IMPACT OF RBI MONETARY POLICY ON INDIAN ECONOMY WITH SPECIAL REFERENCE TOCOVID-19 PERIOD

S. CHANDRA SEKHAR
Research Scholar
Department of Business Administration
Annamalai University, Annamalai Nagar
Tamil Nadu, India

Dr K. SREENIVASA MURTHY
Associate Professor
Department of Management
School of Commerce and Business Management
Central University of Tamil Nadu, India

ABSTRACT

The RBI's most important goal is to maintain monetary stability - moderate and stable inflation in India. The RBI uses monetary policy to maintain price stability and an adequate flow of credit. For this Indian central bank rate, repo rate, reverse repo rate and the cash reserve ratio. The banking system of India should not only be bother free but it should be able to meet new challenges posed by the technology and any other external and internal factors. Banks are important not just from the point of view of economic growth, but also financial stability. Banking sector is treated as to be the back bone of the Indian economy. The task of banking industry is particularly essential as one of the leading and frequently essential service sectors. The banking sector, being the indicator of the economy, is reflective of the macro-economic variables. While the Indian economy is yet to grab strength, the Indian banking system continues to deal with improvement in asset quality, execution of sensible risk management practices and capital adequacy. This paper focuses on the impact of reforms and analysis in Indian banking system.

Keywords: Banking sector- Indian Economy- credit institutions- capital adequacy

INTRODUCTION

The Reserve Bank of India (RBI) is the Indian central bank. The RBI's most important goal is to maintain monetary stability - moderate and stable inflation in India. The RBI uses monetary policy to maintain price stability and an adequate flow of credit. Rates which the Indian central bank uses for this are the bank rate, repo rate, reverse repo rate and the cash reserve ratio. The

Reserve Bank of India (RBI) raised repo and reverse Repo rates 13 times in previous year. RBI also deregulated savings bank deposit rate with immediate effect. This step was taken to arrest rising inflation in Asia's third largest economy. But this RBI's decision to hike short-term lending and borrowing rates could lead to higher interest rates and impact the growth momentum of the economy. An Indian company has postponed expansion plans and review future profitability projections after the Reserve Bank of India raised key interest rates. The central bank also revised the GDP growth rate forFY11-12 to 7.6% from the earlier 8%, while the projection of WPI inflation has been kept unchanged at 7% for March 2012. Since 1991, the Indian financial system has undergone radical transformation. Reforms have altered the organizational structure, ownership pattern and domain of operations of banks, Financial Institutions and Non-banking Financial Companies (NBFCs). The main thrust of reforms in the financial sector was the creation of efficient and stable financial institutions and markets. Reforms in the banking and nonbanking sectors focused on creating a deregulated environment, strengthening ensuring the prudential norms and the supervisory system, changing the ownership pattern and increasing competition. The Reserve Bank of India (RBI) raised repo and reverse repo rates 13 times in previous year. RBI also deregulated savings bank deposit rate with immediate effect. This step was taken to arrest rising inflation in Asia's third largest economy. But this RBI's decision to hike short-term lending and borrowing rates could lead to higher interest rates and impact the growth momentum of the economy. An Indian company has postponed expansion plans and review future profitability projections after the Reserve Bank of India raised key interest rates. The central bank also revised the GDP growth rate for FY20-218.76% from the earlier 10%, while the projection of WPI inflation has been kept unchanged at 10% for March 2021. The Reserve Bank of India was inaugurated as on April 1 1935. Originally, the Reserve Bank was constituted as a shareholders' bank based on the model leading foreign central banks on that time. The bank 's fully paid share capital was Rs.6 Crores divided into shares of Rs. 100 each. Of this, Rs. 4, 92, 50,000 were subscribed by the private shareholders and Rs. 2, 20,000 were subscribed by the Central Government. On January 1, 1949 the Reserve Bank of India started functioning as a state owed central banking institution. As per Reserve Bank of India Bulletin RBI aims at the promotion of monetary integration of the economy, filling in the Credit gaps. The preamble to the Reserve Bank of India Act, 1934 spells out the objectives of the Reserve Bank as "to control the issue of banking notes and the keeping of reserve with review to securing monetary stability in India and generally to operate the currency and credit system of the country to its recompense.

Narasimham Committee Report on Banking Sector Reforms in India

The committee on Financial system (CFS), popularly known as Narasimham committee was set up in 1991, to recommend for bringing about necessary reforms in financial sector. Narasimham Committee appraised and acknowledged the success and progress of Indian banks since the major banks were nationalized on 19th July 1969. Unfortunately, the developments were witnessed only in the field of expansion and spread of bank branches, generation of huge employment and mobilization of savings rather than improvement in efficiency. Besides corruption, fraud, improper utilization of public money, outdated technology was found to be major drawbacks in the real progress of the banks. The United Front Government appointed Narasimham committee to review the progress of reforms in the banking sector. The committee submitted its report to the then Finance Minister on April 23, 1998. The main objective of the Banking Sector Reforms Committee was to establish a strong, efficient and transferable banking system of the global standard the reform measures have brought about sweeping changes in this critical sector of the Indian's economy. Performance of the banking sector has impact across the length and breadth of the economy. The major banking sector reforms comprise of modifying the policy framework improving the financial soundness and credibility of banks creating a competitive environment, and strengthening of the Institutional framework. The banking sector reform measures to enhance efficiency and productivity through competition were initiated and sequenced to create an enabling environment for banks to overcome the external constraints which were related to administered structure of interest rates, high levels of pre-emption in the form of reserve requirements, and credit allocation to certain sectors. An attempt has been made in this paper to provide a brief overview on performance of the Banking Sector in India.

Historical background of banking system in India

The English traders that came to India in the 17th century could not make much use of the indigenous bankers, owing to their ignorance of the language as well the inexperience indigenous people of the European trade, Therefore, the English Agency Houses in Calcutta and Bombay began to conduct banking business, besides their commercial business, based on unlimited liability. The Europeans with aptitude of commercial pursuit, who resigned from civil and military, organized these agency houses. A type of business organization recognizable as managing agency took form in a period from 1834 to 1847.Banking in India originated in the last decades of the 18th century. The first bank in India, though conservative, was established in 1806 in Calcutta by the name of Bank of Bengal. Indian banking system, over the years has gone through various phases. Four phases of evolution of the Indian Banking Sector

Reserve Bank of India

Another breakthrough happened in this phase, which was Reserve Bank of India. The Reserve Bank of India was set up on the recommendations Royal Commission on Indian Currency .and Finance also known as the Hilton-Young Commission. The commission submitted its report in the year 1926, though the bank was not set up for nine years. Reserve Bank of India (RBI) was created with the central task of maintaining monetary stability in India. The Government on December 20, 1934 issued a notification and on January 14, 1935, the RBI came into existence, though it was formally inaugurated only on April I, 1935

Main functions of RBI

- Issue of Bank Notes
- Banker to Government
- Custodian of Cash Reserves of Commercial Banks
- Custodian of Country's Foreign Currency Reserves
- Lender of Last Resort

Major banking functions-changing the face of Indian banking sector:

The financial crisis has taken a devastating toll on global well-being and put the world economy back by several years. As we all know, in India we have been relatively unscathed by the crisis. But this is true only in relative terms. India too paid a heavy price as the crisis interrupted the growth momentum and, thereby the translation of that growth into poverty reduction and towards this endeavour, the banking sector has been ideating on what needs to be done, innovating strategies for converting those ideas into action and implementing various reforms and strategies. In achieving this target, the Reserve Bank of India is playing a pivotal role in the Institutional fabric of the banking sector by shaping and steering the banking sector to become more productive and creative for our great country. Here are some of the major functions discharged by the Indian Banking Sector under stringent control and supervision of the Reserve Bank of India.

1. Ensuring Financial Inclusion:

- Easier Credit Facility

- Simpler KYC Norms
- Use of Information Technology

2. Financial Literacy, Credit counselling and know your customer Norms: The banks have set up Financial Literacy-cum counselling centres to provide financial education on various financial products and services to the people in urban as well as rural areas.

3. Credit Delivery Mechanisms: Credit delivery mechanisms have been enforced by banks to increase the flow of credit to priority sectors through focus on micro credit and self help groups.

4**. Risk Management Systems**: RBI guidelines have been issued for putting in place risk management systems in banks. Risk Management Committees in banks address credit risk, market risk and operational risk.

5. **Adoption of global Standards**: Prudential norms for capital adequacy, asset classification, income recognition and provisioning are now close to global standards.

6. **Technological Up gradation:** The changing face of the banking sector, aided by technological innovations can be seen from various developments like usage of the ATM technology, Tele banking which is just like having a bank in the pocket, mobile banking, internet banking/card banking.

7. **Advent of ATMs**: With the advent of ATMs 'Anytime banking' has come into picture. Satellites and telecom networks across the world have made 'Anywhere banking' possible.

OBJECTIVESOFTHESTUDY

- To study recent reforms initiated by RBI in covid-19 period time
- To evaluate the overall scenario of banking system in India
- To study the growth and Performance of banking sector in India
- To regulate the financial policy and develop banking facilities through the country

RESEARCH DESIGN

It is a master plan specifying method and procedures for collection and analysis of required data. It is a conceptual framework or blue print of the extensive and in-depth review of the literature and empirical findings on the concerned topic, for the research work. This Report is based on secondary data. Data is collected from various lectures, reports, seminars, important **publications** of various banks, statistical tables relating to banks, newspapers, journals and annual reports. Collected data has been classified according to the requirements of the research work.

Tools and Techniques:

Classification: Data collected is suitably classified according to the requirements of this Report.

Modulation: Modulation of the collected data is done according to the requirements of this research work.

Analysis and Interpretation: On the basis of discussions, classification and modulation, suitable analysis and interpretation is made in connection with the research work.

REVIEWOFLITERATURE

Arora and Kaur (2006) stated that banking sector in India has given a positive and encouraging response to the financial sector reforms. Entry of new private banks and foreign banks has shaken up public sector banks to competition.

Sanjeev Kumar (2010) in his Thesis about "Performance measurement systems in Indian Banking Sector" and findings regarding performance measurement system in Indian Banking Sector in CAMELS framework explained that CAMEL framework is an important performance measurement system based on different ratios used to find out ranking of the banks.

Shivamagi (2000) in his article discussed the reforms required in rural banking. He argued that although rural banking in India has made tremendous quantitative progress, its quality is a different matter. He further stated that to be suitable for and effective in India, a rural banking system should be able to operative at the village level, advance a tailor made package of credit with a consumption component and closely supervise its disbursement to a large number of farmers in varied villages and provide technical guidance and marketing links. He concluded that the policy makers should give thrust to nurturing of special skills in institutions, a positive management attitude and a culture conducive to healthy rural banking.

Singh and Das (2002) tried to review the banking sector reforms introduced in India. They found that the various reforms undertaken over the past few years were indeed epoch making and provided the foundation for an efficient and well-functioning financial system thereby facilitating the next stage of the reforms. They opined that Human Resource Development, Technology, Industrial Relations and Customer Service are the four pillars of the banking system of the future.

Shete (2003) discussed priority sector advances of banks during the post reform period. He found that the priority sector advances of banks have come down substantially during the post reform period, despite the expansion of scope/areas of priority sector definition. A large number of PSBs are not able to reach the prescribed target of lending to agriculture and weaker sections. The small and marginal farmers continued to be both credit and demand unnatural.

Meghna Suryakumar, Founder and CEO, Credit watch: **(2020)** While there was a muted cheer from the last two announcements from the RBI and Finance Ministry, there was an expectation of further liquidity measures being brought in by the Central Bank post the extension of the lockdown on 14th April. The Reverse Repo cut to 3.75% is expected to retain some liquidity at Indian Banks helping in credit off take when the situation improves.

NABARD: The special package to NABARD, SIDBI and NHB is further expected to infuse liquidity to small agriculture-driven businesses and low income housing. Since the NBFCs were left out in the previous announcement from the announced benefits, today's announcement of treating their role as SCBs is a positive signal – NBFC play a vital role in addressing credit disbursement in smaller cities and new-to-banking segment and we expect this to help them in improving their balance sheet. The NPA classification methodology of excluding the 3-month moratorium period till end May, is also going to ease the pressure on banks in the current quarter.

Reserve Bank of India Bulletin: While CreditWatch analysis on COVID impact shows that FY21 is expected to see a strain on the supply chain in the Indian economy, different sectors are expected to witness different levels of impact and recovery trajectory post the lockdown. Essential services, utilities and sectors benefiting from lower oil prices may recover faster but auto, tourism and logistics may see a longer recovery cycle. We expect the RBI and Central Government to maintain a close eye on sectoral developments as the lockdown cases.

Ankit Agarwal, Managing Director at Alankit Ltd: Themuch needed liquidity for easing NBFC financing would help in shorter time frame. Reduction in reverse repo rate will disincentive the banks from holding the funds and would be encouraged to lend more to the borrowers and will give relief in these cash stricken situations during covid 19 lockdown.

Ashok Mohanani, Chairman, EKTA World and Vice President, NAREDCO, Maharashtra: Today's announcement focused more on bank relief and commercial real estate; there was no mention of residential real estate. Certain announcements by RBI Governor on the liquidity front will benefit in churning the economic cycle. A rate cut of 25 basis points to 3.75 percent from 4 percent is in favor in terms of RBI from banks. There is indeed a requirement of more clarity and focused announcements towards credit growth. The flexibility provided to NBFC on the DCCO by extension of one year is expected to provide relief to the borrowers in short-run for NBFC and the real estate sector. There is a need for focus on residential real estate and hope for some relief measure to be announced.

P. Nandakumar, MD & CEO of Manappuram Finance Limited: The RBI Governor's announcement of an TLTRO 2.0 of Rs. 50,000 crore to be deployed in investment grade NBFCs besides Rs 15,000 crore to SIDBI for on-lending or refinancing is a welcome step. Of course, going forward, the size may have to be increased significantly. Earlier, the announcement by the Ministry of Home Affairs allowing NBFCs to restart their operations is a major positive development.

Kunal Varma, CBO and Co-Founder, Money Tap: The latest TLTRO announcement from RBI aimed at injecting around Rs. 50,000 Cr of additional liquidity into the banking system, specifically via Banks to small and mid-sized NBFCs and MFIs, is a well-timed move. This will increase the availability of credit to end borrowers, hopefully at lower or more competitive interest rates. It came at a much needed time when NBFCs were suffering from a significant business impact and liquidity stress due to the COVID-19 pandemic.

Motilal Oswal, MD and CEO of Motilal oswal Financial Services: Given the unprecedented times we are in, it is heartening that RBI is addressing all these challenges at a war footing. We believe, the key measures announced by RBI will help inject the much needed liquidity in the system, facilitate and incentivize credit flow and provide flexibility on regulatory forbearance. Markets are in buying zone. Keep accumulating and increasing equity allocations steadily.

Gyanesh Chaudhary, MD- Vikram Solar: I would like to congratulate Directorate General of Foreign Trade (DGFT) for extending the MEIS export incentives till 31st December 2020. It will provide exporters a much needed breathing space as domestic sales will remain relatively low due to the pandemic faced by India. As we pass this pandemic, global supply chains are bound to re-align and India will have a good opportunity to promote its exports.

Punita Rao, K. J. Somaiya: This purpose of this study is to investigate the impact of monetary policy on the profitability of banks in the context of financial sector reforms in India. We discuss the financial sector reforms and the implication of the banks, the various instruments of monetary policy in India, and the impact of monetary policy on the profitability of banks.

B L Pandit & Pankaj Vashisht: Impact of changes in policy rate of interest on demand for bank credit is examined for seven emerging market economies including India for the period 2002 to 2010. Panel data techniques are used after ruling out the presence of unit roots. The results show that when other determinants, like domestic demand pressure, export demand and impact of stock market signals are controlled for, change in policy rate of interest is an important determinant of firms' demand for bank credit. The results confirm that monetary policy is an important countercyclical tool for setting the pace of economic activity.

Prasanna V Salian1, Gopakumar. K: This paper seeks to examine the relationship between inflation and GDP growth in India. Empirical evidence is obtained from the co integration and error correction models using annual data collected from the Reserve Bank of India. The result shows that there is a long-run negative relationship between inflation and GDP growth rate in India. Inflation is harmful rather than helpful to growth.

Saibal Ghosh: The study exploits 2-digit level industry data for the period 1981-2004 to ascertain the inter-linkage between a monetary policy shock and industry value added. Accordingly, we first estimate a Vector Auto Regression (VAR) model to ascertain the magnitude of a monetary policy shock on industrial output. Subsequently, we try to explain the observed heterogeneity in terms of industry characteristics. The findings indicate that (a) industries exhibit differential response to a monetary tightening and (b) both interest rate and financial accelerator variables tend to be important in explaining the differential response.

J K Sachdeva: Indian economy also passed through these stages during the year 2008. The economic growth rate, which was above 8% for consecutive period of three years since 2006, suddenly plunged to an average of 5.5%. Developed world is under the fear that recession may not turn out to be continuous process resulting into great depression.

REFORMS INITIATED IN COVID-19

After providing relief to borrowers and financial markets to handle the disruption caused by the Corona Virus disease (COVID-19) the Reserve Bank has now come to the rescue of state governments, exporters and also provide relief to banks' capital concerns. It has not only enhanced state government's short-term liquidity needs, but relaxed export repatriation limits from nine months to 15 months and also said that capital conservation buffer may not be activated for a year The government has decided to enhance the WMA- a temporary facility to meet revenue mismatches- limits to states and union territories ahead of the recommendations of a committee it constituted for the purpose. "It has been decided to increase WMA limit by 30 percent from the existing limit for all States/UTs to enable the State Governments to tide over the situation arising from the outbreak of the COVID-19 pandemic" the Reserve Bank said in a release. The revised limits will come into force with effect from April 1, 2020 and will be valid till September 30, 2020. Reserve Bank had constituted an Advisory Committee under Sudhir Shrivastava to review the Ways and Means limits for State Government sand Union Territories. In addition RBI has decided to extend of realisation period of export proceeds. "The time period for realization and repatriation of export proceeds for exports made up to or on July 31, 2020, has been extended to 15 months from the date of export" RBI said. Presently value of the goods or software exports made by the exporters is required to be realized fully and repatriated to the country within a period of 9 months from the date of exports.

The Reserve Bank of India (RBI) on Friday announced a slew of measures in order to provide relief for the ongoing Corona virus outbreak in India. These include:

- **Repo Rate** – RBI announced that it was cutting the repo rate by 75 bps, or 0.75% to 4.4. The Repo Rate was earlier 5.15; last being cut in October 2019.

- **Reverse Repo** – The regulator also announced that it would cut the Reverse Repo rate by 90 bps, or 0.90%. On a daily average, banks had been parking Rs 3 lakh crore with the RBI. The current reverse repo rate was 4%.
- **Loan Moratorium** – In a massive relief for the middle class, the RBI Governor also announced that lenders could give a moratorium of **3 months** on term loans, outstanding as on 1 March, 2020. This is applicable to All Commercial Banks including Regional, Rural, Small Finance, **Co-Op Bank**, All India Financial Institutions and NBFCs including Housing Finance and Microfinance.
- **CRR** – The RBI also announced that the Cash Reserve Ratio (CRR) would be reduced by 100 bps, or **1%, to 3%** This would be applicable from March 28, and would inject Rs. 1,37,000 crore.
- **LTRO** – The RBI will also undertake Long Term Repo Operations (LTRO) allowing further liquidity with the banks. The banks however are specified that this liquidity will be deployed in **Commercial papers**, investment grade corporate bonds and non-convertible debentures.
- **Ease of Working Capital financing** – Lenders were allowed lending to recalculate drawing power by reducing margins and/or by reassessing the working capital cycle for the borrowers. The RBI also specified that such a move would not result in asset classification downgrade.
- **Working Capital Interest** – A three month interest moratorium shall also be permitted to all lending institutions.
- **Deferment of NSFR**- Net Stable Funding Ratio (NSFR) which reduces funding risk by requiring banks to fund their activities with sufficiently stable sources of funding was postponed to October 1, 2020. The NSFR was earlier supposed to be implemented by April 1, 2020.
- **MSF** – Marginal Standing Facility (MSF) has also been increased to **3% of SLR,** available till June 30, 2020. "This measure should provide comfort to the banking system by allowing it to avail an additional 1,37, 000 crore of liquidity under the LAF window in times of stress at the reduced" said the RBI.

- **Fresh Liquidity** – The impact of all the announcements today shall inject almost **3.2% of GDP**, the Governor said in his brief today. The RBI also added that since February 2020 it had injected Rs 2.8 lakh crore of liquidity, equivalent to 1.4 percent of GDP.

GROWTHOFBANKINGSYSTEMININDIA

Prior to the outbreak of COVID-19, the outlook for growth for 2020-21 was looking up. First, the bumper Rabi harvest and higher food prices during 2019-20 provided favourable conditions for the strengthening of rural demand. Second, the transmission of past reductions in the policy rate to bank lending rates has been improving, with favourable implications for both consumption and investment demand. Third, reductions in the goods and services tax (GST) rates, corporate tax rate cuts in September 2019 and measures to boost rural and infrastructure spending were directed at boosting domestic demand more generally. The COVID-19 pandemic has drastically altered this outlook.

The global economy is expected to slump into recession in 2020, as post-COVID projections indicate. The sharp reduction in international crude oil prices, if sustained, could improve the country's terms of trade, but the gain from this channel is not expected to offset the drag from the shutdown and loss of external demand.

Turning to key messages from forward-looking surveys, the March 2020 round of the Reserve Bank's survey showed that consumer confidence for the year ahead was expected to remain around its level recorded in the previous survey round in January 2020 However, an important caveat to the forward-looking surveys presented in this section is that they were completed before the nation-wide lockdown effective March 25

Projections - Professional Forecasters

Median Projections of Professional Forecasters	**2019-20**	**2020-21**
Inflation, Q4 (y-o-y)	6.7	3.2
Real GDP growth	5	5.5
Gross domestic saving (per cent of GNDI)	29.4	29.5
Gross capital formation (per cent of GDP)	30	30
Credit growth of scheduled commercial banks	7.2	9.3
Combined gross fiscal deficit (per cent of GDP)	6.8	6.5
Central government gross fiscal deficit (per cent of GDP)	3.8	3.6
Repo rate (end-period)	5.15	4.65

Yield on 91-days treasury bills (end-period)	4.9	4.7
Yield on 10-year central government securities (end-period)	6.2	6.1
Overall balance of payments (US$ billion)	49.8	40
Merchandise exports growth	-2.9	-0.6
Merchandise imports growth	-7.2	-2.9
Current account balance (per cent of GDP)	-1	-0.7

Source: *Survey of Professional Forecasters (March 2020 round, conducted during March 6-19, 2020).*

MPERATIVES OF MONETARY REFORMS:

India, like most developing economies, followed the path of planned development after Independence, based on the assumption that public savings would fund higher levels of investment. Monetary and credit policy was, therefore, geared to fund the requirements of the fiscal policy channelizing public saving to 'socially purposive' investment. The public sector, however, instead of being a source of savings for the community's good became, over time, a consumer of community's savings **(*Jalan,2002a).***As a result, the Government had to take increasing recourse to a draft of resources from the Reserve Bank and the banking system Fiscal dominance affected the conduct of monetary policy and resource allocation in a number of ways.

- First, although interest rates on government borrowings were raised during the 1980s – with the weighted yield on government borrowing climbing to 11.41 per cent during 1990-91 from 7.03 per cent during 1980-81 - they were still not high enough to attract voluntary subscriptions (RBI, 1991). As a result, the statutory liquidity ratio (SLR), originally a prudential norm mandating banks to earmark a portion of their liabilities in risk-free instruments, was increased steadily to provide a captive market for government borrowings, constricting portfolio choice (Chart V.1). The SLR was hiked to a peak of 38.5 per cent of net demand and time liabilities (NDTL) in September 1990 from 25.0 per cent in September 1964
- Second, as the higher SLR was still not sufficient to fund the fiscal deficit, the gap was filled by an almost monotonic increase in the monetisation of the fiscal deficit, with the ratio of monetisation to GDP almost doubling from 1.1 per cent during the 1970s to 2.1 per cent during the 1980s
- Third, by the end of the 1980s, there was increasing empirical evidence that the excessive monetary expansion, emanating from the monetisation of the fiscal deficit,

was beginning to spill over into inflation ***(Rangarajan and Arif, 1990).***Given a higher elasticity of government expenditure with respect to prices relative to receipts, the higher inflation further widened the fiscal deficit. The consequent necessity of higher monetisation thus brought the inflation-fiscal-monetary nexus into sharp focus (Rangarajan, Basu and Jadhav, 1989; RBI, 2002a)

- Fourth, from the viewpoint of monetary management, the Reserve Bank had to hike the cash reserve ratio (CRR) to contain the inflationary impact of the monetisation of the fiscal deficit, thereby imposing an indirect tax on the banking system. The CRR was raised from the statutory minimum of three per cent of NDTL in September 1962 to 15 per cent in July 1989. By March 1991, commercial banks had to, therefore, set aside over 60 per cent of their incremental resources for meeting statutory pre-emptions (after factoring in a 10 per cent incremental CRR)
- Finally, the need to contain the interest burden of public debt necessitated a regime of administered interest rates, both on the lending and the deposit side, resulting in a degree of financial repression. This blunted the interest rate channel of monetary policy transmission by the 1960s. The Bank Rate, in particular, as an instrument of monetary policy fell into disuse by the mid-1970

CHANGES IN THE MONETARY POLICY FRAMEWORK

- The overarching objective of monetary and financial sector reforms was to set free the process of price discovery with a view to enhancing the Allocative efficiency of the financial markets, while at the same time, ensuring macroeconomic stability (*RBI, 1993; Rangarajan, 1997)*.
- The operating procedure of monetary policy, in terms of targets and instruments, saw substantial changes in response to the challenges of financial liberalization.
- The deregulation of interest rates, for instance, sharpened the Reserve Bank’s dilemma of funding both the Government and the commercial sector at a reasonable cost, without stoking inflationary pressures.
- Besides, following the opening up of the external sector, the need to maintain orderly conditions in the foreign exchange market, at times, required higher interest rates, while the pursuit of the growth objective required a softer interest rate regime.

- Finally, the shifts in the channels of transmission of monetary policy, as a result of freeing of financial prices, necessitated monetary operations in terms of both the price and quantum of liquidity

Monetary Policy/ Use of the Bank Rate

	Bank Rate		Inflation Rate	
Decade	**Number of times changed**	**Range**	**Average**	**Range**
	1	2	3	4
1950s	2	3.0-4.0	1.7	(-)12.5-14.0
1960s	4	4.0-6.0	6.4	(-)1.2-13.9
1970s	3	5.0-9.0	9	(-)1.1-25.2
1980s	1	9.0-10.0	8	4.4-18.2
1990s	10	8.0-12.0	8.1	3.3-13.7
April 2000 –Feb 2003	6	6.25-8.0	4.6	3.0-7.2

Source: RBI Monetary Policy/ Use of the Bank Rate

The Reserve Bank now manages liquidity through open market (including repo) operations, reinforced by direct interest rate signals through changes in the policy rates such as the Bank Rate/ repo rates, besides the traditional tools of changes in reserve requirements and standing facilities. While CRR continues to be used as a monetary policy instrument, the adverse impact of impounding lendable resources has been minimised by bringing it down to 4.75 per cent of NDTL, in line with the medium-term goal of reducing it to the statutory minimum of 3.0 per cent. Furthermore, the banks are now remunerated for CRR balances (above the statutory minimum) at the Bank Rate.

CHALLENGES FACED BY INDIAN BANKING INDUSTRY IN COVID-19 PERIOD

- **Covid-19 has crippled our fragile economy**. A pause in production and sale, and an upsurge in unemployment are bound to persist for some time. Bank assets will also erode fast. By announcing a moratorium on EMIs for three months, RBI has unwittingly thrown open the door for citizens to further default on their commitments. The MSME bad loans that were suppressed until March 2020, as per the orders of the RBI, will now increase, nullifying the good work done in the first quarter

- **Furthermore, the Net Interest Margin (NIM)** relies on internal factors like Capital Adequacy Ratio (CAR), Current and Savings Account ratio (CASA), loan book size, operating costs and external factors such as Repo Rate and GDP rate. All of these, except the repo rate, are on a decline. The net interest margin is expected to decrease further in the coming weeks because of two main factors – growing NPA and shrinking CASA.
- **Banks have sufficient** funds now because of lack of credit off-take (including NBFCs) on one hand, and reduction in rates like statutory liquidity ratio (SLR) and cash reserve ratio (CRR) by the regulator on the other. This, in turn, will lead to an increased cost of deposits, while term deposit rates and CASA rates will fall. However, with the RBI driving lower reverse repo rates; banks will also need to push more retail asset business which is likely to improve in the latter part of the year.
- **Developing countries like India,** still has a huge number of people who do not have access to banking services due to geological fragmented locations. But if we talk about those people who are availing banking services, their expectations are raising as the level of services are increasing due to the emergence of Information Technology and competition. With the entry of foreign banks in Indian market, the number of services offered has increased and banks have laid emphasis on meeting the customer expectations. Now, the existing situation has created various challenges and opportunity for Indian Commercial Banks to sustain in the market. In order to encounter the general scenario of banking industry we need to understand the challenges and opportunities lying with banking industry of India.
- **Rise in service charges**: Operating profits of banks have been plummeting for a long time in India. Now with businesses getting severely impacted, interest income is bound to take a huge hit. Limited augmentation in other areas is likely to make banks increase their locker rents, service request charges, digital transaction charges and penal charges. Be that as it may, more and more people are expected to revisit their bank accounts that were largely dormant as government grants and support will be disbursed through this channel.
- **Aftermath of COVID-19 EMI moratorium**: RBI announced that customers have the option to defer repayment of EMIs of loans by three months to retain cash flow, if required. As a result, the loan tenure will automatically extend by three months, but will invariably lead to extra interest charges. This especially affects those customers who are

at the beginning of a loan cycle since EMIs comprise heavier interest in the initial loan term. However, for those availing the moratorium**,** the good news is that this temporary financial relief will not impact their credit score and their loans will not be classified as non-performing assets.

- **Fate of differentiated banks**: Only recently, new forms of banking such as Payment Banks and Small Finance Banks (SFBs) had found their feet in the financial sector. With limited offerings and a lean revenue stream, these banks were already fraught with hardships. In the wake of Covid-19, SFBs are bearing the brunt of the lockdown of their client base (vegetable vendors, carpenters, etc) on their asset quality as well as recovery.
- **Growth of digital banking:** One visible impact of Covid-19 is the increased use of digital banking. As part of the fight against the pandemic, both banks and governments are repeatedly insisting that customers avoid physical banking. Digital solutions are in great demand and the number of online transactions may even increase in the post-Covid period due to the convenience these services offer to both the customers and banks. **Digital transformation** of banks will also take centre stage with an increase in investments towards deep learning-based use cases to tackle the NPA issue.Currently, banks are entertaining only essential services at their branches. All debit cards are now active and customers are urged to use them. The RBI has even removed the charges for using ATMs and this may stay as a permanent measure.
- **Third-party** payment applications, too, have gained momentum as part of digital banking. However, digital banking has to be improved in order to cater to the diverse customer base**.** All web and mobile services should be user friendly and enable communication in local and regional languages. Along with an increase in digital banking operations, there could be a surge in cyber security issues, too. The RBI has promptly created a separate wing comprising 600 officers to tackle this challenge.
- **Disenchantment of bank employees:** There are more than 10 lakh bank employees in our country who need support and security in the form of revised wages. Unfortunately, the present situation has dampened such plans. The legal ecosystem is hardly helping in the recovery of the NPAs. In fact, governmental agencies are using them as a pivot to run welfare schemes like MSME/MUDRA financing. This needs to be addressed immediately. In times like these, there is a need for professional training to enhance a

person's behavioral and technical skills to keep pace with changing requirements of the sector. We have worked with a lot of banks in this regard and have seen the impact that learning and training programmes have helped both people and financial Institutions.

- **Well-designed training:** With digitalization and banks moving most services online, people can explore newer roles and avenues to pursue in their current or newer sectors. A well-designed training capsule can provide practical inputs to the banking fraternity enabling them to tide over the storm with ease. The Covid-19 pandemic is unarguably a watershed event in the history of mankind that is bound to cause paradigm shifts with far-reaching effects. Banking being a pivotal industry is likely to be on the forefront of these changes. While we will truly be able to gauge the impact of these adversities only once the crisis ends, scenario planning is even more imperative now to strategically forecast, plan and manage the future of banking

MONETORY POLICY REPORTS:

The global macroeconomic outlook is overcast with the COVID -19 pandemic, with massive dislocations in global production, supply chains, trade and tourism. Financial markets across the world are experiencing extreme volatility; global commodity prices, especially of **crude oil,** have declined sharply. COVID -19 would impact economic activity in India directly due to lockdowns, and through second round effects operating through global trade and growth. The impact of COVID -19 on inflation is ambiguous, with a possible decline in food prices likely to be offset by potential cost-push increases in prices of non-food items due to supply disruption

- **As this Monetary Policy Report (MPR):** goes for release, the global macroeconomic outlook is overcast with the COVID-19 pandemic. With over 12 lakh confirmed infections and over 67,000 deaths across 211 countries as of April 7, 2020 and counting, the sheer scale and speed of the unfolding human tragedy is overwhelming. The disruption of economic activity in a wide swath of affected countries is set to intensify in the face of headwinds in the form of massive dislocations in global production, supply chains, trade and tourism. Global output is now seen as contracting in 2020.

- **Financial markets across** the world are experiencing extreme volatility: equity markets recorded sharp sell-offs, with volatility touching levels seen during the global financial crisis; flights to safety have taken down sovereign bond yields to record lows; risk spreads have widened; and financial conditions have tightened. Global commodity prices, especially of crude oil, have also declined sharply in anticipation of weakening global demand on the one hand, and the failed negotiations of the Organization of the Petroleum Exporting Countries (OPEC) and Russia, on the other. Many central banks have eased monetary, liquidity and regulatory policies to support domestic demand, including through emergency off-cycle meetings. Bilateral swap lines between some central banks that were deployed during the global financial crisis have been activated. G7 finance ministers and central bank governors have stated that they stand ready to cooperate further on timely and effective measures.
- **G20 finance ministers** and central bank governors have committed to use all available policy tools to deal with COVID-19. G20 Leaders have resolved to do whatever it takes to overcome the pandemic. The International Monetary Fund (IMF) and the World Bank Group are making available US$ 50 billion and US$ 14 billion**,** respectively, through various financing facilities to their membership to help them respond to the crisis
- **Turning to the domestic economy**, India has not been spared from the exponential spread of COVID-19 and by April 7, more than 4,700 cases had been reported. While efforts are being mounted on a war footing to arrest its spread, COVID-19 would impact economic activity in India directly through domestic lockdown. Second round effects would operate through a severe slowdown in global trade and growth.
- More immediately, spillovers are being transmitted through finance and confidence channels to domestic financial markets. These effects and their interactions would inevitably accentuate the growth slowdown, which started in Q1:2018-19 and continued through H2:2019-20. Meanwhile, headline inflation stayed above the upper tolerance band of the inflation target band during December 2019-February 2020, led by a spike in vegetable prices. While it has peaked and vegetable prices are on the ebb, the impact of

COVID-19 on inflation is ambiguous relative to that on growth, with a possible decline in prices of food items being offset by potential cost-push increases in prices of non-food items due to supply disruptions.

- **Targeted Long Term Repos Operations (TLTROs**: The onset and rapid propagation of COVID-19 in India has ignited large sell-offs in the domestic equity, bond and forex markets. With the intensification of redemption pressures, liquidity premium on instruments such as corporate bonds, commercial paper and debentures have surged. Combined with the thinning of trading activity with the COVID outbreak, financial conditions for these instruments, which are used, inter alia, to access working capital in the face of the slowdown in bank credit, have also tightened. In order to mitigate their adverse effects on economic activity leading to pressures on cash flows, it has been decided that the Reserve Bank will conduct auctions of targeted term repos of up to three years tenor of appropriate sizes for a total amount of up to ₹ 1,00,000 crore at a floating rate linked to the policy repo rate.
- **Cash Reserve Ratio**: Liquidity in the banking system remains ample, as reflected in absorption of surpluses from the banking system under reverse repo operations of the LAF of the order of ₹ 2.86 lakh crore on a daily average basis during March 1-25, 2020. It is observed, however, that the distribution of this liquidity is highly asymmetrical across the financial system, and starkly so within the banking system. As a one-time measure to help banks tide over the disruption caused by COVID-19, it has been decided to reduce the cash reserve ratio (CRR) of all banks by 100 basis points to 3.0 per cent of net demand and time liabilities (NDTL) with effect from the reporting fortnight beginning March 28, 2020. This reduction in the CRR would release primary liquidity of about ₹ 1,37,000 crore uniformly across the banking system in proportion to liabilities of constituents rather than in relation to holdings of excess SLR. This dispensation will be available for a period of one year ending on March 26, 2021.
- **Marginal Standing Facility:** Under the marginal standing facility (MSF), banks can borrow overnight at their discretion by dipping up to 2 per cent into the Statutory Liquidity Ratio (SLR). In view of the exceptionally high volatility in domestic financial markets which bring in phases of liquidity stress and to provide comfort to the banking system, it has been decided to increase the limit of 2 per cent to 3 per cent with

immediate effect. This measure will be applicable up to June 30, 2020. This is intended to provide comfort to the banking system by allowing it to avail an additional ₹ 1,37,000 crore of liquidity under the LAF window in times of stress at the reduced MSF rate announced in the MPC's resolution.

- **Widening of the Monetary Policy Rate Corridor**: In view of persistent excess liquidity, it has been decided to widen the existing policy rate corridor from 50 bps to 65 bps. Under the new corridor, the reverse repo rate under the liquidity adjustment facility (LAF) would be 40 bps lower than the policy repo rate. The marginal standing facility (MSF) rate would continue to be 25 bps above the policy repo rate.
- **Moratorium on Term Loans**: All commercial banks (including regional rural banks, small finance banks and local area banks), co-operative banks, all-India Financial Institutions, and NBFCs (including housing finance companies and micro-finance institutions)("lending institutions")are being permitted to allow a moratorium of three months on payment of installments in respect of all term loans outstanding as on March 1, 2020. Accordingly, the repayment schedule and all subsequent due dates, as also the tenor for such loans, may be shifted across the board by three months.
- **Deferment of Interest on Working Capital Facilities**: In respect of working capital facilities sanctioned in the form of cash credit/overdraft, lending institutions are being permitted to allow a deferment of three months on payment of interest in respect of all such facilities outstanding as on March 1, 2020. The accumulated interest for the period will be paid after the expiry of the deferment period.
- **Easing of Working Capital Financing**: In respect of working capital facilities sanctioned in the form of cash credit/overdraft, lending institutions may recalculate drawing power by reducing margins and/or by reassessing the working capital cycle for the borrowers. Such changes in credit terms permitted to the borrowers to specifically tide over the economic fallout from **COVID-19** will not be treated as concessions granted due to financial difficulties of the borrower, and consequently, will not result in asset classification downgrade.
- **Deferment of Implementation of Net Stable Funding Ratio (NSFR):** As part of reforms undertaken in the years following the global financial crisis, the Basel Committee on Banking Supervision (BCBS) had introduced the Net Stable Funding Ratio

(NSFR) which reduces funding risk by requiring banks to fund their activities with sufficiently stable sources of funding over a time horizon of a year in order to mitigate the risk of future funding stress. As per the prescribed timeline, banks in India were required to maintain NSFR of 100 per cent from April 1, 2020. It has now been decided to defer the implementation of NSFR by six months from April 1, 2020 to October 1, 2020.

- **Financial Markets**: The decision in respect of financial markets is essentially of a developmental nature, intended to improve depth and price discovery in the forex market segments by reducing arbitrage between onshore and offshore markets. This measure assumes greater importance in the context of the increased volatility of the rupee caused by the impact of COVID-19 on currency markets.
- **Deferment of Last Tranche of Capital Conservation Buffer:** The 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 Basel standards, the CCB was to be implemented in tranches of 0.625 per cent and the transition to full CCB of 2.5 per cent was set to be completed by March 31, 2019. It was subsequently decided to defer the implementation of the last tranche of 0.625 per cent of the CCB from March 31, 2019 to March 31, 2020. Considering the potential stress on account of COVID-19, it has been decided to further defer the implementation of the last tranche of 0.625 per cent of the CCB from March 31, 2020 to September 30, 2020. Consequently, the pre-specified trigger for loss absorption through conversion/write-down of Additional Tier 1 instruments (PNCPS and PDI) shall remain at 5.5 per cent of risk-weighted assets (RWAs) and will rise to 6.125 per cent of RWAs on September 30, 2020.

Hypothesis of the study:

- Indian banking sector stands well on efficiency parameters close to the global standards.
- Financial sector reforms and policies aim at increasing the banking potential to explore new business opportunities and emerge as the world power paving the way for growth in the years to come.

- IMF and RBI together will respond to the challenge of minimizing the impact of crisis and maintenance of the overall organizational performance ethic of the banking sector.
- Introduction of advanced technology in the Banking Sector is expected to have a multiplier effect on development of the banking sector and provides relief in the form of more effective work process, reduced cost of processing and delivering affordable financial services.
- Policies formulated by RBI aim at, ensuring monetary and financial stability**,** strengthening macro prudential frame work, enhanced customer service and financial inclusion policy.
- The banks however are specified that this liquidity will be deployed in commercial papers, investment grade corporate bonds and non-convertible debentures.
- Decline in food prices likely to be offset by potential cost-push increases in prices of non-food items due to supply disruption.
- Governmental agencies are using them as a pivot to run welfare schemes like MSME/MUDRA financing.
- Offshore markets increased volatility of the rupee caused by the impact of COVID-19 on currency markets.
- Working capital facilities sanctioned in the form of cash credit/overdraft, lending institutions may recalculate drawing power by reducing margins and/or by reassessing the working capital cycle for the borrowers.
- Commercial banks are being permitted to allow a moratorium of three months on payment of instalments in respect of all term loans outstanding as on March 1, 2020.
- Marginal standing facility (MSF), banks can borrow overnight at their discretion by dipping up to 2 per cent into the Statutory Liquidity Ratio (SLR).
- Considering the potential stress on account of COVID-19, it has been decided to further defer the implementation of the last tranche of 0.625 per cent of the CCB from March 31, 2020 to September 30, 2020.

CONCLUSION

COVID-19, the accompanying lockdowns and the expected contraction in global output in 2020 weigh heavily on the growth outlook. The actual outturn would depend upon the speed with which the outbreak is contained and economic activity returns to normalcy. Significant monetary and liquidity measures taken by the Reserve Bank and fiscal measures by the government would mitigate the adverse impact on domestic demand and help motivate economic activity once normalcy is restored. Risks around the inflation projections appear balanced at this juncture and the tentative outlook is benign relative to recent history. But COVID-19 hangs over the future, like a specter. a key objective of macroeconomic policy**,** including monetary policy, must be the avoidance of resurgence of inflationary expectations. In this context, despite a significant improvement in the monetary-fiscal interface during the 1990s, fiscal dominance continues to persist with growing volume of gross market borrowings. The burden of directly financing the fiscal deficit could easily revert back to the Reserve Bank in case of a reversal in the liquidity conditions, especially as banks' investments in Government securities are already far in excess of their statutory SLR requirements. Therefore, the issue of separation of debt management function from the monetary authority needs to be addressed. The proposed Fiscal Responsibility and Budget Management Legislation and the need to accord greater operational flexibility to the Reserve Bank, as indicated in the Union Budget, 2000-01 could have far-reaching ramifications on the operational framework of monetary policy in India.

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