Indian financial system
- Example: If the Central Bank wants to control credit, it will raise the bank rate. As a result, the deposit rate and other lending rates in the money-market will go up. Borrowing will be discouraged, and will lead to contraction of credit and vice versa.

2. Open Market Operations

- **In narrow sense**, the Central Bank starts the purchase and sale of Government securities in the money market
- **In Broad Sense**, the Central Bank purchases and sells not only Government securities but also other proper eligible securities like bills and securities of private concerns. When the banks and the private individuals purchase these securities they have to make payments for these securities to the Central Bank.

3. Variable Reserve Ratio

Cash Reserves Ratio

- Variable Cash Reserve Ratio as an objective of monetary policy was first suggested by J.M. Keynes
- Cash reserve Ratio (CRR) is the amount of Cash that the banks have to keep with RBI
- The commercial banks as per the statute has to maintain reserves based on their demand deposit and fixed deposit with central bank is called as Cash Reserve Ratio
- If the CRR is high, the commercial bank's capacity to create credit will be less and if the CRR is low, the commercial bank's capacity to create credit will be high.

Statutory Liquidity Ratio

- Statutory Liquidity Ratio (SLR) is the amount which a bank has to maintain in the form of cash, gold or approved securities. The quantum is specified as some percentage of the total demand and time liabilities of a bank.
- SLR is used to control the bank's leverage for credit expansion.

Repo Rate and Reverse Repo Rate

- The Repo Rate and the Reverse Repo Rate are the frequently used tools with which the RBI can control the availability and the supply of money in the economy. Repo Rate is always greater than Reverse Repo Rate in India

Repo Rate

- Repo rate is the rate at which the central bank of a country lends money to commercial banks in the event of any shortfall of funds.
- Repo rate is used by monetary authorities to control inflation.

Reverse Repo Rate

- The rate at which the RBI is willing to borrow from the commercial banks is called reverse repo rate
- The Reverse Repo Rate is an important Monetary Policy tool used by the Reserve Bank of India (RBI) to control money supply or liquidity and inflation in the economy.

CALL MONEY MARKET:

- The call money market is an important segment of the money market where borrowing and lending of funds take place on over night basis
- Participants in the call money market are banks and related entities specified by the RBI, Participants in the call money market in India currently include scheduled commercial banks (SCBs) —excluding regional rural banks), cooperative banks (other than land development banks), Primary Dealers (PDs).
- The money that is lent for **one day** in this market is known as **call money** and, if it exceeds one day, is referred to as **notice money**. Notice Money refers to the borrowing and lending of funds for **2-14 days**

NEW FINANCIAL YEAR OF RBI

- Aimed at aligning its financial year with the government's financial year, in February 2020, the RBI decided to shift to April- March as its new financial year from 2020-21 (from its existing financial year July-June).