International Journal of Scientific Research in Engineering and Management (IJSREM)
Volume: 09 Issue: 06 | June - 2025 SJIF Rating: 8.586 ISSN: 2582-3930

Impact of RBI Monetary Policy on Banking Sector Performance in India

Amit Lohani
Under the Guidance of Prof. Rubi Kumari
Master of Business Administration
School of Business
Galgotias University

Abstract

The aim of this study is to analyze the impact of monetary policy on Bank Performance in India. Monetary policy plays a crucial role in shaping the financial landscape of a country, and its impact on the banking sector is particularly significant. In India, the Reserve Bank of India (RBI) implements monetary policy measures to achieve its primary objectives of price stability, economic growth, and financial stability. These measures, such as adjustments in reserve requirements, interest rates, and open market operations, have a direct and indirect bearing on the performance of banks. Monetary policy plays a critical role in shaping the performance of the Indian banking sector, influencing deposit mobilization, credit expansion, and profitability. The impact of monetary policy is transmitted through various channels, including the interest rate channel, the balance sheet channel, and the lending channel. The impact of monetary policy can vary across different types of banks, with public sector banks potentially being more sensitive to monetary policy changes. Policymakers need to carefully consider the impact of monetary policy on the banking sector and strike a balance between achieving their primary objectives while ensuring financial stability. The effectiveness of monetary policy depends on a number of factors, including the structure of the economy, the expectations of businesses and consumers, and the credibility of the central bank. In general, monetary policy is more effective in economies with flexible labor markets and low levels of inflation. When businesses and consumers expect the central bank to achieve its inflation target, monetary policy is more likely to be effective. When the central bank is considered to be credible, its actions are more likely to have the desired impact on the economy. Monetary policy is a powerful tool, but it also has limitations. Monetary policy cannot be used to solve all economic problems. For example, monetary policy cannot directly address supply-side shocks, such as natural disasters or wars. Additionally, monetary policy can take time to have its full impact on the economy. The study examines the impact of the Reserve Bank of India's (RBI) monetary policy on the performance of the Indian banking sector. By analyzing various monetary tools such as the repo rate, CRR, SLR, and open market operations, this research evaluates their influence on banking indicators like profitability, credit growth, asset quality, and liquidity. Using empirical data and relevant literature, the study finds that monetary policy significantly affects banking.

Chapter 1-Introduction: Monetary Policy

Monetary policy is a set of actions taken by a central bank to control the money supply and interest rates in an economy. The goal of monetary policy is to achieve and maintain price stability, while also promoting economic growth and full employment. Central banks use a variety of tools to implement monetary policy, including open market operations, reserve requirements, and the discount rate.

- **Objectives of Monetary Policy:** The primary objectives of monetary policy are:

✓ Price stability: This means keeping inflation low and stable. Inflation is the rate at which prices for goods and services are rising. High inflation can erode purchasing power and make it difficult for businesses to plan for the future. Low and stable inflation is generally considered to be beneficial for economic growth.

✓ Economic growth: This means promoting a sustained increase in the level of economic activity. Economic growth is typically measured by the rate of change in real gross domestic product (GDP). Monetary policy can help to stimulate economic growth by making credit more affordable and encouraging businesses to invest.

✓ Full employment: This means minimizing the level of unemployment. Unemployment is the proportion of the labor force that is unemployed and actively seeking employment. High unemployment can lead to social unrest and economic hardship. Monetary policy can help to promote full employment by stimulating economic growth and creating jobs.

- **Tools of Monetary Policy**: Central banks use a variety of tools to implement monetary policy. Some of the most common tools include:

✓ **Open market operations (OMOs):** This is when the central bank buys or sells government bonds. When the central bank buys bonds, it injects money into the economy. When the central bank sells bonds, it drains money from the economy. OMOs are used to influence the money supply and interest rates.
✓ **Reserve requirements:** This is the proportion of deposits that banks are required to hold as reserves. When reserve requirements are high, banks have less money to lend, which can slow down the economy. When reserve requirements are low, banks have more money to lend, which can stimulate the economy.
✓ **Discount rate:** This is the interest rate that the central bank charges banks for loans. When the discount rate is high, it is more expensive for banks to borrow money, which can slow down the economy. When the discount rate is low, it is less expensive for banks to borrow money, which can stimulate the economy.

- **The Transmission Mechanism of Monetary Policy:**

Monetary policy affects the economy through a variety of channels, known as the transmission mechanism. The transmission mechanism is the process by which changes in monetary policy tools affect economic activity.

✓ One of the main channels of the transmission mechanism is the interest rate channel. When the central bank lowers interest rates, it makes borrowing cheaper for businesses and consumers. This can lead to increased demand for goods and services, which can stimulate economic growth.

✓ Another important channel of the transmission mechanism is the asset price channel. When the central bank lowers interest rates, it makes bonds more attractive, which can cause their prices to rise. This can increase the wealth of households and businesses, which can lead to increased spending and investment.

✓ The exchange rate channel is also an important channel of the transmission mechanism. When the central bank lowers interest rates, it can make the domestic currency less attractive to foreign investors, which can cause the value of the domestic currency to depreciate. This can make exports more competitive, which can boost economic growth.

- **The Effectiveness of Monetary Policy:**

The effectiveness of monetary policy depends on a number of factors, including the structure of the economy, the expectations of businesses and consumers, and the credibility of the central bank. In general, monetary policy is more effective in economies with flexible labor markets and low levels of inflation. When businesses and consumers expect the central bank to achieve its inflation target, monetary policy is more likely to be effective. When the central bank is credible, its actions are more likely to have the desired impact on the economy.

- **The Limitations of Monetary Policy:**

Monetary Policy is a powerful tool, but it also has limitations. Monetary policy cannot be used to solve all economic problems. For example, monetary policy cannot directly address supply-side shocks, such as natural disasters or wars. Additionally, monetary policy can take time to have its full impact on the economy.

Monetary Policy And Bank Performance In India: An Impact Analysis:

The Indian banking sector plays a pivotal role in the country's economic growth and development, channeling funds from savers to borrowers and facilitating financial intermediation. Monetary policy, implemented by the Reserve Bank of India (RBI), exerts a significant influence on the performance of the banking sector, shaping its deposit mobilization, credit expansion, and profitability. This study delves into the intricate relationship between monetary policy and bank performance in India, examining the various channels through which monetary policy tools impact the banking sector's financial metrics.

- **Impact on Bank Deposits:** Monetary policy measures, particularly interest rate adjustments, have a direct bearing on bank deposits. During periods of monetary tightening, when interest rates are raised, deposits tend to become more attractive, as savers can earn higher returns on their savings. This can induce a surge in deposits, bolstering the liquidity position of banks. Conversely, during periods of monetary easing, when interest rates are lowered, deposits may become less attractive, as savers may seek higher returns elsewhere. This can lead to a decline in deposits, potentially posing a challenge to banks' liquidity management.

- **Impact on Bank Lending:** Monetary policy also influences bank lending activities. Higher interest rates during monetary tightening can make borrowing more expensive for businesses and individuals, potentially discouraging loan demand. This can lead to a slowdown in bank lending, affecting the overall credit flow in the economy. Conversely, lower interest rates during monetary easing can make borrowing more affordable, potentially stimulating loan demand. This can boost bank lending activities, fueling economic growth.

- **Impact on Bank Profitability:** Monetary policy measures can also impact bank profitability through various channels. Wider interest rate spreads, the difference between interest rates on loans and deposits can generally benefit bank profitability. During periods of monetary tightening, higher interest rates can lead to wider interest rate spreads, potentially enhancing bank earnings. However, if interest rates rise too quickly, it can lead to an increase in non-performing loans (NPLs), which are loans that are unlikely to be repaid. This can negatively impact bank profitability, as NPLs erode banks' asset quality and earnings potential.

Empirical Evidence from India

- Numerous studies have examined the impact of monetary policy on bank performance in India. These studies have consistently found that monetary policy measures have a significant impact on bank deposits, lending, and profitability. For instance, a study by Nikhil and Deene (2020) found that changes in the benchmark repo rate (BR) had a significant impact on deposits, loans and advances (L&A), and total asset value (TAV) of public sector banks in India (1). Similarly, a study by Mishra and Kelly (2017) found that monetary policy shocks had a strong initial and persistent impact on bank lending (2).

Empirical Studies on the Impact of Monetary Policy on Banking Performance:

- **Interest Rate Sensitivity and Profitability:**

Sinha and Ghosh (2010) studied the relationship between monetary policy and profitability of Indian banks. They found that changes in the repo rate significantly influence Net Interest Margin (NIM), Return on Assets (ROA), and Return on Equity (ROE).
Das and Ghosh (2006) showed that public sector banks are more affected by policy changes compared to private and foreign banks, due to their exposure to government securities and priority sector lending.

- **Credit Growth and Asset Quality:**

RBI Reports (Annual Reports, Financial Stability Reports) consistently highlight how tight monetary policy (i.e., higher interest rates) slows down credit growth and increases non-performing assets (NPAs) due to higher borrowing costs and defaults.
RBI Working Paper Series (2019) analyzed the transmission of policy rates and concluded that while transmission has improved post-MCLR (Marginal Cost of Funds-based Lending Rate), it remains incomplete and asymmetrical.

- **Liquidity and Capital Adequacy:**

Bhattacharya and Sahoo (2011) linked CRR/SLR changes to banking liquidity. A high CRR squeezes liquidity, affecting banks' lending capabilities.
Changes in SLR force banks to invest in government securities, impacting profitability and crowding out private sector lending.

- Impact Post-Global Financial Crisis (2008) and COVID-19 Post-2008, the RBI adopted an accommodative stance with reduced interest rates. This boosted credit growth but also led to excessive lending and later asset quality deterioration, especially in infrastructure and real estate sectors. During COVID-19, the RBI drastically reduced repo rates and injected liquidity via LTROs and TLTROs. This supported bank lending but also increased credit risk, which was mitigated through moratoriums and restructuring.

Studies by NIPFP and ICRA (2020–2022) noted that while monetary policy was effective in stabilizing markets, its impact on credit growth was muted due to risk aversion by banks.

Challenges in Monetary Policy Transmission in India: Several studies (e.g., Mohanty and Misra, 2012) have pointed out structural issues that limit the full transmission of RBI policy to the banking sector:

- High dependence on deposit funding

- Dominance of public sector banks with rigid pricing
- Interest rate rigidity due to small savings schemes
- Asset-liability mismatches

Sectoral Impact and Bank Heterogeneity:

- Public vs Private Banks: Private banks show quicker response to rate changes due to greater autonomy and dynamic pricing mechanisms.
- Large vs Small Banks: Larger banks have more flexibility in managing asset-liability duration, while smaller banks are more vulnerable to policy rate changes.
- Recent Policy Changes and Performance Indicators (2016–2024)
- Introduction of Monetary Policy Committee (MPC) in 2016 improved policy transparency and credibility.
- Implementation of External Benchmark Lending Rates (EBLR) in 2019 improved the pass-through of repo rate changes to loan rates.
- Studies post-EBLR (e.g., RBI Bulletin 2021) show faster adjustment in lending rates, with improved linkage to policy rate changes.

- **Transmission Channels of Monetary Policy:**

The impact of monetary policy on bank performance is transmitted through various channels. The interest rate channel is the most direct and well-understood channel. Changes in interest rates directly affect the cost of funds for banks, influencing their lending and investment decisions. The balance sheet channel operates through the impact of monetary policy on the value of bank assets and liabilities. Changes in interest rates can affect the value of banks' bond portfolios, potentially leading to capital gains or losses. The lending channel operates through the impact of monetary policy on banks' willingness to lend. Changes in interest rates can affect banks' perception of credit risk, influencing their lending decisions.

- **Impact of Monetary Policy on Different Types of Banks:** The impact of monetary policy on bank performance can vary across different types of banks. Public sector banks, which dominate the Indian banking sector, may be more sensitive to monetary policy changes due to their larger size and higher exposure to government-directed lending. Private sector banks, on the other hand, may have more flexibility in responding to monetary policy changes due to their greater focus on commercial lending.

Key Factors Influencing the Impact of Monetary Policy:

Beyond the direct impact of interest rate changes, several factors can influence the
sensitivity of banks to monetary policy changes and the overall impact on their performance. These factors include:

- **Non-Performing Loans (NPLs):** Banks with a higher proportion of riskier assets, such as non-performing loans (NPLs), may be more susceptible to the impact of interest rate changes on their profitability and capital adequacy. Higher NPLs can increase credit risk and erode profitability, making banks more cautious in their lending decisions.

- **Operational Efficiency:** Efficient banks with streamlined operations and low operating costs may be better positioned to capitalize on favorable interest rate environments and expand their lending activities, potentially boosting profitability. Streamlined processes and efficient resource allocation can help banks maintain margins and profitability even during periods of economic volatility.

- **Innovation and Adaptability:** Banks that embrace technological advancements and financial innovations may be able to manage interest rate fluctuations more effectively and maintain their profitability. Digitalization, data analytics, and risk management tools can enhance banks' ability to adapt to changing market conditions and optimize their lending strategies.

- **Inflation and Economic Growth:** The overall economic environment, including inflation, economic growth, and investor sentiment, can amplify or dampen the impact of monetary policy on bank performance. During periods of economic uncertainty or financial instability, banks may be more cautious in their lending decisions, even in response to easing monetary policy. Inflation can also affect the real value of interest rates, influencing the attractiveness of loans and deposits.

- **Market Concentration:** The competitive landscape within the banking sector can also influence how banks respond to monetary policy changes. Banks facing stiff competition may be more inclined to adjust their lending rates more aggressively, while those operating in less competitive markets may have more flexibility in managing their risk appetite.

- **Capital Requirements and Risk Management:** Regulatory changes, particularly those related to capital adequacy requirements or risk management practices, can further shape how banks respond to monetary policy. Stringent regulations can constrain banks' ability to fully exploit favorable interest rate environments, potentially limiting their profitability gains.

- **Global Financial Integration:** India's banking sector is interconnected with global financial markets. Changes in monetary policy or economic conditions in other countries can ripple through the Indian banking system, affecting domestic banks' performance. Exposure to international financial shocks can make banks more vulnerable to external factors.

- **Asset Composition and Risk Profile:** While monetary policy can have an immediate impact on bank performance, its effects can persist over the long run. For instance, sustained periods of monetary tightening may lead to a gradual shift in the composition of bank portfolios towards lower-risk assets, potentially affecting their long-term profitability. Long-term decisions, such as investment in technology or risk management practices, can also influence banks' ability to adapt to changing economic conditions.

- **Implications for Policymakers:**

The intricate relationship between monetary policy and bank performance underscores the importance for policymakers to carefully consider the impact of monetary policy tools on the banking sector. Policymakers need to strike a balance between achieving their primary objectives of price stability and economic growth while ensuring financial stability and a sound banking system. Effective communication with the banking sector is crucial to ensure that monetary policy intentions are well understood and that banks can effectively adjust their strategies accordingly.

Chapter 2: Literature Review

- **Introduction**

Monetary policy is the process by which a central bank, such as the Reserve Bank of India (RBI), controls the supply of money, interest rates, and credit to achieve macroeconomic objectives like price stability, economic growth, and financial stability. The banking sector, being the primary conduit of monetary policy transmission, is deeply influenced by policy tools such as repo rate, CRR, SLR, and open market operations (OMOs).

- **Theoretical Framework**

a. Transmission Mechanism Theory: This theory explains how changes in policy rates influence bank lending, deposits, and ultimately the real economy. Mishkin (1996) outlined several channels—interest rate, credit, exchange rate, and expectations—through which monetary policy affects the banking sector.

b. Keynesian Theory: The Keynesian model emphasizes that interest rate changes affect investment and consumption decisions, and thus influence banking performance in terms of loan disbursals and NPAs.

c. Monetarist View: According to Milton Friedman, control over money supply is key to economic and financial stability. Banking performance reflects effective control over money and liquidity.

- **Empirical Studies – International Context**

1. Bernanke and Gertler (1995): Their study examined the credit channel of monetary policy in the U.S. banking sector. They found that contractionary monetary policy led to reduced lending and increased loan defaults.

b. Kashyap and Stein (2000): This research showed that smaller banks are more sensitive to monetary shocks than larger ones due to their dependence on deposit-based funding.

- **Empirical Studies – Indian Context**

a. Mohanty (2012) – "Monetary Policy Transmission in India": This RBI working paper analyzed various transmission channels. The study found that interest rate channels are more effective in influencing commercial bank lending behavior in India post-2000.

b. Singh and Pattanaik (2015) – "Monetary Policy Transmission in India: A Peep Inside the Black Box": Using Vector Auto Regression (VAR) models, they demonstrated that repo rate changes significantly affect bank lending rates, though with time lags.

c. Nachane et al. (2002) – "Dynamics of Monetary Policy Transmission in India": This study found that the bank lending channel in India is weak due to the dominance of public sector banks and high liquidity in the banking system.

d. Reddy (2017) – "Monetary Policy Impact on Indian Banks' Profitability": Analyzed how policy rates affect interest income and net interest margin (NIM). It was found that lower repo rates improved bank profitability

in the short term but worsened it in the long term due to reduced lending margins.

e. Bhoi and Dhal (1998) – "Monetary Policy and Credit Availability in India": The study explored the role of directed credit programs and found that changes in CRR and SLR had a significant impact on credit creation capacity of banks.

f. RBI Annual Reports (2018–2023): These reports indicate that post-introduction of the Monetary Policy Committee (MPC) framework in 2016, the transparency and predictability of monetary policy decisions have improved, impacting banking operations positively.

Sector-Specific Impacts

- Public Sector Banks (PSBs) are more influenced by RBI directives due to higher compliance requirements and government ownership.
- Private Sector Banks show faster adjustments to monetary changes due to agile interest rate strategies.
- Small Finance Banks and NBFCs face delayed but severe impacts due to liquidity dependencies.

Gaps in Literature

- Limited empirical studies linking monetary policy with non-performing assets (NPAs).
- Sparse research on digital banking and monetary policy transmission.
- Lack of updated studies incorporating post-COVID era monetary easing.

- Regional impacts of RBI policies across urban vs. rural banks are underexplored.

Summary and Link to Present Study

- Existing literature confirms a significant yet varied impact of RBI's monetary policy on the Indian banking sector. However, evolving economic conditions, structural banking reforms, and global financial influences necessitate an updated analysis. This study aims to fill these gaps by analyzing the post-2016 MPC regime, pandemic-induced policies, and their quantitative and qualitative effects on banking sector performance indicators such as profitability, asset quality, credit growth, and liquidity.

Chapter 3: Research Methodology

Research Design:
This study adopts a quantitative, descriptive, and analytical research design to assess the impact of RBI's monetary policy on the Indian banking sector. The approach involves the use of secondary data from RBI, banks' annual reports, and financial databases, supported by statistical tools for analysis.

Objectives of the Study

1. To analyze the relationship between RBI's monetary policy tools and key banking performance indicators.
2. To examine the impact of repo rate, CRR, and SLR changes on bank profitability and credit growth.
3. To assess the effectiveness of monetary policy transmission in the post-MPC regime (after 2016).
4. To identify variations in impact across public, private, and small finance banks.

Hypotheses
H1: There is a significant relationship between repo rate and bank lending/credit growth.

H2: Changes in CRR and SLR significantly affect bank liquidity and profitability.
H3: The monetary policy impact varies significantly across types of banks (public vs. private).
H4: Post-MPC regime monetary policies have had a more predictable and stable impact on the banking sector.

Sources of Data:

Primary Data Sources:

- structured Google Form questionnaire was distributed to employees from IT, finance, music, and consulting industries. The survey contained Likert-scale items, multiple-choice questions, and open-ended prompts.
- 50 responses were collected and used as the core primary data source.

Secondary Data Sources:

- RBI Statistical Bulletins and Reports
- Scheduled Commercial Banks' annual reports
- CMIE Prowess Database / Bloomberg (if accessible)
- RBI Monetary Policy Statements (2010–2024)
- NPA and credit growth data from IBA and RBI publications

Period of Study

The study considers data from FY 2010–11 to FY 2023–24, covering:

a. Pre-MPC period (2010–2015)
b. Post-MPC regime (2016 onwards)
c. COVID-19 impact period (2020–2022)

Analytical Tools Used:

- Descriptive Statistics: Mean, Median, Standard Deviation
- Correlation Analysis: To assess the strength and direction of relationships
- Regression Analysis: To evaluate the impact of monetary variables on bank performance
- Time-Series Analysis: To observe trends and patterns over the 14-year period

Limitations of the Study:

- The study relies Both on Primary data as well as secondary data which may have limitations in terms of accuracy or completeness.
- Policy impacts may be influenced by external factors such as inflation, fiscal policies, or global economic shocks.

Chapter 4: Data Analysis and Findings:

The study concludes that both short- and long-term monetary policies affect growth. The appraisal of monetary policy and its effects on the Indian economy are the main topics of this study. As a dependent variable, the study uses the gross domestic product (GDP), whereas the independent variables are the repo rate, reverse repo rate, unemployment, foreign direct investment, and inflation. Using these variables, we discovered that a country's economy completely depends on these elements. The COVID-19 pandemic sent shock waves through the world economy and triggered the largest global economic crisis in more than a century. The two political giants, the BJP and the Congress, have a significant impact on the economy as well as political turmoil. We saw the economy change while both political parties were in power. The GDP calculation used different inputs. Demonetization, which took place in the nation in 2016, has influenced the Indian economy. After 2014, India's fiscal deficit increased each subsequent year.

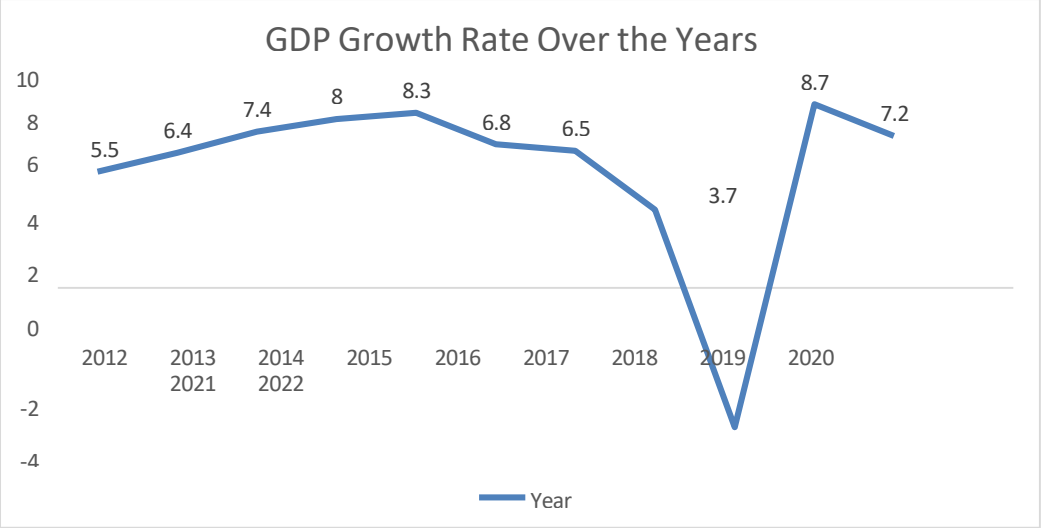
Conclusion of Literature Review: The literature broadly agrees that RBI's monetary policy significantly influences the banking sector performance, though the degree and immediacy of the impact vary based on:

- Type of banks (public/private/foreign)
- Policy instrument used (repo/CRR/SLR)
- Macro-financial conditions
- Regulatory environment
- Effective monetary policy requires robust transmission mechanisms, responsive banking structures, and coordination between fiscal and monetary authorities

Independent factors: foreign direct investment, unemployment rate,
policy rates, and inflation.
Type of Research- Empirical research is used for analyzing the data.
Sample Size- 10 (2012-2022) years data is collected to analyze the impact of selected variables on Indian Economy.
Methods of Data Collection- Secondary-based research, RBI Bulletin, RBI Annual Reports, Currency and Finance Report, Economic Survey, Finance and Growth, The Hindu, ICSSR, Economic Times, IMF Report, Indian Economic Journal, Financial Express, World Bank Reports and Internet, etc. used to collect data with some questionnaire also.

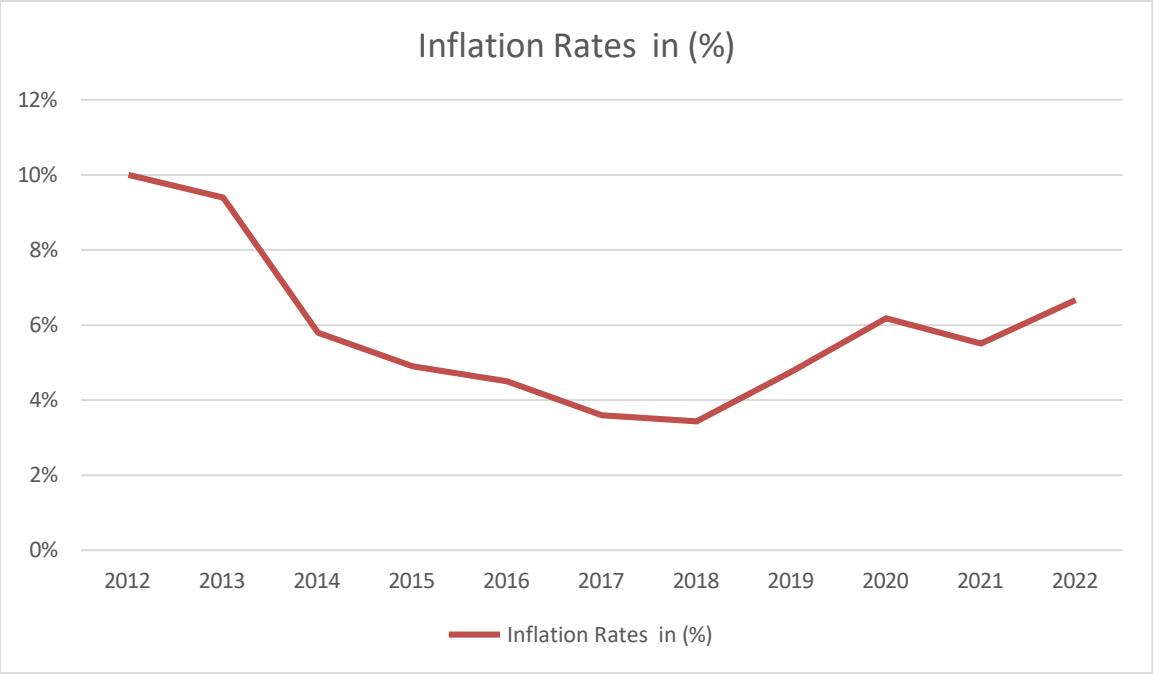
- **Gross Domestic Product:**

GDP refers to the total market value of all goods and services produced in a country per year. It is an important indicator of the economy. As per IMF report India's GDP was 5.5% in 2012 and steadily rose until 2016, but it declined in 2017 due to a demonetization in 2016. GDP of India drastically slowdown in 2020 due to impact of pandemic and high commodity prices (India's GDP contracted by 7.3% in 2020-21). Indian Economy in 2021-2022 has fully recovered the pre- pandemic real GDP level of 2019-2020.



- **Inflation:**

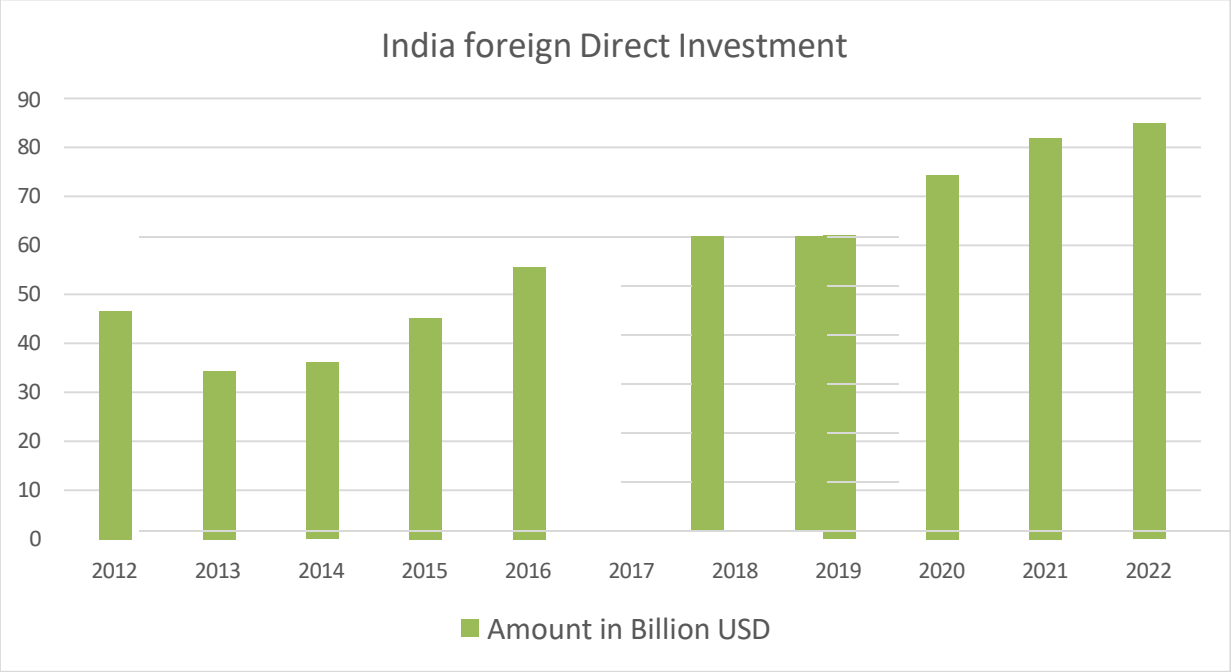
In 2013, the consumer price index took the place of the wholesale price index as the primary indicator of inflation in India. Food and beverages make up the majority of the consumer price index (45.86% of the total weight), with cereals and products accounting for 9.67%, milk and products for 6.61%, vegetables for 6.04%, prepared meals, snacks, and sweets for 5.55%, and meat and fish for 3.61%. Miscellaneous items make up 28.32% of the total weight.The annual inflation rate in India decreased to 4.25% in May 2023 from 4.7% the previous month. This was the lowest level since April 2021 and was significantly lower than market expectations of 4.42%, which coincided with a new slowdown in food prices. The end result reduced worries about a potential continuation of the tightening cycle by bringing inflation closer to the RBI's target of 4% and extending the decline past the central bank's top limit of 6%. With strong deflation for oils and fats (-16.01% vs -12.33% in April), vegetables (-8.18% vs -6.5%), and meat and fish (- 1.29% vs -1.23%), consumer food inflation dropped to 2.91% from 3.84% in the previous month. Meanwhile, housing (4.84% versus 4.91%), gasoline, and transportation and communication inflation all decreased (1.1% vs 1.17%).



The graph clearly shows how the inflation rate has changed over time. The inflation rate was rather high in several years, such as 2012 and 2013, hitting 10% and9.4 %, respectively. Other years, including 2017 and 2018, had comparatively low inflation rates, at about 3.6% and 3.43 %, respectively.

- **Foreign Direct Investment (FDI):**

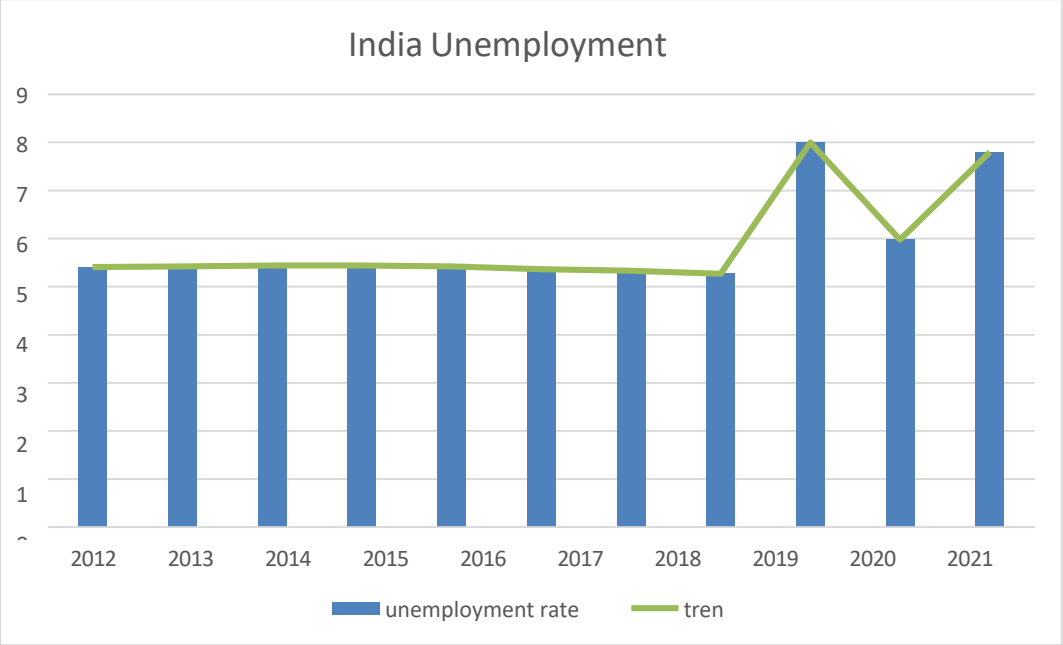
FDIs are an important driver of the country's economy since they boost the job market, technical knowledge base and provide non-debt financial resources. Singapore was leading investor in the country with FDI equity investment amounting to 100 billion USD in the FY 2021 fallowed by USA and Mauritius. The IT sector constituted the largest part in FDI equity inflow with an overall amount close to 26 billion USD for fiscal year 2021 by construction and services sector.



The graph demonstrates that, with a few minor variations over time, FDI inflows into India have been steadily increasing. With a peak of over $84.84 billion in 2022, FDI inflows, which fluctuated in size from $46.56 billion to $60.67 billion from 2012 to 2018, remained incredibly low. The graph also shows that there have been years where FDI inflows have dropped compared to the year before, including 2013 and 2014. This could occur as a result of a variety of things, such as the state of the global economy, changes to governmental rules, or challenges specific to a particular industry. Overall, the graph shows that India has grown to be a more alluring location for FDI over time, with higher FDI inflows, which may have favorable effects on economic expansion, job creation, and technology transfer.

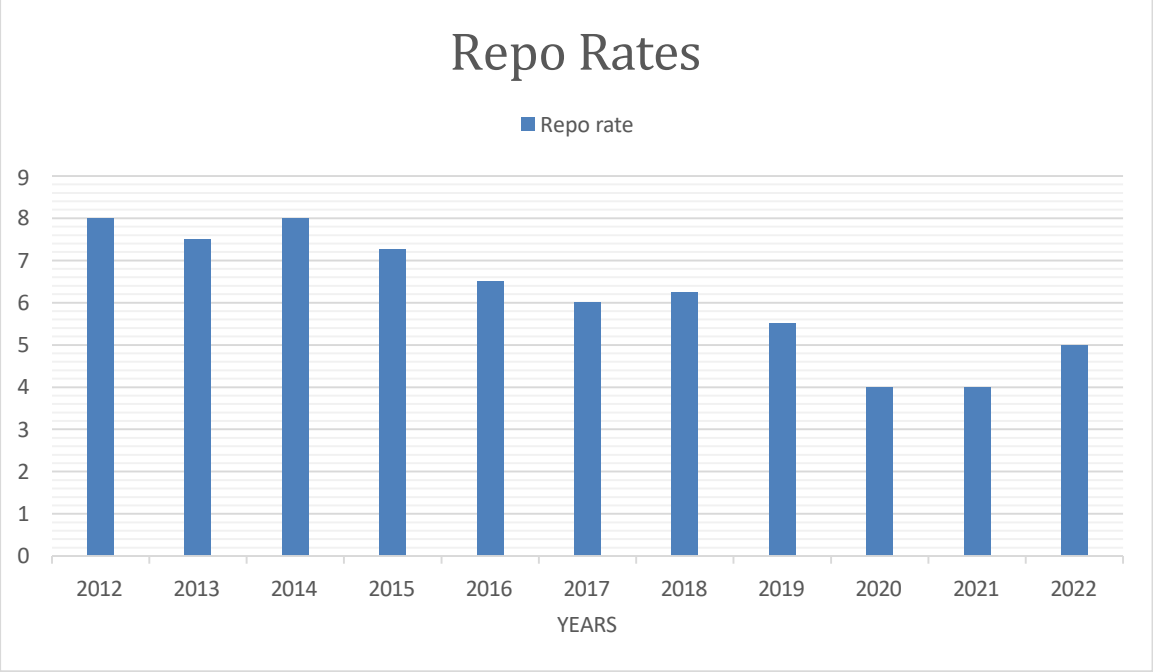
- **Unemployment Rate:**

The unemployment rate in India in 2021 was 5.98%, down 2.02% from the previous year. The unemployment rate in India for 2020 was 8.00%, up 2.73% from the previous year. The unemployment rate in India for 2019 was 5.27%, down 0.06% from 2018.In 2018, India's unemployment rate dropped by 0.03% from the previous year to 5.33%. In 2020 due to adverse effects of covid-19 pandemic unemployment rate in India raised to 10% (highest in the tenure). The horizontal trend line within the graph appears unemployment rate was change within 5% to 6% from FY 2012-2019.



- **Policy Rates:**

In 2012, the rates were 8.2 and 16, and in 2013, they were 7.1 and 13.8. Then, in 2017, it was 6 and 11, and since the economy was already struggling due to Demonetization and the implementation of GST, the government decided to raise the rates once more. As a result, rates didn't change.



We can see the policy rate for each year end in the graph. The repo rate is .00 in 2012 and 7.50 in 2013.

1. Respondent Awareness and Engagement

- **Awareness:** 86% (6 out of 7) respondents are aware of RBI's monetary policy and its objectives.
- **Engagement:** 57% follow policy announcements every time, while the rest do so occasionally.

Insight: Participants demonstrate an above-average engagement with monetary policy updates.

2. Understanding of RBI's Objectives

- Most respondents believe the primary objective of the RBI's monetary policy is to control inflation.
- Other cited objectives include ensuring liquidity and stabilizing the financial system.

Insight: Inflation control is widely recognized as the core goal of monetary policy.

3. Familiarity with Monetary Tools

Respondents identified various tools used by RBI, including:

- Repo Rate
- Reverse Repo Rate
- Cash Reserve Ratio (CRR)
- Bank Rate
- Open Market Operations

Insight: Participants are familiar with multiple tools, though awareness levels vary.

4. Perceived Impact on the Banking Sector

- The majority strongly agree that changes in the repo rate affect bank interest rates.
- All respondents noted the perceived impact of policy changes on bank profitability and credit growth.

Insight: There is strong recognition of the influence of monetary policy on bank operations.

5. Effects of Monetary Tightening

- Mixed responses were received on the effects of monetary tightening:
- Bank Lending: Responses were varied—some believed it increases, others said it decreases or remains unchanged.
- Profitability: Most believe it increases.
- Loan Defaults: Majority felt it leads to a decrease in defaults.

Insight: This reflects varying levels of understanding or interpretation among respondents.

6. Effectiveness of Policy Transmission

- 43% said banks are "Very Effective" in transmitting RBI policy to the public.
- 57% considered them "Effective".

Insight: Respondents believe that the banking system efficiently communicates policy changes.

7. Public vs. Private Sector Bank Reactions

- 57% of respondents felt there is no major difference in how public and private banks react.
- Others were either unsure or believed there is a difference.

8. Overall Impact of RBI Policy

- All respondents either Agree or Strongly Agree that RBI policies have improved the stability and growth of Indian banks over the last five years.

Insight: There is a broadly positive perception of the RBI's role.

9. Sectoral Impact

- Most respondents believe that all sectors are equally affected by monetary policy.
- A few singled out Corporate Banking as being more impacted.

10. Conclusion and Recommendations

This survey reveals that respondents are generally well-informed about RBI monetary policy and its impact. However, inconsistencies in understanding specific effects (e.g., monetary tightening) suggest the need for:

- Improved financial literacy initiatives.
- Clearer communication of monetary tools and their implications by regulatory bodies.
- Further research with a larger sample size for statistically significant insights.

Chapter 5: 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 the 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 and Union Territories. In addition RBI has decided to extend of realization 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 the 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 rate of repo 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.

✓ **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 crores.

✓ **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.

✓ These tools influence the cost and availability of credit, thereby impacting banking sector operations,

profitability, and overall performance.

Chapter 6: 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 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.
- **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 programs 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

Chapter 7: 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 normally 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 the 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 in excess of their statutory SLR requirements. Therefore, the issue of separation of debt management 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,

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Appendices

- **Questionnaire**

1.Are you aware of the RBI's monetary policy and its objectives?

- Yes
- No
- Somewhat

2.How often do you follow RBI's monetary policy announcements?

- Every time
- Occasionally
- Rarely
- Never

3.What do you believe is the primary goal of the RBI's monetary policy?

- Control inflation
- Stabilize exchange rate
- Ensure economic growth
- Ensure liquidity in the system
- Promote employment

4.Which tools of monetary policy are you familiar with?

- Repo rate
- Reverse Repo Rate
- CRR (Cash Reserve Ratio)
- SLR (Statutory Liquidity Ratio)
- Open Market Operations
- Bank Rate

4.Do you think changes in the repo rate directly affect interest rates offered by banks?

- Strongly Agree
- Agree
- Neutral
- Disagree
- Strongly Disagree

5.Have you noticed any impact of RBI policy changes on bank performance (e.g., profitability, credit growth)?

- Yes
- No
- Not Sure

6.In your opinion, how does monetary tightening affect the following?
a. Bank Lending

- Increases
- Decreases
- No Change

b. Profitability

- Increases
- Decreases
- No Change

c. Loan Defaults

- Increase
- Decrease
- No Change

7.How effectively do banks transmit monetary policy changes to the public?

- Very Effective
- Effective
- Neutral
- Ineffective
- Very Ineffective

8.Do public and private sector banks react differently to policy changes?

- Yes
- No
- Not Sure

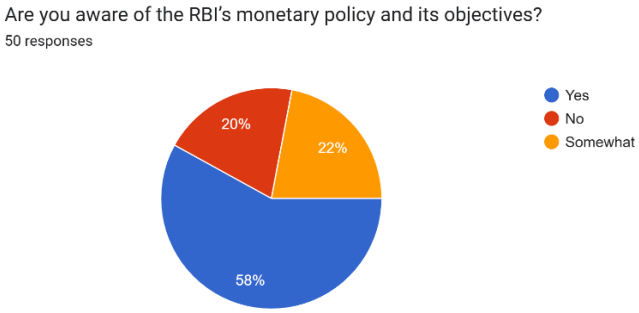
9. Has RBI's monetary policy helped improve stability/growth of Indian banks in the past 5 years?

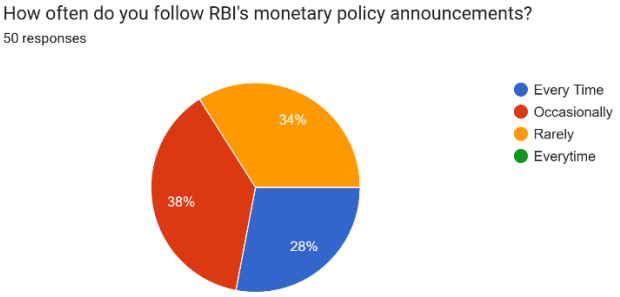
- Strongly Agree
- Agree
- Neutral
- Disagree
- Strongly Disagree

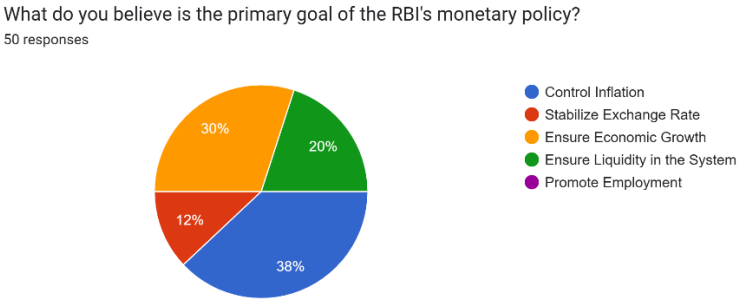
10.Which sector is most affected by monetary policy?

- Retail Banking
- Corporate Banking
- Rural Banking
- NBFCs
- All Equally

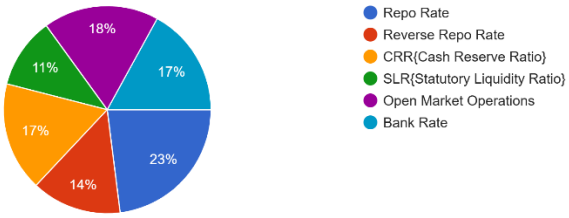
Analysis



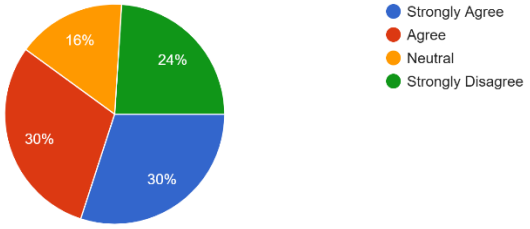




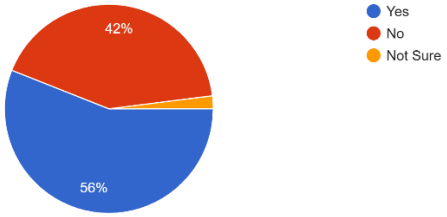
Which tools of monetary policy are you familiar with?
50 responses



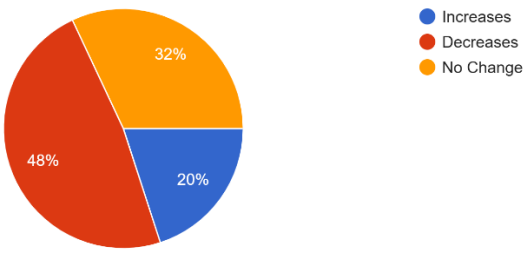
Do you think changes in the repo rate directly affect interest rates offered by banks?
50 responses



Have you noticed any impact of RBI policy changes on bank performance (e.g., profitability, credit growth)?
50 responses

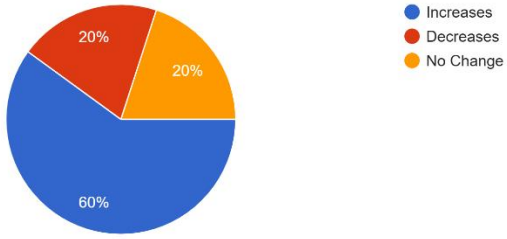


In your opinion, how does monetary tightening affect the following? A. Bank Lending
50 responses



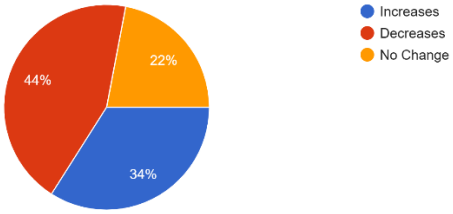
B. Profitability

50 responses



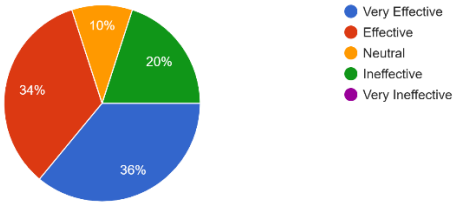
C. Loan Defaults

50 responses



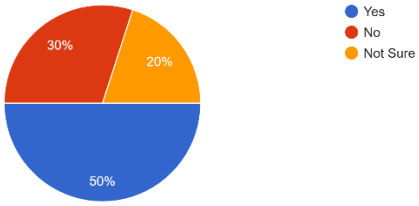
How effectively do banks transmit monetary policy changes to the public?

50 responses

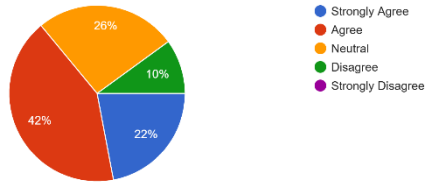


Do public and private sector banks react differently to policy changes?

50 responses



Has RBI's monetary policy helped improve stability/growth of Indian banks in the past 5 years?
50 responses



Which sector is most affected by monetary policy?
50 responses