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NABARD - Economy and Social Issues!

ESI carries weightage of 40 marks in Phase 1 and 50 marks in Phase 2. However, aspirants often ignore this subject. Sometimes due to overconfidence, but mostly because of lack of quality study material.

It is easiest to score marks in ESI, provided one is studying the subject smartly.

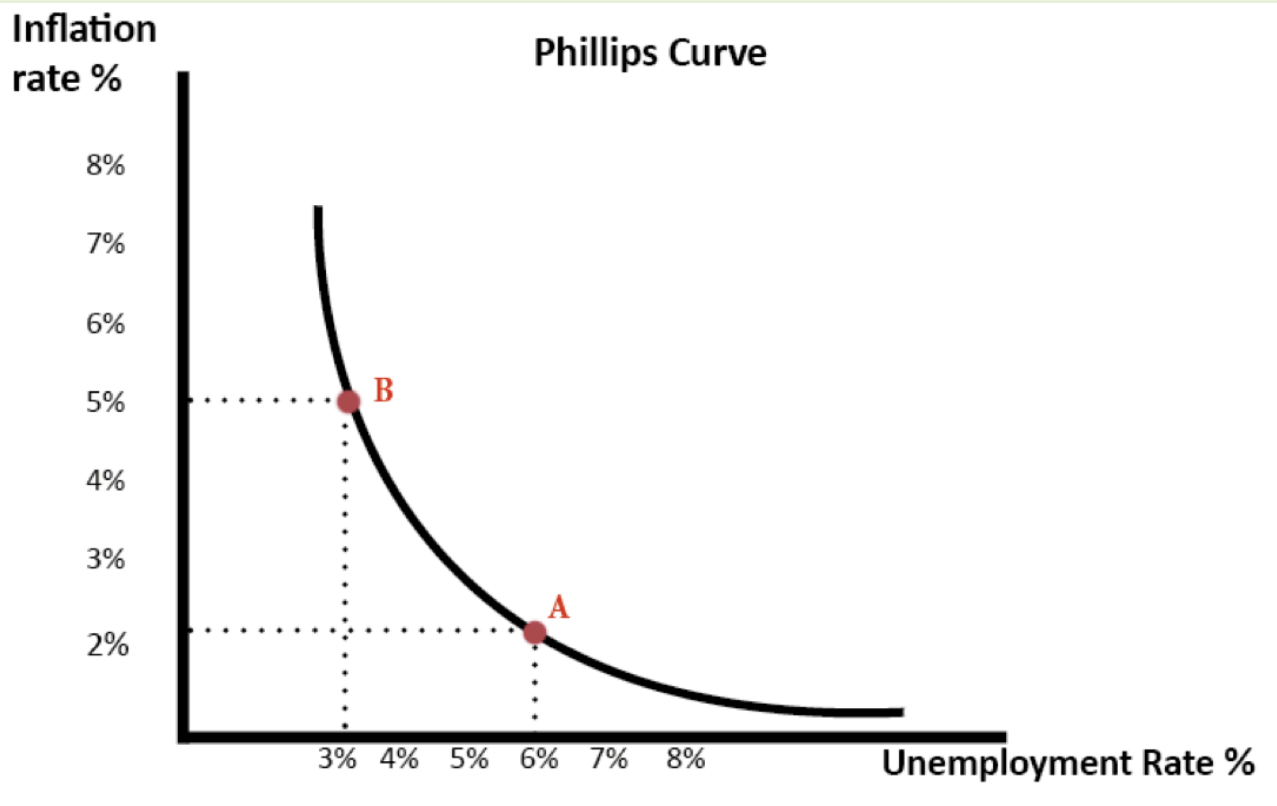
Sharing sample notes from Acads on **Monetary Policy I**. Compact but comprehensive.

Always remember, the secret to success in any exam is revision. Don't start a book/material if you can't revise it at least 10 times.

Study Smart, Not Hard.

NABARD Course- acads.com/nabard

MONETARY POLICY I

Introduction	
Definition	A macroeconomic Polity tool used to influence interest rates, inflation and credit availability through changes in the supply of money available in the economy
Credit Policy	Credit policy is a part of monetary policy as it deals with how much and at what rate credit is advanced to the banks. Both are functions of the central bank of the country
Types of MP	• Expansionary: Increases the supply of money • Contractionary: Decreases the supply of money
Philips Curve	Inflation rate % Phillips Curve  Unemployment Rate % • Philips Curve: Shows inverse relationship between Inflation and Unemployment
Quantitative tools & Concepts	
LAF	Background • Introduced in 2000 What? • Liquidity Adjustment Facility • It is the window through which RBI adjusts liquidity in the market against the collateral of government securities. Repo • When Bank borrows from RBI to meet their daily mismatches between need and availability Repo Mechanism • Repo is short form from Ready forward Contracts. RFCs are transactions in which 2 parties agree to sell and repurchase the same security. • Banks first sell the government security and then buys back it after sometime (Overnight or a few days) Reverse Repo • When Banks Lends to RBI, as they have extra cash with them • Reverse Repo is lower than Repo rates

	Eligible entities - All Commercial Banks except RRB's - Primary Dealers Misc - Can only be done in securities approved by RBI - Treasury Bills, Central/State Govt Securities - Same as SLR securities - Repo rate is also known as policy rate
MSF	Background - Introduced in 2011 What - Marginal Standing Facility - It is a tool which allows banks to borrow from RBI at a penal rate when their LAF limit is exhausted. Uses securities from SLR limit - MSF rates are higher than Repo rate - Reverse Repo Rate < Repo Rate < MSF Rates
Reserve Requirements	Fractional Reserve Requirements - Global norm in which banks keep a fraction of the total deposits of the bank as reserves that are not to be lent to public SLR - Statutory Liquidity Ratio CRR - Cash Reserve Ratio
SLR	What - Portion of Net Time and Demand liabilities that a bank should keep in RBI approved securities and Cash Assets allowed under SLR obligation - Current account deposits with other banks - Gold valued at price not exceeding the market price - SLR Securities - Govt Bonds, Treasury Bills, State development Bonds, etc. - Excess CRR Balance Objective - To ensure solvency of Commercial Banks - To control bank credit - To make SCBs invest in Govt securities SLR Limit 0-40% of Total DTL [Banking Regulation Act, 1949] Note - Compared to CRR, SLR is a more blunt tool and change in SLR signal to the economy on a long term basis
LCR	Background Suggested by Basel Committee on Banking Supervision after GFC, 2007 LCR Liquidity coverage ratio norms aim to ensure that bank has sufficient level of HQLA (High Quality Liquid Assets) that can be converted into cash to meet its liquidity needs for 30 calendar years LCR Vs SLR As some of securities under HQLA/LCR and SLR are common, RBI allows a certain fraction of LCR norms to be met with securities held by banks under SLR mandate.
CRR (Cash Reserve Ratio)	What - Portion of Total TDL that a Bank keeps with RBI in the form of Cash CRR Maintenance - Banks have to maintain CRR of 90% on a daily basis and 100% on average basis during the fortnight Act - CRR is governed by Section 42 RBI Act, 1934 Limits - There is no upper or lower limit on CRR

	Incremental CRR - At certain time, RBI uses multiple CRRs. One CRR for current deposits and another for money collected during a certain duration. E.g. Post demonetisation RBI imposed 100% CRR on cash collected during Sept 16 and Nov 11, 2016. The aim was to prevent banks from lending such huge amount of money Note - Unlike SLR, CRR is medium to short term liquidity management tool
Bank Rate	What - The rate at which RBI used to lend Long term to commercial banks. - On introduction of LAF in 2000, RBI discontinued with long term lending. But it is there in the statute Alignment with MSF - On introduction of MSF in 2011, RBI aligned Bank rate with MSF
Base Rate	Background - RBI introduced the concept of base rate in 2011 What - Rate below which banks cannot lend. (Think why RBI would set a rate below which a bank cannot lend) - Purpose was effective monetary transmission Outcome - Base Rate system wasn't effective, so RBI went for MCLR (External Benchmark based lending after that)
Standing Deposit Facility	Background - RBI act was amended in 2018 to provide for SDF - Proposed by Urjit Patel Committee What - Standing Deposit Facility allows the RBI to absorb liquidity (deposit) from commercial banks without giving government securities in return to the banks. - RBI gives interest = Reverse Repo Rate - It is a voluntary facility for banks. Need Enables RBI to absorb excess liquidity in emergency situation without government securities SDF VS LAF No need for RBI to give securities as collateral
Policy Corridor	Difference between [MSF and RR] OR [RR and Repo Rate]
Window Operations	LAF and MSF operations are operated through e-Kuber - RBI Core Banking Solution
Tri-Party Repo	- Not a monetary tool. Just a mechanism to carry out repo operations. 3 Parties involved are: 1) Borrower 2) Lender (RBI) and 3) Tri Party agent (NSE) - Helps in deepening Corporate Bond Market
OMO	What - Open market operations is the sale and purchase of government securities and treasury bills by RBI or the central bank of the country. Mechanism - To absorb liquidity: RBI sells government securities to Market - To inject liquidity: RBI buys government securities from Market - Total amount of government securities does not change in the market Open Market It essentially means banks and Financial Institutions. Not general public
MSS - Market Stabilization Scheme	Background - RBI introduced the concept of MSS in 2004 What - Used to absorb excess liquidity in market - Initially, it was used to withdraw the excess liquidity in the system that was generated as a result of the RBI's purchase of foreign currencies in the foreign exchange market

	Current Use - When RBI buys Dollars to arrest the appreciation of Rupee, supply of Rupee increases in the market. To avoid inflation in such scenarios, RBI sells MSBs. MSBs - Market Stabilization Bonds - It is the security that RBI sells on behalf of government in MSS - Money obtained by selling MSBs cannot be used by government. It has to be kept with RBI Current Limit - Limit for MSB is currently 6 lakh crore MSB during demonetisation - After demonetisation, huge deposits were put into the banking system. At the same time, banks can't lend it to customers as it is just temporary money. The RBI has instructed banks to keep all the additional deposits as CRR. But here, the banks will suffer losses as they have to pay interest to the depositors. - To compensate banks, the MSS policy is revived. Here, banks can put the excess money obtained from deposits in MSBs. They can get an interest payment as well.
Sterilization/Forex Swap	Details in Exchange Rate
Qualitative Tools	
Moral Suasion	a credit control method of the RBI. Moral Suasion means the use of compulsion or informal suggestion by the RBI on Commercial banks for the condition of Credit Policy. RBI here uses its commanding power over commercial banks to implement the credit policy.
Margin Requirements/LTV	It refers to the % money lent against specified collateral. Eg. If margin requirement is 20% then a person keeping 100 crores worth collateral with the bank can secure a loan worth 80 crores only.
Selective credit Control	Under this RBI can instruct banks to favour loans to specific sectors to make loans difficult in specific sectors. These controls are used to influence specific types of credit for particular purposes
PSL	- Priority Sector Norms - Directing banks to lend a certain fixed percentage of their loans to certain sections of society
Monetary Policy making in India	
7 Ages of MPC in India	1935-49 Exchange rate was the nominal anchor 1949-69 Monetary Policy in sync with the Five-Year Plans 1969-85 Credit Planning 1985-98 Monetary Targeting 1998-2015 Multiple Indicators Approach 2013-16 Preconditions Set for Inflation Targeting 2016 Onwards Flexible Inflation Targeting For more info: https://www.rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=1092
MPC	Background - Based on Urjit Patel Committee Report - Through amendment of RBI Act, 1935

	Composition <table><tr><th>RBI [3 Members]</th><th>Government [3 Member]</th></tr><tr><td> - Tenure tied with their ex-officio job tenure - RBI Gov: Chairman - DG, Monetary Policy 1 Member nominated by RBI central Board </td><td> 4 years, - No re-appointment - Selected by Search cum selection committee headed by IAS </td></tr></table> Terms - Meeting quorum: 4 Members - Min 4 meeting per year. In practice, meet every 2 months - Decision by Majority votes. RBI gov has casting vote - Target: 4% +-2%. They fail their target if not maintain for 3 consecutive quarters - Publish Monetary Policy Report every 6 months	RBI [3 Members]	Government [3 Member]	- Tenure tied with their ex-officio job tenure - RBI Gov: Chairman - DG, Monetary Policy 1 Member nominated by RBI central Board	4 years, - No re-appointment - Selected by Search cum selection committee headed by IAS								
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Monetary Policy transmission	It is essentially the process through which the policy action of the central bank is transmitted to the ultimate objective of stable inflation and growth.												
Why Monetary Transmission is poor	<table><tr><th>Issue</th><th>Explanation</th><th>Suggested Measures</th></tr><tr><td>Rigidity in savings deposit interest rate:</td><td> - Around 58% of the total deposits are term deposits and 77% of the term deposits are for 1 year and above. Most of the term deposits have fixed interest rate which means the transmission is effective only for fresh deposits. - Besides, banks have no incentive to decrease the deposit rate with the decrease in repo rate due to high operating expenses of savings accounts and already stressed balance sheets. </td><td> - Linking repo rate with deposit rate can address the issue and some banks are currently moving towards this system. High dependency on bank deposits for lending has resulted into interest-rate stickiness. - Banks can move over to a variable interest rate structure on longer term deposits. Banks also need to look at other sources to fund lending such as issuance of debentures/commercial papers and borrowings from the capital market. </td></tr><tr><td>Deterioration in the health of the banking sector:</td><td> - Effective monetary transmission is impeded by weak balance sheets due to low loss-absorption capacity to deal with troubled loans. - Increased cost of funds and liquidity crunch due to high NPAs impact bank's profitability, further impacting transmission. </td><td> - Initiatives like Insolvency Banking Code (IBC), NBFC regulations, Prompt Corrective Action (PCA) framework for PSU banks along with increased liquidity in the system has given a chance to banks to recover and transmit the benefit to its customers. </td></tr><tr><td>Competition from other financial saving instruments:</td><td> - With an increased risk appetite, financial literacy, good performance of stock markets and well-structured products, households are diverting a part of their savings to risky assets like mutual funds. </td><td> - In April 2016, the government decided to revise small savings rates quarterly, aligning them with the government bond yields of previous quarter. - The government reduced the interest rate on national savings schemes only by 10 bps for Jul- </td></tr></table>	Issue	Explanation	Suggested Measures	Rigidity in savings deposit interest rate:	- Around 58% of the total deposits are term deposits and 77% of the term deposits are for 1 year and above. Most of the term deposits have fixed interest rate which means the transmission is effective only for fresh deposits. - Besides, banks have no incentive to decrease the deposit rate with the decrease in repo rate due to high operating expenses of savings accounts and already stressed balance sheets.	- Linking repo rate with deposit rate can address the issue and some banks are currently moving towards this system. High dependency on bank deposits for lending has resulted into interest-rate stickiness. - Banks can move over to a variable interest rate structure on longer term deposits. Banks also need to look at other sources to fund lending such as issuance of debentures/commercial papers and borrowings from the capital market.	Deterioration in the health of the banking sector:	- Effective monetary transmission is impeded by weak balance sheets due to low loss-absorption capacity to deal with troubled loans. - Increased cost of funds and liquidity crunch due to high NPAs impact bank's profitability, further impacting transmission.	Initiatives like Insolvency Banking Code (IBC), NBFC regulations, Prompt Corrective Action (PCA) framework for PSU banks along with increased liquidity in the system has given a chance to banks to recover and transmit the benefit to its customers.	Competition from other financial saving instruments:	With an increased risk appetite, financial literacy, good performance of stock markets and well-structured products, households are diverting a part of their savings to risky assets like mutual funds.	- In April 2016, the government decided to revise small savings rates quarterly, aligning them with the government bond yields of previous quarter. - The government reduced the interest rate on national savings schemes only by 10 bps for Jul-
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Sep 2019. To strengthen monetary transmission, the government needs to pro-actively peg the small savings rate with the G-sec bond yields.

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INDUSTRIAL REVOLUTIONS



1765
1st revolution

MECHANIZATION
led by the steam engine



1870
2nd revolution

MASS PRODUCTION
driven by electricity and oil-based power



1969
3rd revolution

AUTOMATED PRODUCTION
supported by electronics and information technologies



Today
4th revolution

NEW TECHNOLOGIES
Internet of Things (IoT), Artificial Intelligence (AI); Big Data, Cloud, Cyber-Physical Systems...

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