

Commercial banks must keep some percentage of their total deposits with themselves. This is known as SLR. It is stored in form of highly liquid government securities, cash, gold, or foreign securities before giving credit to the customers. This ensures that banks always have enough liquidity (cash and cash equivalents) to pay depositors their money, on demand and that banks do not lend away all their funds. During inflationary pressures, RBI increases SLR, less money remains with the banks which can be given in the form of loan. SLR is reduced during deflation.

4) Liquidity Adjustment Facility:

LAF is a monetary policy instrument which help banks to adjust day to day fluctuations in liquidity. LAF are conducted by way of repos and reverse repos: -

Repos Rate

Repo rate refers to the rate at which commercial banks borrow money from the RBI in case of shortage of funds. Commercial banks give government securities and other securities to the RBI. In return, RBI gives one day or overnight loan to the bank. The RBI charges an interest (repo rate) to the bank. Banks repays the loan after one day and repurchases the security they gave as collateral. RBI increases the Repo Rate during inflation and hence borrowing from RBI becomes costly. On the other hand, RBI decreases Repo Rate during the time of deflation.

Reverse Repo Rate

It is the rate at which the RBI borrows from commercial banks. Commercial banks keep their surplus funds with the RBI and earn interest (reverse repo rate). During high levels of inflation, the RBI increases the reverse repo. As a result, banks keep more money with the RBI. Less money remains with banks which can be given in the form of loan. This reduces money supply and purchasing power in the economy.

Qualitative Credit Control Instruments or Selective Credit Control Instruments Used by the Reserve Bank of India

Qualitative or Selective credit control methods aim to change the composition of credit. They are used to reduce the flow of credit in some undesirable direction and to encourage it in desired directions.

The main instruments/tools are:

1) Moral Suasion

It is a method of persuasion, if request, of informal suggestions and of advice given by the Reserve Bank India (RBI) to the commercial banks. The RBI sends letters and conducts meetings of the Board of Directors of banks. These measures are effective only if the commercial banks cooperate. It is an appeal made by RBI to commercial banks to take appropriate action benefitting the economy. Ex- The Reserve Bank of India has, from time to time, issued several guidelines to the banks on the Self-Help Group (SHG) Bank Linkage Programme.

2) Margin Requirements

The term margin implies a part of the loan amount which cannot be borrowed from the bank. The borrower must arrange this amount of finance from his own sources. Generally, the commercial banks do not give loan up to the full amount of value of the security but gives loan less than its value. If the bank increases the margin requirement, then the amount of loan given decreases. During inflation, higher margin is kept and during deflation lower margin is kept.

3) Direct Action

The RBI imposed a penalty of Rs 1.2 crores on Karnataka Bank for not following the central bank's directions. The RBI cancelled the license of The Mapusa Urban Co-operative Bank of Goa Ltd on 17th April 2020 as it failed to follow banking norms. Above are the examples of direct action. It is an extreme step taken by the central bank of the country if the banks do not follow its directives. RBI may refuse to give credit facilities, denies licence to open new branches, cancel the licences of such banks, impose lending restrictions on the banks etc.

4) Regulation of Consumer Credit

Many times, consumers purchase television, refrigerator, laptop etc. on instalment basis by arranging finance from the banks. The RBI regulates credit given by the commercial banks to the consumers for purchasing durable goods. This can be done by regulating the total amount of credit that may be given for purchasing specific durable good, regulating the number of