The Barter System

- In the early history of mankind, money as a medium of exchange was not utilized.
- Exchange of goods was infrequent as households were largely self-sufficient.
- When exchanges did occur, they were conducted through barter—i.e., the exchange of goods for other goods.

Advantages of the Barter System

- **Simplicity**: The barter system is straightforward and uncomplicated, involving direct trade without the need for money.

- **No Money Involvement**: Individuals produce and consume only what they need, avoiding issues of under or overproduction.
- **No Exchange Rate Control**: The value of exchanged goods depends on the traders' negotiations, with no standardized exchange rates.
- **No Foreign Exchange Issues**: Barter allows for trade with any entity, similar to domestic market transactions.

Disadvantages of the Barter System

- **Double Coincidence of Wants**: For a trade to occur, both parties must want what the other offers. For example, if someone has a cow and wants clothes, finding someone who has clothes and wants a cow is challenging.

- **High Search and Transaction Costs**: Locating a suitable trading partner and negotiating terms can be time-consuming and costly.
- **Storage of Perishable Goods**: Perishable items lose value over time, making storage a significant issue.
- **Lack of Specialization and Division of Labour**: The barter system does not encourage specialization, which can limit productivity and efficiency.
- **Fungibility Problems**: Goods do not always have an equal value, and without a standard measure, equitable trade can be difficult.

Evolution to a System of Payments

To address these problems, early humans developed systems of payment and exchange that incorporated certain features:

- **Unit of Account**: Goods and services could be measured in standardized units.
- **High Liquidity**: The medium of exchange could be easily traded and used.
- **Storage**: The instrument used for trade could be stored without loss of value.

- **Universal Demand**: It needed to be widely accepted and desired by everyone.
- **Ease of Exchange**: The medium of exchange should facilitate easy transactions.

Evolution of Money

Commodity Money

- **Early Commodities**: Initially, commodities like arrows, bows, and sea shells, which were commonly needed, served as the first forms of money.
- **Agricultural Shift**: As societies transitioned from hunting to agriculture, animals such as cattle, goats, and sheep began to function as money.
- **Limitations**: Commodity money had limitations including a lack of a standardized unit of account, limited supply, and dependency on natural factors. These limitations eventually led to the development of other forms of money.

Metallic Money

- **Gold and Silver**: Early metallic money primarily consisted of gold and silver.
- **Advantages**:

- **Ease of Handling**: Metal coins were easy to handle and store.
- **Durability**: They did not deteriorate over time.
- **Scarcity**: The right degree of scarcity made them valuable and suitable as a medium of exchange.

- **Coinage System**: With advancements in technology, metal was minted into coins, which became widely used.
  - **Full Bodied Coins (Ancient Times)**: Coins whose intrinsic value (value of the metal) was equal to or greater than their face value.
  - **Token Coins (Modern Times)**: Coins with intrinsic value less than their face value.
    - **Challenge**: Debasement, or decreasing the metal content in coins, often occurred during times of financial distress (e.g., during the reigns of Aurangzeb and Roman emperors).
    - **Modern Coins**: Token coins made from materials like cupronickel to prevent melting, with regulations like the Coinage Act of 2011 prohibiting the melting of coins.

Paper Money

- **Introduction of Fiat Money**: With the rise of state and political structures, paper money emerged. This money has no intrinsic value but is backed by government guarantees, known as fiat money.
- **Bank Notes**: Over time, paper money evolved into bank notes issued by central banks.
- **Bank Deposits**: The latest form of money evolution includes demand deposits, which are held in commercial banks and offer high liquidity.
- **Government Issuance**: Government issues coins up to ₹1,000 under the Coinage Act 2011.
    - **₹1 Note**: Signed by the Finance Secretary and does not include "I promise to pay the bearer..."
- **RBI Issuance**: The Reserve Bank of India (RBI) issues currency notes above ₹1, signed by the Governor with the promise to pay the bearer.

Legal Tender Money

- **Legal Tender**: Money that must be accepted for the settlement of monetary obligations.
    - **Limited Legal Tender Money**: Must be accepted up to a certain limit (e.g., coins).

- **Unlimited Legal Tender Money**: Can be used for any amount (e.g., bank notes).

- **Decimal System**: The Indian currency system was decimalized by the Indian Coinage Act, 1955, effective from April 1, 1957. The previous system of Rupees, Annas, and Paisa was replaced by the Rupee and Paise system (1 Rupee = 16 Annas, 1 Anna = 12 Paise).

Non-Legal Tender Money

- **Optional Money**: Money that is not legally required to be accepted, also known as fiduciary money.
  - **Examples**: Nepalese currency at the India-Nepal border may be used but is not legally compulsory for acceptance.
  - **Fiduciary Money**: Money accepted based on trust between payer and payee, such as cheques, which are not backed by government orders but by trust.

Functions of Money

Money serves several key functions in an economy. The four main functions are:

1. **Medium of Exchange**: Money facilitates the buying and selling of goods and services. It eliminates the need for a double coincidence of wants, which is a major limitation of barter systems.

2. **Unit of Account**: Money provides a common measure of value for goods and services, allowing individuals to compare prices and keep track of costs. It simplifies the process of setting and comparing values.

3. **Store of Value**: Money preserves value over time, allowing individuals to save and store wealth. It provides a way to transfer purchasing power from the present to the future.

4. **Standard of Deferred Payment**: Money allows for the settlement of debts and future payments. It facilitates credit transactions by providing a consistent standard for repayment.

Additional Facts

- **Historical Coinage**: The Indo-Greeks were the first rulers in India to issue coins, including gold, silver, copper, and nickel. They were also the pioneers in minting gold coins.
- **Gupta Era**: The Gupta Empire issued the largest number of gold coins in ancient India.

Redenomination

- **Definition**: Redenomination involves removing zeros from a currency's face value to simplify transactions during periods of high inflation. This process changes the nominal value of the currency but does not immediately withdraw old currency from circulation.

- **Implementation**: Old currency continues to be used alongside the new currency, and people have the option to switch to the new currency. Redenomination is different from demonetization, which involves the withdrawal of old currency from circulation.
- **Limitations**: Redenomination does not address the underlying inflation problem as it does not increase the supply of goods or adjust salaries. Therefore, purchasing power remains proportionally the same.
- **Recent Example**: In Iran, the Toman was introduced to replace the Iranian Rial.

Checks | Digital Payment | Interoperability | NPCI | PPIs

Cheque and Demand Draft (DD)

Cheque

A cheque is a written, dated, and signed document that instructs a bank to pay a specific sum of money to the bearer or a designated recipient.

- **Parties Involved**:
  - **Drawer**: The person or entity who writes the cheque (sender).
  - **Drawee**: The bank that is directed to pay the amount (the bank).

- **Payee**: The individual or entity who receives the payment (recipient).

- **Types of Cheques**:
  - **Stale Cheque**: A cheque that has not been presented for payment within three months from the date of issue.
  - **Post-dated Cheque**: A cheque that is dated for a future date and cannot be cashed until that date arrives.

- **Types of Endorsements**:
  - **Open/Bearer Cheque**: A cheque that does not have any crossing and can be encashed by anyone who presents it.

- **Identification Codes**:
  - **IFSC Code**: Indian Financial System Code. An 11-digit alphanumeric code that identifies the specific branch of a bank, similar to how a PIN code identifies a geographic area.
  - **MICR Code**: Magnetic Ink Character Recognition. A 9-digit code printed in iron oxide ink that helps in the automated clearance of cheques. Not all banks use this system.

- **Cheque Truncation System (CTS-2010)**:

- **NPCI's CTS-2010**: An electronic system where a scanned image of the cheque is sent to the drawee branch for faster clearance, reducing the need for physical transport and preventing theft or tampering. MICR readers are not required for this system.

Demand Draft (DD)

- **Definition**: A Demand Draft is a financial instrument used for making payments. It is a prepaid cheque issued by a bank that cannot be dishonored because the sender must deposit the amount with the bank before the DD is issued.

Overdraft

- **Definition**: An overdraft occurs when a person withdraws more money from their account than is available, effectively receiving a short-term loan from the bank.
- **Features**:
    - **Pradhan Mantri Jan-Dhan Account**: Provides an overdraft facility of up to ₹10,000 under certain conditions.
    - **Purpose**: Overdrafts are primarily used for short-term operating expenses.

Electronic Orders / Digital Payment

Payment & Settlement Systems Act, 2007

- **Overview**: This Act empowers the Reserve Bank of India (RBI) to regulate electronic payment systems and services, including online money transfers, card payments, and payment apps.

Core Banking Solution (CBS)

- **Definition**: CBS is a banking system that allows banks to offer a range of customer-centric services from a single location, available 24x7.
- **Features**:
  - **Access**: Customers can access their accounts from any branch, regardless of where their account was originally opened.
  - **Coverage**: Almost all branches of commercial banks and Regional Rural Banks (RRBs) are integrated into the core banking system.
  - **Example**: E-Kuber by RBI.

Decentralized Payment Systems

- **Overview**: These systems include Real-Time Gross Settlement (RTGS) and National Electronic Funds Transfer (NEFT), among others that the RBI may decide upon.
  - **NEFT (National Electronic Funds Transfer)**:
    - **Introduced**: 2005

    - **Transaction Limits**: No maximum limit for transactions.
    - **Settlement**: Transactions are processed in batches on a half-hourly basis.
    - **Usage**: Suitable for transactions of smaller values.
    - **Availability**: 365 days, 24x7.
    - **Charges**: No charge.
  - **RTGS (Real-Time Gross Settlement)**:
    - **Introduced**: 2004
    - **Transaction Limits**: Minimum amount of ₹2 lakhs; no maximum limit.
    - **Settlement**: Funds are settled instantly and in real-time.
    - **Usage**: Ideal for high-value transactions.
    - **Availability**: 365 days, 24x7.
    - **Charges**: No charge.

Immediate Payment Service (IMPS)

- **Overview**: IMPS provides real-time electronic payment services.
- **Features**:

 - **Minimum/Maximum Limit**: Minimum ₹1; Maximum ₹2 lakh.
 - **Availability**: 365 days, 24x7.
 - **Charges**: Decided by individual banks.

National Payments Corporation of India (NPCI)

Overview

- **Establishment**: NPCI was founded in 2008 with the support of the Reserve Bank of India (RBI) and the Indian Banks' Association (IBA) under the Payment & Settlement Systems Act, 2007.

- **Incorporation**: NPCI is a "Not for Profit" company under Section 8 of the Companies Act, 2013.
- **Objectives**:
  - To consolidate and integrate various payment systems into a standardized nationwide process.
  - To provide affordable payment mechanisms to benefit the common man and promote financial inclusion.

NPCI Products and Services

- **Bharat Bill Payment System (BBPS)**: Facilitates automated monthly payments for utility bills (e.g., gas, electricity).

- **National Automated Clearing House (NACH)**: A web-based system for high-volume, electronic transactions, including subsidies, dividends, salaries, and pensions.
- **National Financial Switch (NFS)**: Manages the ATM network and supports services like IMPS, UPI, and BHIM.
- **Unified Payments Interface (UPI)**:
  - **Introduction**: Launched in 2016, UPI is an advanced version of Immediate Payment Service (IMPS) that offers round-the-clock funds transfer.
  - **Features**:
    - Merges multiple bank accounts into a single mobile app.
    - Supports QR code scanning for merchant payments.
    - Allows linking of Current Accounts (CA), Savings Accounts (SA), and Overdraft Accounts.
  - **Top UPI Apps**: PhonePe, Paytm, Google Pay, Amazon Pay, and BHIM.
  - **Current Limits**:
    - Users can make up to 20 transactions or ₹1 lakh per day.

  - Specific categories like capital markets and insurance have a higher limit of ₹2 lakh.
  - ASBA IPO and retail direct schemes have a limit of ₹5 lakh per transaction.
  - Banks and apps may set their own transaction limits; for instance, PNB and Bank of Baroda have limits of ₹25,000 and ₹50,000, respectively, and some apps may have a limit of ten transactions per day.

- **Bharat Interface for Money (BHIM)**:
  - **Introduction**: Launched in 2016, BHIM works on Android and iOS/Apple phones, as well as on basic feature phones via *99# USSD.
  - **Features**: Supports bank-to-bank and peer-to-peer transactions with a three-factor authentication system.
- **BharatQR**:
  - **Introduction**: A QR code system that works with all UPI-based apps and BHIM.
  - **Interoperability**: Ensures compatibility across different payment apps.
- **RuPay**:

- **Introduction**: Launched in 2016, RuPay is India's own payment gateway, making it the world's 7th payment gateway.
- **Aadhaar Enabled Payment System (AEPS)**:
  - **Uses**: Facilitates Direct Benefit Transfers (DBT) for schemes like MNREGA wages, LPG subsidies, and scholarships.
  - **Bankmitra-MicroATM**: Required for the MicroATM system.
- **National Electronic Toll Collection (NETC)**:
  - **Function**: Supports the FASTag toll collection system with backend technological support.

Prepaid Payment Instruments (PPIs)

Overview

- **Regulation**: Set up under the Companies Act of 2013.
- **Function**: Facilitate the purchase of goods and services, including financial services and remittance facilities, against the value stored on the instrument.

Types of PPIs

1. **Closed System PPIs**

- **Definition**: Issued by an entity for purchasing goods and services only from that entity.
- **Restrictions**: Do not allow cash withdrawal.
- **Regulation**: Do not require RBI approval for operation.

2. **Semi-closed System PPIs**
   - **Definition**: Issued by banks (approved by RBI) and non-banks (authorized by RBI) for use at specific merchant locations that have a contract with the issuer.
   - **Usage**: Limited to purchase of goods and services at merchant locations affiliated with the issuer.

3. **Open System PPIs**
   - **Definition**: Issued only by banks (approved by RBI).
   - **Usage**: Can be used at any merchant for the purchase of goods and services.
   - **Features**: Allows cash withdrawal at ATMs, Point of Sale (PoS) terminals, and Business Correspondents (BCs).

Forms of PPIs

- **Smart Cards**: Embedded with microchips.
- **Magnetic Stripe Cards**: Contain a magnetic strip for data storage.
- **Internet Accounts and Wallets**: Used online for transactions.

- **Mobile Accounts and Wallets**: Accessible via mobile phones.
- **Paper Vouchers**: Physical vouchers used for transactions.

Credit & Debit | Tokenization | NCMC | FASTag | ATM | MDR | PIDF | Digital Transactions Ombudsman | Cryptocurrency | CBDCs

Credit and Debit Cards (Plastic Money)

Credit Card

- **Function**: Allows the cardholder to borrow funds up to a credit limit from the issuing financial institution. Cardholders are expected to repay the borrowed amount with interest as per the institution's terms.
- **Usage**: Acts like a short-term loan for purchases.
- **Billing**: Monthly statement with the total amount due; cardholders can pay the minimum due or the full amount.

Debit Card

- **Function**: Allows the cardholder to spend funds directly from their own bank account.
- **Usage**: Only as much as the available balance in the account.
- **Billing**: No interest charges as funds are directly deducted from the account.

Card Types Based on Security Features

1. **Magnetic Card**
   - **Technology**: Uses a magnetic stripe to store data.
   - **Security Issues**: Data on the stripe can be cloned or skimmed, leading to fraud.
   - **Regulation**: RBI mandated migration to more secure cards from January 1, 2019, due to security concerns.
2. **EMV Card**
   - **Full Form**: Europay, Mastercard, and Visa chip infrastructure.
   - **Technology**: Contains a chip that encrypts data, providing enhanced security.
   - **Transaction Process**: Slower compared to magnetic cards as the chip communicates securely with the payment processor.
   - **Security Advantage**: Generates a unique transaction code for each purchase, which cannot be reused, reducing the risk of counterfeit fraud.

Tokenization

- **Concept**: Replaces card details with a unique code (token) for each transaction.

- **Function**: The token is used at Point of Sale (POS) terminals and QR code payment systems instead of the actual card details.
- **Purpose**: Enhances security by ensuring that sensitive card information is not exposed during transactions.
- **Implementation**: Approved by RBI in 2019 to improve the safety of digital payments.

Dominant Companies in Card Transactions in India

1. **Visa**
   - **Market Presence**: One of the leading payment card networks globally and in India.
2. **Mastercard**
   - **Market Presence**: Another major player in the global and Indian card transaction market.
3. **RuPay**
   - **Market Presence**: India's domestic payment card network, introduced by NPCI.
4. **American Express**
   - **Market Presence**: Offers credit card services, known for its premium services and global reach.
5. **Discover**

- Market Presence: Although less common in India, it is a significant player globally.

National Common Mobility Card (NCMC) / One Nation One Card

- **Function**: An interoperable transport card that allows users to pay for various services such as bus travel, toll taxes, parking charges, retail shopping, and even withdraw money.
- **Technology**: Operates on the RuPay card network and supports both online (contact and contactless) and offline (contactless) transactions.
- **Components**:
  - **SWEEKAR**: Automatic Fare Collection System.
  - **SWAGAT**: Swachalit / Automated Gate.
- **Recommendation**: Recommended by the Nandan Nilekani committee set up by the Reserve Bank of India (RBI).

FASTag

- **Function**: Prepaid rechargeable tags that enable automatic toll collection at electronic toll collection gates using Radio-Frequency Identification (RFID) technology.
- **Operation**: Affixed to the vehicle’s windscreen, allowing it to pass through toll plazas without stopping.

- **Validity**: Valid for five years and can be recharged as needed.
- **Management**: Operated by the National Highway Authority of India (NHAI), with payments collected by the National Payments Corporation of India (NPCI) under the National Electronic Toll Collection (NETC) programme.

Objectives of the National Electronic Toll Collection (NETC) System

- **Interoperability**: Create a composite and interoperable ecosystem for toll collection across the country.
- **Security and Transparency**: Provide a secure framework that enhances transparency and efficiency in transactions.
- **Environmental and Economic Benefits**:
  - Reduce air pollution and fuel consumption by minimizing congestion around toll plazas.
  - Reduce cash handling.
  - Enhance audit control by centralizing user accounts.

ATM (Automated Teller Machine)

- **Function**: Allows bank customers to withdraw money or check their account balance without visiting a branch.
- **Network**: Operates on the National Financial Switch (NFS) managed by NPCI.

Types of ATMs

1. **Bank-Owned ATM**: Operated and managed by the bank itself.
2. **Brown Label ATM**: Owned by a bank but operations (such as cash refilling and security) are outsourced to third-party service providers.
3. **White Label ATM**: Owned and operated by non-bank entities.
4. **Micro-ATM**: Used by Bankmitras for manual entries of deposits and withdrawals using handheld devices and Aadhaar biometrics, with backend support from NPCI's AEPS (Aadhaar Enabled Payment System) technology.

Merchant Discount Rate (MDR)

- **Definition**: MDR is the fee that a merchant must pay to their acquiring bank for every credit or debit card transaction. It is typically shared among three parties:
  1. The customer's card issuing bank
  2. The merchant's acquiring bank
  3. The payment gateway provider
- **Impact**: MDR affects merchants' profit margins and can discourage them from adopting Point of Sale (PoS) terminals, which can be an obstacle to the growth of the digital economy.

Recent Developments

- **MDR Waiver**: The government has mandated that neither customers nor merchants will have to pay MDR for digital payments made using BHIM UPI, UPI QR Code, Aadhaar Pay, Debit Cards, NEFT, RTGS, and other similar methods. The RBI and banks will absorb this cost.

Payments Infrastructure Development Fund (PIDF)

- **Established**: June 2020
- **Funding**: ₹500 crore (₹250 crore from RBI and ₹250 crore from banks and card gateway operators)
- **Objective**: To provide funding or subsidies to encourage the adoption of PoS card swiping machines in small towns, villages, and North Eastern states.

Digital Transactions Ombudsman (DTO)

- **Role**: RBI designates senior officials as DTOs across 21 locations in India.
- **Function**:
  - Hear customer complaints up to ₹20 lakh related to prepaid payment instruments, mobile wallets, apps, NEFT/RTGS, and other digital transactions.
  - Can order companies or banks to resolve issues and pay up to an additional ₹1 lakh for mental anguish.

- Matters exceeding ₹20 lakh are outside the DTO's jurisdiction and must be taken to ordinary or consumer courts.

Cryptocurrency

- **Definition**: A digital or virtual currency created and stored using blockchain technology.
- **Blockchain**: A secure, decentralized database that maintains a growing list of records or transactions. It's primarily used for cryptocurrency networks and ensures transparency and immutability of records.
- **Origin**: Created in response to dissatisfaction with fiat money and traditional banking systems, particularly after the subprime crisis of 2007.
- **Bitcoin**: Launched in 2009 by the pseudonymous Satoshi Nakamoto. It has a total supply cap of 21 million coins, with 1 Bitcoin (BTC) divided into 108 Satoshis (the smallest unit).
- **Other Cryptocurrencies**: Ethereum, Litecoin, Ripple, etc.
- **Legal Status**: Initially banned in India, but the ban was lifted by the Supreme Court of India.

Digital Currencies vs. Cryptocurrencies

- **Centralization**:

- **Digital Currencies**: Centralized, with transactions regulated by a central authority such as a bank.
- **Cryptocurrencies**: Mostly decentralized, with regulations governed by the community. Some cryptocurrencies are centrally controlled by their founding organizations.

- **Transparency**:
  - **Digital Currencies**: Transactions are not transparent and are kept confidential.
  - **Cryptocurrencies**: Generally transparent, with transactions recorded on the blockchain. Privacy coins, however, aim to keep transactions confidential.

- **Authority**:
  - **Digital Currencies**: Managed by a central authority that can address issues and freeze transactions.
  - **Cryptocurrencies**: Regulated by their respective communities, with decentralized governance.
- **Stability**:
  - **Digital Currencies**: Stable and traded with markets.
  - **Cryptocurrencies**: Highly volatile, influenced by consumer sentiment and psychological factors in price movement.

Central Bank Digital Currencies (CBDCs)

- **Definition**: CBDCs are digital versions of a country's fiat currency issued and regulated by the central bank. Unlike private virtual currencies, which derive their value from trading and ownership dynamics, CBDCs hold the same value as traditional money issued by the central bank.
- **Characteristics**:
  - **Digital Payment Instrument**: CBDCs are denominated in national currency and represent a digital equivalent of physical cash.
  - **Issued by Central Banks**: Only central banks have the authority to issue CBDCs, ensuring that they are backed by the national currency's value.
  - **Blockchain Technology**: CBDCs are generally based on blockchain technology, which provides a secure and transparent framework for digital transactions.
  - **Transaction Capabilities**: CBDCs enable users to perform both domestic and cross-border transactions directly, potentially bypassing traditional intermediaries like banks.

Key Features and Benefits

1. **Secure and Efficient Transactions**: By using blockchain technology, CBDCs can offer secure and efficient transaction processing.
2. **Financial Inclusion**: CBDCs can enhance financial inclusion by providing access to digital payments for unbanked and underbanked populations.
3. **Reduced Transaction Costs**: CBDCs could lower transaction costs by minimizing the need for intermediaries.
4. **Cross-Border Transactions**: They can facilitate easier and more cost-effective cross-border transactions by streamlining processes and reducing reliance on correspondent banking systems.

Central Bank vs. Private Cryptocurrencies

- **Value Basis**:
  - **CBDCs**: The value of a CBDC is equivalent to the fiat currency it represents, ensuring stability and predictability.
  - **Private Cryptocurrencies**: The value of cryptocurrencies is driven by market demand, supply, and trading dynamics, often leading to high volatility.
- **Regulation**:
  - **CBDCs**: Issued and regulated by central banks, adhering to the nation's monetary policy and financial regulations.

- **Private Cryptocurrencies**: Operate in a decentralized manner with varying degrees of regulatory oversight, often leading to regulatory challenges.

- **Centralization**:
  - **CBDCs**: Centralized, with control and issuance managed by the central bank.
  - **Private Cryptocurrencies**: Often decentralized, governed by a distributed network of participants.

Money: Demand, Supply & Creation

Demand for Money: Liquidity Preference Theory

The demand for money refers to the desire to hold money rather than other assets. According to British economist John Maynard Keynes, people have different motives for holding money, which he explained through his **Liquidity Preference Theory** in his book *The General Theory of Employment, Interest, and Money* (1936).

Motives for Holding Money

1. **Transaction Motive**:
   - **Purpose**: Money is held for day-to-day transactions, such as buying goods and services.

- **Example**: Keeping cash on hand to purchase groceries or pay for transportation.

2. **Precautionary Motive**:
   - **Purpose**: Money is held as a precaution against unexpected expenses or emergencies.
   - **Example**: Saving money for medical emergencies or sudden repairs.
3. **Speculative Motive**:
   - **Purpose**: Money is held to take advantage of future investment opportunities or to avoid losses from falling asset prices.
   - **Example**: Holding cash to buy assets like gold or real estate when their prices are expected to decrease.

Interest Rates and Demand for Money

- **High Interest Rates**: As interest rates rise, holding cash becomes less attractive because it does not earn interest. Therefore, people are less inclined to hold large amounts of money and prefer to invest in interest-bearing assets. This leads to a decrease in the demand for money.
- **Low Interest Rates**: Conversely, when interest rates are low, the opportunity cost of holding money is reduced, making it

more attractive to hold cash rather than invest in interest-bearing assets.

Negative Interest Rates

- **Concept**: In a negative interest rate environment, depositors are charged to keep their money with banks rather than earning interest.
- **Effect**: This policy is intended to encourage spending and investment rather than saving, as holding money incurs a cost.

Liabilities of Banks

Banks have various types of liabilities, categorized based on their nature and the terms of repayment.

Time Liabilities of a Bank

- **Definition**: These are liabilities that banks are not required to pay immediately and are typically fixed in duration.
- **Examples**:
  - **Fixed Deposits**: Funds deposited for a specific term with a fixed interest rate.
  - **Cumulative/Recurring Deposits**: Deposits with regular contributions and maturity benefits.
  - **Staff Security Deposit**: Funds deposited by staff members for security purposes.

- **Characteristics**:
  - **Less Liquidity**: These deposits are less liquid as they cannot be withdrawn before maturity without penalties.
  - **Higher Returns**: Generally offer higher interest rates due to their fixed term.

Demand Liabilities of a Bank (CASA)

- **Definition**: These are liabilities that can be withdrawn on demand.
- **Examples**:
  - **Current Accounts**: Accounts with no interest, used for regular transactions.
  - **Savings Accounts**: Accounts offering interest but allowing withdrawals.
  - **Demand Drafts**: Instruments for transferring money between banks.
- **Characteristics**:
  - **More Liquidity**: These deposits are highly liquid, allowing easy access to funds.
  - **Lower Returns**: Typically offer lower interest rates compared to time liabilities due to their immediate accessibility.

Assets of Banks

Banks' assets are resources they own and can use to generate income. Here are the key categories:

1. **Physical Assets**:
   - **Definition**: Tangible assets like land, buildings, furniture, and equipment.
   - **Characteristics**: Generally minor in terms of financial value compared to other assets.
2. **Cash**:
   - **Definition**: Money held by the bank for daily operations, such as withdrawals and cheque processing.
   - **Characteristics**: Essential for liquidity and immediate transactions.
3. **Interest on Loans**:
   - **Definition**: Earnings from interest on loans provided to customers.
   - **Characteristics**: A major source of revenue for banks, as it often exceeds the interest paid on savings accounts.
4. **Investments**:

- **Definition**: Investments in government securities, treasury bills, and other financial instruments.
- **Characteristics**: Provides returns and helps in managing liquidity.

Monetary Aggregates

Monetary aggregates are metrics used to measure the money supply within an economy. The Reserve Bank of India (RBI) tracks these aggregates to monitor economic conditions. Here's how they are defined:

1. **M1 (Narrow Money)**:
   - **Components**:
     - **C**: Currency held by the public.
     - **DD**: Demand Deposits with banks (Current Account, Savings Account).
   - **Characteristics**: Includes highly liquid assets, providing a narrow view of money supply.
2. **M2**:
   - **Components**:
     - **M1**: As defined above.
     - **Savings Account Deposits with Post Offices**.

   - **Characteristics**: Includes more types of liquid assets than M1 but excludes Time Deposits.

3. **M3 (Broad Money)**:
   - **Components**:
     - **M1**: As defined above.
     - **TD**: Time Deposits with Banks (Fixed Deposits, Recurring Deposits, and Time Liabilities of Savings Accounts).
   - **Characteristics**: Widely used measure for tracking money supply; includes a broader range of liquid and semi-liquid assets.

4. **M4**:
   - **Components**:
     - **M3**: As defined above.
     - **Total Deposits with Post Offices**.
   - **Characteristics**: Very similar to M3, as deposits with post offices are relatively negligible.

Important Terms

1. **Liquidity**:
   - **Definition**: The ease with which an asset can be converted into cash without affecting its price.

- **Highly Liquid Assets**: Cash, demand deposits, government securities (G-Sec), and bonds of reputed companies.
- **Relatively Illiquid Assets**: Real estate, art, collectibles, which may require time to sell and may not always fetch the expected price.

2. **Liquidity Injection/Infusion**:
   - **Definition**: The process where the central bank (e.g., RBI) buys financial assets from banks or non-banking financial companies (NBFCs) to provide them with cash.
   - **Purpose**: To enhance liquidity in the banking system, especially during times of economic stress or to stimulate the economy.

Reserve Money (M0)

Reserve Money, also known as **central bank money**, **monetary base**, or **high-powered money**, is the base level of money in an economy. It represents the foundational component of the money supply.

Definition:

- **Reserve Money (M0)**: Currency in Circulation + Deposits of Commercial Banks with RBI

Components:

1. **Currency in Circulation**: All the physical currency (notes and coins) in the hands of the public and held by banks.
2. **Deposits of Commercial Banks with RBI**: Reserves that commercial banks hold with the Reserve Bank of India.

Issued Under:

- Issued under the RBI Act by RBI's Issue Department. The assets of the Issue Department must match its liabilities.

Assets of the Issue Department:

- **Rupee Coins**: Purchased from the government and circulated by RBI.
- **Gold Coins**: Minimum value of ₹200 crores.
- **Gold Bullion**: Minimum value of ₹115 crores.
- **Foreign Securities**: Including IMF (Earlier minimum ₹400 crores; no requirement post-1995).
- **Indian Government Securities**: Representing government borrowing from RBI, which must be repaid with interest.

Liabilities of the Issue Department:

- **Currency Notes**: Includes all currency notes in circulation.
- **Vault Cash**: Cash held by banks for day-to-day operations.
- **Other Deposits**: Deposits of the public, banks, and governments with RBI.

Factors Affecting Money Supply (M1, M3)

Money Supply Increases When:

1. **Money Multiplier and Velocity of Money Increase**:
   - **Money Multiplier**: The amount of money banks generate with each unit of reserves.
   - **Velocity of Money**: The rate at which money changes hands in the economy.
2. **RBI's Asset Side Increases**:
   - **Government Borrowing**: Increased borrowing by the government using G-secs or increasing RBI's foreign securities.
3. **Increased Banking Penetration**:
   - **Financial Inclusion**: More people have access to banking services.
   - **Formalization of Economy**: More economic activities are recorded formally.
4. **Economic Boom**:
   - **Increased Loan Demand**: Higher demand for loans can lead to increased money supply.
5. **Expansionary Monetary Policy**:

- **Dovish Policy**: Policies adopted by RBI to combat deflation by making money cheaper and more accessible.

6. **Currency Deposit Ratio (CDR)**:
   - **Definition**: Ratio of money held by the public to the public's deposits in banks.
   - **Impact**: CDR increases during periods like festivals when people convert deposits to cash.
7. **Reserve Deposit Ratio (RDR)**:
   - **Definition**: Ratio of a commercial bank's vault cash to its deposits with RBI (such as CRR - Cash Reserve Ratio).
   - **Impact**: Banks keep some cash for daily operations and other business expenses.

Money Multiplier

Definition: The money multiplier describes how an initial deposit can lead to a more significant increase in the total money supply in an economy. It reflects the capacity of the banking system to expand the money supply through the process of depositing and lending.

Example:

- If commercial banks receive an initial deposit of $1 million and this deposit ultimately results in a total money supply of $10 million, the money multiplier is 10.

Mechanism:

1. **Initial Deposit**: Banks receive an initial deposit, which adds to the monetary base.
2. **Fractional Reserves**: Banks hold a fraction of the deposit as reserves (as mandated by the reserve ratio) and lend out the remaining amount.
3. **Re-depositing**: The loans made by banks are re-deposited into other banks, which leads to further lending and increases the money supply.

Impact of Reserve Ratio:

- **Higher Reserve Ratio**: Banks hold more reserves and lend out less money, resulting in a lower money multiplier. This constrains the increase in the money supply.
- **Lower Reserve Ratio**: Banks hold fewer reserves and lend out more money, resulting in a higher money multiplier. This allows a more significant increase in the money supply.

Velocity of Money Circulation

Definition: The velocity of money circulation measures how frequently money changes hands within a given time period. It is an indicator of the rate at which money is spent and re-spent in the economy.

Example:

- If you spend ₹10 to buy a pen, and the shopkeeper uses the same ₹10 note to purchase tea, the same note has facilitated transactions worth ₹20. This demonstrates the concept of velocity.

Factors Affecting Velocity:

1. **Income Distribution**: Money held by poorer individuals tends to have a higher velocity compared to money held by wealthier individuals, as poorer individuals often spend a larger portion of their income.
2. **Borrowing and Spending**: Increased borrowing and spending lead to a higher velocity of money. In developed countries, higher consumer spending and confidence in government social-security programs contribute to higher velocity.
3. **Economic Boom**: During periods of economic expansion, increased production, raw material purchases, and hiring contribute to a higher velocity of money.

Overall Relationship:

- The velocity of money provides insight into the level of economic activity and the efficiency of the money supply in stimulating economic growth. Higher velocity generally indicates more vigorous economic activity, while lower velocity may signal reduced economic activity or increased savings.

Monetary Policy

Definition: Monetary policy refers to the actions taken by a central bank, such as the Reserve Bank of India (RBI), to manage the economy by influencing interest rates, money supply, and credit availability. The primary goal of monetary policy is to ensure price stability and control inflation while supporting economic growth.

Key Instruments Used by RBI:

1. **Repo Rate**: The rate at which the RBI lends money to commercial banks. A decrease in the repo rate encourages borrowing and investment, while an increase can help control inflation by making borrowing more expensive.
2. **Reverse Repo Rate**: The rate at which the RBI borrows money from commercial banks. It helps manage liquidity and control inflation by absorbing excess money from the economy.
3. **Cash Reserve Ratio (CRR)**: The percentage of a bank's total deposits that must be kept in reserve with the RBI. Increasing CRR reduces the amount of money banks can lend, while decreasing CRR allows more money to be lent out.
4. **Statutory Liquidity Ratio (SLR)**: The percentage of a bank's net demand and time liabilities (NDTL) that must be kept in the form of liquid assets like government securities. It ensures that banks maintain a certain level of liquidity.

5. **Open Market Operations (OMOs)**: The buying and selling of government securities by the RBI to regulate the money supply. Buying securities increases the money supply, while selling securities decreases it.

Objective: The primary objective of monetary policy is to maintain price stability while supporting economic growth. Price stability is crucial for sustainable economic growth.

Inflation Target

Objective: To maintain price stability and control inflation. A stable price level supports sustainable economic growth and prevents excessive fluctuations in the economy.

Current Target:

- **Inflation Target (2021-26)**: 4% with a tolerance range of ±2%.

Failure to Achieve Inflation Target:

- **Upper Tolerance Level**: If the average inflation exceeds the upper limit of 6% for three consecutive quarters (9 months), it is considered a failure to meet the target.
- **Lower Tolerance Level**: If the average inflation falls below the lower limit of 2% for three consecutive quarters, it is also considered a failure to meet the target.

Main Objectives of Fiscal Policy in India

1. **Full Employment**: To achieve and maintain a high level of employment across the economy, ensuring that all individuals who are willing and able to work can find employment.
2. **Price Stability**: To control inflation and stabilize the price level, avoiding excessive price increases or deflation.
3. **Economic Growth Stabilization**: To manage and stabilize the growth rate of the economy, avoiding periods of boom and bust.
4. **Balance of Payments Equilibrium**: To maintain a balance between the country's international payments and receipts, avoiding large deficits or surpluses.
5. **Economic Development**: To promote economic development, especially in underdeveloped and less developed regions, ensuring equitable growth across all sectors of the economy.

Relationship Between Monetary and Fiscal Policy:

- **Monetary Policy**: Focuses on managing the money supply, interest rates, and credit to control inflation and support economic stability.
- **Fiscal Policy**: Involves government spending and taxation decisions to influence economic activity, stabilize the economy, and promote growth.

Monetary Policy - Quantitative Tools

Quantitative Tools: These tools affect the overall economy rather than specific sectors and are used to regulate the money supply and overall economic activity. Major quantitative tools include:

1. Cash Reserve Ratio (CRR)

- **Definition**: The percentage of a bank's net demand and time liabilities (NDTL) that must be kept as reserves with the RBI in cash.
- **Purpose**: Ensures that banks hold a portion of their deposits in reserve, which helps control the money supply.
- **Current Rate**: 3% of NDTL.
- **Regulation**: Mandated under the RBI Act, 1934. There is no legal minimum or maximum ceiling, but currently set at 3%.
- **Effect on Inflation**: Increasing CRR can help control inflation by reducing the amount of money available for lending. Decreasing CRR can increase the money supply.

2. Statutory Liquidity Ratio (SLR)

- **Definition**: The percentage of a bank's net demand and time liabilities (NDTL) that must be maintained in liquid assets such as cash, gold, government securities, and other approved securities.
- **Purpose**: Ensures banks have sufficient liquidity and reduces the risk of insolvency.

- **Current Rate**: 18% of NDTL.
- **Regulation**: Mandated under the Banking Regulation Act, 1949. The maximum legal limit is 40%.
- **Effect on Inflation**: Similar to CRR, increasing SLR helps control inflation by reducing the money available for lending. Decreasing SLR can increase the money supply.

Role of CRR and SLR:

- **Money Multiplier Effect**: CRR and SLR affect the money multiplier, which measures how an initial deposit can lead to a larger increase in the total money supply.
- **Bank Run Protection**: They provide a buffer during financial crises by ensuring banks have enough liquid assets to meet withdrawal demands.
- **Regulation**: Both CRR and SLR are reviewed and adjusted periodically. Banks are penalized if they fail to maintain the required ratios.

3. Bank Rate

- **Definition**: The rate at which the RBI provides loans to commercial banks without collateral.
- **Purpose**: Influences the overall level of interest rates in the economy and regulates liquidity.

- **Current Practice**: Bank rate is usually higher than the repo rate because it is used for longer-term borrowing.
- **Regulation**: Introduced under the RBI Act, 1934.

4. Liquidity Adjustment Facility (LAF)

- **Components**:
  - **Repo Rate**: The interest rate at which the RBI lends short-term funds to banks, using government securities as collateral.
  - **Reverse Repo Rate**: The interest rate at which the RBI borrows money from banks, providing government securities as collateral.
- **Purpose**: To manage liquidity in the banking system and influence short-term interest rates.
- **Effect**:
  - **Increasing Repo Rate**: Reduces money supply, helps control inflation.
  - **Decreasing Repo Rate**: Increases money supply, supports economic growth.
  - **Increasing Reverse Repo Rate**: Encourages banks to park surplus funds with the RBI, reducing money supply.

    - **Decreasing Reverse Repo Rate**: Encourages banks to lend more, increasing money supply.

5. Market Repo

- **Definition**: Short-term borrowing and lending between banks and other financial institutions, secured by collateral such as government securities.
- **Purpose**: Helps manage short-term liquidity and interest rates in the financial market.

6. Long-Term Repo Operations (LTROs)

- **Definition**: RBI's provision of long-term loans (1 year or 3 years) to banks, with government securities as collateral.
- **Purpose**: To provide long-term funding to banks at favorable rates, supporting economic growth and reducing the marginal cost of funds for banks.
- **Implementation**:
    - **Date**: Introduced in February 2020.
    - **Amount**: ₹1,00,000 crore.
    - **Interest Rate**: Prevailing repo rate, compounded annually.
- **Effect**: Lowers the cost of funds for banks, potentially reducing lending rates and stimulating economic activity.

Marginal Standing Facility (MSF) and Other Market Operations

Marginal Standing Facility (MSF)

- **Definition**: MSF is the interest rate at which the RBI provides short-term loans to Scheduled Commercial Banks (SCBs) against their Statutory Liquidity Ratio (SLR) quota government securities (G-Sec) as collateral.
- **Current Rate**: MSF rate is typically higher than the Repo Rate by 0.25%.
- **Borrowing Limit**: Banks can borrow up to 1% of their Net Demand and Time Liabilities (NDTL) under MSF.
- **Application**: Banks can apply for MSF loans on all working days except Saturdays. The minimum borrowing amount is ₹1 crore, with additional increments in multiples of ₹1 crore.

Policy Corridor

- **Definition**: The Policy Corridor represents the range between the MSF rate, the Repo Rate, and the Reverse Repo Rate.
- **Purpose**: It helps in managing the liquidity and guiding the interest rates in the economy.
- **Operations**: Managed through the RBI's E-Kuber Core Banking Solution (CBS) platform.

Market Operations

1. **Open Market Operations (OMO)**

- **Definition**: The RBI buys and sells government securities to regulate the money supply.
- **Impact**:
  - **Buying Securities**: Increases money supply and injects liquidity into the market.
  - **Selling Securities**: Decreases money supply and absorbs liquidity from the market.

2. **Market Stabilization Scheme (MSS)**
   - **Definition**: A mechanism where the RBI sells special government securities (G-sec), Treasury Bills (T-Bills), and Cash Management Bills (CMB) to absorb excess liquidity.
   - **Purpose**: To stabilize excess liquidity in the market and manage short-term fluctuations.

3. **Sterilization / Forex Swap**
   - **Definition**: Used to control currency exchange rate volatility and manage liquidity.
   - **Purpose**: To stabilize the exchange rate and control inflationary pressures.

Operation Twist

- **Definition**: A strategy where the RBI simultaneously buys long-term securities and sells short-term securities.
- **Purpose**: To lower long-term interest rates while maintaining short-term rates.
- **Mechanism**:
  - **Buying Long-Term Securities**: Increases their prices and lowers their yields.
  - **Selling Short-Term Securities**: Maintains or increases short-term yields.
- **Effects**:
  - **On Interest Rates**: Lower long-term rates make long-term loans cheaper, potentially boosting consumption and investment.
  - **On Bond Prices**: As bond prices increase, yields decrease, benefiting fixed income investors.
  - **On Economy**: Encourages borrowing and spending, which can support economic growth.

Bond Yield and Inversion

- **Bond Yield**: The effective rate of return on a bond, which varies with its price.

- **Example**: If a bond is issued at a 10% interest rate but market rates fall to 8%, the bond's price will rise above its face value, reducing its yield.

- **Yield Inversion**: Occurs when long-term bond yields are lower than short-term bond yields.
  - **Significance**: Often signals an impending recession as it reflects expectations of lower future growth and reduced demand for money.

Soft-Landing

- **Definition**: A successful monetary tightening process where the central bank reduces inflation without causing a recession. The economy slows down gradually rather than abruptly.
- **Contrast with Hard-Landing**: A hard-landing occurs when monetary tightening leads to a recession, causing significant economic disruption.

Reverse Currency Wars

- **Context**: When the US Federal Reserve raises interest rates aggressively, it attracts more investors to the US due to higher returns, making the US dollar stronger.
- **Impact on Other Currencies**: A stronger dollar makes other currencies weaker in comparison, which can boost exports from countries with weaker currencies.

- **Historical Context**: Previously, the US has accused other countries of manipulating their currencies to maintain trade surpluses, leading to so-called "currency wars."

Monetary Policy: Qualitative Tools

- **Purpose**: Qualitative tools manage the distribution of credit rather than just the volume. They focus on directing loans to specific sectors or groups rather than controlling the total money supply.
- **Examples**:
  - **Priority Sector Lending (PSL)**: Ensures that a certain percentage of loans are directed to sectors like agriculture, small industries, and housing.
  - **Loan to Value (LTV) Ratios**: Determines the maximum loan amount banks can provide relative to the value of the collateral.

Qualitative Tools Explained

1. **Moral Suasion**
   - **Definition**: Persuading banks and other financial institutions to act in line with the central bank's policy objectives without using direct regulatory or punitive measures.

- **Methods**: Conferences, informal meetings, letters, and public statements by the RBI Governor.
- **Examples**: Encouraging banks to transmit repo rate cuts, expand rural banking services, or extend credit beyond the PSL quota.

2. **Publicity**
    - **Definition**: Using media and public statements to influence behavior and create public pressure on banks and financial institutions.
    - **Methods**: Speeches, media statements, and public engagements by the RBI Governor.
    - **Purpose**: To generate public opinion that encourages banks to comply with regulatory expectations and improve practices.
3. **Direct Action**
    - **Definition**: The RBI uses its regulatory powers to enforce compliance and impose penalties.
    - **Examples**:
        - **Clawback Provisions**: Forcing executives to return bonuses if involved in fraud or misconduct.

   - **Penalties**: Imposing fines or other sanctions on banks and non-banking entities for regulatory non-compliance.

4. **Margin Requirements / Loan to Value (LTV)**
   - **Definition**: Setting limits on the amount that can be lent against a given value of collateral.
   - **Purpose**: To manage the risk associated with loans and control credit expansion.
   - **Examples**:
     - **Gold Loans**: Restricting the loan amount to a percentage of the gold's value.
     - **Home Loans**: Limiting the loan amount to a percentage of the property's value.
   - **Adjustment**: Changing the LTV ratio to either stimulate or restrain demand based on economic conditions.

Priority Sector Lending (PSL)

Definition:

- **Priority Sector Lending**: Refers to sectors deemed essential by the Government of India and the Reserve Bank of India (RBI) for national development. Banks are required to prioritize these sectors in their lending activities.

Key Points:

- **Mandate**: All scheduled commercial banks and foreign banks with a significant presence in India must allocate 40% of their Adjusted Net Bank Credit (ANBC) to priority sectors.
- **Origins**: The concept originated in 1966 to boost credit to agriculture and small industries. The formal definition was established by the RBI in 1972.
- **Post-Nationalization**: The policy enabled direct credit to focus on various sectors.
- **Deposit Insurance and Credit Guarantee Corporation (DICGC)**: Established to support bank lending to priority sectors.

Priority Sector Norms (Updated 2015):

1. **Weaker Sections**: SC, ST, Women, Physically Handicapped, Minorities, Manual Scavengers, Artisans, PMJDY overdrafts up to ₹10,000, NRLM/NULM beneficiaries.
    - **Quota**: 10%
2. **Agriculture**:
    - **General**: 10%
    - **Marginal Farmers** (up to 1 hectare); **Small Farmers** (more than 1 hectare but up to 2 hectares): 8%

3. **Micro Enterprises, Khadi and Village Industries**: 7.5%
4. **Small & Medium Enterprises, Affordable Housing Loans under Pradhan Mantri Awas Yojana, Food Processing Companies, Vermicomposting, Biofertilizer, Seed Production, Exporters, Education Loans (up to ₹10 lakh), Social Infrastructure (schools, healthcare, sanitation), Renewable Energy Projects (solar, wind, biomass, etc.), and Start-ups**: 4.5%
   - **Total PSL Requirement**: 40% for Scheduled Commercial Banks and foreign banks with 20 or more branches. Foreign banks with fewer than 20 branches also must meet the 40% PSL quota but without specific internal quotas for certain categories.
5. **Regional Rural Banks (RRBs), Small Finance Banks, and Urban Co-operative Banks**:
   - **Quota**: 75% (40% minimum PSL quota + 35% additional PSL as per the bank's discretion).

Additional Details:

- **Indirect Lending**: Loans given to Non-Banking Financial Companies (NBFCs) for PSL categories are counted towards the bank's PSL quota. Joint lending with NBFCs also qualifies.

Priority Sector Lending Certificates (PSLCs):

- **Purpose**: Allows banks to meet PSL targets by purchasing or selling PSL certificates.
- **Mechanism**: Banks with excess PSL achievement can sell PSLCs, while those with shortfalls must contribute to NABARD's Rural Infrastructure Development Fund (RIDF), SIDBI, NHB, MUDRA Ltd., etc.

Urban Infrastructure Development Fund (UIDF)

Establishment:

- **Announced**: Union Budget 2023-24.
- **Purpose**: Created from PSL shortfalls to support urban infrastructure development in Tier 2 and Tier 3 cities.

Management:

- **Managed by**: National Housing Bank (NHB).

Features:

- **Objective**: To enhance urban infrastructure, with a focus on projects with lower carbon footprints.
- **Operational Goals**:
  - Transition to mechanical desludging for septic tanks and sewers.
  - Improved scientific management of waste.

  - Incentives for improving creditworthiness for municipal bonds.

City Classification:

- **Tier II Cities**: Population between 50,000 and 100,000.
- **Tier III Cities**: Population between 20,000 and 50,000.

Rural Infrastructure Development Fund (RIDF)

Establishment:

- **Setup**: 1995-96.
- **Maintained by**: National Bank for Agriculture and Rural Development (NABARD).

Objective:

- **Purpose**: To provide loans to State Governments and State-owned corporations for ongoing rural infrastructure projects.

Repayment Terms:

- **Loan**: To be repaid in equal annual installments over seven years from the date of withdrawal, including a two-year grace period.

Monetary Policy Committee (MPC)

Overview:

- The **Monetary Policy Committee (MPC)** of the Reserve Bank of India (RBI) is responsible for formulating monetary policy to achieve the inflation target.
- **Established**: 2016 under Section 45ZB of the RBI Act.
- **Policy Rate**: The MPC primarily uses the **Repo Rate** as its policy rate. Changes in the repo rate impact the money market and influence aggregate demand, affecting inflation and growth.

Composition:

- **Members**: The MPC comprises six members.
  - **Government Nominees**: Selected by a Search-cum-Selection Committee, which includes:
    - Cabinet Secretary
    - RBI Governor
    - Economic Affairs Secretary
    - Three experts in economics, banking, finance, or monetary policy.
- **Term**: Each member serves a four-year term with no reappointment.

Decision-Making:

- **Process**: Decisions are made by majority vote.

- **Casting Vote**: The RBI Governor has a casting vote in case of a tie.
- **Quorum**: At least four members, including the Governor, are required for a quorum.
- **Meetings**: Legally, the MPC must hold at least four meetings annually, but they typically meet every two months to decide on monetary policy updates.

Policy Stances of the RBI

1. **Accommodative Stance**:
    - **Objective**: To expand the money supply and boost economic growth.
    - **Action**: Typically involves cutting interest rates.
    - **When Adopted**: When growth needs support and inflation is not a primary concern.
2. **Neutral Stance**:
    - **Objective**: Maintain a balanced approach to both inflation and growth.
    - **Action**: The central bank may either increase or decrease rates based on evolving economic conditions.
    - **When Adopted**: When inflation and growth are equally prioritized.

3. **Hawkish Stance**:
    - **Objective**: Focus on keeping inflation low.
    - **Action**: Generally involves increasing interest rates to reduce money supply and curb demand.
    - **When Adopted**: When the central bank prioritizes controlling inflation and adopting tight monetary policy.
4. **Calibrated Tightening**:
    - **Objective**: Gradual approach towards increasing rates.
    - **Action**: May involve selective rate hikes over time, not necessarily at every meeting.
    - **When Adopted**: When a gradual tightening of monetary policy is required, potentially adjusting policy outside of regular meetings based on economic conditions.