Chapter 4

RBI & Monetary Policy

Establishment and Nationalization

Establishment	RBI was set up on the basis of the recommendations of the Hilton Young Commission on April 1, 1935 in Calcutta but permanently moved to Mumbai in 1937. Sir Osborne Smith the first Governor of the Bank. The Bank was constituted as a shareholders' bank. RBI has four zonal offices at Chennai, Delhi, Kolkata, and Mumbai.
Nationalization	on 1st January, 1949 on the basis of the Reserve Bank of India (Transfer to Public Ownership) Act, 1948
Act which governs the RBI functions	Reserve Bank of India Act, 1934
Act which governs the Banking sector	Banking Regulation Act, 1949

Q.1 IAS Prelims 1998
The accounting year of the Reserve Bank of India is
(a) April – March (b) July – June (c) October – September (d) January – December

Q.2 ES-2012
Banking in India is controlled by :
(a) RBI (b) Union Finance Commission (c) Union Ministry of Finance (d) Union Ministry of Commerce

Objectives, Functions and Organizational structure

Basic objectives	to regulate the issue of Bank Notes to keeping of reserves with a view to securing monetary stability in India to operate the currency and credit system of the country
Functions	Formulation and execution of monetary policy, Foreign exchange and reserves management, (RBI is the custodian of the country's foreign exchange reserves and is vested with the responsibility of managing their investment.) Government debt management, (CG & SG) Financial regulation and supervision, Acting as banker to the banks and to the Government (CG & SG)
Central Board of Directors	As per RBI Act, General superintendence and direction of the affairs and business of the Bank shall be entrusted to a Central Board of Directors
Composition of the Central Board	The Central Board shall consist of the following Directors, namely:- (a) a Governor and [not more than four] Deputy Governors to be appointed by the Central Government; (b) four Directors to be nominated by the Central Government, one from each of the four Local Boards as constituted by section 9; (c) [ten] Directors to be nominated by the Central Government; and (d) [two Government officials] to be nominated by the Central Government;] The Governor and Deputy Governors shall devote their **whole time** to the affairs of the Bank. The Governor and a Deputy Governor shall hold office for **such term not exceeding five years** as the Central Government may fix when appointing them and shall be **eligible for re-appointment**. A Director nominated under (c) above shall hold office for a period of **four years and shall be eligible for reappointment**. Provided that any such Director shall not be appointed for more than two terms, that is, for a maximum period of eight years either continuously or intermittently. A Director nominated under (d) above shall hold office during the pleasure of the Central Government. A **retiring Director** shall be eligible for re-nomination. **<u>Local Boards in Delhi, Mumbai, Kolkata and Chennai</u>** As per RBI Act, A Local Board shall be constituted for each of the four areas specified in the First Schedule and shall consist of five members to be appointed by the Central Government to

	represent, as far as possible, territorial and economic interests and the interests of co-operative and indigenous banks. The members of the Local Board shall elect from amongst themselves one person to be the chairman of the Board. Every member of a Local Board shall hold office for a **term of four years** and shall be eligible for reappointment: Provided that any such Director shall not be appointed for more than two terms, that is, for a maximum period of eight years either continuously or intermittently.
Nomination of part-time non-official Directors	Central Government has nominated Shri Anand Gopal Mahindra, Shri Venu Srinivasan, Shri Pankaj Ramanbhai Patel and Dr Ravindra H. Dholakia as **part-time non-official Directors** on Central Board of Reserve Bank of India, for a period of four years with effect from June 14, 2022
RBI chief executive	The Governor is the Reserve Bank's chief executive. The Governor supervises and directs the affairs and business of the RBI

RBI as Banker to Government

In terms of Section 20 of the RBI Act 1934, **RBI has the obligation** to undertake the receipts and payments of the Central Government and to carry out the exchange, remittance and other banking operations, including the management of the public debt of the Union.

Further, as per Section 21 of the said Act, RBI has the right to transact Government business of the Union in India.
State Government transactions are carried out by RBI in terms of the agreement entered into with the State Governments in terms of section 21 A of the Act. As of now, such agreements exist between RBI and all the State Governments except Government of Sikkim. Thus, the **legal provisions vest Reserve Bank of India with both the right and obligation** to function as banker to the government.

How does Reserve Bank of India discharge its statutory obligation of being 'Banker to Government'?
RBI carries out the general banking business of the governments through its own offices and commercial banks, both public and private, appointed as its agents. At present all the public sector banks and select private sector banks act as RBI's agents. Only designated branches of **agency banks** can conduct government banking business.

Any scheduled payment bank or scheduled small finance bank that intends to undertake Government agency business may be appointed as an agent of RBI upon execution of an agreement with RBI.

Reserve Bank of India **maintains the Principal Accounts of Central** as well as State Governments at its Central Accounts Section, Nagpur. It has put in place a well-structured arrangement for revenue collection as well as payments on behalf of Government across the country.

All monies for credit to government account like taxes or other remittances can be made by filling the prescribed challans of the Government/Department concerned. The tax payers are encouraged to pay dues to Government electronically by login in to respective government portals. However, if they prefer to pay dues by way of cash, cheque, demand draft, these are required to be tendered with the **authorized agency bank** branches along with requisite challan.

Are agency banks compensated for conduct of Central/State Government banking?
The accredited banks are paid remuneration by RBI for conduct of State/Central Government transactions. Such remuneration is called Agency Commission.

What is RBI's role in Goods and Service Tax regime?
The Reserve Bank of India is the aggregator for accounting of all GST collections in the respective government accounts. Agency banks who collect the GST for challans generated by tax payers online on the GST portal report the collections for settlement to government accounts to RBI. RBI has also facilitated payment of GST by tax payers directly into government accounts at RBI by using NEFT / RTGS payment options provided in GST portal.

Q.3 CAPF-2009
Which one of the following is not a function of Reserve Bank of India ?
(a) Banker to the government (b) Keeping foreign exchange reserve
(c) Issuing of one rupee coin and note (d) Regulating credit in the country

Q.4 CISF-LDC-2013
With reference to Reserve Bank of India which of the following statements is/are correct ?
I. It acts as a Banker's Bank
2. It issues one rupee coins
3. It acts as a lender of the last resort to sick industrial units
Select the correct answer using the code given below :
(a) I only (b) 2 and 3 only (c) 3 only (d) I, 2 and 3

Q.5 IAS Prelims 2004
Consider the following statements:
1. Reserve Bank of India was nationalized on 26 January, 1950.
2. The borrowing programme of the Government of India is handled by the Department of Expenditure, Ministry of Finance.
Which of the statements given above is/are correct?
(a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2

Q.6 IAS Prelims 2001
Consider the following statements regarding Reserve Bank of India :
I. It is a banker to the Central Government.
II. It formulates and administers monetary policy.
III. It acts as an agent of the Government in respect of India's membership of IMF.
IV. It handles the borrowing programme of Government of India.

Which of these statements are correct ?
(a) I and II (b) II, III and IV (c) I, II, III and IV (d) III and IV

Q.7 IAS Prelims 1991
Which one of the following functions of the Reserve Bank of India is not performed by the other banks ?
(a) Making advances to agriculturists (b) Dealing in foreign exchange
(c) Industrial Refinancing (d) Acting as the banker to the Government

Q.8 IAS Prelims 2012
The Reserve Bank of India (RBI) acts as a bankers' bank. This would imply which of the following?
1 Other bank retains their deposits with the RBI.
2 The RBI lends funds to the commercial banks in times of need.
3 The RBI advises the commercial banks on monetary matters.
select the correct answer using the codes given below:
(a)2 and 3 only (b)1 and 2 only (c)1 and 3 only (d)1, 2 and 3

Q.9 Prelims 2021
Consider the following statements:
1. The Governor of the Reserve Bank of India (RBI) is appointed by the Central Government.
2. Certain provisions in the Constitution of India give the Central Government the right to issue directions to the RBI in the public interest.
3. The Governor of the RBI draws his power from the RBI Act.
Which of the above statements are correct?
a) 1 and 2 only b) 2 and 3 only c) 1 and 3 only d) 1, 2 and 3

Q.10 IAS Prelims 2013
The Reserve Bank of India regulates the commercial banks in matters of
1. liquidity of assets
2. branch expansion
3. merger of banks
4. winding-up of banks

Select the correct answer using the codes given below.
a. 1 and 4 only b. 2, 3 and 4 only c. 1, 2 and 3 only d. 1, 2, 3 and 4

Q.10A CDS 2022
Which one of the following is considered as an agency function of commercial banks in India ?
(a) acceptance of deposits (b) investment of surplus funds
(c) acceptance of income tax payments (d) providing overdraft facilities

Monetary policy

Responsibility of conducting monetary policy	RBI is vested with the responsibility of conducting monetary policy. This responsibility is explicitly mandated under the Reserve Bank of India Act, 1934
Primary objective	Maintaining price stability while keeping in mind the objective of growth. Price stability is a necessary precondition to sustainable growth.
Announcement	Bi-monthly (i.e. every 2 months)
Inflation target	In May 2016, the RBI Act, 1934 was amended to provide a statutory basis for the implementation of the **flexible inflation targeting** framework. Section 45-ZA of the RBI Act, 1934 requires that the Central Government shall, in consultation with the Reserve Bank of India (RBI), determine the inflation target in terms of **consumer price index (CPI)**, once in every five years and notify the inflation target in the Official Gazette.

	Accordingly, in a notification on March 31, 2021, the Central Government, in consultation with the RBI, **retained the inflation target at 4 per cent** (with the upper tolerance level of 6 per cent and the lower tolerance level of 2 per cent) for the 5-year period April 1, 2021 to March 31, 2026. If the average inflation is more than the upper tolerance level of 4% + 2%, that is, 6%, or less than the lower tolerance level of 4%- 2%, that is 2%, for any 3 consecutive quarters, it would mean a failure to achieve the inflation target. Where RBI fails to meet the inflation target, it shall set out a report to the Central Government stating the reasons for failure to achieve the inflation target; remedial actions proposed to be taken by RBI; and an estimate of the time-period within which the inflation target shall be achieved pursuant to timely implementation of proposed remedial actions.
6 members Monetary policy committee (MPC)	As per section 45-ZB of the RBI Act 1934, Central Government, by notification in the Official Gazette, constitute the 6 members Monetary Policy Committee to determine the policy rate required to achieve the inflation target. Following is the **member of committee**: **1. RBI Governor- Chairperson**, ex officio; (Shaktikanta Das) 2. Deputy Governor of RBI, in charge of Monetary Policy, ex officio; (Dr. Michael Debabrata Patra) 3. One officer of the RBI to be nominated by the Central Board, ex officio; (Dr. Rajiv Ranjan, Executive Director RBI) **Other three members appointed by the CG** from amongst persons of ability, integrity and standing, having knowledge and experience in the field of economics or banking or finance or monetary policy: **(will hold office for a period of four years** and shall not be eligible for re-appointment) 4. Dr. Shashanka Bhide, Senior Advisor, National Council of Applied Economic Research, Delhi; 5. Dr. Ashima Goyal, Professor, Indira Gandhi Institute of Development Research, Mumbai; 6. Prof. Jayanth R. Varma, Professor, Indian Institute of Management, Ahmedabad.
MPC function	MPC shall **determine the policy interest rate** required to achieve the inflation target. The decision of the Monetary Policy Committee **shall be binding** on the RBI
Monetary policy making	• The MPC will meet at least **four times** in a year. • The **quorum** for the meeting of the MPC is **four members**. • Each member of the MPC has one vote, and in the event of an equality of votes, the Governor has a second or casting vote. • The questions which come up before the MPC shall be decided by a majority of votes by the members present and voting. • Central Government may, if it considers necessary, convey its views in writing to the Monetary Policy Committee from time to time. • The resolution adopted by the MPC will be published after conclusion of every meeting. • On the 14th day, the minutes of the proceedings of the MPC are published which include: a. the resolution adopted by the MPC; b. the vote of each member on the resolution; and c. the statement of each member on the resolution adopted.
Monetary Policy Report	As per section 45-ZM of the RBI Act 1934, Once in **every six months**, RBI shall publish a document called the Monetary Policy Report which will explain: Source of inflation; and Forecast of inflation for 6-18 months ahead.

Q.11 CDS 2017
Which one of the following indices is now used by the Reserve Bank of India to measure the rate of inflation in India?
(a) NASDAQ Index (b) BSE Index (c) Consumer Price Index (d) Wholesale Price Index

Q.12 Prelims 2017
Which of the following statements is/are correct regarding the Monetary Policy Committee (MPC) ?
1. It decides the RBI's benchmark interest rates .
2. It is a 12-member body including the Governor of RBI and is reconstituted every year .

3. It functions under the chairmanship of the Union Finance Minister.
Select the correct answer using the code given below:
(a) 1 only (b) 1 and 2 only (c) 3 only (d) 2 and 3 only

Q.13 ES 2022
Which one of the following policies is concerned with changing the supply of money stock and the rate of interest, for the purpose of stabilizing the economy at full potential output level ?
(a) Commercial policy (b) Fiscal policy (c) Monetary policy (d) Social policy

Q.14 Prelims 2022
In India, which one of the following is responsible for maintaining price stability by controlling inflation ?
(a) Department of Consumer Affairs (b) Expenditure Management Commission
(c) Financial Stability and Development Council (d) Reserve Bank of India

Quantitative Instruments of Monetary policy

Direct Instruments or **Variable** Reserve Ratios	Cash Reserve Ratio (CRR)	The **average daily balance** that a bank is required to maintain with the RBI as a per cent of its **net demand and time liabilities (NDTL i.e. Deposits)** as on the last Friday of the second preceding fortnight that the RBI may notify from time to time in the Official Gazette. Reserve Bank does not pay any interest on the CRR balances. Bank shall maintain minimum CRR of not less than 90% of the required CRR on all days during the reporting fortnight, in such a manner that the average of CRR maintained daily shall not be less than the CRR prescribed by the RBI. Example: Presently, CRR rate is 4.50% and Suppose Bank has deposits of Rs. 100 crores then it has to deposit Rs. 4.50 crores with RBI.
	Statutory Liquidity Ratio (SLR)	Every bank shall **maintain in India, assets**, the value of which shall not be less than **such percentage not exceeding 40%** of the total of its demand and time liabilities in India as on the last Friday of the second preceding fortnight, as the Reserve Bank may, by notification in the Official Gazette, specify from time to time and **such assets shall be maintained** as may be specified in such notification (typically in unencumbered government securities, cash and gold). Higher the CRR and SLR, lower will be the liquidity in the system as Banks will have lesser money for providing loans. Example: Presently CRR and SLR rate is 4.50% and 18% respectively. Suppose Bank deposits is Rs. 100 crores then bank can sanction loans upto 77.50 crores.
Indirect Instruments	Repo Rate (also called **Policy rate**)	Interest rate at which the Reserve Bank **provides liquidity** to banks **against the collateral** of government and other approved securities under the liquidity adjustment facility (LAF). Reduction in Repo rate helps the banks to get money at a cheaper rate and increase in Repo rate discourages the banks.
	Reverse Repo rate	Interest rate at which the Reserve Bank **absorbs liquidity** from banks **against the collateral** of eligible government securities under the liquidity adjustment facility (LAF). Following the introduction of SDF, the fixed rate reverse repo operations will be at the discretion of the RBI for purposes specified from time to time. When RBI increases the reverse repo rate then Banks are attracted to deposit with RBI for higher return.
	Standing Deposit Facility (SDF) Rate	The rate at which the Reserve Bank accepts **uncollateralised deposits**, on an overnight basis, from banks. The SDF is also a financial stability tool in addition to its role in liquidity management.

<table>
<tr><td></td><td></td><td>The SDF rate is placed at 25 basis points below the policy repo rate.

With introduction of SDF in April 2022, the SDF rate replaced the fixed reverse repo rate as the floor of the LAF corridor.

<u>CRR and SLR Eligibility</u>
Deposits under the SDF shall not be reckoned as balances eligible for the maintenance of the cash reserve ratio (CRR) but shall be an eligible asset for maintenance of the statutory liquidity ratio (SLR).</td></tr>
<tr><td></td><td>Liquidity Adjustment Facility (LAF)</td><td>The LAF refers to the Reserve Bank's operations through which it injects/absorbs liquidity into/from the banking system. It consists of overnight as well as term repo/reverse repos (fixed as well as variable rates), SDF and MSF.

Apart from LAF, instruments of liquidity management include outright open market operations (OMOs), forex swaps and market stabilisation scheme (MSS).

Main Liquidity Management Tool: A 14-day term repo/reverse repo auction operation at a variable rate conducted to coincide with the cash reserve ratio (CRR) maintenance cycle is the main liquidity management tool for managing frictional liquidity requirements.

Fine Tuning Operations: The main liquidity operation is supported by fine-tuning operations, overnight and/or longer tenor, to tide over any unanticipated liquidity changes during the reserve maintenance period. In addition, the Reserve Bank conducts, if needed, longer-term variable rate repo/reverse repo auctions of more than 14 days.

Liquidity management, which is the operating procedure of monetary policy, seeks to ensure adequate liquidity in the system so that sufficient credit is provided to all productive sectors in the economy.

<u>Weighted Average Call Rate</u>
WACR is the operating target of monetary policy in India.

WACR represents the unsecured segment of the overnight inter bank money market.

A bank meets the shortage in its required reserves like CRR by borrowing in the inter-bank market; similarly it deploys its excess reserve holdings in the inter-bank market.

However, if the banking system as a whole holds less reserves than is required, the system shortage is supplied by the RBI through its liquidity operations in the form of repurchase (or, repo) operations. If the banking system as a whole holds more reserves than is required, the excess reserves are absorbed by the central bank through reverse repo operations/standing deposit facility.

Once the policy repo rate is announced, liquidity operations are conducted to keep the WACR closely aligned to the repo rate to facilitate transmission of repo rate changes through the entire financial system, which, in turn, influences aggregate demand – a key determinant of inflation and growth.

if the call rate inches above the repo rate, it would signal liquidity deficit and RBI will bring its tools to infuse liquidity. Similarly, if the call rate is below the repo rate, that would mean the banking system has surplus liquidity. In that case, RBI will bring its tools to absorb liquidity.</td></tr>
<tr><td></td><td>LAF Corridor</td><td>Width of the LAF corridor is 50 bps. The LAF corridor has the marginal standing facility (MSF) rate (25 basis points above the repo rate) as its upper bound (ceiling)</td></tr>
</table>

		and the **standing deposit facility** (SDF) rate (25 basis points below the repo rate) as the lower bound (floor), with the policy repo rate in the middle of the corridor.
	Marginal Standing Facility (MSF)	The **penal rate** at which banks can borrow, on an overnight basis, from the Reserve Bank by dipping into their Statutory Liquidity Ratio (SLR) portfolio up to a predefined limit (2 per cent). This provides a safety valve against unanticipated liquidity shocks to the banking system. The MSF rate is placed at 25 basis points above the policy repo rate.
	Bank Rate or Discount rate	Under Section 49 of the RBI Act, 1934, Bank Rate has been defined as "the standard rate at which the Reserve Bank is prepared to buy or rediscount bills of exchange or other commercial papers. On introduction of LAF, discounting/rediscounting of bills of exchange by the Reserve Bank has been discontinued. As a result, the **Bank Rate became dormant** as an instrument of monetary management. It is now aligned to MSF rate and, therefore, changes automatically as and when the MSF rate changes alongside policy repo rate changes. The Bank Rate **acts as the penal rate** charged on banks for shortfalls in meeting their reserve requirements (cash reserve ratio and statutory liquidity ratio).
	Open Market Operations (OMO)	These include outright purchase/sale of government securities by RBI for injection/absorption of durable liquidity in banking system. During inflation the central bank sells government securities. As a result money supply in the economy falls causing prices to fall. During deflation, the central bank will buy back the securities thus causing money supply to rise which cures deficiency in demand.
	Market Stabilization Scheme (MSS)	MSS was introduced in 2004. Under the scheme 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 cash so mobilised is held in a separate government account with the Reserve Bank. Thus RBI sterilizes the economy against adverse external shocks. This operation of RBI is known as **sterilization**.

IF	**Increase/Decrease**	**Liquidity in Market**	**Inflation**	**Monetary policy**
CRR/SLR/Repo/Reverse Repo/SDF/Bank Rate	Increases	Decreases	Decreases	Dearer/Tight/ Contractionary Monetary Policy
CRR/SLR/Repo/Reverse Repo/SDF/Bank Rate	Decreases	Increases	Increases	Accommodative/Easy/ Expansionary monetary policy

Repo market

Repo or ready forward contact is an instrument for borrowing funds by selling securities with an agreement to **repurchase** the said securities on a mutually agreed future date at an agreed price which includes interest for the funds borrowed.

The reverse of the repo transaction is called '**reverse repo**' which is lending of funds against buying of securities with an agreement to resell the said securities on a mutually agreed future date at an agreed price which includes interest for the funds lent.

Predominantly, repos are undertaken on overnight basis, i.e., for one day period. Settlement of repo transactions happens along with the outright trades in G-Secs.

The overall effect of the repo transaction would be borrowing of funds backed by the collateral of G-Secs.

The repo market is regulated by the Reserve Bank of India

Net demand and time liabilities (NDTL)

Demand Liabilities of a bank are liabilities which are payable on demand. These include **current deposits, demand liabilities portion of savings bank deposits**, margins held against letters of credit/guarantees, balances in overdue fixed deposits, cash certificates and cumulative/recurring deposits, outstanding Telegraphic Transfers (TTs), Mail Transfers (MTs), Demand Drafts (DDs), unclaimed deposits, credit balances in the Cash Credit account and deposits held as security for advances which are payable on demand. Money at Call and Short Notice from outside the Banking System should be shown against liability to others.

Time Liabilities of a bank are those which are payable otherwise than on demand. These include **fixed deposits, cash certificates, cumulative and recurring deposits, time liabilities portion of savings bank deposits**, staff security deposits, margin held against letters of credit, if not payable on demand, deposits held as securities for advances which are not payable on demand and Gold deposits.

RBI Monetary Policy Stance

Calibrated Tightening- Calibrated tightening means that in the current rate cycle, a cut in the policy repo rate is off the table, and we are not obliged to increase the rate at every policy meeting. In that case policy repo rate is kept unchanged. Later, RBI decresed the repo rate and changed the policy stance from Calibrated tightening to Neutral.

Neutral Stance - means policy repo rate may be unchanged/increased/decreased.

Accommodative Stance - means policy repo rate will be further decreased.

RBI Policy Rates (31-07-2023)

Policy Repo Rate	6.50%
Standing Deposit Facility Rate	6.25%
Marginal Standing Facility Rate	6.75%
Bank Rate	6.75%
Fixed Reverse Repo Rate	3.35%

Reserve Ratios (31-07-2023)

CRR	4.50%
SLR	18.00%

Statutory reserve requirements mean Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR)

Repo rate reduction/increase in the past

1. August 1, 2018, The policy repo rate was **increased** by 25 bps to 6.50 per cent.
2. October 5, 2018, The monetary policy stance was changed from neutral to calibrated tightening.
3. February 7, 2019, The policy repo rate was **reduced by 25 basis** point to 6.25 per cent and the monetary policy stance was changed from calibrated tightening to neutral.
4. April 4, 2019, The policy repo rate was **reduced by 25 bps** to 6.0 per cent.
5. June 6, 2019, The policy repo rate was **reduced by 25 bps** to 5.75 per cent and the monetary policy stance was **changed from neutral to accommodative.**
6. August 7, 2019, The policy repo rate was **reduced by 35 bps** to 5.40 per cent.
7. October 4, 2019, The policy repo rate was **reduced by 25 bps** to 5.15 per cent.
8. **On 27th March 2020,** The policy repo rate was **reduced by 75 basis points** (bps) to 4.4 per cent. The reverse repo rate was reduced by 90 bps to 4.0 per cent creating an asymmetrical corridor. The purpose of this measure relating to reverse repo rate is to make it relatively unattractive for banks to passively deposit funds with the Reserve Bank and instead, to use these funds for on-lending to productive sectors of the economy.

9. On 22nd May 2020, The policy repo rate was **reduced by 40 bps** to 4 per cent. The reverse repo rate was reduced by 40 bps to 3.35 per cent.
10. On May 4, 2022, **Policy repo rate** was i**ncreased** by 40 basis points to 4.40 per cent.
11. On June 8, 2022, **Policy repo rate** was i**ncreased** by 50 basis points to 4.90 per cent.
12. On August 5, 2022, **Policy repo rate** was i**ncreased** by 50 basis points to 5.40 per cent.
13. On September 30, 2022, **Policy repo rate** was i**ncreased** by 50 basis points to 5.90 per cent.
14. On December 7, 2022, **Policy repo rate** was i**ncreased** by 35 basis points to 6.25 per cent.
15. On February 8, 2023, **Policy repo rate** was i**ncreased** by 25 basis points to 6.50 per cent.
16. On April 6, 2023, **Policy repo rate** was kept unchanged at 6.50 per cent.

Monetary Policy Statement, 2023-24 Resolution of the Monetary Policy Committee (MPC) June 6-8, 2023

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) at its meeting (June 8, 2023) decided to:

- Keep the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 6.50 per cent.
- The standing deposit facility (SDF) rate remains unchanged at 6.25 per cent and the marginal standing facility (MSF) rate and the Bank Rate at 6.75 per cent.
- The MPC also decided to remain focused on withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth.

These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 per cent within a band of +/- 2 per cent, while supporting growth.

Q.15 Prelims 2022
With reference to the Indian economy, consider the following statements:
1. If the inflation is too high, Reserve Bank of India (RBI) is likely to buy government securities.
2. If the rupee is rapidly depreciating, RBI is likely to sell dollars in the market.
3. If interest rates in the USA or European Union were to fall, that is likely to induce RBI to buy dollars.
Which of the statements given above are correct?
(a) 1 and 2 only (b) 2 and 3 only (c) 1 and 3 only (d) 1, 2 and 3

Q.16 IAS Prelims 2014
The terms 'Marginal Standing Facility Rate' and 'Net Demand and Time Liabilities', sometimes appearing in news, are used in relation to A. banking operations B. communication networking C. military strategies D. supply and demand of agricultural products

Q.17 ES 2017
Consider the following statements regarding Repo rate:
I. It is the rate at which RBI lends money to Commercial Banks generally against Government Securities
2. It is the rate at which RBI borrows money from Commercial Banks generally against Government Securities
3. it is the rate at which Commercial Banks keep Deposits with RBI
Which of the above statements is/are correct?
(a) 1 only (b) 2 only (c) 3 only (d) I, 2 and 3

Q.18 CDS 2020
Which one of the following is **not** correct about Repo rate?
(a) It is the interest rate charged by the Central Bank on overnight loan.
(b) It is the interest rate paid by the commercial banks on overnight borrowing.
(c) It is the interest rate agreed upon in the loan contract between a commercial bank and the Central Bank.
(d) It is the cost of collateral security.

Q.19 CDS 2020
The cast reserve ratio refers to
(a) the share of Net Demand and time liabilities that banks have to hold as liquid assets
(b) the share of Net Demand and time liabilities that banks have to hold as balances with the RBI
(c) the share of Net demand and time liabilities that banks have to hold as part of their cash reserves
(d) the ratio of cash holding to reserves of banks

Q.20 CDS-2010
Consider the following statements with regard to Statutory Liquidity Ratio (SLR) :
1. To meet SLR, commercial banks can use cash only.

2. SLR is maintained by the banks with themselves.
3. SLR restricts the banks' leverage in pumping more money into the economy.
Which of the statements given above is/ are correct? (a) 1, 2 and 3 (b) 1 and 3 only (c) 2 and 3 only (d) 2 only

Q.21 CAPF-2013
Consider the following statements :
1. Repo rate is the interest rate at which RBI lends to commercial banks for short period.
2. Reverse repo rate is the interest rate which RBI pays to commercial banks on short term deposits.
3. Gap between repo rate and reverse repo rate has been declining in India in the recent past.
Which of the statements given above is/are not correct?
(a) 1 (b) 2 only (c) 3 only (d) 2 and 3

Q.22 CISF-LDC-2013
What is "bank rate", quite often in the news?
(a) It is the rate at which RBI lends to Commercial Banks (b) It is the rate at which commercial banks lend to general public
(c) It is the rate at which World Bank lends to governments (d) It is the rate at which commercial banks lend to corporate houses

Q.23 CISF-LDC-2014
The term "Repo Rate" sometimes found in news is related to :
(a)Banking System (b) Demographic trends © Foreign trade (d) Human fertility

Q.24 IAS Prelims 2010
Which of the following terms indicates a mechanism used by commercial banks for providing credit to the government?
(a) Cash Credit Ratio (b) Debt Service Obligation (c) Liquidity Adjustment Facility (d) Statutory Liquidity Ratio

Q.25 IAS Prelims 2010
When the Reserve Bank of India announces an increase of the Cash Reserve Ratio, what does it mean?
(a)Commercial banks will have less money to lend (b)Reserve Bank of India will have less money to lend
© Union Government will have less money to lend (d) The commercial banks will have more money to lend

Q.26 IAS Prelims 1992
'Interest Rate Policy' is a component of
(a) Fiscal Policy (b) Monetary Policy (c) Trade Policy (d) Direct Control

Q.27 IAS Prelims 1993
Variable reserve rates and Open Market Operations are instruments of
(a) Fiscal Policy (b) Monetary Policy (c) Budgetary Policy (d) Trade Policy

Q.28 IAS Prelims 1995
Which one of the following is not an instrument of selective credit control in India ?
(a) Regulation of consumer credit (b) Rationing of credit (c) Margin requirements (d) Variable cost reserve ratios

Q.29 IAS Prelims 1995
Bank Rate implies the rate of interest
(a) paid by the Reserve Bank of India on the Deposits of Commercial Banks (b) charged by Banks on loans and advances
(c) payable on Bonds (d) at which the Reserve Bank of India discounts the Bills of Exchange

Q.30 IAS Prelims 1998
The banks are required to maintain a certain ratio between their cash in hand and total assets. This is called
(a) SBR (Statutory Bank Ratio) (b) SLR (Statutory Liquid Ratio) (c) CBR (Central Bank Reserve) (d) CLR (Central Liquid Reserve)

Q.31 IAS Prelims 2015
With reference to India economy, consider the following:
1. Bank rate 2. Open market operations 3. Public debt 4. Public revenue
Which of the above is/are component/components of Monetary Policy?
a) 1 only b) 2, 3 and 4 c) 1 and 2 d) 1, 3 and 4

Q.32 IAS Prelims 2015
When the Reserve Bank of India reduces the Statutory Liquidity by 50 basis points, which of the following is likely to happen?
a) India's GDP growth rate increases drastically b) Foreign Institutional Investors may bring more capital into our country
c) Scheduled Commercial Banks may cut their lending rates d) It may drastically reduce the liquidity to the banking system.

Q.33 IAS Prelims 2014
In the context of Indian economy; which of the following is/are the purpose/purposes of 'Statutory Reserve Requirements'?
1. To enable the Central Bank to control the amount of advances the banks can create
2. To make the people's deposits with banks safe and liquid
3. To prevent the commercial banks from making excessive profits
4. To force the banks to have sufficient vault cash to meet their day-to-day requirement

Select the correct answer using the code given below.
A. 1 only B. 1 and 2 only C. 2 and 3 only D. 1, 2, 3 and 4

Q.34 IAS Prelims 2013
An increase in the Bank Rate generally indicates that the

a. Market rate of interest is likely to fall
b. Central Bank is no longer making loans to commercial banks
c. Central Bank is following an easy money policy
d. Central Bank is following a tight money policy

Q.35 IAS Prelims 2013
In the context of Indian economy, Open Market Operations refers to
a. borrowing by scheduled banks from the RBI
b. lending by commercial banks to industry and trade
c. purchase and sale of government securities by the RBI
d. None of the above

Q.36 IAS Prelims 2011
The lowering of bank rate by the reserve bank of India leads to ?
(a) More liquidity in the market. (b) Less liquidity in the market.
(c) No change in the liquidity in the market. (d) Mobilization of more deposits by commercial banks.

Q.37 CDS 2017
The monetary policy in India uses which of the following tools?
1. Bank rate 2. Open market operations 3. Public debt 4. Public revenue
Select the correct answer using the code given below
(a) 1 and 2 only (b) 2 and 3 only (c) 1 and 4 only (d) 1, 2 , 3 and 4

Q.38 Prelims 2020
If the RBI decides to adopt an expansionist monetary policy, which of the following would it not do?
1. Cut and optimize the Statutory Liquidity Ratio
2. Increase the Marginal Standing Facility Rate
3. Cut the Bank Rate and Repo Rate
Select the correct answer using the code given below:
(a) 1 and 2 only (b) 2 only (c) 1 and 3 only (d) 1, 2 and 3

Q.39 Prelims 2021
With reference to Indian economy, demand-pull inflation can be caused/increased by which of the following?
1. Expansionary policies
2. Fiscal stimulus
3. Inflation-indexing wages
4. Higher purchasing power
5. Rising interest rates

Select the correct answer using the code given below.
a) 1, 2 and 4 only
b) 3, 4 and 5 only
c) 1, 2, 3 and 5 only
d) 1, 2, 3, 4 and 5

Q.39A Prelims 2023
Which one of the following activities of the Reserve Bank of India is considered to be part of 'sterilization?
(a) Conducting 'Open Market Operations'
(b) Oversight of settlement and payment systems
(c) Debt and cash management for the Central and State Governments
(d) Regulating the functions of Non-banking Financial Institutions

Qualitative or selective credit control Instruments of Monetary policy

Quantitative instruments of credit control regulate the total volume of credit. Qualitative or Selective credit controls are considered to be superior to the Quantitative instruments of credit control as they are directed not only to control total volume of credit but also the specific uses for which credit is granted.

Variations in Margin Requirements: The cental bank is empowered to fix the margin for various types of collateral securities. An increase in margin requirement will reduce the amount of loan which can be granted against a security. This will limit the quantum of credit and help combat inflation.

For example- RBI allowed a loan-to-value ratio (LTV) of up to 90% for home loans of Rs.30 lakh or less.
For properties above Rs 30 lakh and up to Rs 75 lakh, the LTV will be up to 80 per cent and those above Rs 75 lakh, it will be 75 per cent.

Rationing of Credit: Rationing of credit is a method by which the central bank seeks to fix ceiling of loans and advances and also in certain cases, fix limit for specific categories of loans and advances. In this way it tries to restrict credit in the non-priority segments so as to divert availability of credit in the desired sectors of the economy.

Moral Suasion: It implies persuasion and request made by the central bank to commercial banks to follow the general monetary policy of the country. In a period of inflationary pressures, commercial banks may be persuaded to curb loan facilities for financing speculative and non-essential activities. During deflationary periods banks may be requested to expand their loans and advances even against inferior securities which they normally do not accept, This method involves only putting moral pressure on commercial banks to seek their cooperation as it does not carry any threat or legal sanction.

Direct Action: It refers to the penal action which a central bank may take against a bank like
(i) charging penal rate of interest, over and above the bank rate, for credit demanded by a commercial bank beyond a prescribed limit.
ii) refusing rediscounting facilities to those commercial banks whose credit policy is not in line with its general monetary policy.

Issue of Directives to banks: to seek their help and cooperation in effective implementation of its monetary policy.

Basis Point

100 basis point means 1%. It is used for measuring change in interest rate

Marginal Cost of Funds based Lending Rate (MCLR)

Background	Earlier, loans were priced at a spread over the Base Rate. **Base Rate is the minimum rate** of interest for all loans. Spread is the margin of bank based on risk associated with loans. Bank were using different cost methodology to compute base rate. When RBI cut interest rates many times, Banks were reluctant to pass on these rate cuts to borrowers giving excuse that they have old deposits for which the interest rate remains high. To counter this, RBI has introduced MCLR so that banks link their lending rates to marginal funding costs (i.e cost of fresh or incremental borrowings from public).
Effective from	As per RBI, All rupee loans sanctioned and credit limits renewed w.e.f. April 1, 2016 will be priced with reference to the Marginal Cost of Funds based Lending Rate (MCLR). It will be a tenor linked internal benchmark rate for loans
Purpose	to improve transparency in the methodology followed by banks for determining interest rates on loans
Actual lending rates	Actual lending rates will be determined by adding the components of spread to the MCLR.

Q.40 Prelims 2016

What is/are the purpose/purposes of the `Marginal Cost of Funds based Lending Rate (MCLR)' announced by RBI?
1. These guidelines help improve the transparency in the methodology followed by banks for determining the interest rates on advances.
2. These guidelines help ensure availability of bank credit at interest rates which are fair to the borrowers as well as the banks.
Select the correct answer using the code given below.
(a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2

RBI Makes External Benchmark Based Interest Rate mandatory for certain categories of loans from October 1, 2019

Reserve Bank had constituted an Internal Study Group (Chairman: Dr. Janak Raj) to examine various aspects of the marginal cost of funds-based lending rate (MCLR) system.

The final report of the ISG was published in October 2017. The ISG observed that internal benchmarks such as the Base rate/MCLR have not delivered effective transmission of monetary policy. The Study Group had, therefore, recommended a switchover to an external benchmark in a time-bound manner.

Internal benchmarks were linked to Banks' cost of funds. This gave banks a lot of discretion while setting interest rates and spreads, thereby slowing transmission of policy rate changes by RBI. When RBI cuts the policy rates banks generally do not pass the cut to borrowers.

The RBI therefore has issued a circular making it mandatory for banks that **All new floating rate personal or retail loans** (housing, auto, etc.) and floating rate loans to Micro and Small Enterprises extended by banks from **October 01, 2019** shall be benchmarked to **one of the following**:

- Reserve Bank of India policy repo rate
- Government of India 3-Months **or** 6-Months Treasury Bill yield published by the Financial Benchmarks India Private Ltd (FBIL)
- Any other benchmark market interest rate published by the FBIL.

Spread under External Benchmark-Banks are free to decide the spread over the external benchmark. However, credit risk premium may undergo change only when borrower's credit assessment undergoes a substantial change, as agreed upon in the loan contract.

Banks are free to offer such external benchmark linked loans to other types of borrowers as well.

The **interest rate** under external benchmark shall be **reset at least once** in three months.

External Benchmark Based Interest Rate to Medium Enterprises (26-02-2020)

Subsequent to the introduction of an external benchmark system, the monetary policy transmission has improved in respect of the sectors where new floating rate loans have been linked to the external benchmarks.

With a view to further strengthening monetary policy transmission, RBI has decided that all new floating rate loans to the Medium Enterprises extended by banks from April 01, 2020 shall be linked to the external benchmarks.

Financial Benchmark India Private Ltd (FBIL)

Financial Benchmark India Private Ltd (FBIL) is jointly owned by Fixed Income Money Market & Derivative Association of India (FIMMDA), Foreign Exchange Dealers' Association of India (FEDAI) and Indian Banks' 'Association (IBA).

It was incorporated on 9th December 2014 under the Companies Act 2013. It was recognised by Reserve bank of India as an **independent Benchmark administrator** on 2nd July 2015.

Its aim is to develop and administer benchmarks relating to money market, government securities and foreign exchange in India.

The FBIL is committed to providing financial benchmarks that are (i) free from bias, (ii) backed by robust data driven research and (iii) compliant with global best practices.

Basel Committee on Banking Supervision

The BCBS is the primary global standard setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability.

The Secretariat is provided by the Bank for International Settlements (BIS) Basel, Switzerland

The Basel Committee comprises 45 members from 28 jurisdictions, consisting of central banks and authorities with formal responsibility for the supervision of banking business.

Committee has established a series of international standards for bank regulation, most notably its landmark publications of the accords on **capital adequacy** which are commonly known as Basel I (1988), Basel II (2004) and, most recently, Basel III (2010).

Basel III is an **internationally agreed set of measures** developed by the Basel Committee on Banking Supervision in response to the financial crisis of 2007-09. The measures aim to strengthen the regulation, supervision and risk management of banks.

Basel III reforms are the response of Basel Committee on Banking Supervision (BCBS) to improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, thus reducing the risk of spill over from the financial sector to the real economy.

Capital Adequacy ratio and Capital Conservation Buffer (CCB) (Basel III Capital Regulations)

Capital acts as a buffer in times of crisis or poor performance by a bank. Sufficiency of capital also instills depositors' confidence. As such, adequacy of capital is one of the pre-conditions for licensing of a new bank as well as its continuance in business.

Capital Adequacy Ratio (CAR) is an important measure of "safety and soundness" for banks because it serves as a buffer or cushion for absorbing losses.

The Basel Accord recommends **minimum Capital Adequacy Ratios** that banks should meet so as to safeguard depositors' interest and ensure continued existence of banks.

As per RBI, Banks operating in India shall maintain a **minimum total capital (MTC) of 9%** (8% as per Basel III recommendation) of total risk weighted assets (RWAs) i.e. capital to risk weighted assets ratio(CRAR). Out of which, Common Equity Tier 1 (CET 1) capital must be at least 5.5% of RWAs (4.5% as per Basel III recommendation)

Bank's capital consists of tier 1 capital ((going-concern capital) and tier 2 capital (gone-concern capital). Tier 1 capital is a bank's core capital , whereas tier 2 capital is a bank's supplementary capital.

Going-concern capital is the capital which can absorb losses without triggering bankruptcy of the bank. Gone-concern capital is the capital which will absorb losses only in a situation of liquidation of the bank.

Minimum CAR is 9%.
Tier 1 capital consists of Common Equity Tier 1 (CET 1) and Additional Tier 1 capital

Minimum Tier 1 Capital must be 7% out of 9% CAR (Minimum Common Equity Tier 1 must be 5.5% out of 7% Tier 1 capital)

Tier 1 capital
1. CET 1 Capital - Common shares (paid-up **equity capital**), Stock surplus (share premium) resulting from the issue of common shares, Reserves (excluding revaluation reserve), Capital reserve arising due to sale of assets.

2. Additional Tier 1 capital- Perpetual Non-cumulative Preference Shares (PNCPS), Stock surplus (share premium) resulting from the issue of PNCPS, Perpetual Debt Instruments that may be issued as bonds or debentures by Indian banks.

AT1 bonds

AT1 bonds are issued by banks **for inclusion in Additional Tier 1 Capital** so that they can maintain capital adequacy ratio.

After the global financial crisis of 2007-08, BASEL III Capital regulation allowed the AT1 bond for inclusion in Tier 1 capital of bank **if they are issued** as Perpetual Debt Instruments i.e. no maturity date.

Since they are perpetual hence they become the long term capital of bank and help in maintaining the Capital adequacy ratio.

Banks offer **higher interest rate** on AT1 bonds which makes them attractive to investors willing to take the risk.

As per SEBI amendments in October, 2020, **only qualified institutional buyers** can subscribe the AT1 bonds and minimum allotment size and trading lot size is fixed at **₹1 crore**.

Tier 2 capital
1. Perpetual Cumulative Preference Shares (PCPS)/ Redeemable Non-Cumulative Preference Shares (RNCPS) / Redeemable Cumulative Preference Shares (RCPS),

2. Stock surplus (share premium) resulting from the issue of such instruments
3. Redeemable Debt capital instruments that may be issued as bonds / debentures by Indian bank
4. Revaluation reserves at a discount of 55%
5. General Provisions and Loss Reserves (Provisions or loan-loss reserves held against future, presently unidentified losses)

Capital conservation buffer (CCB) is designed to ensure that banks build up capital buffers during normal times (i.e. outside periods of stress) which can be drawn down as losses are incurred during a stressed period.

As per RBI, Banks are required to maintain a capital conservation buffer of 2.5%, comprised of Common Equity Tier 1 capital, above the regulatory minimum capital requirement of 9% to withstand future periods of stress.

Q.41 Prelims 2018
Consider the following statements:
1. Capital Adequacy Ratio (CAR) is the amount that banks have to maintain in the form of their own funds to offset any loss that banks incur if the account-holders fail to repay dues.
2. CAR is decided by each individual bank
Which of the statements given above is/are correct?
a) 1 only b) 2 only c) Both 1 and 2 d) Neither 1 nor 2

Countercyclical Capital Buffer (CCCB) (Basel III Capital Regulations)

The aim of the Countercyclical Capital Buffer (CCCB) regime is twofold. Firstly, it requires banks to build up a buffer of capital in good times which may be used to maintain flow of credit to the real sector in difficult times. Secondly, it achieves the broader macro-prudential goal of restricting the banking sector from indiscriminate lending in the periods of excess credit growth that have often been associated with the building up of system-wide risk.

The CCCB may be maintained in the form of Common Equity Tier 1 (CET 1) capital only, and the amount of the CCCB may vary from 0 to 2.5% of total risk weighted assets (RWA) of the banks.

The credit-to-GDP gap shall be the main indicator in the CCCB framework in India. However, it shall not be the only reference point and shall be used in conjunction with gross non-performing assets (GNPA) growth.

Credit-to-GDP gap is the difference between credit-to-GDP ratio and the long term trend value of credit-to-GDP ratio at any point in time.

However, Based on the review and empirical testing of CCCB indicators, RBI decided that it is not necessary to activate CCCB at this point in time.

Leverage ratio (Basel III Capital Regulations)

An underlying cause of the global financial crisis in 2007 was the build-up of excessive on and off-balance sheet leverage in the banking system. In many cases, banks built up excessive leverage while apparently maintaining strong risk-based capital ratios. Therefore, under Basel III, a simple, transparent, non-risk based leverage ratio has been introduced.
The leverage ratio acts as a credible supplementary measure to the risk based capital requirement. **As per RBI, minimum Leverage Ratio shall be 4% for Domestic Systemically Important Banks (DSIBs) and 3.5% for other banks** (Basel III recommended 3%).

The Basel III leverage ratio is defined as the capital measure (Tier-1 capital) divided by the exposure measure, with this ratio expressed as a percentage.

Leverage ratio is a calculation of the common equity needed to cover all assets on and off-balance sheet.

Increasing the leverage ratio means banks have more capital reserves and can more easily survive a financial crisis.

Higher leverage ratio can decrease the profitability of banks because it means banks can do less profitable lending.

Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) (Basel III Framework on Liquidity Standards)

Liquidity Coverage Ratio

LCR is defined as a ratio of HQLA to the total net cash outflows estimated for the next 30 calendar days. Minimum LCR requirement set out in the RBI guideline is 100%.

The LCR standard aims to ensure that a bank maintains an adequate level of **unencumbered high quality liquid assets** (HQLAs) that can be converted into cash to meet its liquidity needs for a **30 calendar day** to survive an acute liquidity stress scenario by which time it is assumed that appropriate corrective actions can be taken.

Liquid assets comprise of high quality assets that can be readily sold or used as collateral to obtain funds in a range of stress scenarios. They should be unencumbered i.e. without legal, regulatory or operational impediments. Assets are considered to be high quality liquid assets if they can be easily and immediately converted into cash at little or no loss of value.

Net Stable Funding Ratio (NSFR)

The NSFR promotes resilience over a longer-term time horizon by requiring banks to fund their activities with **more stable sources of funding** on an ongoing basis.

A sustainable funding structure is intended to reduce the probability of erosion of a bank's liquidity position due to disruptions in a bank's regular sources of funding that would increase the risk of its failure and potentially lead to broader systemic stress.

The NSFR **limits overreliance on short-term wholesale funding.**

The NSFR is expressed as a ratio that **must equal or exceed 100%.**

NSFR =

$$\frac{\text{Total Available Stable Funding (ASF)}}{\text{Total Required Stable Funding (RSF)}} \geq 100\%$$

ASF

A bank's total ASF is the portion of its capital and liabilities that will remain with the institution for more than one year.

RSF

A bank's total RSF is the amount of stable funding that **it is required to hold** given the liquidity characteristics and residual maturities of its assets.

The NSFR is generally calibrated such that longer-term liabilities are assumed to be more stable than short-term liabilities.

Provisioning Coverage Ratio

Provisioning Coverage Ratio (PCR) is essentially the ratio of provisioning to gross non-performing assets and indicates the extent of funds a bank has kept aside to cover loan losses.

Government Security

Definition	A Government security is a tradable instrument issued by the Central Government or the State Governments. It acknowledges the Government's debt obligation. G-Secs are issued through auctions conducted by RBI.
Short term securities	maturity period of less than one year (e.g. treasury bills)
Long term securities	maturity period of one year or more (e.g. Government bonds or dated securities).
Issue by CG	Central Government issues both, treasury bills and bonds or dated securities
Issue by SG	State Governments issue only bonds or dated securities, which are called the State Development Loans (SDLs). Like dated securities issued by the Central Government, SDLs

	issued by the State Governments also qualify for SLR. They are also eligible as collaterals for borrowing through market repo.
Gilt-edged securities	Government securities carry practically no risk of default and, hence, are called risk-free gilt-edged securities
Treasury Bills (T-bills)	Treasury bills or T-bills, which are money market instruments, are short term debt instruments issued by the Government of India and are presently issued in three tenors, namely, 91 day, 182 day and 364 day. Treasury bills are zero coupon securities and pay no interest. They are issued at a discount and redeemed at the face value at maturity. For example, a 91 day Treasury bill of ₹100/- (face value) may be issued at say ₹ 98.20, that is, at a discount of say, ₹1.80 and would be redeemed at the face value of ₹100/-. The return to the investors is the difference between the maturity value or the face value (that is ₹100) and the issue price. **Cash Management Bills** In 2010, Government of India, in consultation with RBI introduced a new short-term instrument, known as Cash Management Bills (CMBs), to meet the temporary mismatches in the cash flow of the Government of India. The CMBs have the generic character of T-bills but are issued for maturities less than 91 days.
Dated G-Secs	Dated G-Secs are securities which carry a fixed or floating coupon (interest rate) which is paid on the face value, on half-yearly basis. Generally, the tenor of dated securities ranges from 5 years to 40 years. The Public Debt Office (PDO) of the Reserve Bank of India acts as the registry / depository of G-Secs and deals with the issue, interest payment and repayment of principal at maturity. Most of the dated securities are fixed coupon securities.
Issuance of Govt. Securities	G-Secs are issued through auctions conducted by RBI. Auctions are conducted on the electronic platform called the E-Kuber, the Core Banking Solution (CBS) platform of RBI. They may be held by investors either as physical stock (certificate) or in dematerialized (demat/electronic) form. An auction may either be yield based or price based. **Yield Based Auction**: A yield-based auction is generally conducted when a **new G-Sec** is issued. Investors bid in yield terms up to two decimal places (e.g., 8.19%, 8.20%, etc.). Bids are arranged in **ascending order** and the cut-off yield is arrived at the yield corresponding to the notified amount of the auction. The cut-off yield is then fixed as the coupon rate for the security. Successful bidders are those who have bid **at or below the cut-off yield**. Bids which are higher than the cut-off yield are rejected. **Price Based Auction**: A price based auction is conducted when Government of India **re-issues securities** which have already been issued earlier. Bidders quote in terms of price per ₹100 of face value of the security (e.g., ₹102.00, ₹101.00, ₹100.00, ₹ 99.00, etc., per ₹100/-). Bids are arranged in **descending order of price offered** and the successful bidders are those who have bid **at or above the cut-off price**. Bids which are below the cut-off price are rejected. **Auction –Multiple price and Uniform Price** Depending upon the method of allocation to successful bidders, auction may be conducted on **Uniform Price basis or Multiple Price basis.** In a Uniform Price auction, all the successful bidders are required to pay for the allotted quantity of securities at the same rate, i.e., at the auction cut-off rate, irrespective of the rate quoted by them. On the other hand, in a Multiple Price auction, the successful bidders are required to pay for the allotted quantity of securities at the respective price / yield at which they have bid. **Bidding**

	An investor, depending upon his eligibility, may bid in an auction under either of the following categories: **Competitive Bidding**: In a competitive bidding, an investor bids at a specific price / yield and is allotted securities if the price / yield quoted is within the cut-off price / yield. Competitive bids are made by well-informed institutional investors such as banks, financial institutions, PDs, mutual funds, and insurance companies **Non-Competitive Bidding** (NCB):With a view to encouraging wider participation and retail holding of Government securities, retail investors are allowed participation on "non-competitive" basis in select auctions of dated Government of India (GoI) securities and Treasury Bills. NCB means the bidder would be able to participate in the auctions of dated G-Secs without having to quote the yield or price in the bid. Allotment under the non-competitive segment will be at the weighted average rate of yield/price that will emerge in the auction on the basis of the competitive bidding.
Buyback of Govt. Securities	Repurchase (buyback) of G-Secs is a process whereby the CG/SG buy back their existing securities, by redeeming them prematurely, from the holders. The objectives of buyback can be reduction of cost (by buying back high coupon securities), reduction in the number of outstanding securities and improving liquidity in the G-Secs market (by buying back illiquid securities) and infusion of liquidity in the system. The repurchase by the Government of India is also undertaken for effective cash management by utilising the surplus cash balances. State Governments can also buy-back their high coupon (high cost debt) bearing securities to reduce their interest outflows in the times when interest rates show a falling trend. Governments make provisions in their budget for buying back of existing securities. Buyback can be done through an auction process (generally if amount is large) or through the secondary market route i.e. NDS-OM (if amount is not large).

Q.42 Prelims 2000

Gilt edged market means
(a) bullion market (b) market of Government securities
(c) market of guns (d) market of pure metals

Q.43 Prelims 2018
Consider the following statements:
1. The Reserve Bank of India manages and services Government of India Securities but not any State Government Securities.
2. Treasury bills are issued by the Government of India and there are no treasury bills issued by the State Governments.
3. Treasury bills offer are issued at a discount from the par value.
Which of the statements given above is/are correct?
(a) 1 and 2 only (b) 3 Only (c) 2 and 3 only (d) 1, 2 and 3

Government Securities Market

The Government securities market trades securities issued by Central and State Governments. It has a sizeable primary and an active secondary segment. Trading predominantly takes place on the Negotiated Dealing System-Order Matching (NDS-OM), an anonymous screen-based order-matching electronic trading platform which facilitates participants to trade anonymously in Government securities.

NDS-OM is operated by the Clearing Corporation of India (CCIL) **on behalf of the RBI** and is authorised as an ETP under the Electronic Trading Platforms (Reserve Bank) Directions, 2018.

Individuals can access the Government securities market through the RBI Retail Direct in addition to through stock exchanges or through gilt accounts with commercial banks.

Clearing Corporation of India (CCIL)

CCIL was set up in April 2001 by banks, financial institutions and primary dealers, to function as an industry service organisation for clearing and settlement of trades in money market, government securities and foreign exchange markets.

The CCIL is the clearing agency for G-Secs. CCIL also guarantees settlement of all trades in G-Secs. That means, during the settlement process, if any participant fails to provide funds/ securities, CCIL will make the same available from its own means. For this purpose, CCIL collects margins from all participants and maintains 'Settlement Guarantee Fund'.

Rbi Retail Direct

Retail Direct scheme is a one-stop solution to facilitate investment in Government Securities by Individual Investors.

Under this scheme Individual Retail investors can open Gilt Securities Account – “Retail Direct Gilt (RDG)” Account with the RBI.

The investor can place non competitive bids in Primary issuance of all Central Government securities (including Treasury Bills and Sovereign Gold bonds) as well as securities issued by various State Governments.

Under this scheme, the individual can also access Secondary market through “NDS OM” - RBI’s trading system.

The investor will automatically receive any interest paid/maturity proceeds into his linked bank account on due dates.

Q.43A Prelims 2021
With reference to India, consider the following statements:
1. Retail investors through demat account can invest in ‘Treasury Bills’ and ‘Government of India Debt Bonds’ in primary market.
2.The Negotiated Dealing System Order Matching’ is a government securities trading platform of the Reserve Bank of India.
3.The ‘Central Depository Services Ltd.’ is jointly promoted by the Reserve Bank of India and the Bombay Stock Exchange.
Which of the statements given above is/are correct?

a 1 only b 1 and 2 c 3 only d 2 and 3

Ans-CDSL was promoted by BSE Ltd. jointly with leading banks such as State Bank of India etc.

Bond

A bond is a debt instrument in which an investor loans money to an entity (typically corporate or government) which borrows the funds for a defined period of time at a variable or fixed interest rate.

Bonds are used by companies, municipalities, states and sovereign governments to raise money to finance a variety of projects and activities. Owners of bonds are debt holders, or creditors, of the issuer.

Fixed Rate Bonds – These are bonds on which the coupon rate is fixed for the entire life (i.e. till maturity) of the bond. Most Government bonds in India are issued as fixed rate bonds.

Floating Rate Bonds (FRB) – FRBs are securities which do not have a fixed coupon rate. Instead it has a variable coupon rate which is re-set at pre-announced intervals (say, every six months or one year).

Relation between interest rates and bond prices
Interest rates and bond prices are inversely related. Interest rate risk directly affects the values of fixed rate bonds.

When interest rate rises, old bond prices fall. When interest rate rises then new bonds with higher interest rate are issued in the market, investors tend to purchase the new bond due to higher interest rate. For this reason, price of older bonds based on lower interest rate decreases.

When Price decreases then bond yield (return) increases because interest rate is fixed and bond price is lower.

Conversely, when interest rates fall, bond prices tend to rise. When interest rates fall then new bonds with lower interest rate are issued in the market, investors are less likely to purchase new issues. Hence, the older bonds that have higher interest rate tend to increase in price.

When question comes related to impact on bond prices and bond yield then first think impact on Interest rate
For Example- Impact of Inflation on Bond Price

When high inflation then RBI will increase interest rate. When interest rate increases, now you know the answer.

Zero Coupon bond

Zero coupon bonds are bonds with no coupon payments. (Coupon means interest rate)

However, like T- Bills, They are issued at discount and repayment are made at par value.

Eg. Face value of bond is Rs. 100. Issued at Rs. 90 and repayable at Rs. 100

The Government of India had issued such securities in the nineties, It has not issued zero coupon bonds after that.

Capital Indexed Bonds

These are bonds, the principal of which is linked to an accepted index of inflation with a view to protecting the Principal amount of the investors from inflation. A 5 year capital indexed bond, was first issued in December 1997 which matured in 2002.

Inflation Indexed Bonds (IIBs)

IIBs are bonds wherein both coupon flows and Principal amounts are protected against inflation. The inflation index used in IIBs may be Whole Sale Price Index (WPI) or Consumer Price Index (CPI).

Globally, IIBs were first issued in 1981 in UK. In India, Government of India through RBI issued IIBs (linked to WPI) in June 2013. Since then, they were issued on monthly basis (on last Tuesday of each month) till December 2013.

Based on the success of these IIBs, Government of India in consultation with RBI issued the IIBs (CPI based) exclusively for the retail customers in December 2013.

Q.44 Prelims 2022
With reference to the India economy, what are the advantages of “Inflation-Indexed Bonds (IIBs)”?
1. Government can reduce the coupon rates on its borrowing by way of IIBs.
2. IIBs provide protection to the investors from uncertainty regarding inflation.
3. The interest received as well as capital gains on IIBs are not taxable.
Which of the statements given above are correct?
(a) 1 and 2 only (b) 2 and 3 only (c) 1 and 3 only (d) 1, 2 and 3

Bonds with Call/ Put Options

Bonds can also be issued with features of optionality wherein the issuer can have the option to buy-back (call option) or the investor can have the option to sell the bond (put option) to the issuer during the currency of the bond.

Special Securities

Under the market borrowing program, the Government of India also issues, from time to time, special securities to entities like Oil Marketing Companies, Fertilizer Companies, the Food Corporation of India, etc. (popularly called oil bonds, fertiliser bonds and food bonds respectively) as compensation to these companies in lieu of cash subsidies.

These securities are usually long dated securities and carry a marginally higher coupon over the yield of the dated securities of comparable maturity. These securities are, however, not eligible as SLR securities but are eligible as collateral for market repo transactions.

The beneficiary entities may divest these securities in the secondary market to banks, insurance companies / Primary Dealers, etc., for raising funds.

Government of India has also issued Bank Recapitalisation Bonds to specific Public Sector Banks in 2018. These securities are named as Special GoI security and are non-transferable and are not eligible investment in pursuance of any statutory provisions or directions applicable to investing banks.

STRIPS – Separate Trading of Registered Interest and Principal of Securities.

STRIPS are the securities created by way of separating the cash flows associated with a regular G-Sec i.e. each semi-annual coupon payment and the final principal payment, into separate securities.

They are essentially Zero Coupon Bonds (ZCBs). However, they are created out of existing securities only and unlike other securities, are not issued through auctions.

Being G-Secs, STRIPS are eligible for SLR.

For example, when ₹100 of the 8.60% GS 2028 is stripped, each cash flow of coupon (₹ 4.30 each half year) will become a coupon STRIP and the principal payment (₹100 at maturity) will become a principal STRIP. These cash flows are traded separately as independent securities in the secondary market.

Shut period

Shut period means the period during which the securities can not be traded. The main purpose of having a shut period is to facilitate finalizing of the payment of maturity redemption proceeds and to avoid any change in ownership of securities during this process. Currently, the shut period for the securities is one day.

Sovereign Gold Bonds Scheme

About SGB	SGBs are unique instruments, prices of which are linked to commodity price viz Gold. SGBs are also budgeted in lieu of market borrowing.
Issuance	To be issued by Reserve Bank India on behalf of the Government of India.
Eligibility	The Bonds will be restricted for sale to resident individuals, HUFs, Trusts, Universities and Charitable Institutions.
Denomination	The Bonds will be denominated in multiples of gram(s) of gold with a basic unit of 1 gram.
Tenor	The tenor of the Bond will be for a period of 8 years with exit option from 5th year to be exercised on the interest payment dates.
Minimum size	Minimum permissible investment will be 1 grams of gold.
Maximum limit	The maximum limit of subscribed shall be 4 KG for individual, 4 Kg for HUF and 20 Kg for trusts and similar entities per fiscal (April-March)
Issue price	The nominal value of gold bond shall be based on the simple average of closing price [published by the India Bullion and Jewellers Association Ltd (IBJA)] for gold of 999 purity of the last three working days of the week preceding the subscription period. Issue price of the SGBs will be less by Rs. 50 per gram for the investors who subscribe online and pay through digital mode.
Redemption price	Redemption price will be in Indian Rupees based on simple average of closing price of gold of 999 purity, of previous three working days published by IBJA Ltd.
Interest rate	The investors will be compensated at a fixed rate of 2.50 per cent per annum payable semi-annually on the nominal value.
Collateral	Bonds can be used as collateral for loans.
Tax treatment	The interest on Gold Bonds shall be taxable. The capital gains tax on redemption to an individual has been exempted. The indexation benefits will be provided to long term capital gains.
Sales channel	The Bonds will be sold through Scheduled Commercial banks(except Small Finance Banks and Payment Banks), Stock Holding Corporation of India Limited (SHCIL), designated post offices, and recognised stock exchanges *viz*., National Stock Exchange of India Limited and Bombay Stock Exchange Limited.
Tradability	Bonds will be tradable on stock exchanges from such date as notified by the RBI.
SLR eligibility	SGBs acquired by the banks through the process of invoking lien/hypothecation/pledge alone, shall be counted towards Statutory Liquidity Ratio.
Benefit	The scheme will help in reducing the demand for physical gold by shifting a part of the estimated 300 tons of physical bars and coins purchased every year for Investment into gold bonds. Since most of the demand for gold in India is met through imports, this scheme will, ultimately help in maintaining the country's Current Account Deficit within sustainable limits.

Gold Monetization Schemes, 2015

Benefit	Scheme will help in mobilizing the large amount of gold lying as an idle asset with households, temple trusts and various institutions in India and put this gold into productive use and in the long-run, to reduce the current account deficit by reducing the country’s reliance on the imports of gold to meet the domestic demand. Mobilized gold will also supplement RBI’s gold reserves and will help in reducing the government's borrowing cost

Gold Deposit	The minimum deposit at any one time shall be 10 grams of raw gold (bars, coins, jewellery excluding stones and other metals). There is no maximum limit for deposit under the scheme. Deposits will be accepted by the designated banks on behalf of the Central Government. Gold received will be auctioned by the agencies notified by Government and the sale proceeds will be credited to Government's account held with RBI.
Type of Deposits	Short Term Bank Deposit (STBD) can be made for 1-3 years Medium Term Government Deposit (MTGD) for 5-7 years and Long Term Government Deposit (LTGD) for 12-15 years.
Interest rate	Banks are free to fix the interest rates on Short Term Bank Deposit. Rate of interest on medium and long term deposit will be decided by Central Government. The current rate of interest are as under: (i) On medium term deposit – 2.25% p.a. (ii) On long term deposit – 2.50% p.a. Interest shall be paid in Indian Rupee only.
Lock-in period	Banks may determine minimum lock-in period on Short Term Bank Deposit. A Medium Term Government Deposit (MTGD) is allowed to be withdrawn any time after 3 years and a Long Term Government Deposit (LTGD) after 5 years.
Maturity	The redemption of principal at maturity shall, at the option of the depositor, be either in Indian Rupee equivalent of the value of deposited gold at the time of redemption, or in gold. However, any pre-mature redemption shall be only in INR.

Q.45 Prelims 2016
What is/are the purpose/purposes of Government's 'Sovereign Gold Bond Scheme' and 'Gold Monetization Scheme'?
1. To bring the idle gold lying with Indian households into the economy
2. To promote FDI in the gold and jewellery sector
3. To reduce India's dependence on gold imports
Select the correct answer using the code given below.
(a) 1 only
(b) 2 and 3 only
(c) 1 and 3 only
(d) 1, 2 and 3

Q.46 ES 2019
Which of the following are the main objectives of Gold Monetization Scheme launched in the country?
1. To monetize gold holdings in the country
2. To increase export of gold from the country
3. To reduce India's import bill
4. To meet the targets of reduction in fiscal deficit
Select the correct answer using the codes given below:
(a) 1 and 4 only (b) 2 and 4 only (c) 2 and 3 only (d) 1 and 3 only

Operation Twist by RBI (19-12-2019)

Operation Twist is the monetary policy first adopted by Federal Reserve of United States in which it sells short term government bonds and buys long terms bonds to bring the long term interest rate down in order to stimulate the economy.

On 19th December 2019, Reserve Bank of India decided to conduct its version of 'Operation Twist' through simultaneous purchase (Long term bonds) and sale (Short term bonds) of government securities under Open Market Operations (OMOs) for Rs 10,000 crore each.

Through buying long term bonds and selling short term bonds, the demand for the long term bonds increases than the supply, which drives up the prices of these bonds and yield move down (as interest is fixed and price increases) and vice versa in case of short term bonds.

Hence by creating this combination, The RBI is able to twist the yields curve on long term and short term bonds. And it is able to ease out the economy by lowering the long term interest rate. Operation twist is simply the reducing the gap between long term and short term interest rates.

High-term premia, the difference between the prevailing 10-year government security yield and the repo rate, is an impediment to monetary policy transmission.

The high yields on long-term government borrowings had led to banks pricing their retail loans (vehicle, housing etc) at high rates. These loans can now be expected to get slightly cheaper with Operation Twist. Cheaper retail loans can boost consumption spending.

Cash Management of Government

Cash account	Government's cash account is maintained with the RBI. The cash flow mismatches of the Central Government are largely managed through issuance of Treasury Bills, Cash Management Bills and access to the Ways and Means Advances facility from RBI, whenever there is a cash deficit. There is auction of Government's cash balances in the market (through RBI) and buy-back of securities from the market whenever there are cash surpluses. Further, the Reserve Bank conducts purchase/ sale of G-Secs under Open Market Operations, whenever required, based on its assessment of prevailing and evolving liquidity conditions.
Minimum balance by CG	Central Government is required to maintain a minimum cash balance with the Reserve Bank. Currently, this amount is Rs.10 crore on a daily basis and Rs.100 crore on Fridays.
Minimum balance by SG	All the State Governments are required to maintain a minimum balance with the Reserve Bank, which varies from state to state depending on the relative size of the state budget and economic activity.
Ways and Means Advances/Overdraft	To tide over temporary mismatches in the cash flow of receipts and payments, the Reserve Bank provides Ways and Means Advances/Overdraft to the Central and State Governments.

WMA Limit for Government of India

RBI, in consultation with the Government of India, has decided that the limit for Ways and Means Advances (WMA) for the first half of the financial year 2023-24 (April 2023 to September 2023) will be ₹1,50,000 crore.

The Reserve Bank may trigger fresh floatation of market loans when the Government of India utilises 75 per cent of the WMA limit.

The Reserve Bank retains the flexibility to revise the limit at any time, in consultation with the Government of India, taking into consideration the prevailing circumstances.

The interest rate on WMA/Overdraft will be:
WMA: Repo Rate
Overdraft: Two percent above the Repo Rate

WMA Scheme

Under Section 17(5) of RBI Act, 1934, the RBI provides Ways and Means Advances (WMA) to the **Central and State Governments** repayable in each case not later than **three months** from the date of the making of the advance.

They are provided to help them to tide over temporary mismatches in the cash flow of their receipts and payments.

They are intended to provide a cushion to the Govt. to carry on their essential activities and normal financial operations.

Review of Ways and Means Advances Scheme of State Governments/ UTs (01-04-2022)

There are two types of WMA, viz., (i) Normal WMA or clean advance, which was introduced in 1937; and (ii) Special WMA instituted in 1953, which is a secured advance provided against the collateral of GoI securities. In 2014, nomenclature of Special WMA was changed to Special Drawing Facility (SDF).

In addition to WMA, OD facility is also provided whenever financial accommodation to a State exceeds its SDF and WMA limits.

Ways and Means Advances
The WMA limit for State Governments/UTs will be ₹47,010 crore.

India's Foreign exchange reserves

Item	As on July 7, 2023	
	₹ Cr.	US$ Mn.
1 Total Reserves	49,33,658	5,96,280
1.1 Foreign Currency Assets	43,76,744	5,28,968
1.2 Gold	3,64,561	44,060
1.3 Special Drawing Rights (SDRs)	1,50,875	18,235
1.4 Reserve Tranche Position in the IMF	41,479	5,017

- India's has World's 4th largest foreign-exchange reserves. China (US$ 3371 Billions) has the largest reserves followed by Japan (US$ 1254 Billions), Switzerland (US$ 898 Billions).
- Reserve position in IMF represents India's quota contribution to IMF in foreign currency. The IMF is a quota-based institution. Quotas are a key determinant of the voting power in IMF decisions.
- At end of December 2022, foreign exchange reserves cover of imports (on balance of payments basis) increased to 9.3 months from 8.9 months at end-September 2022.

Advantages of a strong reserve

1. It serve as a cushion against market volatility and gives foreign investors and credit rating companies added comfort that the government can meet its debt obligations despite a deteriorating fiscal outlook.

2. It is an important guarantee to make up for the balance of payments deficit.

3. It also help the rupee to strengthen against the dollar. The exchange rate of the rupee is determined largely by the market forces of demand and supply. The Reserve Bank of India intervenes occasionally, only for **maintaining orderly conditions** in the market by curbing excessive volatility. RBI sells the dollar when the rupee weakens and buys the dollar when the rupee strengthens.

Foreign Currency Assets (FCA)

Foreign Currency Assets (FCA) are maintained in major currencies, such as, US dollar, Euro, Pound sterling, Japanese yen, etc. and are valued in terms of US dollars.

Movements in the FCA occur mainly on account of purchase and sale of foreign exchange by the RBI, income arising out of the deployment of the foreign exchange reserves, external aid receipts of the Central Government and changes on account of revaluation of the assets. For example-effect of appreciation/depreciation of non-US currencies (such as Euro, Sterling, Yen) held in reserves.

As at end-March 2023, out of the total FCA of USD 509.69 billion, USD 411.65 billion was invested in securities, USD 75.51 billion was deposited with other central banks and the BIS and the balance USD 22.52 billion comprised deposits with commercial banks overseas

Management of Gold Reserves

As at end-March 2023, the Reserve Bank held 794.64 metric tonnes of gold (including gold deposits of 56.32 metric tonnes). While 437.22 metric tonnes of gold is held overseas in safe custody with the Bank of England and the Bank of International Settlements (BIS), 301.10 metric tonnes of gold is held domestically.

Q.47 Prelims 2013
Which one of the following groups of items is included in India's foreign-exchange reserves?
a. Foreign-currency assets, Special Drawing Rights (SDRs) and loans from foreign countries
b. Foreign-currency assets, gold holdings of the RBI and SDRs
c. Foreign-currency assets, loans from the World Bank and SDRs
d. Foreign-currency assets, gold holdings of the RBI and loans from the World Bank

Q.48 Prelims 2020
"Gold Tranche" (Reserve Tranche) refers to
(a) a loan system of the World Bank (b) one of the operations of a Central Bank
(c) a credit system granted by WTO to its members (d) a credit system granted by IMF to its members

General Allocation of Special Drawing Rights by the IMF (23-08-2021)

The Board of Governors of the IMF had approved a general allocation of about SDR 456 billion (effective from August 23, 2021) of which the share of India is SDR 12.57 billion.

The total SDR holdings of India now stands at SDR 13.66 billion (equivalent to around USD 19.41 billion at the latest exchange rate) as on August 23, 2021.

The SDR allocation will provide additional liquidity to the global economic system – supplementing countries' foreign exchange reserves and reducing their reliance on more expensive domestic or external debt. This most recent allocation was to address the long-term global need for reserves, and help countries cope with the impact of the COVID-19 pandemic.

SDRs are being distributed to countries in proportion to their quota shares in the IMF. To date, a total of SDR 660.7 billion (equivalent to about US$943 billion) have been allocated.

About SDR

The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. The SDR was created as a supplementary international reserve asset in the context of the Bretton Woods fixed exchange rate system.

The SDR was initially defined as equivalent to 0.888671 grams of fine gold—which, at the time, was also equivalent to one U.S. dollar. After the collapse of the Bretton Woods system, the SDR was redefined as a basket of currencies.

The value of the SDR is based on a basket of five major **freely usable currencies**—U.S. dollar, Euro, Chinese renminbi (RMB), Japanese yen, and Pound sterling. Chinese renminbi (also called Yuan) was included in the SDR basket from October 1, 2016.

A "freely usable" currency mean a currency that the IMF determines
- is widely used to make payments for international transactions, and
- is widely traded in the principal exchange markets.

IMF lending operations are, in practice, conducted in freely usable currencies or SDRs.

The SDR is neither a currency, nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members. SDRs can be exchanged for freely usable currencies. Holders of SDRs can obtain these currencies in exchange for their SDRs

If SDRs are not money, how can countries use them?

Countries can exchange their SDRs for hard currencies with other IMF members. This has historically been done on a voluntary basis, with countries in a stronger financial position agreeing to help others when needed. They can also use their SDRs in a range of operations with other countries or to settle financial obligations to the Fund.

Is there a cost to allocating SDRs?

An SDR allocation is cost free. Allocating SDRs does not require contributions from donor countries' budgets. SDRs are a reserve asset, not foreign aid. Most importantly, an SDR allocation does not add to any country's public debt burden.

IMF Executive Board Concludes Quinquennial SDR Valuation Review and Determines New Currency Weights for SDR Valuation Basket (14-05-2022)

The value of the SDR will continue to be based on a weighted average of the values of a basket of currencies comprising the U.S. dollar, euro, Chinese renminbi, Japanese yen, and pound sterling.

With effect from August 1, 2022, the IMF has determined that the five currencies that meet the selection criteria for inclusion in the SDR valuation basket will be assigned the **following weights** based on their roles in international trade and finance:

1. U.S. dollar 43.38 percent
2. Euro 29.31 percent
3. Chinese renminbi 12.28 percent
4. Japanese yen 7.59 percent
5. Pound sterling 7.44 percent

The updated basket implies **slightly higher weights for** the U.S. dollar and the Chinese renminbi and, accordingly, somewhat lower weights for the British pound, the euro, and the Japanese yen

The last SDR valuation review was concluded in 2015. Under the existing SDR valuation method adopted by the Executive Board, the SDR currency basket is reviewed every five years unless developments in the interim justify an earlier review.

Q.49 CDS-2012
Special Drawing Rights (SDRs) relate to
(a) the World Bank (b) the Reserve Bank of India (c) the World Trade Organization (d) the International Monetary Fund

Q.50 Prelims-2016
Recently, which one of the following currencies has been proposed to be added to the basket of IMF's SDR?
(a) Ruble (b) Rand (c) Indian Rupee (d) Renminbi

Q.51 PRELIMS 2010
Which of the following is/are treated as artificial currency ?
(a)ADR (b)GDR (c) SDR (d) Both ADR and SDR

Q.52 Prelims 2007
Special Drawing Rights (SDR), the currency of IMF, is in the form of
(a) Paper currency (b) Book-keeping entry only (c) Gold (d) PPP-Dollar

Promissory note

It's a signed document containing a written promise to pay a stated sum to a specified person or the bearer at a specified date or on demand.

Bank note is not a promissory note

As per section 4 of Negotiable Instruments Act of 1881, A "promissory note" is an instrument in writing (**not being a bank-note or a currency-note**) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.

Minimum reserve system

The original RBI Act prescribed a proportional reserve system which required that 40% of the note issue had to be backed by gold coin, gold bullion and foreign securities. Under the new system, known as minimum reserve system, note issuance is to be backed by Rs.200 crore in gold, bullion and foreign securities (with atleast Rs.115 crore in gold and bullion.

Bank notes printing presses

No of press	Four printing presses print and supply banknotes
Location	• Dewas in Madhya Pradesh, • Nasik in Maharashtra, • Mysore in Karnataka, and • Salboni in West Bengal
Owned by Govt	The presses in Madhya Pradesh and Maharashtra are owned by the Security Printing and Minting Corporation of India (SPMCIL), a wholly owned company of the Government of India. SPMCIL is the only PSU under the Department of Economic Affairs (MoF)
Owned by RBI	The presses in Karnataka and West Bengal are owned by the Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL), a wholly owned subsidiary of the Reserve Bank.
Coins	Coins are minted in four mints owned by SPMCIL. The mints are located at Mumbai, Hyderabad, Kolkata and NOIDA. The Government of India is responsible for the designing and minting of coins in various denominations as per the Coinage Act, 2011. The Reserve Bank is the agent of the Government for distribution, issue and handling of coins.
Currency chest	To facilitate the distribution of banknotes and rupee coins, the Reserve Bank has authorised select scheduled banks to establish currency chests. These are storehouses where banknotes and rupee coins are stocked on behalf of the Reserve Bank for distribution to bank branches in their area of operation. As on March 31, 2020, there were 3367 currency chests.

Reserve Bank as Banker to Banks

Banks are required to maintain a portion of their demand and time liabilities (i.e. Deposits) as cash reserves with the Reserve Bank. For this purpose, they need to maintain current account with the Reserve Bank. The current account of the banks is opened in e-Kuber (CBS of RBI) by the Banking Departments of the Reserve Bank's Regional offices.

These current accounts are also maintained for participation in Centralised and decentralised Payment Systems and are used for settling inter-bank obligations, such as clearing transactions or clearing money market transactions between two banks, buying and selling securities and foreign currencies. Thus, Reserve Bank acts as a common banker, known as '**Banker to banks' function.**

Among other provisions, the Reserve Bank stipulates minimum balances to be maintained by banks in these accounts. It is the responsibility of each bank maintaining current account with the Reserve Bank to ensure that sufficient balance is available in the account to avoid defaults in payments and settlements.

As Banker to banks, the Reserve Bank provides short-term loans and advances to select banks, when necessary, to facilitate lending to specific sectors and for specific purposes.

Lender of Last Resort

As a Banker to Banks, the Reserve Bank also acts as the 'lender of the last resort'. It can come to the rescue of a bank that is solvent but faces **temporary liquidity problems** by supplying it with much needed liquidity when no one else is willing to extend credit to that bank.

The Reserve Bank extends this facility to protect the interest of the depositors of the bank and to prevent possible failure of the bank, which in turn may also affect other banks and institutions and can have an adverse impact on financial stability and thus on the economy.

Q.53 Prelims 2021
In India, the central bank's function as the ''lender of last resort'' usually refers to which of the following?
1. Lending to trade and industry bodies when they fail to borrow from other sources
2. Providing liquidity to the banks having a temporary crisis
3. Lending to governments to finance budgetary deficits
Select the correct answer using the code given below
a) 1 and 2 b) 2 only c) 2 and 3 d) 3 only

RBI Prompt Corrective Action (PCA) Framework for Scheduled Commercial Banks (excluding Small Finance Banks, Payment Banks and Regional Rural Banks) (02-11-2021)

Capital, Asset Quality and Leverage will be the key areas for monitoring in the revised framework.

Indicators to be tracked for Capital, Asset Quality and Leverage would be CRAR/ Common Equity Tier I Ratio, Net NPA Ratio and Tier I Leverage Ratio respectively.

RBI has given three risk threshold. Breach of any risk threshold may result in invocation of PCA.

The objective of the PCA Framework is to enable Supervisory intervention at appropriate time and require the Supervised Entity to initiate and implement remedial measures in a timely manner, so as to restore its financial health. The PCA Framework is also intended to act as a tool for effective market discipline.

The PCA Framework does not preclude the Reserve Bank of India from taking any other action as it deems fit at any time, in addition to the corrective actions prescribed in the Framework.

When a bank is placed under PCA, one or more of the following corrective actions may be prescribed:

1. Mandatory Actions:

if Risk Threshold 1 is breached-

- Restriction on dividend distribution/remittance of profits.
- Promoters/Owners/Parent (in the case of foreign banks) to bring in capital

if Risk Threshold 2 is breached- In addition to mandatory actions of Threshold 1

- Restriction on branch expansion; domestic and/or overseas

if Risk Threshold 3 is breached- In addition to mandatory actions of Threshold 1 and 2

- Restrictions on capital expenditure, other than for technological upgradation

2. Discretionary actions:

- Special Supervisory Actions
- Strategy related
- Governance related
- Capital related
- Credit risk related
- Market risk related
- HR related
- Profitability related
- Operations/Business related
- Any other

Prompt Corrective Action (PCA) Framework for Non-Banking Financial Companies (NBFCs) (14-12-2021)

NBFCs have been growing in size and have substantial interconnectedness with other segments of the financial system. Accordingly, RBI has decided to put in place a PCA Framework for NBFCs to further strengthen the supervisory tools applicable to NBFCs.

RBI releases "Enabling Framework for Regulatory Sandbox" (13-08-2019)

Regulatory sandbox (RS) usually refers to **live testing of new products** or services in a controlled/test regulatory environment for which regulators may (or may not) permit certain regulatory relaxations for the limited purpose of the testing.

The RS allows the regulator, the innovators, the financial service providers (as potential deployers of the technology) and the customers (as final users) to conduct field tests to collect evidence on the benefits and risks of new financial innovations, while carefully monitoring and containing their risks.

Objectives
The objective of the RS is to foster responsible innovation in financial services, promote efficiency and bring benefit to consumers.

The proposed financial service to be launched under the RS should include new or emerging technology, or use of existing technology in an innovative way and should address a problem and bring benefits to consumers.

Feedback from customers, as end users, educates both the regulator and the innovator as to what costs and benefits might accrue to customers from these innovations..

If any concerns arise, during the sandbox period, appropriate modifications can be made before the product is launched in the broader market.

Regulatory Sandbox – Announcement of Theme for Fifth Cohort (05-09-2022)

The Reserve Bank's Regulatory Sandbox (RS) has so far introduced four cohorts on 'Retail Payments'; 'Cross Border Payments'; 'MSME Lending' and 'Prevention and Mitigation of financial frauds'

Fifth Cohort under Regulatory Sandbox will be theme neutral.

Inauguration of the Reserve Bank Innovation Hub (24-03-2022)

RBI has set up the RBIH as a Section 8 company under Companies Act, 2013, with an initial capital contribution of ₹100 crore to encourage and nurture financial innovation in a sustainable manner through an institutional set-up.

RBIH has been set up as a **wholly owned subsidiary** of the RBI at Bengaluru, Karnataka.

RBIH would be guided and managed by a Governing Council (GC) led by a Chairperson. The Reserve Bank has appointed Shri Senapathy (Kris) Gopalakrishnan, co-founder and former co-Chairman, Infosys, as the first Chairperson and other eminent persons from industry and academia as members.

RBIH aims to create an ecosystem that focuses on promoting access to financial services and products for the low-income population in the country. This is in line with the objective behind establishment of RBIH i.e., to bring world class innovation to financial sector in India, coupled with the underlying theme of financial inclusion.

The Hub will collaborate with financial sector institutions, technology industry and academic institutions and coordinate efforts for exchange of ideas and development of prototypes related to financial innovations. It would develop internal infrastructure to promote fintech research and facilitate engagement with innovators and start-ups.

Surplus payable to the Central Government

Under Section 47 of the RBI Act, 1934, after making provisions for bad and doubtful debts, depreciation in assets, contribution to staff and superannuation funds and for all matters for which provisions are to be made by or under the Act or that are usually provided by bankers, the balance of the profits of the Reserve Bank is required to be paid to the Central Government.

Under Section 48 of the RBI Act, 1934, the Reserve Bank is not liable to pay income tax or super tax on any of its income, profits or gains.

602nd Meeting of Central Board of the Reserve Bank of India (19-05-2023)
The Board approved the transfer of ₹87,416 crore as surplus to the Central Government for the accounting year 2022-23, while deciding to keep the Contingency Risk Buffer at 6%.

Housing Price Index by RBI

The Reserve Bank of India (RBI) began compiling a House Price Index (HPI) in 2007 with a quarterly HPI for Mumbai city (Base 2002-03=100).

Since then, it has extended its coverage to nine more cities, revised its base to 2010-11=100, and started publishing a composite All India HPI.

RBI's quarterly HPI is based on transactions data received from housing registration authorities in ten major cities. (viz., Ahmedabad, Bengaluru, Chennai, Delhi, Jaipur, Kanpur, Kochi, Kolkata, Lucknow and Mumbai).

Housing Price Index by NHB

The Housing Price Indices (HPIs) are a broad measure of movement of residential property prices observed within a geographical boundary.

The first official housing price index for the country named '**NHB RESIDEX'** was launched in July 2007 by the National Housing Bank. Currently, National Housing Bank publishes NHB RESIDEX for 50 cities on a quarterly basis with FY 2017-18 as the base year.

Storage of Payment System Data in India

Reserve Bank of India issued a circular on April 06, 2018 on 'Storage of Payment System Data' advising all system providers to ensure that, within a period of six months, the entire data relating to payment systems operated by them is stored in a system located only in India.

MANI (Mobile Aided Note Identifier)

RBI Governor launched the "Mobile Aided Note Identifier (MANI)", a mobile application for aiding visually impaired persons to identify the denomination of Indian Banknotes. (01-01-2020)

This App, which identifies the denomination of banknotes through audio notification in Hindi and English, is now capable of notifying the banknote denomination in 11 other languages (Assamese, Bengali, Gujarati, Kannada, Malayalam, Marathi, Odia, Punjabi, Tamil, Telugu, Urdu).

The MANI application is free and can be downloaded from the Android Play Store and iOS App Store without any charges/payment.

Answers of MCQs

1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**	**15**	**16**	**17**	**18**
a	a	c	a	d	c	d	d	c	d	c	a	c	d	b	a	a	c
19	**20**	**21**	**22**	**23**	**24**	**25**	**26**	**27**	**28**	**29**	**30**	**31**	**32**	**33**	**34**	**35**	**36**
b	c	c	a	a	d	a	b	b	d	d	b	c	c	a	d	c	a
37	**38**	**39**	**40**	**41**	**42**	**43**	**44**	**45**	**46**	**47**	**48**	**49**	**50**	**51**	**52**	**53**	**10A**
a	b	a	c	a	b	c	a	c	d	b	d	d	d	c	b	b	c
39A	**43A**																
a	b																

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